

**~ The Transition to the Dematerialization  
of Stock Certificates in Japan ~**

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## 1. Introduction

The dematerialization of commercial paper (CP), Japanese government bonds (JGBs), corporate bonds, beneficial rights of investment trusts and other securities, have sequentially been legislated in Japan up to now.

Further, “Law for partial amendments to the Law concerning Book-entry Transfer of Corporate Bonds and other securities for the purpose of streamlining the settlement for trades of stocks and other securities <sup>(Note1)</sup>” was submitted to the Diet in March 2004 and passed after deliberations at both the Upper House and Lower House, and was promulgated on June 9, 2004. Under this Law, “Law concerning Book-entry Transfer of Corporate Bonds, Stocks and other securities<sup>(Note2)</sup>” (hereinafter referred to as the “New Law”) was newly enacted by reforming “Law concerning Book-entry Transfer of Corporate Bonds and other securities<sup>(Note3)</sup>”, and the relevant parts of the Commercial Code and other related laws were amended. Thereby measures to introduce dematerialized book-entry transfer system of stocks and related securities will be implemented by June 2009. It is the objective of the legislation that eliminating stock certificates will streamline and accelerate settlements for trades of stocks etc. and reduce risks and costs in issuance and trading of stocks, etc.

The new laws, which cap the development of a series of laws for dematerialization of securities certificates in Japan, will contribute to an improvement in convenience for market participants, and strengthen the infrastructure up to the standard of the global capital market.

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<sup>(Note1)</sup> The Japanese title is “*Kabushiki tou no Torihiki ni kakaru Kessai no Gouri-ka o hakarutameno Shasai tou no Furikae ni kansuru Houritsu tou no ichibu o kaisei suru Houritsu*”.

<sup>(Note2)</sup> The Japanese title is “*Shasai Kabushiki tou no Furikae ni kansuru Houritsu*”.

<sup>(Note3)</sup> The Japanese title is “*Shasai tou no Furikae ni kansuru Houritsu*”.

Securities applicable to dematerialization in the this law (enacted in June 2002 and enforced in January 2003) are following;

corporate bonds, Japanese government bonds, municipal bonds, investment company bonds prescribed in the Law Concerning Investment Trusts and Investment Companies (*Toushi Shintaku oyobi Toushi Houjin ni kansuru Houritsu*), corporate bonds issued by mutual companies prescribed in the Insurance Business Act (*Hoken Gyouhou*), specified corporate bonds prescribed in the Law Concerning Liquidization of Assets (*Shisan no Ryuudou-ka ni kansuru Houritsu*), rights that should be represented by bond certificates issued by companies under a special law, beneficiary rights of investment trusts or foreign investment trusts prescribed in the Law Concerning Investment Trusts and Investment Companies, beneficiary rights of loan trusts prescribed in the Loan Trust Act (*Kashitsuke Shintaku Hou*), beneficiary rights of special purpose trusts prescribed in the Law Concerning Liquidization of Assets, rights that should be represented by bond certificates issued by any governments or companies in foreign countries.

## 2. Enforcement Date

“Law for partial amendments to the Law concerning Book-entry Transfer of Corporate Bonds and other securities for the purpose of streamlining the settlement for trades of stocks and other securities” should be enforced on the day prescribed by the Cabinet Order within 5 years after the promulgation date, i.e. June 9, 2004, however, the partial amendments to the Commercial Code and other related laws are expected to come into force on the day prescribed by the Cabinet Order within 1 year.

## 3. The Basic Scheme of the New Law

### (1) Holders of Rights

The holders of rights attached to stocks and related securities, for which the book-entry institution (hereinafter referred to as the “central securities depository”) makes eligible, shall be determined by the description or record in the ledger of book-entry transfer accounts in the case of transfer, pledge and issuance, etc.

### (2) Securities applicable to the New Law

The followings are securities newly covered by the New Law:

- (A) stocks
- (B) preemptive rights to new shares (*Shinkabu hikiukeken*)
- (C) subscription rights to new shares (*Shinkabu yoyakuken*)
- (D) corporate bonds with subscription rights to new shares
- (E) investment interests (*Toushi guchi*) prescribed in the Law Concerning Investment Trusts and Investment Companies
- (F) preferred equities (*Yuusen shusshi*) and preemptive rights to preferred equity (*Yuusen shusshi hikiuke ken*) prescribed in the Law Concerning Preferred Equity Investment in Credit Union-Based Financial Institutions (*Kyoudou Soshiki Kinyuu Kikan no Yuusen Syusshi ni kansuru Houritsu*)
- (G) preferred equities (*Yuusen shusshi*), preemptive rights to preferred equities (*Shin yuusen shusshi no hikiuke ken*), convertible specified corporate bonds (*Tenkan tokutei shasai*), and specified corporate bonds with preemptive rights to preferred equities (*Shin yuusen shusshi hikiuke ken tsuki tokutei shasai*), prescribed in the Law Concerning Liquidation of Assets

### (3) Provisions concerning Stocks of All Corporations

- (A) All corporations can apply for the dematerialization of stock certificates by

amending their articles of incorporation, approved by a special resolution made at a general meeting of shareholders, under the Commercial Code<sup>(Note4)</sup>.

- (B) If corporations provide the item pursuant to the above (3)(A) in their articles of incorporation, they do not have to issue stock certificates even if shareholders make such demands.

#### **(4) Provisions concerning Stocks of Publicly-held Corporations** <sup>(Note5)</sup>

##### **(A) Transition to new book-entry ownership**

- (a) Notwithstanding the above (3)(A), publicly-held corporations will implement the dematerialization of stock certificates without any amendments of the articles of incorporation because the resolution of the necessary amendments is deemed to be legally passed as of “implementation date”<sup>(Note6)</sup>.
- (b) Under the new system, all the stocks of publicly-held corporations will be managed in the ledger of book-entry transfer accounts created by legally-defined “account management institutions”, such as securities companies, banks, trust banks and so forth, which open accounts in the central securities depository.

##### **(B) Provisions concerning the list of shareholders**

- (a) Under the new system, management of shareholder’s ownership will be unified in the list of shareholders (*Kabunushi meibo*) of the issuer, while prior to the amendments it had been managed in both the list of shareholders and the list of beneficial shareholders (*Jisshitsu kabunushi meibo*) of the issuer.
- (b) Transfer of shareholder’s title should be conducted based on “the notification of general shareholders’ list”, which the central securities depository will send to the issuer at certain times, such as fiscal year end (normally 2 times in a year).
- (c) Based upon the said notification of general shareholders’ list, issuers will update the list of shareholders and identify shareholders who can exercise shareholder’s rights. However, with regard to the exercise of minority shareholder’s rights etc., identification of qualified shareholders should separately be determined based

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<sup>(Note4)</sup> This amendment will be prescribed in article 227 of Commercial Code and scheduled to be enforced on October 1<sup>st</sup>, 2004.

<sup>(Note5)</sup> They mean corporations that are listed on stock exchanges or registered with JASDAQ as of September 2004.

<sup>(Note6)</sup> ) The “implementation date” means the enforcement date of dematerialization, which should be designated by the Cabinet Order within 5 years after the promulgation date, i.e. June 9, 2004.

) The rules of stock exchanges or JASDAQ regulate listed corporations to deposit their stocks to JASDEC. In this regard, if publicly-held corporations apply for the dematerialization of stock certificates by amending the articles of incorporation prior to the implementation date (by way of procedure (3) (A)-(B)), they have to withdraw their stocks from the JASDEC system, which is predicated on the existence of physical stock certificates. Accordingly, it becomes impossible for publicly-held corporations to keep their stock listed.

upon a continuous holding period etc. on the records of the ledger of book-entry transfer account, and accordingly the central securities depository needs to separately send notifications to the relevant issuers upon the shareholder's request.

- (C) Provisions concerning pledge etc.
- (a) If stocks of publicly-held corporations are subject to pledge, such pledge shall be in effect through the record (in the column for pledge) in a book-entry transfer account opened by the pledgee.
  - (b) Taking into account the current business practice in the “non-registered pledge” (*Ryakushiki jichi*) and in order to protect the anonymity of a pledgee, the central securities depository is not generally required to notify the issuer of the pledgee's name etc. in the notification of general shareholders' list. However, this principle does not apply to the case where the relevant pledgee requests that his/her name etc. be included in the notification<sup>(Note7)</sup>.
  - (c) “Security by way of assignment” (*Jouto tanpo*) on stocks of publicly-held corporations will also be imputed with the record of book-entry transfer accounts opened by a secured party. The central securities depository will notify the issuers of the name etc. of the secured party in the notification of general shareholders' list, unless otherwise the relevant secured party makes a special application. If a secured party makes an application, the name etc. of the party, who has created a “security by way of assignment”, will be notified as a shareholder.
- (D) Interim measures to transfer to dematerialization (special exceptions)
- (a) The smooth implementation of dematerialization is guaranteed for investors within the JASDEC system (shareholders who deposit stocks with JASDEC) since their records on the ledger of customer account will be forwarded to the “Participant” <sup>(Note8)</sup> account in the ledger of the book-entry transfer account.
  - (b) Shareholders may not demand the withdrawal of stock certificates deposited with JASDEC as of the “implementation date”<sup>(Note9)</sup>.
  - (c) Stocks, which have not been deposited with the JASDEC at the time of the “implementation date”, should be maintained in “special accounts”<sup>(Note10)</sup> opened at the account management institutions designated by the issuers. For the sale of

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<sup>(Note7)</sup> The person who gives a notification of the name etc. as a pledgee will be recorded on the list of shareholders, and treated as a registered pledgee.

<sup>(Note8)</sup> “Participant”, which is legally prescribed as “account management institutions” and “investors”, refers to “investors” here.

<sup>(Note9)</sup> Such demand was also prohibited from 14 days prior to the “implementation date” in the supplementary provisions of the New Law.

<sup>(Note10)</sup> Such account holders mean shareholders who are recorded in the list of shareholders.

such stocks, shareholders need a one-time transfer of stocks into their own book-entry transfer account in account management institutions such as securities companies.

- (d) Stock certificates shall be invalid as of the “implementation date”. However, the shareholder’s rights will not be forfeited as long as their names are recorded on the list of shareholders of the issuer.

#### **4. Other Provisions**

- (1) In new stocks issuance, subscribers (investors) of stocks should designate their book-entry transfer accounts in the form of the stock application certificate. Thereby new stocks will be credited to subscribers’ book-entry transfer accounts<sup>(Note11)</sup>.
- (2) Stocks registered as lost stock certificates will be recorded, pursuant to the procedures of new stocks issuance, in the book-entry transfer account designated by an applicant of the lost stock certificates registration or special accounts opened by the issuers, on the date of deletion of the lost stock certificates registration, resulting from the application for deletion of the lost stock certificates registration by the relevant applicant, assertions by stock certificate holders, or elapse of one year after the lost stock certificates registration.
- (3) A safety net (a participant protection trust) is deployed to protect retail investors from certain contingent loss caused by an excess record in the ledger of book-entry transfer account kept by the central securities depository or account management institutions.
- (4) “The specific period closing system in the list of shareholders” to suspend transfers of shareholder’s titles has been permitted under the current Commercial Code, but the “record date system” (to eliminate a suspended period) will be adopted by the amended Commercial Code. The amended Commercial Code should come into effect on the day, no later than June 9, 2005, designated by the Cabinet Order<sup>(Note12)</sup>.
- (5) Under the amended Commercial Code, subscribers for new stocks shall become shareholders on the “payment date for new stock”, changed from “the day following the payment date for new stock” in the current Commercial Code. This amendment will come into effect on the same day of the above 4 (4).

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<sup>(Note11)</sup> Stock splits etc. should be imputed based on the record in the ledger of the book-entry transfer account.

<sup>(Note12)</sup> This amendment will come into effect as of October 1<sup>st</sup>, 2004. Please refer to “Note 4”.

Figure 1. <New Book-entry Transfer System >

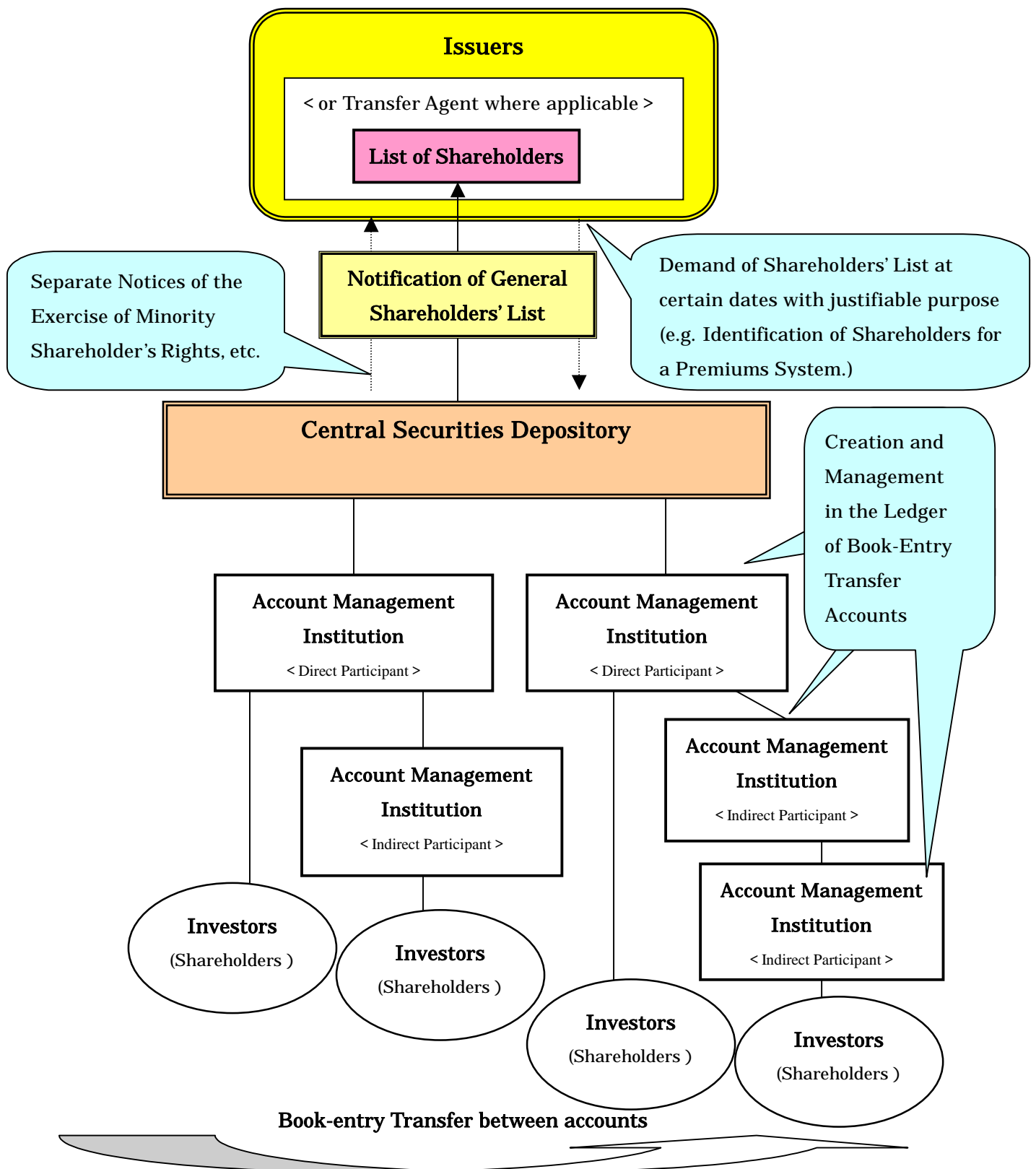
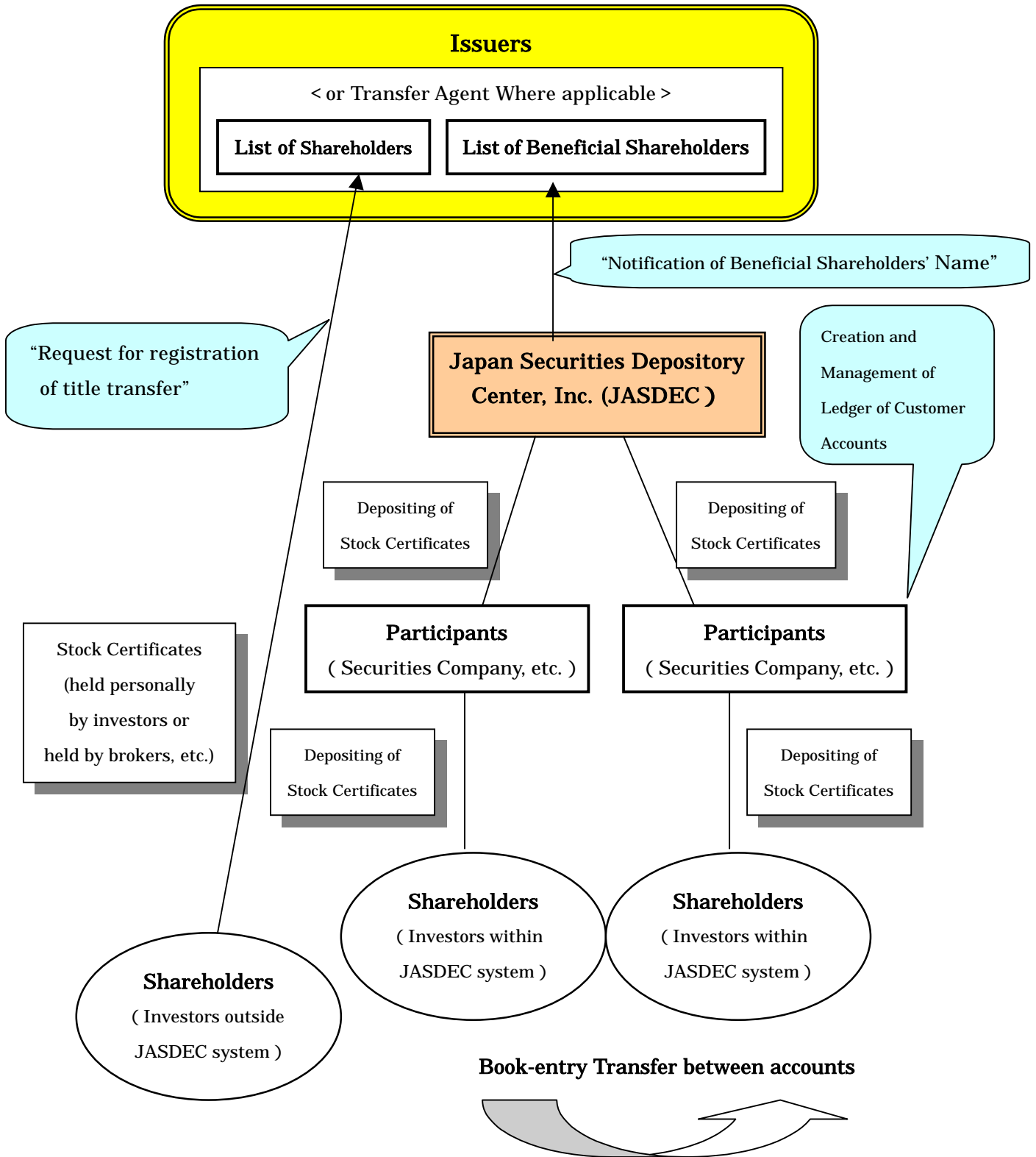




Figure 2. <Current System>



## 5. Questions and Answers

Q1) What benefits would dematerialization of stock certificates provide?

A1) Dematerialization of stock certificates allows investors to eliminate the risks associated with loss, theft and forgery of stock certificates. It will also reduce the costs associated with printing, safekeeping and issuing certificates, and simplify procedures regarding stock splits or reverse splits. As a result, it will contribute to make Japanese securities markets more efficient and secure.

Q2) How will the “implementation date” for stocks of publicly-held corporations be legally determined?

A2) The “implementation date” for stocks of publicly-held corporations should be the date within 5 years after promulgating the new Law on June 9, 2004, and designated by the Cabinet Order.

The specific date shall be fixed with due consideration given to the conditions of the system support and business progress etc. for transition in the central securities depository and account management institutions, etc.

Q3) How will the shareholder’s title be transferred in the list of shareholders under the new book-entry transfer system?

A3) The renewal of the list of shareholders for corporations applicable to the new book-entry transfer system shall be conducted based on the notification of general shareholders’ list<sup>(Note13)</sup> that is sent by the central securities depository to the issuers, at certain times such as the fiscal year end (including the each half fiscal year end) or the record date for stock splits or reverse splits. If issuers have justifiable reasons such as the identification of stockholders for premiums system etc., they can demand the central securities depository to provide the notification of the shareholders’ list at certain dates at their own expense.

Q4) How will the handling of sole shareholder’s rights or minority shareholder’s rights be changed under the new book-entry transfer system?

A4) To exercise some sole/minority shareholder’s rights such as proposal of representative action, shareholder’s suggestion rights or convocation rights of general meetings, shareholders may be required to have a 6 month-continuous

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<sup>(Note13)</sup> Issuers receive notifications of necessary items such as the name and address of shareholders, the number of holdings, etc. in relation to all shareholders.

holding period.

To meet this requirement, their titles should be registered in the list of shareholders for 6 months or longer at the moment. Under the existing JASDEC system, the continuous holding period is calculated from the time when the shareholder's title is registered in the list of beneficial shareholders of the issuer with the notification of the beneficial shareholders<sup>(Note14)</sup>.

However, under the new book-entry transfer system, the holding period will be calculated from the time when the shareholder's title is recorded on the ledger of the book-entry transfer account.

For the exercise of sole/minority shareholder's rights under the new book-entry transfer system, sole/minority shareholders should ask the central securities depository, through account management institutions, to separately send notifications to the relevant issuers. Accordingly, sole/minority shareholders may exercise their rights within a certain period<sup>(Note15)</sup> following these notifications.

Q5) How would procedures of transition to the new book-entry transfer system differ to the method of possessing stock certificates?

A5) (1) In the case of shareholders in the JASDEC system

As for shareholders within the JASDEC system as of the "implementation date", their rights will be transferred to the new book-entry transfer system without following any special procedures, since the central security depository (JASDEC) will take care of necessary procedures.

(2) In the case of shareholders depositing stock certificates with securities companies.

As for shareholders who deposit their stock certificates with securities companies for safe custody as of the "implementation date", their rights may smoothly be transferred pursuant to the above procedures since securities companies can legally deposit these stocks to JASDEC from a month before the "implementation date" to the previous day of two-weeks before the "implementation date". In this case, securities companies are obliged to immediately provide the notifications concerned to shareholders.

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<sup>(Note14)</sup> Since the notification of general shareholders' list is sent by JASDEC at certain times such as the fiscal year end (normally 2 times in a year) under the existing JASDEC system, the period between the acquisition date (when the title is recorded in the Ledger of Customer Account) and the next notification date of the beneficial shareholders is not calculated.

<sup>(Note15)</sup> Details of this period shall be stipulated in the Cabinet Order.

(3) In the case of shareholders holding the stock certificates

As for shareholders who personally hold stock certificates before the “implementation date”, their rights can also smoothly be moved to the new book-entry transfer system as long as in advance shareholders deposit their stock certificates with JASDEC.

Unless shareholders take such actions, their rights will be moved to the new system through the custody in “special accounts” opened by issuers for maintenance of shareholder’s rights<sup>(Note16)</sup>. Shareholders can exercise the rights of such stocks through “special accounts”, however, they cannot transfer such rights to any accounts other than the accounts opened by themselves in account management institutions<sup>(Note17)</sup>.

Q6) If shareholders possess stocks of publicly-held corporations, being outside JASDEC system and under other shareholder’s name, as of “the implementation date”, how can they maintain their shareholder’s rights?

A6) If stocks have not been deposited with JASDEC and shareholder’s titles have not been transferred by “the implementation date”, the rights of stocks shall be maintained on “special accounts” opened by issuers under the name on the list of shareholders (the name of the nominal owner). In addition, since stock certificates simultaneously become null and void, non-recorded shareholders may lose their shareholder’s rights.

For that reason, shareholders who have not taken the necessary steps must maintain their shareholder’s rights by taking one of the below measures against the issuers and by requiring the issuers to open “special accounts” under their own name.

Shareholders need to:

- (1) Apply in collaboration with the nominal owners (the nominee recorded on the special account) to the court to be pardoned for not taking the necessary steps,
- (2) Apply with an original text or a certified copy of the final court decision, demanding that the nominal owner should transfer his/her title to the beneficial owner, or with such other documents as prescribed by the Cabinet Order, or
- (3) Take other applicable measures stipulated by the Cabinet Order or the

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<sup>(Note16)</sup> This provision is applied to shareholders who are recorded on the list of shareholders.

<sup>(Note17)</sup> When the shareholders want to sell the above-mentioned stocks, they have to make a one-time transfer of them to their book-entry transfer account in account management institutions.

ordinance of the relevant Ministry.

Q7) Shall stock certificates of publicly-held corporations be collected as of the “implementation date”?

A7) Stock certificates of publicly-held corporations will not be collected under the new book-entry transfer system<sup>(Note18)</sup>. Stock certificates of publicly-held corporations will become null and void as of “ the implementation date”, and the records on the ledger of book-entry transfer account represent the rights of shareholders<sup>(Note19)</sup>.

Q8) Will it be possible for shareholders to request the certification of matters recorded in the ledger of book-entry transfer account?

A8) Any shareholders of publicly-held corporations, who are participants under the new book-entry transfer system, can request the relevant account management institutions to deliver the document (in writing or by electronic means) that certify the matters recorded in the participant’s own account in the ledger of book-entry transfer account by paying the required fee.

Q9) What kinds of measures are provided for pledgees of stock certificates in order to preserve their rights of pledge under the new book-entry transfer system?

A9) Under the current law<sup>(Note20)</sup>, pledgees are individually forbidden to deposit stock certificates as rights of pledge with the JASDEC system.

Under the New Law, pledgees are individually able to deposit pledged stock certificates with JASDEC for preservation of their rights of pledge, only within a fixed period before “the implementation date” <sup>(Note21)</sup>, and thereby their rights of pledge can be smoothly transferred to the ledger of book-entry transfer account.

If the pledgee deposits such stocks with JASDEC, the pledgee is obliged to immediately provide a notifications concerned to the pledgor.

Q10) How will the risks arising from excess records in book-entry transfer accounts be handled under the new system?

A10) In the case where excess records occur in book-entry transfer accounts provided by

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<sup>(Note18)</sup> The law does not demand the collection of stock certificates.

<sup>(Note19)</sup> “It shall be presumed that the participant legally possesses the right of stocks recorded in their book-entry transfer account.”(Please refer to Article 151 of “Law concerning Book-entry Transfer of Corporate Bonds, Stocks and other securities”)

<sup>(Note20)</sup> This law is the “Law concerning Central Securities Depository and Book-Entry Transfer of Stock certificates and Other Securities”.

<sup>(Note21)</sup> This period is from a month before “the implementation date” to the previous day of 2-weeks before “the implementation date”.

the central securities depository or account management institutions and thereby result in the bona fide acquisitions of third parties, the total amount of book-entry transfer stocks of the issue will exceed the aggregated issuance amount of book-entry transfer stocks of the issue. In this case, the central securities depository or account management institutions are obliged to acquire the equivalent of the excess shares and to abandon the rights on the acquired shares against the issuers, since they are unable to set up the requirements against the issuer.

To protect retail investors from the risks associated with the bankruptcy of account management institutions etc. in this process, a participant protection trust (participants' safety net) funded by the central securities depository and account management institutions has been established under the law.

Q11) How will stock certificates of privately-held corporations be handled under the new system?

A11) If privately-held corporations want to implement the dematerialization of stock certificates<sup>(Note22)</sup>, such corporations shall amend their articles of incorporation, prohibiting the issuance of stock certificates, through a special resolution in the general meeting of shareholders. Privately-held corporations can implement the dematerialization of stock certificates at their own option, unlike publicly-held corporations.

In assigning rights of stocks of privately-held corporations, which are dematerialized and do not fall within the scope of the new book-entry transfer system, shareholders can take effect of such assigning of rights by specifying their intention between concerned parties. However, they may not assert their rights against third parties, including the issuers etc. without the records of shareholder's titles in the list of shareholders.

Q12) How will the current "Law concerning Central Securities Depository and Book-Entry Transfer of Stock Certificates and Other Securities" be treated after the "implementation date"?

A12) Along with the transition to the new book-entry transfer system, "Law concerning Central Securities Depository and Book-Entry Transfer of Stock Certificates and Other Securities" shall be repealed as of the "implementation date".

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<sup>(Note22)</sup> Privately-held corporations can implement dematerialization of stock certificates, with amendment of their articles of incorporation, from Oct.1 2004. Please refer to "Note 4".

Instead, under “Law concerning Book-entry Transfer of Corporate Bonds, Stocks and other securities” which is a unified securities clearing and settlement system law, the Japanese market can realize the upgraded and streamlined book-entry transfer system for a wide range of securities, including stocks and related securities.

Please note that this document is provisional and may be revised.