Minutes of the 15th Council of Experts Concerning the Follow-Up of Market Restructuring

Date: Friday, March 22, 2024 1:30 - 3:20 p.m.

Place: Tokyo Stock Exchange 15F Conference Room

Attendees: See member list (Ms. Okina, Mr. Kanda and Mr. Kumagai were absent)

Kikuchi, Director, Listing Department, TSE:

Now that the scheduled time has arrived, we will convene the 15th Council of Experts Concerning the Follow-up of Market Restructuring. Thank you very much for your cooperation today.

Ms. Okina, Mr. Kanda, and Mr. Kumagai are absent today, and Mr. Nagami is in attendance online.

We would now like to begin the meeting. First, let us explain today's agenda.

Ikeda, Senior Manager, Listing Department, TSE:

Thank you again for your cooperation today.

There are three main agenda items today. The first item is about action to implement management that is conscious of cost of capital and stock price. We will update you on the most recent company responses and explain our policy for future follow-up.

The second item, in Document 2, is about revising the Code of Corporate Conduct. We expect we should discuss this topic in several sessions in the future. In this first session today, we will present facts about the institutional framework of the code and the recent situation of companies. I hope that we can have a broad discussion based on these facts.

The third item, in Document 3, is listing criteria for the Growth Market. We would appreciate it if you could discuss the basic ideas for further discussion based on facts, such as the actual situation of listed companies.

That concludes my explanation of today's agenda.

Kikuchi, Director, Listing Department, TSE:

We would now like to begin to explain the documents. Today, I would like to explain and then ask for your comments on each of the three topics on the agenda, respectively.

First, we will explain the status of disclosure on "action to implement management that is conscious of cost of capital and stock price" based on Document 1.

Ikeda, Senior Manager, Listing Department, TSE:

With regard to action to implement management that is conscious of the cost of capital and stock price, we believe we have seen good initial results this fiscal year in that listed companies have begun to consider and disclose information, and domestic and foreign investors have shown a high level of interest in the issue.

On the other hand, corporate efforts will naturally take time. We believe it is extremely necessary to follow up painstakingly in the coming year, or even afterwards, and continue the movement with ongoing measures to address the issue.

We will continue to disclose the status of responses as appropriate to demonstrate to companies and investors. We assume that the timing in August, when the responses of companies with a fiscal year ending in March are finalized in the form of earnings announcements, shareholder meetings, and subsequent governance report updates, will be a major climax.

At that point, a year will have passed and we will be able to see the whole picture. Based on this, we hope to discuss how to improve the disclosure rate of companies, how to brush up the content of each company's disclosure, how we should view the difference in disclosure rates between the Prime and Standard Markets, and how we should address it.

I will now report only briefly on the current status based on Document 1. As shown on page two, the disclosure rate in the Prime Market has grown by about 5% per month since we began publishing the list in January. At present, companies that have already disclosed their information account for less than 50% of the total, and 60% of the total, when including companies that are under consideration. On the other hand, the disclosure rate in the Standard Market is about 20%.

See page three. Regarding the delay in response by companies with P/B ratios of 1x or more, which has been discussed in the past, we have been increasing our efforts since last year, and as shown on the right, an increasing number of companies are now responding to this issue.

We will continue our recent initiatives as described on page four. In addition, some companies do not have an accurate understanding of the disclosure and listing rules. As indicated in the yellow box, we would like to remind and make these items known as easily and clearly as possible to companies, with a fiscal year ending in March, when they newly disclose or update their financial statements.

This is how we intend to proceed for the time being. If you have any suggestions at this stage, we would appreciate it if you could point them out to us.

Kikuchi, Director, Listing Department, TSE:

If any of you members have any comments or questions, we would like to hear from you.

Sampei, member:

I think it is a good situation that companies are responding to the TSE's message, but I think TSE is following up the status of disclosure intensively. As Mr. Ikeda said, it is good to look at the status of disclosure in terms of looking at the initial response to a message. However, the essential question is whether capital profitability and growth are increasing and whether the market appreciates this. I think we need to look at those points in future follow-ups. For example, we need to look at how the distribution of return on capital is moving and keep a close eye on whether it seems to be fairly valued by the market. If the ROE has increased in the short

term but has not been evaluated by the market, it would mean that it is not yet evaluated as sustainable. I think these points need to be monitored.

Such aggregate and analytical data can be used to point out the position of a company when investors are talking with the company and can be used as material for dialogue.

Regarding the Standard Market, I mentioned at the beginning of this council that the concept was unclear. The problem is that, although we can see the difference in concept relative to other markets, we cannot explain the Standard Market by itself in a simple way. I think we need to go back to basics and discuss what the Standard Market is.

In parallel, if we look at the Prime Market and the Standard Market from the perspective of capital return, growth potential, and market valuation, which are the monitoring points I mentioned earlier, we can see how the Standard Market is viewed. Even if a company is listed on the Standard Market with a different stance from the global perspective, these three points are important because it is listed, and if they are far inferior to those in the Prime Market, there is a problem. Therefore, in terms of understanding such issues, three points are important to follow-up and can be applied to the Standard Market.

I believe the reminder to listed companies, which you wrote at the end of this document, is important. I want you to re-inform listed companies, and I think it would be a good idea to re-inform investors who see this list. I think it would clarify the dialogue if they could see in which angle the list is being made.

Kuronuma, member:

I too am concerned about the significantly lower disclosure rate in the Standard Market compared to the Prime Market. I think we need to examine the issues in the Standard Market, including this. First, why does TSE think the disclosure rates are so different?

Ikeda, Senior Manager, Listing Department, TSE:

I think there are several factors. Compared to companies listed on the Prime Market, companies on the Standard Market have relatively less contact with investors, so there is naturally a difference in awareness. I also believe that internal resources are not sufficient compared to Prime Market-listed companies. I believe that a combination of these factors has led to a low disclosure rate in the Standard Market.

Kuronuma, member:

Is the first reason you mentioned that Standard Market-listed companies believe that they do not need to have a dialogue with investors and that there are few opportunities for such dialogue, so there is no need to disclose such information?

Ikeda, Senior Manager, Listing Department, TSE:

It is not because dialogue is not necessary, but because there are currently few opportunities for dialogue with investors, so there is relatively little awareness of the need for disclosure.

Kuronuma, member:

I understand. I am sure it is one of the challenges.

Koike, member:

As a first step in this effort, it is good to see that corporate disclosure is progressing and gaining market recognition. We in the field feel that there is a definite increase in the number of approaches from companies asking to explain how they can improve their corporate value or voices from people, including securities companies, introducing companies that are making efforts to do so. I have not yet been able to tally the numbers, but I feel that the number has increased by 20% to 30%. It is good to see the situation develop in this way, and our dialogue with engagement personnel, including analysts, gives us a sense that efforts to increase corporate value are increasing.

I believe that as we continue to deepen our understanding of each other and gradually create more opportunities for dialogue, literacy on the part of companies will improve, and they have high hopes for this. On the other hand, I have previously discussed the reality that if all companies demanded dialogue, we would not have enough resources to respond. This is becoming more and more realistic. There are many requests for meetings, which our current staff is not able to undertake. However, we cannot afford not to undertake it, so we do. As a result, the time per meeting is shorter.

My biggest concern is that the quality of engagement per company may not increase for those reasons, and I think we need to come up with some countermeasures. As for engagement, the number is, of course, important, but we emphasize quality and it is difficult to find the right balance between the two. In addition, the number one thing that should not happen in this effort is increased frustration in listed companies, that investors do not accept dialogue despite their attempts to conduct dialogue based on our requests. We feel, through our practical experience, that how to control this is a very big issue.

What I have just said is what we feel. As stated in the document, the market as a whole would benefit if TSE could conduct a survey to see how institutional investors feel, provide feedback, and adjust the market as a whole through dialogue.

Two members pointed out the differences in the disclosure status of the Prime and Standard Markets. I too think this is an issue. I think it is necessary to analyze how the different disclosure conditions affect, for example, corporate value and stock price, and to provide incentives for companies.

Ando, member:

First, I would like to comment on the progress in the number of disclosed companies. I positively evaluate that 48% of the companies in the Prime Market, excluding those under consideration, have disclosed as of the end of February this year, 2024. Assuming the start of disclosure by companies whose fiscal year ends in March and updates by companies under consideration, the percentage will certainly exceed 50% by the end of March. Once the ratio exceeds 50%, the percentage of disclosed companies should increase even more rapidly toward the 2/3 mark, as companies become more serious about their efforts.

On the other hand, the 14% of disclosed companies in the Standard Market may indeed be inferior to the Prime Market. However, examples of disclosures published by companies in the Prime Market are

accumulating, and the number of examples of initiatives that the management of listed companies in the Standard Market can refer to is steadily increasing. This point is extremely important. After all, companies in the Standard Market have limited financial reserves or insufficient staff in their corporate departments. However, consultants are increasingly active in proposing responses to the theme of achieving cost of capital- and stock price-conscious management, and if these are also utilized, the ratio is likely to steadily increase.

TSE asked whether the goal is to increase the number of disclosing companies or to improve the quality of disclosure. Of course, the ideal is to aim for both. The process we originally aim for is that companies autonomously enhance their management capabilities through dialogue and engagement with investors, with the disclosure rate reaching 100% in the Prime and Standard Markets.

In this regard, I look forward to the FSA's current review of the Stewardship Code. I ask that you fully discuss what role institutional investors, sell-side analysts at securities firms, and voting advisory firms should play in market restructuring.

Matsumoto, member:

I think we are generally moving in the right direction. I think the reason various companies reacted last year is that, in a way, TSE demanded more from them, to the detriment of their expectations. I think TSE has been a good stimulus for them, as it had not said much to issuers in the past. I think that reminder and the like are good initiatives, but there is a risk that they will become unresponsive if the request falls in a rut and they become accustomed to it. In that light, I believe that the examples of initiatives you published in February are examples of initiatives that received support from investors, and you did not provide any examples of initiatives that were complained about. Considering that the noisiness stimulated companies to move, it is important to continue the noisiness by providing bad examples, even if anonymously.

Sampei, member:

I have already mentioned this earlier, but I would like to reiterate that disclosure is not the goal. Although we are now tracking the status of disclosure, I hope that you do not come to the conclusion that it is enough if disclosure is proceeding. Even without disclosure, if profitability increases, investors will autonomously check the status of the company, and the less disclosure there is, the more they will try to engage in dialogue, which is fine. However, I think it would be better from the perspective of fair disclosure if there is disclosure. However, the disclosure should be a means to an end and not an end in itself.

I would also like to comment on what Mr. Koike said regarding his concern about companies saying that investors do not engage in dialogue with them. When I speak to corporate executives, I tell them that from the perspective of actively managed investors, they only see companies they are interested in, which means that some companies do not have the opportunity to interact with investors because those investors are not interested in them. If companies want an opportunity for dialogue, they have to produce results or demonstrate the magnitude of the change. If the results have not changed, I don't think disclosure will cause investors to devote their limited time to that company as a priority.

Kikuchi, Director, Listing Department, TSE:

Thank you very much.

We would like to continue with an explanation of revising the Code of Corporate Conduct based on Document 2.

Yamawaki, Manager, Listing Department, TSE:

I would like to explain about Document 2.

Pages two and three are the table of contents. Page four onward is about the Code of Corporate Conduct in its entirety. Page four shows the history of the Code of Corporate Conduct to date. The Code of Corporate Conduct was established in 2007 to require listed companies, which are members of the securities market and have many public shareholders, to act responsibly.

The background to this is that, with the increased freedom of corporate behavior following the enactment of the Companies Act of 2006, there were corporate actions that interfered with the functioning of the secondary market and the rights of shareholders. In addition to the existing obligation to fulfill timely disclosure, we have been providing step-by-step regulations, focusing on matters to regulate such corporate behavior.

In 2015, we established a Corporate Governance Code, and the Code of Corporate Conduct was updated to include respect for this and comply or explain.

Page five is an excerpt from the discussion at the time of enactment for your reference, so I will omit the explanation. Pages six and seven show the current provisions.

The Code of Corporate Conduct includes "matters to be observed," which stipulates matters to be observed as a listed company and "matters desired to be observed," which stipulates matters to be recommended, each of which has provisions as shown in the material.

Page eight is about enforcement of the Code of Corporate Conduct. Violations of matters to be observed are subject to public disclosure and other measures, while matters desired are exempt from such measures.

In addition, although matters desired to be observed are not designed in such a way that an explanation is always required in case of non-implementation, as in the case of the "comply or explain" of the governance code, as stated under the asterisk, some provisions require disclosure of the company's approach and/or initiatives in corporate governance reports, for example.

Page nine shows the details of the measures for your reference. I will omit a description of the details of each measure. We have a history of diversifying our measures since the establishment of the Code of Corporate Conduct.

Page 10 is a comparison of the Code of Corporate Conduct and the Corporate Governance Code. Although there is some overlap in content between the two, we have maintained the content of both, based on the differences between the two.

The first difference is the subject. The Code of Corporate Conduct is basically applicable to all markets, but under the Corporate Governance Code, for example, only the basic principles are to be applied to the Growth Market.

The second difference is the format. While there is an obligation to comply with or strive to comply with the Code of Corporate Conduct, there is even no obligation to strive to comply with the Corporate Governance Code, if explained.

On pages 11 and 12, for your reference, we have excerpted the main items where overlap can be found between the Code of Corporate Conduct and the Corporate Governance Code. For example, there are overlapping items, such as the appointment of independent outside directors and the development of an environment for the exercise of voting rights.

Next, let's look at the recent discussion on the responsibilities of listed companies.

See page 14. In accord with the formulation of the Corporate Governance Code, it has recently been widely recognized that sustainable growth of a company and enhancement of its corporate value over the medium to long term are the responsibilities of a listed company.

Based on our discussion, the Council has also implemented requests related to corporate value enhancement, such as last year's "management that is conscious of cost of capital and stock price."

Page 15 shows the status after the requests. This is a restatement of the status of the disclosures presented in Document 1, so I will omit the explanation.

Page 16 contains the results of a survey conducted by Sumitomo Mitsui Trust Bank, Limited regarding the status of dialogue with shareholders and investors and the implementation of IR activities that are a prerequisite for such dialogue.

In the Prime Market, many companies conduct IR activities, such as dialogues with shareholders and investors and financial results briefings, but in the Growth and Standard Markets, there are differences in the status of IR activities.

Page 17 shows what has been discussed so far at this Council. Some commented that it is necessary for listed companies with a large number of unspecified investors to write into the Code of Corporate Conduct the responsibilities of the Board of Directors with respect to improving corporate value and awareness of the cost of capital, and others suggested that an overall inspection should be conducted on this occasion. As a specific point of discussion, you also raised issues related to recent MBOs and acquisitions.

On page 18 and beyond, you will find recent developments related to the current provisions of the Code of Corporate Conduct.

First, I would like to discuss the status of M&A and other activities.

Page 19 shows the status of delistings through MBOs, conversion to wholly owned subsidiaries by controlling shareholders, et cetera. In light of the recent increase in awareness of capital costs and other factors, both the number of cases and the size have been at a high level. However, in the midst of structural conflicts of interest and asymmetric information, some investors have raised doubts about the functioning of the special committee as a measure to ensure fairness, as well as about the method of price calculation and the content of disclosure.

The information on page 20 and beyond is compiled based on companies' disclosures about the state of practice in light of the Fair M&A Guidelines developed by METI in 2019. Although the guidelines themselves are positioned as best practices, it has become common practice to establish special committees that include outside directors and the Board of Directors to follow their decisions.

On page 23, for your reference, we have provided the contents of the current Code of Corporate Conduct provisions regarding MBOs and making wholly owned subsidiaries by the controlling shareholder.

The first point is about disclosure. With the matters to be observed, listed companies are required to make necessary and sufficient disclosures when expressing their opinions with respect to MBOs, et cetera.

Second, on the procedural side, they are required to obtain a statement of calculation from the calculation agency and submit it. In the case of a wholly owned subsidiary by a controlling shareholder, the company is also required to obtain an opinion from a disinterested party, such as an independent outside director.

Starting on page 24, we present the main contents of the Timely Disclosure Guidebook regarding the necessary and sufficient disclosure required by the Code of Corporate Conduct.

It requires certain disclosures about the special committee as a measure to ensure fairness and about the material assumptions used in the calculation that are necessary for investors to judge the appropriateness of the results of the calculation.

Page 25 shows the status of corporate takeovers and the introduction of policies for dealing with takeovers.

Although there have been a certain number of takeovers made without the consent of the target company in the recent past, the number of cases in which a policy for dealing with takeovers has been introduced has been decreasing in light of the rising rate of opposition by institutional investors. In relation to this, on page 26, we present the Guidelines for Corporate Takeovers, which were formulated by METI last August. I will omit the explanation.

Page 27 presents the framework in the current Code of Corporate Conduct. In the phase of introducing takeover response policies, it requires, among other things, the sufficiency of disclosure, transparency in terms of conditions for triggering countermeasures against takeovers, and the impact on the secondary market and the respect for the rights of shareholders as matters to be complied with.

We have also established criteria for delisting in cases where the content of shareholder rights or their exercise is unreasonably restricted, as described under the arrowhead at the bottom of the table.

From page 28 onward is the status of the appointment of independent outside directors, et cetera.

See page 29. Since 2009, TSE has established an independent director/auditor rule in its Code of Corporate Conduct, to protect general shareholders by requiring that independent directors/auditors must be secured and free from any risk of conflict of interest with general shareholders. Subsequently, the Corporate Governance Code was formulated, and as you know, progress has been made in appointing independent outside directors, with 95% of listed companies in the Prime Market now having at least 1/3 independent directors.

Page 30 shows the status of appointments by market segment. In the Standard Market, 80% of companies have appointed two or more persons. In addition, 98% of companies in the Growth Market, which is not covered by the code, have appointed independent outside directors.

On page 31, we provide the current regulations regarding independence criteria for your reference.

The independent director rule requires, as a substantive requirement, that the independent director be a person who is "unlikely to have conflicts of interest with general shareholders," and sets the independence criteria as the minimum requirement to be secured in this context.

The Corporate Governance Code also asks that each company's Board of Directors shall develop and disclose substantive independence criteria. In addition to the exchange's standards, some companies have established their own quantitative standards regarding relationships with business partners, et cetera, and some have included factors, such as mutual appointment relationships and tenure of outside directors, et cetera.

Page 32, also for your reference, quotes the results of a survey conducted by Sumitomo Mitsui Trust Bank regarding the perception gap, regarding the expected role of outside directors in terms of the fulfillment of their functions.

Investors expect outside directors to be involved in dialogue with shareholders and investors in the nomination and decision-making process, and in succession planning, but there is a gap in the perception between them and listed companies.

Page 33 is an introduction to the awareness-raising activities for independent outside directors that we are promoting with related parties. I will omit the explanation.

Page 34 onward is about third-party allotment, et cetera.

Please move to page 35. In response to a number of cases in which third-party allotments involving large-scale dilution, et cetera, were carried out solely at the will of management, TSE established delisting criteria for significant third-party allotments that infringe on the interests of shareholders in 2009. Furthermore, as a matter to be observed in the Code of Corporate Conduct, we require, as a necessary procedure to increase shareholders' understanding, that companies obtain an opinion from a person independent of management or confirm the intent of shareholders through a resolution at a general meeting of shareholders.

Page 36 shows the recent third-party allotments. Cases with a dilution ratio of more than 300% that are subject to delisting review account for less than 1% of all cases. Most of the cases are done as a remedial response after an injection of public funds or a general meeting to confirm the shareholders' intentions, and no cases have been identified as an infringement of shareholders' interests.

Cases involving a 25% dilution or a change in controlling shareholder, which are subject to procedures under the Code of Corporate Conduct, account for 12% of all cases.

In this context, page 37 shows a recent case study on third-party allotments. Specifically, there was a case where, as a result of repeated third-party allotments, et cetera, the number of outstanding shares has increased significantly, and even if the market valuation has been sluggish and at a very low level, the continued listing standards regarding the market capitalization of tradable shares have not been violated.

It is also a reason that the current market classification does not have penny stock standards as in the US, and therefore there is no mechanism to ensure proper price, market capitalization, formation by exiting due to low stock prices or by encouraging reverse stock splits.

Finally, on page 39, I will explain the items we would like you to discuss today. The items are divided into several sections. Since this is the first time that we are having a discussion on the Code of Corporate Conduct, we would like to receive your frank opinions on any item and not only on the items mentioned.

The first point is about the objectives of the Code of Corporate Conduct. So far, from the perspective of maintaining the functioning of the secondary market and protecting the rights of shareholders, we have stipulated matters that require listed companies to act responsibly. We would appreciate your opinion on whether it is conceivable to stipulate necessary matters from the perspective of sustainable growth and enhancement of corporate value over the medium to long term. Along with this, we would also appreciate your opinion on how you think it should be separated from the Corporate Governance Code.

The second point is about ensuring effectiveness. In particular, while desired matters are not subject to the measures, we believe that the issue is how to encourage autonomous efforts by listed companies.

For example, we wonder if, after properly reorganizing the contents of desired matters, it is conceivable to systematically require disclosure of companies' thinking and status of efforts, et cetera. In addition, we would

like to know if we could consider a general overhaul of the contents of the corporate governance report. We would appreciate your comments on how to ensure its effectiveness.

Finally, the third point is individual provisions. Whether there are any matters regarding the current provisions that need to be reviewed in light of the recent situation of corporate behavior and overlap with the Corporate Governance Code, alternatively, in relation to the objectives on the first point, if we were to establish provisions necessary from the perspective of sustainable growth and medium- to long-term improvement of corporate value, we would appreciate your opinions on what specific provisions could be considered.

This is the end of the explanation for Document 2.

Kikuchi, Director, Listing Department, TSE:

Now we would like to receive your comments.

Ando, member:

Thank you for your explanation. The materials are very thought-provoking and very informative.

First, I absolutely agree with you about the overhaul of the Code of Corporate Conduct. However, in the first place, the Code of Corporate Conduct and the Corporate Governance Code are completely different, and the overhaul of the Code of Corporate Conduct should be conducted with this in mind.

This is because the difference between the Code of Corporate Conduct and the Corporate Governance Code is very large. The former is rule-based, while the latter is principle-based. From that perspective, the main part of the Code of Corporate Conduct should be the matters to be observed, and the desired matters should be positioned as reference. Therefore, I would like to request that the principles and supplementary principles contained in the Corporate Governance Code not be added to the desired matters of the Code of Corporate Conduct in a blind way.

However, since it has been a long time since the code itself was revised, I think it would be good to consider what to include as material items, focusing on matters to be observed, and to consider whether or not to add matters desired. This is because I do not believe that what is not included in the desired matters of the Code of Corporate Conduct are not desired. I am concerned that as a result of the increased number of items in the Corporate Governance Code, such a perception may occur.

Nagami, member:

First, I am very sorry that I do not understand the past history, but since it was 15 years ago that the Code of Corporate Conduct was systematically developed, I think that the current provisions listed on page six to seven could be reviewed from scratch.

I don't think either, that items should be included more and more in the desired matters. However, for example, regarding the desired matters on page seven, regarding securing at least one independent director who is a director, I think the situation is different now than it was 15 years ago. I think the appointment of female board members has been slow in coming, and I personally think that there could be talk of making it more compulsory.

As I mentioned two specific examples, I think this is a good opportunity for a fundamental review of matters to be observed and matters desired.

Secondly, a bit linked to what I just said, on the assumption that we are discussing the issues as in Document 1, I think we can at least include the request for disclosure as in Document 1 in the matters desired.

Third, regarding individual issues, with the various requests and actions from TSE, I believe that the number of companies that think it is better to do an MBO will increase in the future. In fact, MBOs of large companies increased in 2023. The main issues in MBOs are the reasonableness of the price and the reasonableness of the terms. I believe that the process is already prescribed and that you often receive responses regarding the actual situation from investors.

I believe the difficult issue is how to align the process with the actual situation. For example, we can improve the governance of valuations by obtaining valuation reports from at least two companies.

In particular, in talking with investment funds in general, I find that many of them have the outlook that MBOs will increase in the future. They recognize that more and more listed companies will consider it. I think it would be good if we could get ahead of the curve and make communication smoother for both investors and issuers.

Sampei, member:

One major point is that the principle-based approach was brought to Japan with the introduction of the Corporate Governance Code and the Stewardship Code, but I don't think this principle-based approach has penetrated the market at all yet.

Japan is very accustomed to the bylaw principle, especially the numerical standard, and it is properly addressed. On the other hand, I think that we should properly indicate the important attitude and spirit of the company in the first place, before the bylaw principle.

Earlier, Mr. Ando mentioned that we should distinguish between rule-based and principle-based. I believe rather that it should be clarified that the principle-based approach is the fundament and some things are rule-based.

In addition to this, timely disclosure is very important in general. Section 2 of the Listing Rules and Regulations contains detailed rules for the timely disclosure of corporate information.

As we discussed last year in the Working Group on Corporate Disclosure of the Financial System Council and at the time of the abolition of quarterly reports, timely disclosure is still not taking place as expected. However, there is some discussion as to whether we should place more emphasis on timely disclosure and less on statutory disclosure in the future. If we are to move in that direction, timely disclosure must be better understood.

For timely disclosure, the detailed items stipulate standards for disclosure depending on the event. It would be good to write about why timely disclosure is important and what attitude should be taken with regard to those that are not specified.

Another perspective is on enforcement. The most severe form of enforcement is delisting. However, in the case of an MBO, a company is trying to delist itself, and also, it is the last deal for the public shareholders and there is nothing that can be done if it gets away. I don't think normal enforcement will be sufficient.

Regulations, such as minimum price regulations, could be introduced. I think it may be difficult for TSE to regulate it, but I think it is necessary to consider establishing it as a general rule.

However, from what I have seen so far, there are quite a few cases where, if you look back 250 days from the transaction date, very negative information is disclosed somewhere, the upward trend of the stock price begins leveling out or declining, and then an MBO is announced. To an investor, this seems like a very sneaky approach. If you could go back 250 days and analyze the stock price situation, such as whether there was any negative information during the process and at what stock price level the MBO was conducted, I think you would be able to see what kind of price controls should be established.

In other cases, there are actual cases where CEO succession is complied with the principle in the Corporate Governance Code, but in reality, no succession plan has been prepared.

It would be better to clearly state in the matters to be observed, et cetera, that as long as there is a succession plan, there should be at least a preparation period for the next CEO or president candidate, and that he/she should have a period of study as the head of management, not as the head of a business unit or head of operations, before being appointed to the top position. The Japan Directors Association gives awards to companies that are doing well in succession, but there is a very large gap between those that are doing well and those that are not. I think this is a point for consideration, as it is becoming clear that it is not sufficient for a succession plan, that the Nominating Committee has monitored the process, and the outside directors have approved the succession.

The other point is about controlling shareholder responsibility and fiduciary duty in group management, about MBOs, I mentioned earlier.

Regarding takeovers, as noted in the document, the takeover guidelines released by METI last year have changed significantly from the takeover defense guidelines issued in 2005. I think this part needs to be reviewed, including the language to be used.

Finally, for your information, the minimum price principle has been introduced in 39 out of 48 countries/regions. This was published in the OECD's Corporate Governance Factbook last September. There may be differences in degree and strength, but I think it is at least conceivable to use this as a reference and write the minimum desired price somewhere in the Code of Corporate Conduct.

Koike, member:

As Mr. Nagami mentioned, the situation has changed from 15 years ago with regard to the matters described on pages six and seven. Therefore, I think it is necessary to review the items and change them to match the current era, for example, by clearly stating the concept of cost of capital and corporate value. I also find it a bit disconcerting that the hurdles are so low compared to the institutional voting guidelines. I do not think it is necessary to match, but I hope you will keep this in mind.

Kuronuma, member:

The Code of Corporate Conduct has a history of stipulating matters to be observed, with the intent of prohibiting certain conduct because some companies used to behave abusively in the capital market. Even today, the matters to be observed still include such details. We should not think that we do not need rules on these matters because everyone is currently following them. I think we should keep items that are legally possible but are problematic for investor protection.

In addition to the rules regarding M&A and MBOs included in the matters to be observed, various other guidelines have been issued. I believe that METI's guidelines are directed to the courts, so if the exchange were to update and include separate desirable M&A and MBO norms from the perspective of investor protection, there would be no problem with duplication with the guidelines.

In terms of the relationship with the CG Code, the CG Code is positioned as a best practice for improving corporate value, including that of stakeholders, while the Code of Corporate Conduct is a set of measures that the exchange considers desirable for investor protection, so strictly speaking, the principles are different. Even so, since the Code of Corporate Conduct includes items related to the corporate organization and there is some duplication, I think it would be acceptable to leave some of the duplication to the CG Code and remove it from the desired matters. However, TSE has established independence criteria for securing independent directors, at least one, under matters to be observed and for securing independent directors who are directors, at least one, under desired matters. On the other hand, under the CG Code, the criteria for independence are to be determined by each company, although many companies actually determine this with reference to the rules of TSE. Even if it is removed from the Code of Corporate Conduct, the idea of TSE's independence needs to be maintained.

Matsumoto, member:

As Mr. Kuronuma mentioned, I think the matters to be observed in the Code of Corporate Conduct are important. We recognize that the matters to be observed, which is the only way to stop abuses that are legally permitted and has been in effect when abuses occur, such as third-party allotments, is one of the most important rules governing listed companies in our country. Also, while I think it is necessary to review the code as a whole, including unnecessary items, et cetera, we should proceed with care so that the power of enforcement, strength, and clarity of the matters to be observed is not weakened, and so that the perception of what must be observed at a minimum in the listed companies and society is not obscured.

Speaking to individual issues, I was under the impression that the request for cost of capital may not fit in with the Code of Corporate Conduct. One way might be to include it under matters desired. I don't think this fits in with matters to be observed, since those matters are meant to stop wrong things, so mixing in capital cost talk weakens the strength of the original matters to be observed.

Regarding the role of outside directors, I believe that we should eventually consider requiring Japanese directors to have the fiduciary duty, such as the Revlon standard in the US. On the other hand, the content is very heavy and there is the issue of personal responsibility, so I think it is too much to go that far in the Code of Corporate Conduct.

If so, I think the most important thing is the MBO or parent-subsidiary listing. The number of cases has been increasing recently, and it is a serious situation in which enforcement is not effective and some cases are implemented even though they clearly violate the METI's guidelines on fair M&A practices. It may be as big a problem as the significantly dilutive third-party allotments of the past. Since it is the matters to be observed in the Code of Corporate Conduct that is both agile and involves enforcement, I think that the same guidelines for fair M&A practices should be included here.

Kikuchi, Director, Listing Department, TSE:

Thank you very much.

I will continue with an explanation of the listing criteria for the Growth Market based on Document 3.

Isogai, Manager, Listing Department, TSE:

I will now explain Document 3. On the first page, we have laid out the measures to be taken to enhance the functionality of the Growth Market, which was also presented at our last meeting in January.

Today, we would like to ask you to discuss your basic ideas on the listing criteria under number five, including the purpose and points to keep in mind if the criteria are to be raised, based on facts such as the actual situation of listed companies, in order to proceed with future consideration.

On page two, before we get into the main topic, we described the discussions that have taken place so far and the main subjects to be considered in the future based on them.

As indicated in the gray box below, the criteria for initial listing will be discussed while keeping an eye on the progress of the government's five-year plan for start-up development and other efforts to create an environment that will allow unlisted companies to grow significantly. We are considering to proceed with the discussion, giving priority to the criteria for maintaining listing first.

Page three and beyond provide facts, including the actual status of listed companies.

The first question is what is happening now to companies that have previously been listed on the Growth and Mothers Markets. Many companies have changed their market classification or delisted, and only about 60% are still listed on the Growth Market.

Next, on page four, we show the distribution of market capitalization in terms of how those 60% of the companies are doing. The median amount is JPY6 billion, and 31%, 177 companies, did not reach the current standard level of JPY4 billion.

The current standard is effective after 10 years of listing, so at this time, only the companies in the bottom-left red box actually conflict with the standards. However, as indicated "possible future conflicts" in the red dotted line above, there are a certain number of companies that will conflict with the standards if 10 years pass since their listing.

Page five shows the growth in market capitalization since the initial listing.

The median value is 1.03x. From the opposite perspective, 49% of all companies have a market capitalization below that of their initial listing.

Page six is a cross tabulation of the data on pages four and five.

The dark green shaded area is the volume zone. It can be seen that there are some companies that have a small current market capitalization but have grown significantly since their listing, as in, 1, and some companies that have a certain market capitalization even though they have not grown since their listing, as in, 2.

Page seven shows the status of companies to which transitional measures are applied. In the Growth Market as a whole, 52 companies are subject to transitional measures, 25 of which conflict with the market capitalization criteria.

This is a decrease of four companies and an increase of 11 companies from the time of the market restructuring the year before last. Some of the increased 11 companies have newly conflicted with the criteria during the past two years as they have been listed for 10 years. Thus, we can see that the companies that I mentioned earlier as "possible future conflicts" are actually beginning to conflict with the standards.

As shown on page eight, the current market capitalization standard was increased by a factor of 4 at the time of the market restructuring.

On page nine, we provide an international comparison of standards for your reference. NASDAQ allows a company to remain listed if it meets one of three criteria, one of which, criterion 2, relates to market capitalization, which is defined as approximately JPY5.3 billion or more. There are 47% of companies that do not meet this criterion 2, but maintain their listing by meeting criterion 1 or 3.

Also, as you can see on page 10, some of the comments mention changing market classification to the Standard Market as an option for companies that did not meet the criteria for the Growth Market. However, each of the three markets is an independent concept, and any change in market segmentation must be subject to review.

The formal requirements for the Standard Market include a profit standard of at least JPY100 million for the most recent one-year period and a circulating market capitalization standard of at least JPY1 billion, which is one level higher than the Growth Market. Therefore, 3/4 of the companies in the Growth Market with a market capitalization of less than JPY4 billion currently fail to meet some criteria.

On pages 11 and 12, we provide a comparison of new listing criteria for your reference.

The items on page 13 and beyond are items we would like you to discuss at this time. The first thing I would like to ask for discussion is what the purpose of the increase would be if it were to be implemented.

One opinion is that it should be raised to motivate the realization of higher growth after listing. However, as noted under the arrowhead, some may argue that the effect will be limited for companies that have no concerns about conflicting with the criteria, and even if the criteria are raised, it is unlikely to motivate start-ups to grow significantly after listing.

On the other hand, some believe that, for companies that have not grown much since their listing and are about to conflict with the criteria, it will have the effect of making them rethink how they should grow in the future, including mergers and acquisitions with other companies, and the market should encourage such a renewal of industry.

This concept is also considered to be linked to the summary of discussions compiled in January of last year.

Please see the last page 15. In light of the facts, we would appreciate your discussion on what points should be kept in mind if the stricter criteria were to be implemented.

The factors section is a summary of the data to date, so I will omit it. Regarding the notes, first, if a large number of companies were to be delisted, we should consider the possible impact on shareholders and in turn, the atrophying of the supply of funds to the Growth Market.

We also state that we should be aware of the time frame, because if the standards that were revised two years ago were to change again, it could affect the initiatives of many listed companies, as well as companies currently subject to transitional measures.

Lastly, we are considering the possibility of encouraging listed companies to take other measures, in addition to raising the criteria for maintaining their listing.

For example, in the disclosure of "Business Plans and Matters Related to High Growth Potential," companies currently describe growth stories, but when the market capitalization is below a certain level, the content is not fully evaluated by the market. From the viewpoint of asking companies to reconsider the content of disclosure after recognizing this, we have presented a proposal to describe the analysis of the cause and countermeasures based on that analysis.

That concludes my explanation.

Kikuchi, Director, Listing Department, TSE:

Now we would like to receive your comments.

Sampei, member:

Thank you for your explanation. I was a little concerned about the fact-based considerations. As we have discussed in the past, with the Growth Market not working as expected, making a few changes as an extension of reality would not essentially change things. In the first place, we must consider the "ideal" of what we expect from the Growth Market and what we want the Growth Market to be. I think that a fact-based discussion might lead to raising the minimum line a bit, but I think that is negative thinking and will not lead to a movement to improve the market or make it more appealing.

One of our expectations of listed companies in the Growth Market, for example, is that they will boldly take on challenges. If they fail to overcome a challenge, they could increase their capital for another challenge. On the other hand, a company that does not take on any challenges, whose goal is to go public and then do nothing, should be asked to leave the market. I think one of the goals of the market restructuring was to clarify the concept. We should clarify the "ideal" of what we expect from the Growth Market. Only after that discussion should we consider where we are, how far we are from the ideal, and how to move toward the ideal. If the discussion focuses on raising the minimum line a bit, I don't think we would not able to paint the picture of the Growth Market as it should be.

Nagami, member:

I think Mr. Sampei is right. The Growth Market is a market that incubates and hatches companies that will represent Japan in the future, and we should expect its listed companies to be bold risk-takers. In this sense, the criteria for maintaining listing should not be set too low. According to page four and other pages of the document, if the market capitalization standard is set at, say, JPY10 billion, about 70% of the companies would conflict with it, and we naturally understand that this would have an impact. However, I believe it is acceptable to set certain high standards in order to create a nucleus of innovation in a growing industry by encouraging such companies to rise to the occasion and depending on the circumstances, join with other companies. In other words, I believe that the primary purpose of raising the criteria for maintaining listing is to encourage mergers and acquisitions among growing companies, thereby creating core companies and as a result, fostering companies that will represent Japan.

Koike, member:

The stock market is currently strong and attracting attention from foreign investors. However, even if they try to invest in small and mid-caps or set-up funds, they are not investing in Japan's Growth Markets due to small capacities. The document states, "which in turn could have a negative impact on the supply of funds to the Growth Market," but I believe that it has, in fact, already negative impact. In this sense, I think it would be better to reform the market fundamentally and rethink the concept.

There are several issues, some as a market and some on the corporate side. First of all, I think it is important to rethink the IPO system in the first place, that is, to rethink not only the criteria for listing examination, but also the objectives and to rework the concept and brand of the Growth Market. At present, it is still an extension of the Mothers and JASDAQ Markets, and it seems that the image that it belongs to the lower classes of the three markets has not been fully erased. I believe that if we can make the Growth Market where companies do not aim for the Prime Market but rather stays while realizing growth, because the image of growth disappears when moving to the Prime Market, it will naturally attract money from all over the world and help Japanese industry.

One more thing, discussions between institutional investors and listed companies alone are of little use. It is still necessary to reexamine the thinking of stakeholders involved in IPOs, including securities firms, for example, and I don't think it will be easy to make changes even if we try to improve the situation piecemeal.

Raising the listing standards may be one of the necessary actions, but first, we need to demand improvements from the listed companies. For example, we could ask the Growth Market to consider policies, ideas, and frameworks for growth, as well as with the case of requests regarding responses to achieving cost of capital- and stock price-conscious management. I believe that this should be a step-by-step approach, such that if nothing changes as a result of seeking voluntary improvements, then the standards should be revised.

Ando, member:

It is true that there are various challenges in the current Growth Market, and a multifaceted approach is needed to solve them. Regarding what Mr. Koike pointed out earlier, there are companies listed on the Prime Market that are like those listed on the Growth Market. I think this is due to the fact that the characteristics of the market segments are not recognized, and the image of the Prime Market as more noteworthy and easier to finance is prevailing. It is quite difficult to change this mindset of start-up managers, and the issue now is what can be done to promote listing in accordance with the market classification concept.

As a different angle, the number of IPOs has generally been around 90 per year since 2015, although there have been some fluctuations. The same results were seen even in the 2020 to 2022 COVID-19 pandemic, indicating a high need for IPOs. Most recently, there have been some major tidal shifts, such as the increased focus on Japanese companies, the fact that deflation is coming to an end, and the Bank of Japan's decision to lift negative interest rates, so it is important to monitor these developments.

It may be necessary to spend at least a year or so watching how market conditions and the environment change. As I said at the beginning, the issues in the Growth Market are complex, but I feel that most of the matters are not necessarily causally related to the criteria for maintaining listing. In addition, a sudden increase in the listing maintenance criteria would have important consequences for companies that are already listed or about to be listed. I would like to request that TSE take the stance that it will review the proposal if necessary, while building consensus through dialogue with the market. Of course, I am not saying that it should not be reviewed, but I would very much appreciate constructive discussions with all parties involved, taking into account the changing environment.

After reviewing the materials, I felt once again that the NASDAQ is a mature market. The Growth Market may also benefit from multiple criteria, rather than just one.

Kuronuma, member:

I think Mr. Sampei is right in pointing out that an examination in light of the facts may lead to maintaining the status quo, and he is also right in pointing out that we should consider what we need to do to encourage growth in Growth Market-listed companies. However, looking at the current situation, the listing criteria for the Growth Market are a tradable share market capitalization of at least JPY500 million and a tradable share ratio of at least 25%, which means that companies with a minimum market capitalization of JPY500 million to JPY2 billion are listed.

In contrast, the criteria for maintaining listing are set at JPY4 billion after 10 years, which I believe provides an incentive for a certain degree of growth. In that sense, even with the current criteria, a mechanism is in place to provide growth incentives to companies listed on the Growth Market, and taking into consideration the fact that the system has just been changed due to a review of market classifications, I do not think it is necessary to change the current listing maintenance criteria.

Matsumoto, member:

Since the Growth Market has the issue of too many small companies, I think it would be a good idea to reform the market at this time with the goal of promoting mergers and acquisitions. Some may say that is too much, but we have done the PBR/cost of capital thing as well, even though some say it is too much for the exchanges to do, so I don't see a problem.

One problem faced by large and venture companies alike is the inability to create the necessary critical mass due to disparate production factors, such as human and capital resources and products and services. As for the fact that it is generating young managers who want to create new businesses and IPOs, I think the Growth Market is functioning as a market. However, with growth not continuing after listing, M&A may be encouraged so that the company can move on to the next stage. As a design to encourage this, rather than an increase in the criteria for maintaining listing, I believe there could be some kind of mechanism to make the criteria more lenient in the case of M&As.

Regarding NASDAQ, since SPAC and other companies are also listed on the capital market, it may be inferred that there are multiple criteria in place as stated in the document. If so, it would be difficult to make a general comparison with the Japanese Growth Market. How are the other markets on NASDAQ?

Isogai, Manager, Listing Department, TSE:

The NASDAQ Global Select Market and Global Market also have multiple criteria, and their standards are higher than those of the capital market.

Nagami, member:

As a different issue from the criteria for maintaining listing, companies in the Growth Market are suffering considerably from a build-up of short positions in their stock, a situation that is being shorted. I understand that short-selling on loan is good from the perspective of increasing liquidity, but it also makes it more difficult to increase market capitalization. I am not sure what to make of this, and I am not sure if TSE should take any action, but I thought I would share the situation with you. Some say that Tesla's stock price began to rise quickly after the GPIF stopped lending foreign stocks. While the short position has some positive aspects in terms of liquidity, I have concerns that it is going too far in terms of stocks in the Growth Market.

Sampei, member:

I mentioned earlier that I would like to see more challenges in the Growth Market. As an image, for example, if a company is number one or "first" in something, it could be rewarded with a relaxation of the criteria for maintaining listing required under the regulations. If a business model is new or a challenge is taken on for the first time, there is naturally a risk of failure, but if certain standards are waived and challenges are encouraged, the characteristics of the market will emerge and managers with a high interest in such matters will be attracted to the market. I think they would consider giving it a try, not for such a simple reason that the image of the Prime Market is easier to finance, but because the criteria are typical of the Growth Market. I suggest you think about those things.

Kikuchi, Director, Listing Department, TSE:

Thank you very much.

We have received feedback from all members. The Ministry of Economy, Trade and Industry, which is participating as an observer, would like to make a statement.

Kameyama, Director, Industrial Finance Division, Ministry of Economy, Trade and Industry:

The Ministry of Economy, Trade and Industry, METI, is also in charge of start-up policy and has been promoting support measures from the stage of unlisted companies as part of the five-year start-up plan. While we have made progress in improving our measures, we often hear these days that the growth stops after a company is listed. Especially for the Growth Market, as several members have pointed out, I think it is important to challenge the concept of growth, and I would like to see a fundamental review from that perspective. There was an explanation that the system was just changed, but when the system is changed, it cannot be applied immediately but requires a period of familiarization, so considering the familiarization period, it seems to me that the discussion of the review must proceed promptly or it will not be completed in time.

Also, from the perspective of the review, I would like to reiterate that I think M&A is important as a company grows after listing and how to promote the entry of institutional investors, which is one of the challenges of the Growth Market, is also important as a player in supporting growth. I think it is necessary to consider whether the criteria for maintaining a listing are appropriate from the perspective of growing a company to a size in which institutional investors can invest.

In addition, the current standards maintaining listing is JPY4 billion after 10 years of listing, but I would like you to consider reviewing whether the timing of 10 years is sufficient. Since the perspective of motivating growth is important, I think there are some points that need to be reviewed, such as whether growth should

be encouraged only after 10 years or by detailed milestones, such as after three or five years. I hope you would have a discussion on these points as well.

Kikuchi, Director, Listing Department, TSE:

Thank you very much. We still have a little time left, so if you would like to make any comments, even about the whole issue, please do so.

Matsumoto, member:

I wasn't sure where this would fit into today's three agenda items. My opinion on what to do with the Standard Market is that it is okay for the Standard Market to be unglamorous.

In the Prime Market, companies will be required high standards, and companies in the Prime Market will respond to these demands, increasing their corporate value. This is similar to the American model. The goal is not for all companies to grow together, but for good companies to become even better.

Companies in the Standard Market who see this will think, "we can't go on like this, we have to move to the Prime Market," and there will be pressure from investors for such companies to go to the Prime Market.

Considering the history to date, I have the impression that a model in which companies that respond properly to our demands are improving, and other companies are following suit is more appropriate than trying to improve all of the companies.

Sampei, member:

I mentioned earlier that there are ways to specifically regulate the minimum price for MBOs with respect to the Code of Corporate Conduct, and I think another way is to have a regulation that states that MBOs should not be made within a number of days, say 90 or 180 days, after the announcement of material negative information in foreign countries.

This is exactly what matters to be observed deserve. I think we can be very specific about how to set the price by also looking at the historical price data I mentioned earlier.

Koike, member:

Earlier, the Ministry of Economy, Trade and Industry, METI, commented that "institutional investors support growth," and we are highly aware of this as well. However, let me first share that there is a dilemma for institutional investors who are aware of it but have difficulty getting in.

One of the things that I think could be a breakthrough is crossover. Publicly offered investment trusts are now allowed to include up to 15% unlisted venture capital stock. By operating it, you will be able to ensure engagement from the unlisted stage and continue to hold the stock and engage with the company after it is listed. This is one sign of change and we hope to make a breakthrough here.

However, I still feel that the market itself needs to improve more, because without a sophisticated market for listing, subsequent growth will be difficult.

Kikuchi, Director, Listing Department, TSE:

With that, we will conclude today's meeting.

Finally, as of today's meeting, Mr. Ando will be stepping down. Mr. Ando would like to offer his greetings.

Ando, member:

On a personal note, today will be the last time I will participate as a member. I would like to take this opportunity to thank you, members and the secretariat.

In April, I will become the first president of the organization for promotion of financial and economic education, which will be newly established by the Financial Services Agency, and I would like to support the realization of the government's themes of "new form of capitalism," " promote Japan as a leading asset management center," and "doubling asset income" from an educational perspective. I would like to thank all of you attending the follow-up meeting for your continued guidance and support.

Briefly, I would like to thank you for your help and support over the past year and eight months, starting in July 2022.

Kikuchi, Director, Listing Department, TSE:

We would like to thank you once again for your support and active discussions at our meetings over the past 15 meetings. I am pleased to hear that you will become president of the organization for the promotion of financial and economic education in April, and I look forward to your continued success. We look forward to working with you in the future.

With that, we would like to conclude the meeting today.

Thank you very much again today. We look forward to working with you again next time.

[END]