

# Revising the Code of Corporate Conduct

Tokyo Stock Exchange Listing Department

March 22, 2024



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- 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 as listed companies.
  - Based on **actual occurrences of corporate actions that impeded the functioning of the secondary market and the rights of shareholders**, provisions have been brought in step by step, focusing on those that regulate these types of actions.
- In 2015, with the introduction of the Corporate Governance Code, the Code of Corporate Conduct was updated to include respect for this and comply or explain.

2006



## Enforcement of Companies Act

- Traditionally, discipline imposed on listed companies by exchanges was mostly timely disclosure obligations for corporate information.
- With the liberalization and deregulation brought by the Companies Act, corporate actions became a lot more liberalized, and some **corporate actions occurred which impeded the functions of the secondary market or the rights of shareholders** (e.g. dilution of shareholder value due to overuse of moving strike convertible bonds (MSCB), etc.).

2007



## Establishment of Code of Corporate Conduct

- As a general code of conduct for listed companies, the Code **stipulates respect for the functioning of the secondary market and shareholder rights**, as well as separately stipulating **items requiring listed companies to act responsibly** (contents gradually enhanced from this point on).

2009



## Code of Corporate Conduct's current structure developed

- Code of Corporate Conduct reorganized into the categories of "**Matters to be Observed**" and "**Matters Desired to be Observed**"

2015



## Establishment of Corporate Governance Code

- Corporate Governance Code established as an attachment to the Listing Regulations (the Code of Corporate Conduct stipulates **comply or explain**)

## Tokyo Stock Exchange, Interim Report of the Advisory Group on Improvements to TSE Listing System (March 27, 2007)

Historically, TSE has maintained a neutral stance when it comes to being involved in the corporate activities of listed companies, because it has believed that listed companies will behave in the manner and exercise the discipline expected of public companies, in accordance with their own decisions. Under the current TSE listed company rules, timely disclosure is positioned in the center of the listed company rules and other rules such as rules for corporate activities are very limited.

**As a result of the recent changes in the form of liberalization and the deregulation of the Corporation Law or other laws and ordinances, an intensifying of competition in the global marketplace, and a greater increase of the role and importance of securities markets, there are several corporate activities which might impair the well-being of the markets. TSE, as a market operator, is required to appropriately respond to such corporate activities from the perspective of protecting shareholders and investors.**

...

As a securities-market operator, **it is appropriate for TSE**, in addition to enhancing corporate information disclosure, **to develop codes of conduct for corporate activities and ask listed companies to operate properly in accordance with the codes, while taking care not to excessively restrict the freedom of their conduct**, from the perspective of protecting shareholders and investors and operating fair and sound market.

The Advisory Group believes **TSE should improve the listing system by: (i) describing generally its expectation that the listed companies should respect the functions of secondary market and the rights of shareholders and investors, and (ii) explicitly stipulating the matters for which TSE asks listed companies to be responsible for as participants of a securities market**; in addition to conventional imposition of obligation for appropriate timely disclosure.

- Comprised of **Matters to be Observed, which are compulsory** for listed companies, and **Matters Desired to be Observed, which are recommended**

## Matters to be Observed

- Matters to be observed for third-party allotment (receipt of opinion from independent entity, confirmation of intent of shareholders)
- Prohibition of share splits, etc. that are likely to disrupt the secondary market or infringe upon shareholder interests
- Matters to be observed pertaining to issuance of MSCBs, etc. (restriction of conversion or exercise by purchasing entity)
- Exercise of voting rights in writing, etc.
- Framework improvement to facilitate exercise of voting rights for listed foreign companies
- Securing independent directors/auditors (at least one)
- Explanation of reason for compliance or non-compliance with Corporate Governance Code
- Organs of listed domestic companies (1. board of directors, 2. board of auditors/supervisory committee/three committees, 3. accounting auditors)
- Securing outside directors (at least one)
- Certified public accountants, etc. (to be the same as those defined under the FIEA and Companies Act)
- Development of system and structure necessary to ensure appropriateness of business
- Matters to be observed pertaining to introduction of takeover defense measures (sufficient disclosure, transparency, effect on the secondary market, respect for shareholders' rights)
- Matters to be observed pertaining to disclosure of MBOs, etc. (necessary and sufficient timely disclosure)
- Matters to be observed pertaining to significant transactions, etc. with controlling shareholder (receipt of opinion from entity with no interest, necessary and sufficient timely disclosure)
- Prohibition of insider trading
- Exclusion of anti-social forces
- Prohibition of actions damaging to the functions of the secondary market or shareholders' rights

## Matters Desired to be Observed

- Efforts toward the shift to and maintenance of the desired investment unit level (less than JPY 500,000)
- Respect for the Corporate Governance Code
- Securing independent directors/auditors as directors on the board (at least one)
- Preparation of an environment for the functioning of independent directors/auditors
- Provision of information regarding independent directors/auditors, etc. (in a manner which contributes to the exercise of voting rights in the general shareholders meeting)
- Appointment of female officers (numerical targets for the percentage of female officers)
- Framework improvement to facilitate exercise of voting rights
- Documents to be delivered to shareholders owning shares without voting rights
- System improvement for prevention of occurrence of insider trading
- Development of system, etc. for excluding anti-social forces
- Development of systems and structures to properly respond to changes in accounting standards, etc.
- Fair provision of supplementary explanatory materials related to the details of account settlement

# Enforcement of the Code of Corporate Conduct

- **Violations of the Code's Matters to be Observed are subject to measures to ensure effectiveness, whereas "Desired" matters are not subject to these measures.**
  - However, for some provisions of the "Desired" matters, disclosure of the company's approach and/or initiatives is required in the CG report, for example.

## Scope of Measures to Ensure Effectiveness of the Code

|                           |                                | Measures to Ensure Effectiveness |
|---------------------------|--------------------------------|----------------------------------|
| Code of Corporate Conduct | Matters to be Observed         | In scope                         |
|                           | Matters Desired to be Observed | Out of scope                     |

## Matters Desired to be Observed for Which Disclosure is Required

| "Desired" Matter   | Content of Required Disclosure  |
|--|---|
| Efforts toward the shift to and maintenance of the desired investment unit level                   | Timely disclosure (annually) of approach to and policies regarding lowering the investment unit made compulsory                     |
| Development of system, etc. for excluding anti-social forces                                       | Disclosure of basic approach to elimination of anti-social forces, and the status of its development, in the CG report              |
| Securing independent directors/auditors as directors on the board (at least one)                   | Disclosure of appointment status of independent directors/auditors in the Independent Directors/Auditors Notification and CG report |
| Preparation of an environment for the functioning of independent directors/auditors                | Disclosure of support system for outside directors/auditors in the CG report  |
| Framework improvement to facilitate exercise of voting rights                                      | Disclosure of status of efforts to vitalize shareholders' meetings and facilitate the exercise of voting rights in the CG report    |
| Development of systems and structures to properly respond to changes in accounting standards, etc. | Disclosure of membership of the Financial Accounting Standards Foundation, etc. (annually)  |



# (Ref.) Outline of Measures to Ensure Effectiveness

- After the Code of Corporate Conduct was established, **measures to ensure its effectiveness were gradually diversified** under the thinking that these **should be principled on a different dimension to the conventional method that supposes delisting**.
- Currently, violations of Matters to be Observed may be subject to measures to ensure effectiveness including, as **improvement measures, request for an Improvement Report or designation as a Security on Special Alert, and as penalty-type measures, a public announcement measure or imposition of a listing agreement violation penalty**.

## Types of Measures Applicable to Violations of Matters to Be Observed

### Improvement Measures

#### Request for Improvement Report

- When the need for improvement is deemed to be high, TSE requests the listed company to submit an Improvement Report detailing their progress and improvement measures

#### Designation as Security on Special Alert

- When improvement in the internal management system, etc. is deemed to be highly necessary, TSE designates the listed stock that the company issues (this is then delisted if no improvement is seen)

### Penalty-Type Measures

#### Public announcement measure

- When deemed necessary, TSE publishes information about the violation on the JPX website

#### Imposition of listing agreement violation penalty

- When TSE deems that the company has undermined shareholder/investor confidence in the TSE market, payment of a listing agreement violation penalty is imposed

# The Code of Corporate Conduct and the Corporate Governance Code



- Although **there is some overlap** between the Code of Corporate Conduct and the Principles of the Corporate Governance Code, **the content of both has been maintained in light of the differences in scope and format between the two.**

## Differences in Scope

- While the **Code of Corporate Conduct basically covers listed companies across all market segments, the Corporate Governance Code's comply or explain obligations vary in scope depending on the segment.**
  - Under the Corporate Governance Code, **Growth Market companies are only subject to the General Principles.**

|   | Prime  | Standard   | Growth                          |
|---|--|--|---------------------------------|
| Code of Corporate Conduct<br>(Matters to be/Desired to be Observed) | Applied<br>(inc. Prime-only items)                     | Applied  | Applied                         |
| Corporate Governance Code<br>(Comply or Explain)                    | All Principles applied<br>(inc. Prime-only Principles) | All Principles applied<br>(except Prime-only Principles) | Only General Principles applied |

## Differences in Format

- While the Code of Corporate Conduct involves an **obligation to comply with Matters to be Observed and an obligation to endeavor to comply with Desired matters**, under the Corporate Governance Code, there is **no obligation to comply or endeavor to comply with a Principle for which "explain" is chosen.**

|                           |                                | Format  |
|---------------------------|--------------------------------|---|
| Code of Corporate Conduct | Matters to be Observed         | Compliance is needed  |
|                           | Matters Desired to be Observed | Endeavor is needed  |
| Corporate Governance Code |                                | Comply or explain<br>(an explanation is needed where there is non-compliance) |

# (Ref.) Major Overlaps with Corporate Governance Code (1)

| Code of Corporate Conduct<br>(Matters Desired to be Observed)   | Corporate Governance Code   |
|---|---|
| <p>Rule 445-4<br/>A listed domestic company must make efforts to <b><u>secure at least one independent director/auditor as a member of its board of directors.</u></b></p> <p>(Note) <b><u>Securing at least one independent director/auditor</u></b> (Rule 436-2) and <b><u>securing at least one outside director</u></b> (Rule 437-2) are also stipulated in the Matters to be Observed.</p>   | <p>-Principle 4.8 Effective Use of Independent Directors-<br/>Independent directors should fulfill their roles and responsibilities with the aim of contributing to sustainable growth of companies and increasing corporate value over the mid- to long-term. <b><u>Companies listed on the Prime Market should therefore appoint at least one-third of their directors as independent directors (two directors if listed on other markets) that sufficiently have such qualities.</u></b><br/>Irrespective of the above, <b><u>if a company listed on the Prime Market believes it needs to appoint the majority of directors (at least one-third of directors if listed on other markets) as independent directors</u></b> based on a broad consideration of factors such as the industry, company size, business characteristics, organizational structure and circumstances surrounding the company, <b><u>it should appoint a sufficient number of independent directors.</u></b></p>   |
| <p>Rule 445-5<br/>A listed domestic company shall make efforts to <b><u>develop an environment where an independent director(s)/auditor(s) will fulfill the role expected thereof.</u></b></p> <p>(Note) In "Roles Expected of Independent Officers," published in 2010, the following were suggested:</p> <ul style="list-style-type: none"> <li>• Establishing/maintaining a system for timely and appropriate information communication to independent officers</li> <li>• Collaboration with other departments</li> <li>• Securing personnel to assist</li> </ul> | <p>-Principle 4.12 Active Board Deliberations-<br/>The board should endeavor to foster a climate where free, open and constructive discussions and exchanges of views take place, including the raising of concerns by outside directors.</p> <p>-Principle 4.13 Information Gathering and Support Structure-<br/>In order to fulfill their roles and responsibilities, directors and <i>kansayaku</i> should proactively collect information, and as necessary, request the company to provide them with additional information. <b><u>Also, companies should establish a support structure for directors and kansayaku, including providing sufficient staff.</u></b><br/>The board and the <i>kansayaku</i> board should verify <b><u>whether information requested by directors and kansayaku is provided smoothly.</u></b></p> <p>-Principle 4.14 Director and <i>Kansayaku</i> Training-<br/>New and incumbent directors and <i>kansayaku</i> should deepen their understanding of their roles and responsibilities as a critical governance body at a company, and should endeavor to acquire and update necessary knowledge and skills. Accordingly, <b><u>companies should provide and arrange training opportunities suitable to each director and kansayaku along with financial support for associated expenses.</u></b> The board should verify whether such opportunities and support are appropriately provided.</p> |

# (Ref.) Major Overlaps with Corporate Governance Code (2)

## Code of Corporate Conduct (Matters Desired to be Observed)

### Rule 446

A listed domestic company shall endeavor to carry out matters prescribed by the Enforcement Rules as a **framework improvement to facilitate the exercise of voting rights at general shareholders meetings.**

- **Avoidance of days when AGMs are concentrated** (⇒SP 1.2.3)
- **Early dispatch of AGM notice** (⇒SP 1.2.2)
- Early provision of AGM notice/reference materials **electronically 3 weeks before** (⇒SP 1.2.2)
- **English translations of AGM notices**, etc. (⇒SP 1.2.4)
- **Exercise of voting rights by shareholders** (including those holding shares through a trust bank or custodian) **by electronic means** (⇒SP 1.2.4)
- Other framework improvements to facilitate exercise of voting rights

## Corporate Governance Code

### -Principle 1.2 Exercise of Shareholder Rights at General Shareholder Meetings-

Companies should recognize that general shareholder meetings are an opportunity for constructive dialogue with shareholders, and should therefore **take appropriate measures to ensure the exercise of shareholder rights** at such meetings.

### Supplementary Principles

- 1.2.1 Companies should provide accurate information to shareholders as necessary in order to facilitate appropriate decision-making at general shareholder meetings.
- 1.2.2 While ensuring the accuracy of content, companies should strive to send convening notices for general shareholder meetings **early enough** to give shareholders sufficient time to consider the agenda. During the period between the board approval of convening the general shareholder meeting and sending the convening notice, **information included in the convening notice should be disclosed by electronic means such as through TDnet or on the company's website.**
- 1.2.3 The **determination of the date of the general shareholder meeting and any associated dates should be made in consideration** of facilitating sufficient constructive dialogue with shareholders and ensuring the accuracy of information necessary for such dialogue.
- 1.2.4 Bearing in mind the number of institutional and foreign shareholders, companies should **take steps for the creation of an infrastructure allowing electronic voting**, including the use of the Electronic Voting Platform, and the provision of **English translations of the convening notices** of general shareholder meeting. In particular, companies listed on the Prime Market should make the Electronic Voting Platform available, at least to institutional investors.
- 1.2.5 In order to prepare for cases where institutional investors who hold shares in street name express an interest in advance of the general shareholder meeting in attending the general shareholder meeting or exercising voting rights, companies should work with the trust bank (*shintaku ginko*) and/or custodial institutions to consider such possibility.

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- Traditionally, the Code of Corporate Conduct has been positioned as **requiring listed companies to act responsibly from the perspective of respecting the functions of the secondary market and the rights of general shareholders.**
- On the other hand, with the formulation also of the Corporate Governance Code, **sustainable growth and medium- to long-term corporate value improvement are now widely recognized as being responsibilities of listed companies.**
  - Based on discussions at this Council, in March 2023 TSE published requests to companies related to **improving corporate value, including "management that is conscious of cost of capital and stock price" and "better dialogue with shareholders and related disclosure."**

## Corporate Governance Code (excerpt)

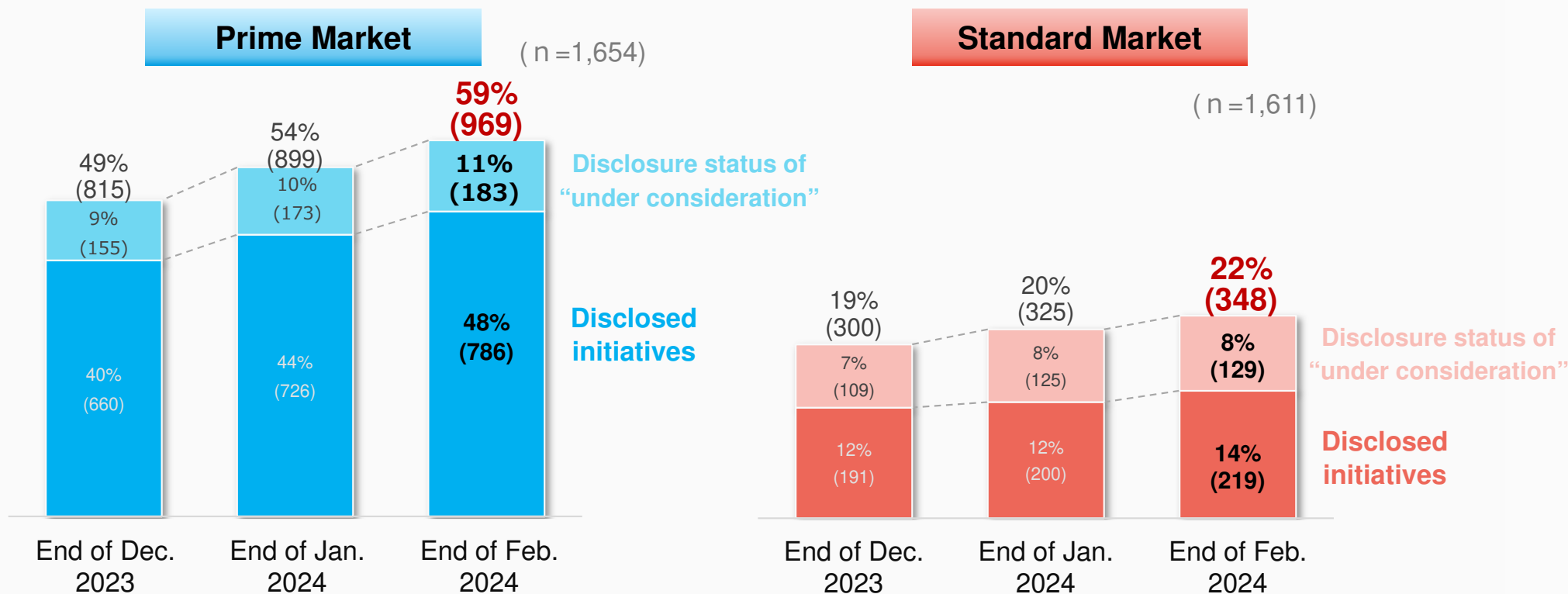
### General Principle 4

**Given its fiduciary responsibility and accountability to shareholders, in order to promote sustainable corporate growth and the increase of corporate value over the mid- to long-term and enhance earnings power and capital efficiency, the board should appropriately fulfill its roles and responsibilities, including:**

- (1) Setting the broad direction of corporate strategy;
- (2) Establishing an environment where appropriate risk-taking by the senior management is supported; and
- (3) Carrying out effective oversight of directors and the management (including *shikkoyaku* and so-called *shikkoyakuin*)

from an independent and objective standpoint.

- ◆ As of February 29, 2023, 59% of Prime Market listed companies (969 cos.) and 22% of Standard Market listed companies (348 cos.) have disclosed information regarding "Action to Implement Management that is Conscious of Cost of Capital and Stock Price." (including companies with a disclosure status of "under consideration".)
- Increase of 10 pt (154 companies) in the Prime Market and 3 pt (48 companies) in the Standard Market from the end of December 2023

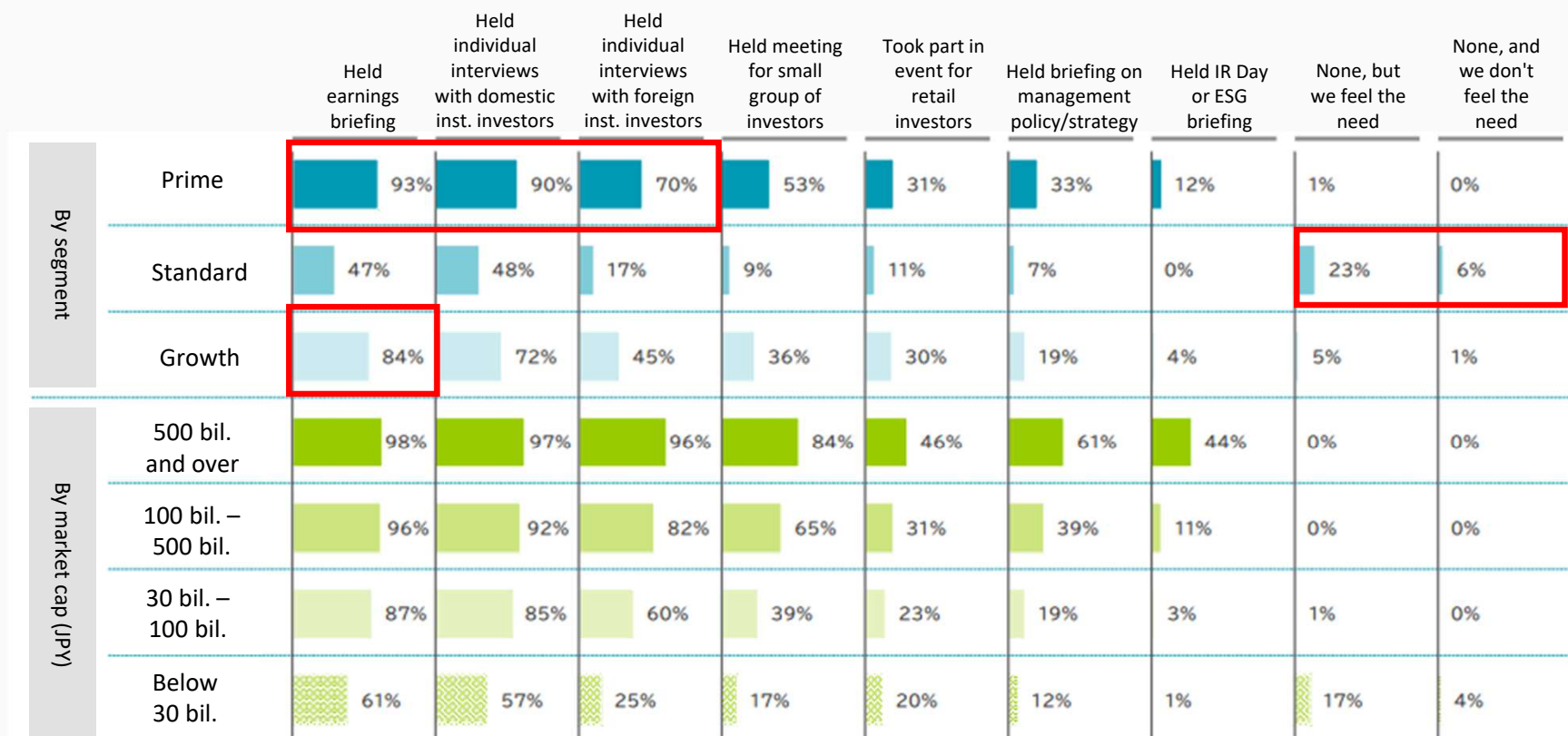


# (Ref.) Status of Dialogue with Shareholders/Investors and IR Activities

- Most Prime Market companies conduct dialogue with shareholders/investors and IR activities such as earnings briefings.
- Most Growth Market companies also carry out IR activities such as earnings briefings, but among Standard Market companies, many do not, even though they feel the need.

## Status of Dialogue/IR Activities (by segment/market cap)

91. What specific IR activities have you carried out as a company in the past year?



Source: Sumitomo Mitsui Trust Bank "Corporate Governance Reforms that Enhance Corporate Value through Strategy Linkage and Capital Efficiency – Governance Survey 2023" (translated by TSE)



# (Ref.) Opinions Previously Given at This Council

- **Opportunities are needed to rethink the responsibility of conducting business by raising funds from an unspecified number of investors in the stock market**, which could be addressed through the Code of Corporate Conduct.
- In recent years, the **fiduciary responsibility of the board to shareholders** has been clarified by the formulation of the Corporate Governance Code in 2015, and the **role of outside directors** has been clarified by the revision of the Companies Act making them mandatory in 2021. In addition, **cost of capital** has been brought fully to the fore with the Corporate Governance Code revision in 2018, so **these kinds of things need to be written into the Code of Corporate Conduct**.
- **"Action to Implement Management that is Conscious of Cost of Capital and Stock Price" and "Better Dialogue with Shareholders and Related Disclosure"** are fine as requests for now, but it would be good **to eventually make them part of the Code of Corporate Conduct**.
- It is 15 years since the establishment of the Code of Corporate Conduct, so TSE should take this opportunity to **conduct an overall review**. Along with this, it would also be appropriate to consider the measures to ensure effectiveness, including their variety.
- In recent years, **MBOs and conversions of listed subsidiaries into wholly-owned subsidiaries by parent companies** have been increasing, but there are occasional **cases that have issues with the price**, which is a big problem. Since there are cases where the measures set out in METI's "Fair M&A Guidelines" are not being adequately implemented, **the process of confirming the interests of minority shareholders should be made mandatory in the Code of Corporate Conduct's "Matters to be Observed."**
- **In order to ensure that companies fully understand and implement METI's "Guidelines for Corporate Takeovers," TSE should consider how to incorporate them into the Code of Corporate Conduct**.
- An overall review of the Code of Corporate Conduct should be conducted with **items to be included in the Corporate Governance Report in mind. Increased comparability is important** for both companies and investors.

(Note) It was also suggested in the "Study Group to review Minority Shareholder Protection and other Framework of Quasi-Controlled Listed Companies" that the **responsibilities of listed companies which are controlling shareholders should be explicitly stipulated in the Code of Corporate Conduct**.

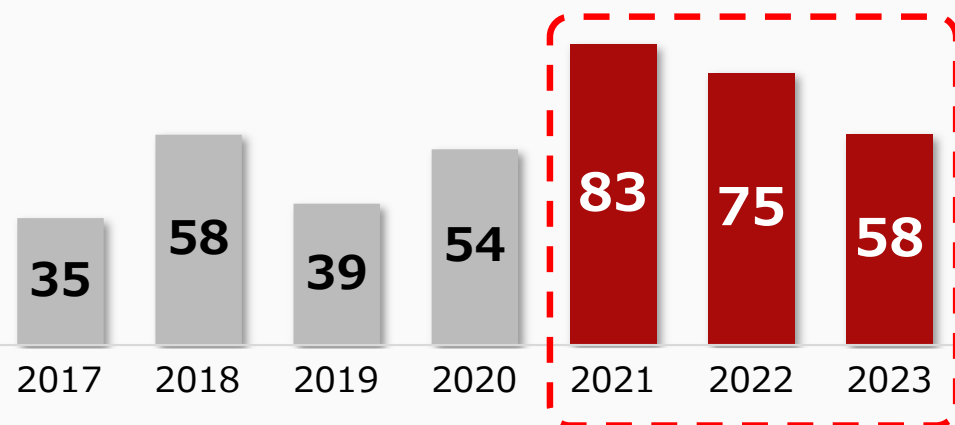
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# Delistings through MBOs, etc.

- In recent years, the number and scale of delistings due to corporate actions such as MBOs and conversion of listed subsidiaries into wholly-owned subsidiaries have been high.

- Amid structural conflicts of interest and asymmetry of information, there have been cases where investors have raised doubts about whether the special committee is functioning as a measure to ensure fairness and about the price calculation methods.

Numbers of Delistings Related to Corporate Actions (MBOs, controlling shareholder converting a subsidiary into a wholly-owned subsidiary, M&As, etc.)



## Questions Raised by Investors Regarding Recent MBOs

### Case. a

- The following points were raised by several investors over the special committee and the price:
  - Doubts over the eligibility of the committee members** (as there were no outside directors included, more rigorous procedures are required to ensure fairness)
  - That the committee did not appoint a separate financial advisor** (it confirmed the opinion of the FA appointed by the board)
  - That the MBO price was far too low for its intrinsic value** (a discount to NAV per share; unclear as to how the price took into account the ample surplus funds held by the company)

### Case. b

- An opinion about the price was received from an investor
  - That the **selection of other companies used when carrying out the comparison was not appropriate** (the growth rates and profit margins were not comparable)
  - That recent strong performance had not been fully taken into account**
  - The CAGR for the next five years provided as a premise for the DCF valuation by the third-party appraiser was less than half of that for the previous five years, and there was no detailed explanation for this**

## Major MBOs in 2023

| Company                                 | Segment  | Purchase price (JPY) |
|---|----------|----------------------|
| Taisho Pharmaceutical Holdings Co.,Ltd. | Standard | 707.7 bil.           |
| Outsourcing Inc.                        | Prime    | 221.1 bil.           |
| Benesse Holdings,Inc.                   | Prime    | 207.9 bil.           |
| SHiDAX Corporation                      | Standard | 36.5 bil.            |
| CMIC Holdings Co.,Ltd.                  | Prime    | 33.7 bil.            |

# Progress Following "Fair M&A Guidelines" (1 – Special Committees)

- After the publication of METI's "Fair M&A Guidelines" in 2019, implementation of the measures for ensuring fairness that were recommended in said Guidelines and disclosure of progress on those measures have spread to a certain extent.
  - Practices such as establishment of special committees that include outside directors and boards of directors following the decisions of special committees have become common.

## Disclosure Based on "Fair M&A Guidelines" (July 2021 – June 2022)

| Disclosure Item  | Disclosure made  | MBOs             | Subsidiary conversions |
|--|------------------|------------------|------------------------|
| <b>Cases covered by survey</b>   | <b>41</b>        | <b>14</b>        | <b>27</b>              |
| <b>Information on the eligibility of special committee members</b>   | <b>41</b> (100%) | <b>14</b> (100%) | <b>27</b> (100%)       |
| Disclosure that the committee consists solely of outside officers*   | 13               | 2                | 11                     |
| (of which, disclosure of reasons for appointment, etc.)  | 1                | 0                | 1                      |
| Disclosure that the committee is composed of outside officers and outside experts  | 27               | 12               | 15                     |
| (of which, disclosure of reasons for appointment, etc.)  | 19               | 7                | 12                     |
| Disclosure that the committee consists solely of outside experts   | 1                | 0                | 1                      |
| (of which, disclosure of reasons for appointment, etc.)  | 1                | 0                | 1                      |
| <b>Handling of special committee decisions by the board</b>  | <b>39</b> (100%) | <b>14</b> (100%) | <b>25</b> (93%)        |
| (1) That the board respects the decision of the special committee decisions to the maximum extent<br>+ (2) That it is stipulated in advance by the board that if the special committee determines that the terms of the transaction are not appropriate, the company will not support the M&A. | 38               | 13               | 25                     |
| Disclosure of only (1)   | 1                | 1                | 0                      |
| <b>Information on the special committee's review process (information received and deliberations)</b>  | <b>41</b> (100%) | <b>14</b> (100%) | <b>27</b> (100%)       |

\*Not limited to independent directors; includes outside directors and outside company auditors (*kansayaku*).

| Disclosure Item  |   | Disclosure made  | MBOs             | Subsidiary conversions |
|--|---|------------------|------------------|------------------------|
| <b>Cases covered by survey</b>   |   | <b>41</b>        | <b>14</b>        | <b>27</b>              |
| <b>Authority of the special committee to appoint advisors or approval or authority to nominate/approve advisors of the reporting company</b> |   | <b>39</b> (95%)  | <b>14</b> (100%) | <b>25</b> (93%)        |
|  | (1) That the committee is authorized to appoint its own advisors + (2) That the committee approves, or is authorized to appoint or approve, advisors of the reporting company | 38               | 13               | 25                     |
|  | Disclosure of only (2)  | 1                | 1                | 0                      |
| <b>Status of appointment of advisors by special committee</b>  |   | <b>10</b> (24%)  | <b>1</b> (7%)    | <b>9</b> (33%)         |
|  | (1) Separate financial advisor or calculation agent appointed + (2) Separate legal advisor appointed  | 2                | 1                | 1                      |
|  | Disclosure of only (1)  | 7                | 0                | 7                      |
|  | Disclosure of only (2)  | 1                | 0                | 1                      |
| <b>Involvement of special committee in transaction terms negotiation process</b>   |   | <b>41</b> (100%) | <b>14</b> (100%) | <b>27</b> (100%)       |
|  | Special committee is involved through direct negotiation  | 9                | 2                | 7                      |
|  | Special committee is involved through expressing opinions to reporting company  | 32               | 12               | 20                     |

# Progress Following "Fair M&A Guidelines" (3 – Other)



| Disclosure Item   |  | Disclosure made | MBOs             | Subsidiary conversions |
|---|--|-----------------|------------------|------------------------|
| <b>Cases covered by survey</b>                              |  | <b>41</b>       | <b>14</b>        | <b>27</b>              |
| <b>Committee member compensation structure</b>              |  | <b>39 (95%)</b> | <b>14 (100%)</b> | <b>25 (93%)</b>        |
|   | Fixed fee or time charge system <sup>1</sup>                         | 39              | 14               | 25                     |
|   | Contingency fee structure or fee structure including contingency fee | 0               | 0                | 0                      |
| <b>Calculation agent compensation structure<sup>2</sup></b> |  | <b>35 (85%)</b> | <b>14 (100%)</b> | <b>21 (78%)</b>        |
|   | Fixed fee or time charge system                                      | 18              | 9                | 9                      |
|   | Contingency fee structure or fee structure including contingency fee | 17              | 5                | 12                     |
| <b>Obtainment of a fairness opinion<sup>3</sup></b>         |  | <b>5 (12%)</b>  | <b>0 (0%)</b>    | <b>5 (19%)</b>         |
| <b>Majority of minority condition set</b>                   |  | <b>7 (17%)</b>  | <b>7 (50%)</b>   | <b>0 (0%)</b>          |

<sup>1</sup> Includes cases where outside officers are appointed as members of a special committee and do not receive compensation as a member outside of their compensation as an outside officer

<sup>2</sup> Compensation structures of calculation agents appointed by companies covered by the survey

<sup>3</sup> Includes those obtained from financial advisors or calculation agents appointed separately by the special committee

- The Code of Corporate Conduct stipulates as a Matter to be Observed that **listed companies must make necessary and sufficient timely disclosure when announcing an opinion or representation to shareholders relating to a bid for an MBO or conversion to a wholly-owned subsidiary by a controlling shareholder.**
- Also, in terms of procedures, **as well as the requirement for submission of a calculation report prepared by a calculation agent** (including a summary of the calculation), **in the case of a subsidiary conversion**, the Code's Matters to be Observed stipulate that **companies must obtain an opinion from a person/entity which has no interest in the controlling shareholder.**
- **Opinions are generally obtained from special committees including independent directors or from independent directors**

## Securities Listing Regulations Rule 441. Matters to be Observed Pertaining to Disclosure of MBO, etc.

**Timely disclosure, in cases where a listed company conducts the announcement of an opinion or representation to shareholders as prescribed in Rule 402, Item (1), y., relating to a takeover bid from an officer of the target of the takeover bid (including takeover bids where the takeover bidder is conducting the bid based on the request of an officer of the target of the takeover bid and has a common interest with the officer of such target) shall be made in a necessary and sufficient manner.**

## Enforcement Rules for Securities Listing Regulations Rule 417. Submission of Documents Pertaining to Decisions Requiring Disclosure

(11) Matters referred to in Rule 402, Item 1, y. of the Regulations:

Where it is expected that the stocks, etc. issued by the listed company will be delisted as a result of a takeover bid or **where the takeover bid is carried out by an officer of the listed company, a person who carries out the takeover bid based on request by an officer of the listed company where that person and the officer of the listed company share the common interest, the controlling shareholder of the listed company or the person specified in the Rule 436-3:**

**Document containing a view on the price for the takeover bid, etc.** expressed by a person other than the companies concerned **who has expertise and experience in the valuation of corporate value or stock:** immediately after it is prepared (...)

## Securities Listing Regulations Rule 441-2. Matters to be Observed Pertaining to Significant Transactions, etc. with Controlling Shareholder

A listed company that has a controlling shareholder shall, in the cases referred to in the following items, **obtain opinion from an entity that has no interest in such controlling shareholder**, that any decision on the matters prescribed in such items will not undermine interests of minority shareholders of such listed company. (...)

# (Ref.) Timely Disclosure on MBOs, etc.

- Regarding the necessary and sufficient timely disclosure on MBOs, etc. as required by the Code of Corporate Conduct, the Guidebook for the Timely Disclosure of Corporate Information sets out the following:

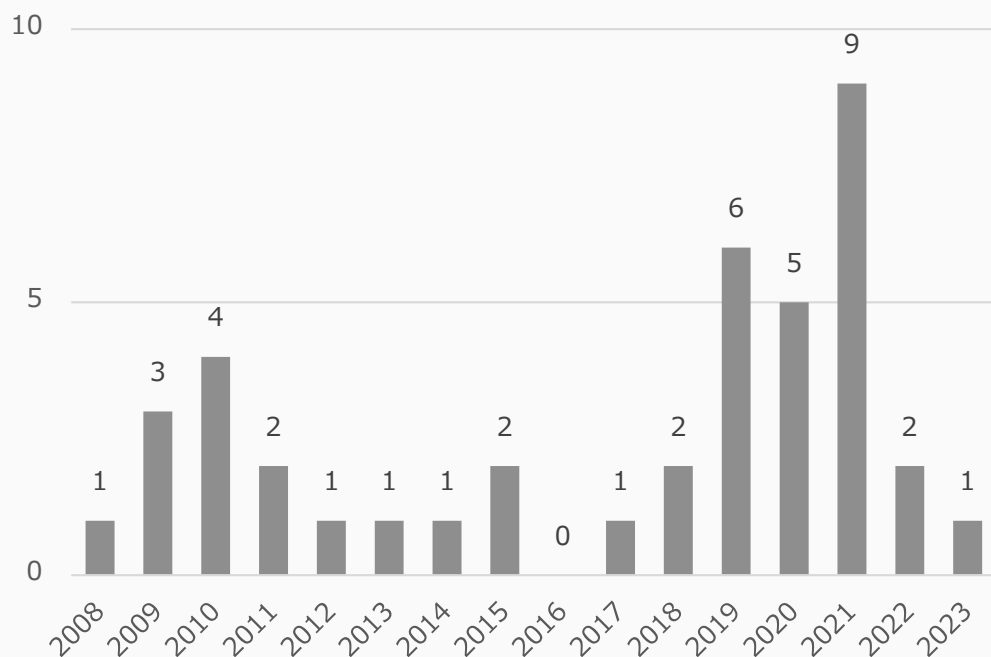
| Topic   | Content Requested in the Timely Disclosure Guidebook   |
|---|--|
| <b>Information on the special committee</b>   | <p>(If a special committee is established)</p> <ul style="list-style-type: none"> <li>➤ Outline of the special committee (names/occupations of members, etc.)</li> <li>➤ If the committee gave advice on the announcement of opinion, the contents of that advice and the response to that advice</li> <li>➤ If the committee was commissioned to negotiate with the offeror, a statement to that effect</li> </ul> <p>(When obtaining an opinion from a special committee, etc. in the case of conversion to a wholly-owned subsidiary by a controlling shareholder)</p> <ul style="list-style-type: none"> <li>➤ Outline of the opinion stating that the bid is not disadvantageous to minority shareholders</li> </ul>  |
| <b>Information on the share value calculation (important assumptions for the calculation)</b>   | <p>(When using the DCF method)</p> <ul style="list-style-type: none"> <li>➤ Specific figures for the financial projections on which the calculation is based                             <ul style="list-style-type: none"> <li>– If these include a significant increase or decrease, the reasons for this</li> </ul> </li> <li>➤ Sources for the financial projections on which the calculation is based</li> <li>➤ Whether the financial projections assume that the transaction in question will take place</li> <li>➤ Specific figures for discount rates</li> <li>➤ Calculation methodology for going concern value and specific parameters used in the calculation</li> <li>➤ Other special preconditions, if any</li> </ul>                                |
| <b>Information on the fairness opinion</b>  | <ul style="list-style-type: none"> <li>➤ If a fairness opinion has been obtained from the calculation agent, the contents of said opinion</li> </ul>   |
| <b>Information on material interest relationships with third-party evaluation organizations</b> | <ul style="list-style-type: none"> <li>➤ If there is a material interest relationship with a calculation agent (see note), the details of that relationship and why the company requested the calculation from an agent with which it has a material interest relationship</li> </ul> <p>(Note) e.g., a) When the agent falls under the definition of a related party; b) when the request is given to an agent recommended or introduced by the offeror (including the offeror's shareholders, officers, financial advisors, or other similar parties); c) when the agent receives requests from both the listed company and the offeror; d) when the company or any of its related companies (including subsidiaries) are receiving financing from the agent</p> |



# Corporate Takeovers and Takeover Response Policies

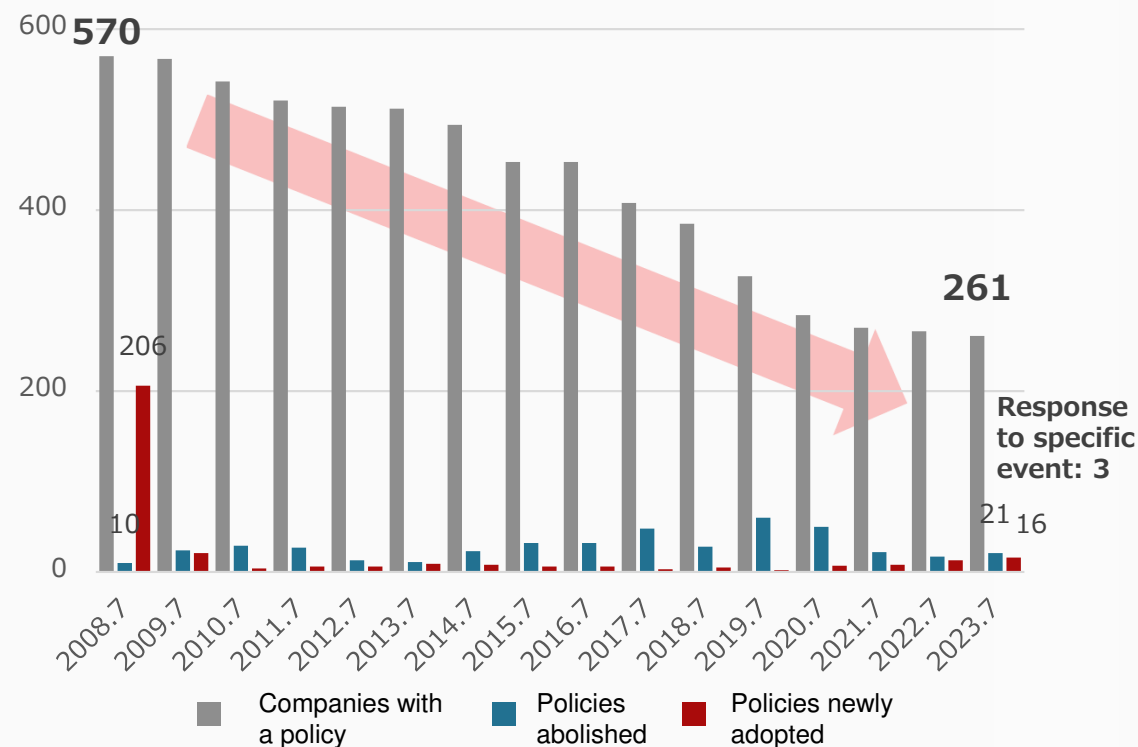
- Amid changes in shareholder composition and awareness about capital efficiency, a **certain number of takeovers are happening without the consent of the target company's management or board.**
- **The number of companies with takeover response policies has been declining** as the proportion of institutional investors that oppose having such policies in normal times (i.e., not in response to a specific event) increases (there have been cases of companies introducing/activating such policies in response to specific events).

## Numbers of Non-consenting Takeovers



Source: Daiwa Institute of Research Ltd. "Recent Trends in Takeover Defense Measures (as of January 2024)"

## Numbers of Companies With Takeover Response Policies



Source: Prepared by TSE based on Shojihomu "Introduction of Hostile Takeover Defense Measures (2024, 2012, 2006 Sumitomo Mitsui Trust Bank research)"

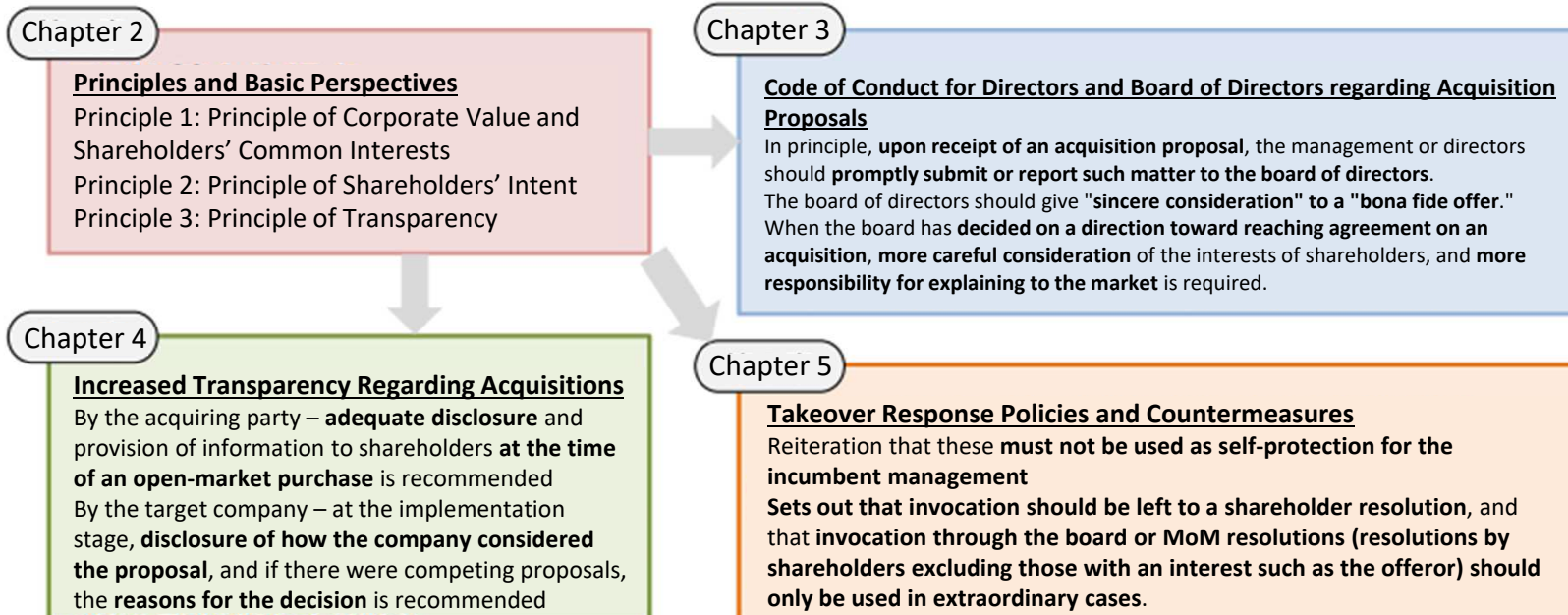
# (Ref.) METI "Guidelines for Corporate Takeovers"

- METI published its "Guidelines for Corporate Takeovers" in August last year.
  - It sets out principles and best practices that should be shared to formulate fair rules for M&A transactions, focusing on the behavior of parties involved in takeovers where managerial control of a listed company is obtained.

## Overview of "Guidelines for Corporate Takeovers"

- **Comprehensive guidelines covering every stage of a company's response to an acquisition proposal**, applicable to all types of listed company takeovers including unsolicited ones (**soft law**).
- Sets out guidance on **prompt submission and reporting of acquisition proposals to the board, recommendations for appropriate information disclosure** for shareholder decisions, and **the importance of conforming shareholder intentions on takeover response policies and countermeasures**.

### Overview of Guidelines for Corporate Takeovers



Source: Ministry of Economy, Trade and Industry

- TSE's Code of Corporate Conduct stipulates **Matters to be Observed when introducing takeover response policies (sufficient disclosure, transparency, effect on the secondary market, respect for shareholders' rights).**

## Listing Rules Regarding Takeover Response Policies (Takeover Defense Measures)

### Securities Listing Regulation

| Item                      | Required Action  |
|---------------------------|--|
| Code of Corporate Conduct | <ul style="list-style-type: none"> <li>✓ Compliance with the below is mandatory:                             <ul style="list-style-type: none"> <li>i. <b>Sufficient disclosure</b> (making <b>necessary and sufficient timely disclosure</b> concerning takeover defense measures)</li> <li>ii. <b>Transparency</b> (that the conditions of implementation and abolishment <b>do not depend on arbitrary decisions by management</b>)</li> <li>iii. <b>Effect on the secondary market</b> (that the measures <b>do not include factors which may cause extremely unstable price formation of a share</b> or other factors which may cause unpredictable damage to investors)</li> <li>iv. <b>Respect for shareholders' rights</b> (that the measures <b>give consideration to shareholders' rights and their exercise</b>)</li> </ul> </li> </ul> |
| Delisting Criteria        | <ul style="list-style-type: none"> <li>✓ Delisting, <b>where the details of shareholders' rights and their exercise are unreasonably restricted</b> <ul style="list-style-type: none"> <li>➤ Introducing a rights plan that only applies to current shareholders, putting a dead hand provision in the rights plan, issuing shares with veto rights, changing shares to those with voting restrictions, issuing shares with more voting rights than listed shares</li> </ul> </li> </ul>   |

(Note) We plan to revise the regulations around April this year to revise the use of the term "takeover defense measures."

### Corporate Governance Code

#### Principle 1.5 Anti-Takeover Measures

Anti-takeover measures must not have any objective associated with entrenchment of the management or the board. With respect to the adoption or implementation of anti-takeover measures, the board and *kansayaku* should carefully examine their necessity and rationale in light of their fiduciary responsibility to shareholders, ensure appropriate procedures, and provide sufficient explanation to shareholders.

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# Regulation Regarding and Recent Status of Independent Director Appointments

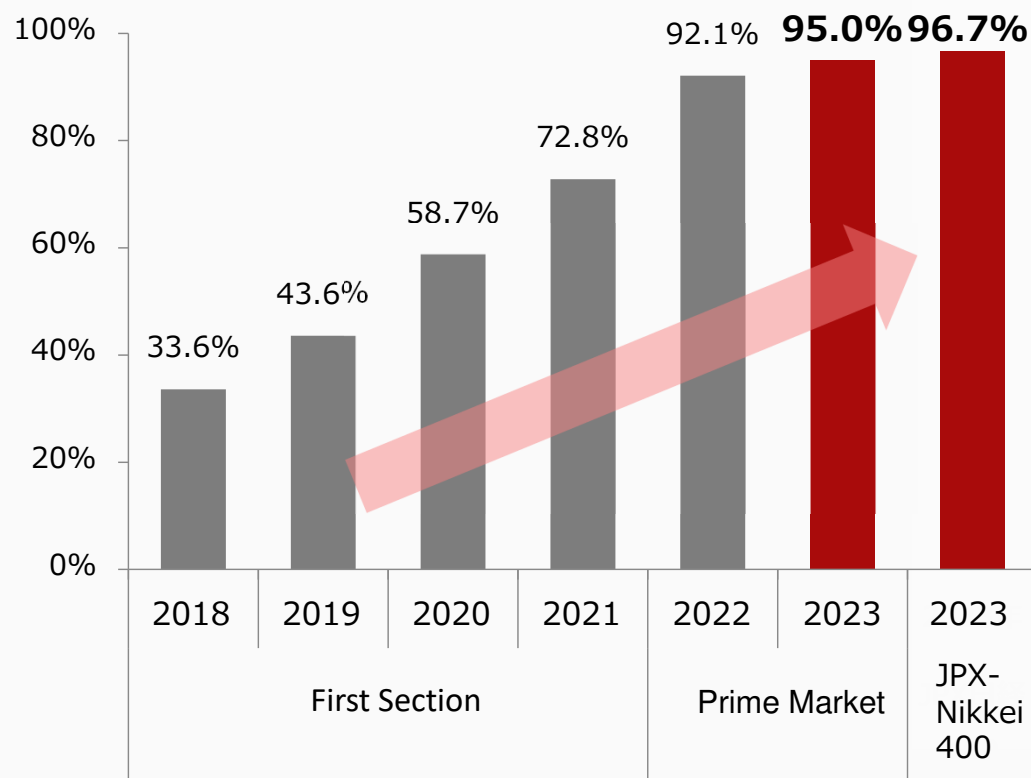


- TSE created an independent director/auditor rule in 2009 for the purposes of general shareholder protection (companies must secure an outside director or outside auditor who is unlikely to have conflicts of interest with general shareholders).
- Later, with the formulation of the Corporate Governance Code, **appointments of independent directors progressed further.**
  - Among Prime-listed companies, over 90% now have at least one-third independent directors

## Listing Rules Regarding Independent Directors/Auditors

| Segment  | Code of Corporate Conduct   | (Ref.)<br>Corporate Governance Code  |
|----------|---|--|
| Prime    | <p><b>Matters to be Observed</b></p> <ul style="list-style-type: none"> <li>• At least one independent director/auditor</li> </ul>  | <ul style="list-style-type: none"> <li>• At least <b>one-third independent directors (a majority if the company believes it is necessary)</b></li> </ul> |
| Standard | <ul style="list-style-type: none"> <li>• At least one outside director</li> </ul> <p><b>Matters Desired to be Observed</b></p> <ul style="list-style-type: none"> <li>• At least one independent director on the board</li> </ul> | <ul style="list-style-type: none"> <li>• At least <b>two independent directors (one third if the company believes it is necessary)</b></li> </ul>        |
| Growth   | <ul style="list-style-type: none"> <li>• At least one independent director on the board</li> </ul>  | —  |

## Companies With At Least One-Third Independent Directors



# Status of Independent Director Appointments (By Market Segment)



- Companies with at least one-third are increasing among Prime-listed companies and those with at least two are increasing among Standard-listed companies.
- Even among Growth-listed companies, 98% have at least one independent director.

| Segment                | No. of Comps. | At least one   |                   | At least two    |                   | At least one-third |                   | A majority   |                   |
|------------------------|---------------|----------------|-------------------|-----------------|-------------------|--------------------|-------------------|--------------|-------------------|
|                        |               | No.            | %                 | No.             | %                 | No.                | %                 | No.          | %                 |
| Prime                  | 1,833         | 1,832<br>(-3)  | 99.9%<br>(±0.0pt) | 1,819<br>(-3)   | 99.2%<br>(±0.0pt) | 1,741<br>(+49)     | 95.0%<br>(+2.9pt) | 291<br>(+68) | 15.9%<br>(+3.8pt) |
| Standard               | 1,440         | 1,406<br>(-10) | 97.6%<br>(+0.3pt) | 1,157<br>(+45)  | 80.3%<br>(+3.9pt) | 708<br>(+38)       | 49.2%<br>(+3.2pt) | 62<br>(-5)   | 4.3%<br>(-0.3pt)  |
| Growth                 | 538           | 527<br>(+62)   | 98.0%<br>(+0.5pt) | 346<br>(+62)    | 64.3%<br>(+4.8pt) | 305<br>(+59)       | 56.7%<br>(+5.1pt) | 77<br>(+22)  | 14.3%<br>(+2.8pt) |
| Total listed companies | 3,811         | 3,765<br>(+49) | 98.8%<br>(+0.2pt) | 3,322<br>(+104) | 87.2%<br>(+1.8pt) | 2,754<br>(+146)    | 72.3%<br>(+3.1pt) | 430<br>(+85) | 11.3%<br>(+2.1pt) |

Note: Figures in parentheses are comparisons with last July

# (Ref.) Provisions on Independence Standards

- As part of the independent director/auditor rule, TSE stipulates that an independent director/auditor must be someone that is "unlikely to have conflicts of interest with general shareholders," and **sets out several "Independence Tests" (cases in which there is a likelihood of conflicts of interest with general shareholders) which a candidate must pass at a minimum to meet this definition.**
- Also, the Corporate Governance Code asks companies to **establish and disclose independence standards aimed at securing effective independence.**
  - Some companies set **quantitative standards related to counterparty or consultant relationships**, for example, while other companies take into account **other factors such as cross-outside director or other positions and length of service.**

## TSE's Independence Standards

|              |                        | Attribute of Director   |   |   |  |   |   |   |
|--------------|------------------------|---|---|---|--|---|---|---|
|              |                        | Executive (or family member of executive) of listed company or subsidiary | Executive (or family member of executive) of parent or sister company | Executive (or family member of executive) of major client or consultant, etc. who receives a large amount of money or other assets from the company | Executive of major shareholder                               | Executive of a client other than a major client | Executive of a company with which the company holds cross-outside directorships or an entity receiving donations from the company | Those not falling under any of the criteria on the left |
| Time horizon | Current                | Not outside<br>(Family members not independent)                           |   | Not independent   | Disclosure required  |   |   | No disclosure required                                  |
|              | Recent                 |   |   |   | Disclosure of relationship with the company in the CG report |   |   |   |
|              | Within past 10 years   |   |   |   |  |   |   |   |
|              | Prior to past 10 years |   |   |   |  |   |   |   |

## Corporate Governance Code

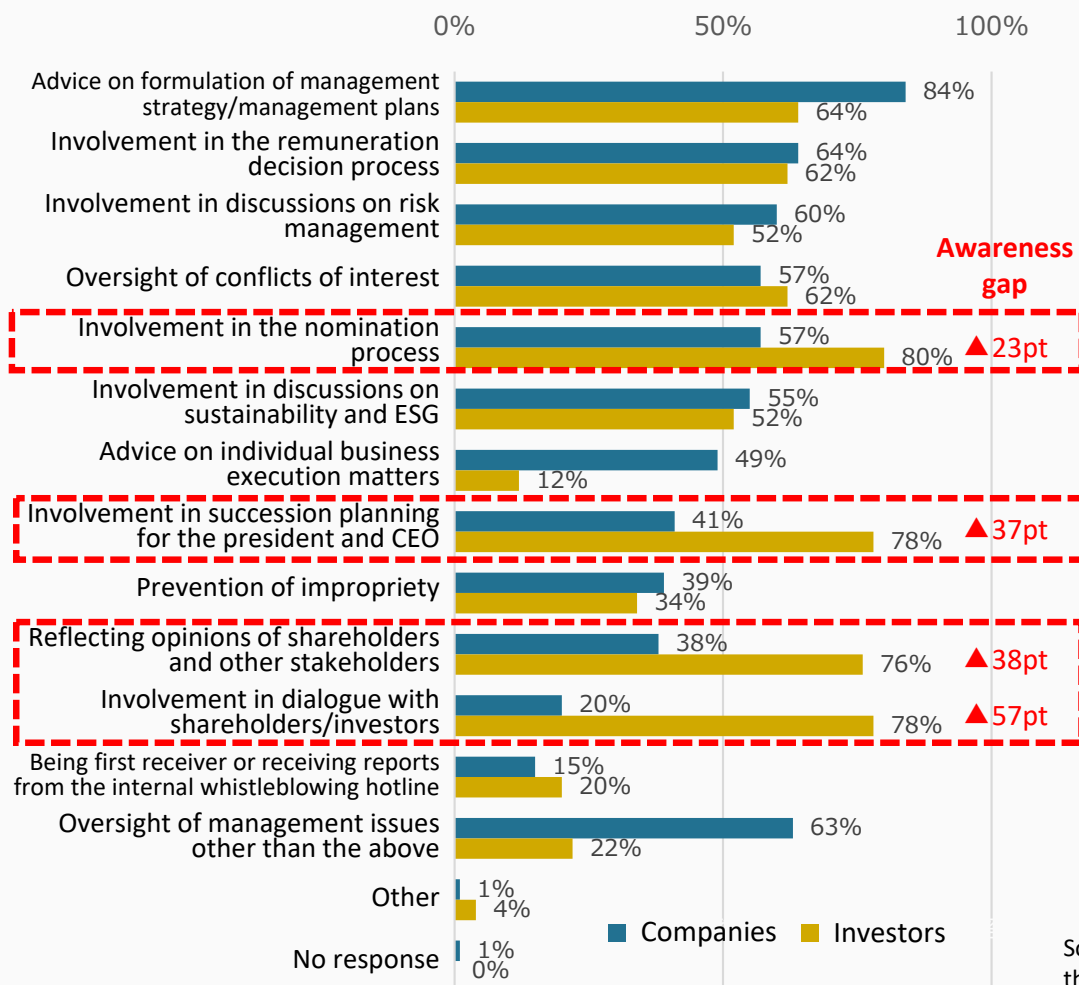
### Principle 4.9 Independence Standards and Qualification for Independent Directors

Boards should **establish and disclose independence standards aimed at securing effective independence of independent directors**, taking into consideration the independence criteria set by securities exchanges. The board should endeavor to select independent director candidates who are expected to contribute to frank, active and constructive discussions at board meetings.

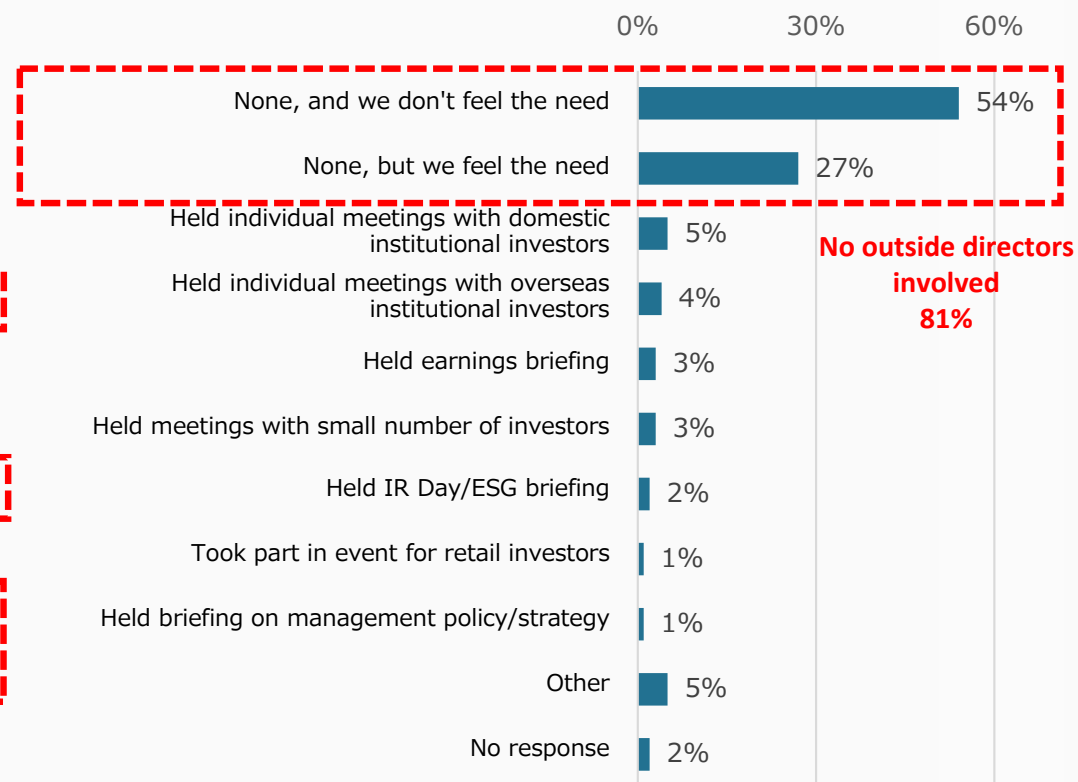
# (Ref.) Roles Expected of Outside Directors

- While investors expect outside directors to be involved in dialogue with shareholders/investors, the nomination and decision processes, and succession planning, there is a large awareness gap between them and listed companies.
  - 80% of companies do not carry out dialogue involving outside directors.

## Roles Expected of Outside Directors



## Enactment of IR Activities Such as Dialogue Involving Outside Directors

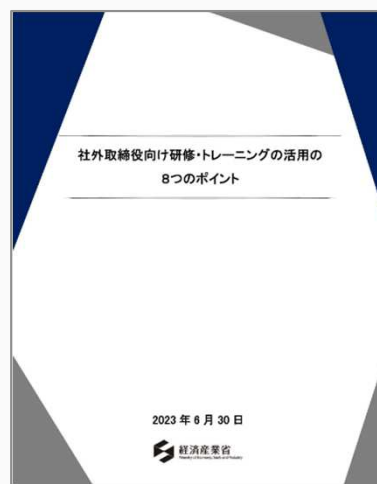
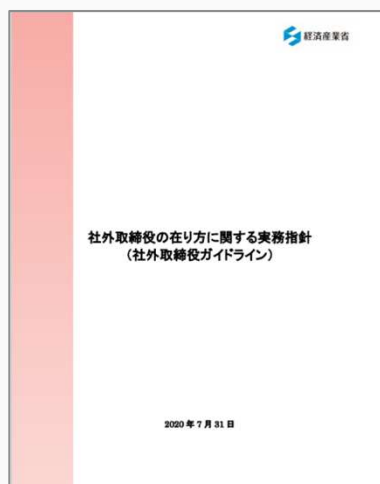


(Note) Graph excludes companies not carrying out any IR activities as a company

Source: Sumitomo Mitsui Trust Bank "Corporate Governance Reforms that Enhance Corporate Value through Strategy Linkage and Capital Efficiency – Governance Survey 2023" (translated by TSE)



- Given that **ensuring independent directors fulfil their functions has become an important issue in terms of increasing corporate value**, many related parties have conducted **educational activities** for independent directors to **promote understanding of their expected roles**.
  - July 2020 "Practical Guidelines for Independent Directors" (METI)
    - Distributed by TSE to independent directors of all companies in April 2023
  - June 2023 "Eight Points to Use in Training Independent Directors" and "Case Studies for Independent Directors" (METI)
  - January 2024 leaflet "Introduction to Independent Directors" (METI/FSA/TSE)
  - December 2023 – as part of the Study Group to review Minority Shareholder Protection and other Framework of Quasi-Controlled Listed Companies, report compiled and published, envisaging specific situations, on the role of independent directors in a listed company with a controlling shareholder from the perspective of protecting the interests of minority shareholders (TSE)



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# Regulations Regarding Capital Increases by Third-Party Allotment



- In 2009, TSE established **delisting criteria for sizable third-party allotments that infringe on shareholder interests and stipulated the procedures necessary to increase shareholder acceptance as Matters to be Observed in the Code of Corporate Conduct.**

## Listing Rules Pertaining to Third-Party Allotments

### Securities Listing Regulations

| Item                      | Applies To   | Outline of Response   |
|---------------------------|--|---|
| Delisting Criteria        | Dilution of over 300%  | ✓ Delisting, unless it is deemed that there is little risk of infringement of shareholder interests   |
|                           | Damage to sound transactions with controlling shareholder    | ✓ Delisting, when it is deemed that there is considerable damage to sound transactions with the controlling shareholder within the coming 3 years   |
| Code of Corporate Conduct | Dilution of 25% or more or Change of controlling shareholder | ✓ In principle, the procedures in (1) or (2) should be performed.<br>(1) Receipt of the opinion of an entity who has a specific degree of independence from the management regarding the necessity and suitability of such allotment<br>(2) Confirmation of the intent of shareholders regarding such allotment by means such as a resolution in the general shareholders meeting   |
| Timely Disclosure         | All cases  | ✓ Timely disclosure of the following matters, etc.<br>a. Details of the confirmation regarding the existence of assets required for payment by the recipient of the allotment<br>b. Calculation base of payment amount and the specific details of such base (If deemed necessary by TSE, this shall include the opinion, etc. of an auditor, etc. regarding the legality of the allotment, in terms that are not particularly advantageous for the recipient)<br>c. Details of the procedures required under the Code of Corporate Conduct, if applicable... and so on |

### Corporate Governance Code

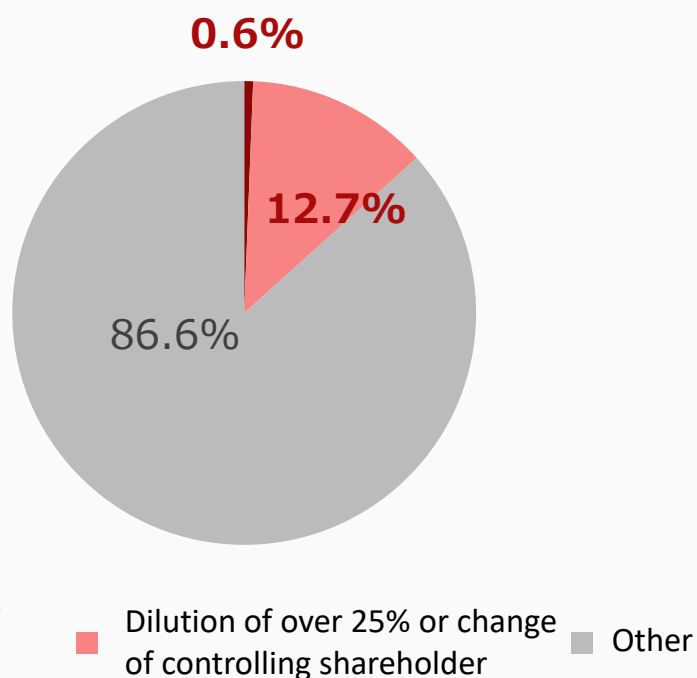
#### Principle 1.6 Capital Policy that May Harm Shareholder Interests

With respect to a company's capital policy that results in the change of control or in significant dilution, including share offerings and management buyouts, the board and *kansayaku* should, in order not to unfairly harm the existing shareholders' interests, carefully examine the necessity and rationale from the perspective of their fiduciary responsibility to shareholders, should ensure appropriate procedures, and provide sufficient explanation to shareholders.

# Breakdown of Capital Increases by Third-Party Allotments

- In recent years, **0.6% of all cases of capital increases by third-party allotments resulted in a dilution ratio of over 300% (and subject to the delisting examination).**
  - These are cases where the capital increase by third-party allotment was conducted as a relief measure by a sponsor after going through the procedure for confirming the will of shareholders, because of a situation where there was a danger of corporate failure or an injection of public funds (these are not delisted because it was deemed that there was little risk of infringement of shareholder interests)
- **12.7% of cases had a dilution ratio of over 25% or a change of controlling shareholder (and subject to procedures under the Code of Corporate Conduct)**

## Breakdown of Third-Party Allotments (2021-2023)



(Excluding those related to stock-based compensation such as RSs and ESOPs. Dilution ratio is calculated by treating the third-party allotments within six months as one unit.)

## Cases Where the Dilution Ratio Exceeded 300%

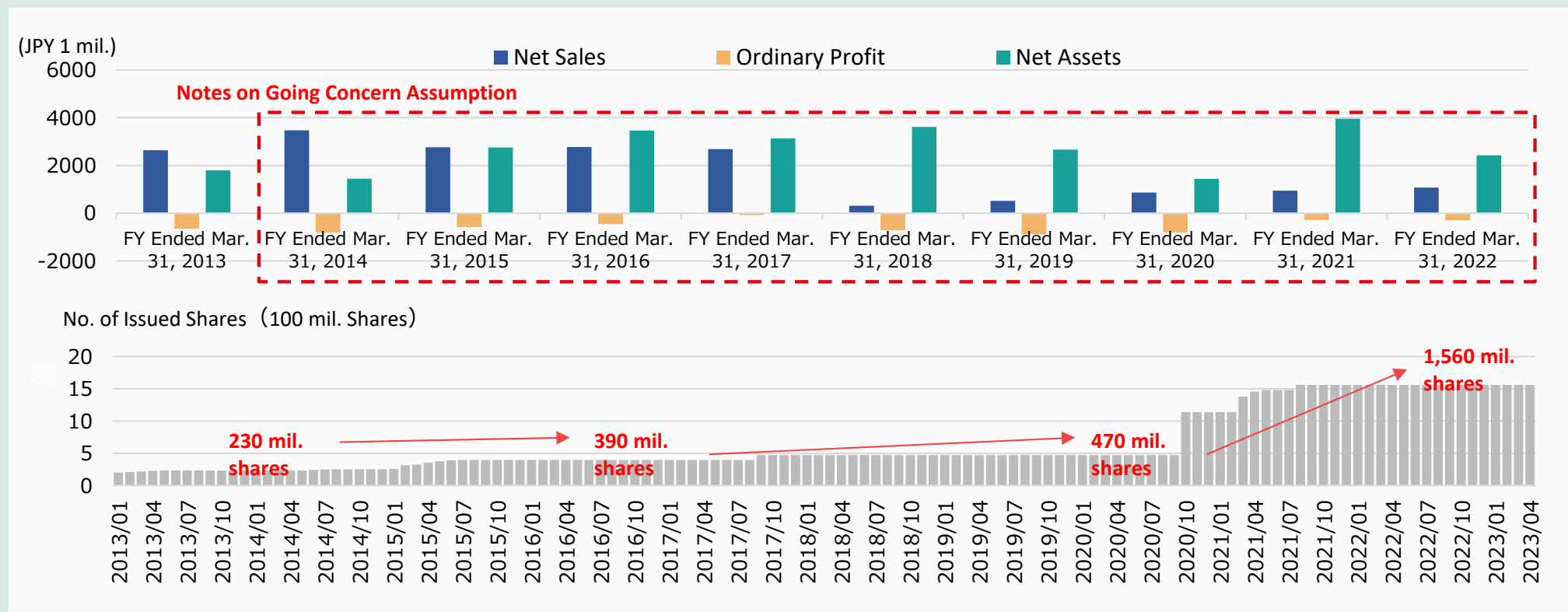
| Company Name                                | Disclosure Date | Dilution Ratio (Max.) |
|---|-----------------|-----------------------|
| CSK Holdings Corporation                    | 9/8/2009        | 518%                  |
| ARRK CORPORATION                            | 3/31/2011       | 1090%                 |
| Tokyo Electric Power Company Holdings, Inc. | 5/21/2012       | 2092%                 |
| Kirayaka Bank, Ltd.                         | 9/14/2012       | 403%                  |
| PIONEER CORPORATION                         | 12/07/2018      | 407%                  |
| Japan Display Inc.                          | 07/21/2020      | 457%                  |
| WATABE WEDDING CORPORATION                  | 03/19/2021      | 504%                  |
| SADO KISEN Co.,Ltd.                         | 02/07/2022      | 444%                  |
| Nichi-Iko Pharmaceutical Co., Ltd.          | 11/13/2022      | 900%                  |
| Japan Display Inc.                          | 02/10/2023      | 413%                  |
| Jimoto Holdings, Inc.                       | 09/01/2023      | 325%                  |
| amana inc.                                  | 11/20/2023      | 627%                  |

# A Recent Case of a Capital Increase by Third-Party Allotment

- Cases have occurred where the delisting criteria pertaining to the market capitalization of a company's tradable shares did not function properly when the company's stock price was significantly depressed because a large-scale third-party allotment or similar action had significantly increased the number of the company's issued shares. (TSE has no listing criteria related to minimum price as in the U.S.)

## Case Study

- The company had been posting long-term ordinary losses, which raised significant doubts about whether it was a going concern.
- On the other hand, due to large-scale financing, its number of issued shares was significantly larger than the average for listed companies (exceeding 1.5 billion shares at its highest), and though its stock price had fallen to single digits, it still met the market capitalization criteria for tradable shares (JPY 1 billion) on the Standard Market.



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## Objectives of the Code of Corporate Conduct

- So far in the Code of Corporate Conduct, we have stipulated matters requiring listed companies to act responsibly from the perspective of maintaining the functions of the secondary market and protecting the rights of shareholders, but should we also think about stipulating matters required from the perspective of sustainable growth and medium- to long-term corporate value improvement?
  - In such a case, how should we think about the differentiation from the Corporate Governance Code?

## Ensuring Effectiveness

- We ensure the effectiveness of "matters to be observed" by making them subject to regulatory measures in the case of non-compliance, but given that "matters desired to be observed" are not subject to these measures, how listed companies be encouraged to take autonomous action?
  - For example, currently only some of the "desired" matters are required to be disclosed in the CG report, but could we consider reorganizing the contents of the report and requiring disclosure of other things such as companies' thinking and progress on initiatives? (At the same time, given the overlaps with the Annual Securities Report and other reasons, could we consider a general overhaul of the CG Report contents?)

## Individual Provisions

- Within the current provisions, are there any items that need to be reviewed in light of recent corporate actions, overlap with the Corporate Governance Code, or other reasons?
- From the perspective of sustainable growth and medium- to long-term corporate value improvement, what kind of provisions specifically could be introduced?
  - Would it be conceivable for the Code of Corporate Conduct to stipulate, for example, awareness of cost of capital and stock price, or promotion of dialogue and investor relations?