

## **Minutes of the Sixth Council of Experts Concerning the Follow-Up of Market Restructuring**

Date: Tuesday, January 10, 2023 18:30-19:45

Place: Tokyo Stock Exchange 15F Special Conference Room

Attendees: See member list (Ms. Okina was absent)

[Kikuchi, Director, Listing Department, TSE]

It's already the scheduled start time, so I'd like to open the sixth meeting of the Council of Experts Concerning the Follow-up of Market Restructuring.

Thank you for joining us at this late hour. I would appreciate your active participation.

First of all, regarding attendance, Ms. Okina is absent today.

Now I would like to begin proceedings right away. First, our representative will explain today's agenda.

[Ikeda, Senior Manager, Listing Department, TSE]

I will explain today's agenda in accordance with Document 2.

At this Council, we have had various discussions for improving the effectiveness of the market restructuring since last July, and now we'd like to summarize key points of the discussions so that TSE can proceed with specific actions.

Specifically, we prepared Document 3, which is a draft of "Summary of Discussions" at this Council. We summarized your discussions made so far, covering generalities about perspectives that TSE should have in promoting reforms, as well as specific initiatives for raising awareness of capital efficiency and stock price, improving the quality of corporate governance, enhancing English disclosure practices, and promoting dialogue with investors, as discussed in the previous meeting, and the handling of transitional measures, and so on. We would appreciate your comments and suggestions.

Furthermore, we prepared Document 4, which contains a draft of TSE's specific future actions in response to discussions of this Council. It describes

what TSE should work on. As pointed out at the Council, we would like to take various actions speedily, so we have included specific details and timelines. If you have any comments or suggestions, please let us know.

With respect to a specific proposal for transitional measures, I'd like you to discuss it at the next meeting, so at this meeting, we'd like you to discuss premises of such a proposal today.

That's all for the agenda.

[Kikuchi, Director, Listing Department, TSE]

Now, I would like to ask a TSE representative to explain the drafts of Summary of Discussions and TSE's Future Actions.

[Monden, Manager, Listing Department, TSE]

First, I'll explain Document 3, which is a draft summary of discussions.

Page 1 shows the table of contents. Part I summarizes major policies for taking actions. Part II summarizes specific initiatives: Section 1 describes how to deal with transitional measures, and Section 2 describes initiatives for facilitating the improvement of corporate value over the medium- to long-term from perspectives shown in Sub-sections 2.a) to 2.d).

We'd like you to review the drafts and provide your inputs.

Main text starts from the next page. Page 2 is a summary of general discussions made so far regarding policies for improving the effectiveness of the market restructuring.

First of all, in terms of the macro environment, in order to develop the Japanese economy, it is necessary to promote industrial metabolism (replacing the old with the new) and innovation so that factors of production, such as human resources and capital, can be smoothly transferred to growth areas. In doing so, we will not only encourage individual companies to work independently, but also to exchange factors of production with other companies and to combine their efforts in order to improve productivity.

Under these circumstances, in order to ensure the effectiveness of the market restructuring and to make it an opportunity for change, it is necessary for TSE to engage in continuous and speedy reform, which is also expected from the

perspective of achieving the government's goal of financial inclusion.

In light of this background, two points are stated as policies to be taken by TSE.

First, TSE should immediately clarify how the transitional measures will be handled in the future, including the end date of the transitional period, for the purpose of ensuring the healthy functioning of market metabolism.

Second, in order to revitalize the market and the Japanese economy, measures should be taken, by targeting even listed companies which are unlikely to violate the criteria, so that they take steps to increase their corporate value, such as promoting capital efficiency-conscious management, while taking advantage of the characteristics of the three market segments.

The following slides summarize discussion of specific measures for these two points.

Page 3 is about the handling of transitional measures.

A specific proposal concerning transitional measures will be discussed at the next meeting, so here is a summary of premises for that based on the discussion at the fourth meeting.

Specifically, transitional measures should be terminated as soon as possible in order to allow market metabolism to function. On the other hand, such measures should be designed to take into account the fact that companies have formulated their plans with when there was no set deadline and that some companies are making progress in their efforts. In doing so, it is also important that such measures are easy for investors to understand.

In addition, it is appropriate to use the existing framework for the Securities to Be Delisted in order to ensure investors' redemption opportunities.

We also prepared Document 5 as a reference material that contains summaries of discussions on transitional measures at the fourth meeting and data on actual application of transitional measures. Please refer to it as appropriate.

The following pages discuss initiatives to promote medium- to long-term improvements in corporate value, and on page 4 we begin with a summary of the overall picture.

As indicated in the document for the previous meeting as well, what is required of companies is to redesign their management itself by backcasting

from a future vision, and it is necessary to encourage a shift to balance sheet-focused management and cash flow-focused management. Especially, considering the purpose of this market restructuring, it is important to take steps to improve the situation where about half of the companies have a Price to Book Ratio (P/B ratio) below 1x.

From this perspective, we described four specific initiatives a) to d), which are to be promoted according to the characteristics of each market segment.

An important point to keep in mind when doing so is that it is appropriate to take initiatives that allow autonomy to function, rather than micromanaging individual companies.

The slides that follow summarize your discussions of a) through d) in more detail.

Page 5 is for Sub-section “a) Raise Awareness of Capital Efficiency and Stock Price”.

As a response to promote such a change in management awareness and autonomy, the first step would be to encourage management to disclose its policies and initiatives for improvement based on proper understanding and evaluation of the cost of capital and capital profitability, and to use such disclosure as an opportunity to promote dialogue with investors and to improve management's literacy.

In particular, disclosure should be required especially for companies that continuously have a P/B ratio below 1x, in other words, companies that have not achieved capital profitability where the return exceeds cost of capital.

Furthermore, the Code of Corporate Conduct should be reviewed overall from various perspectives, including ensuring its effectiveness with clarifying the responsibilities of listed companies, while taking into account developments related to corporate governance and other issues.

In addition, in order to raise management's awareness, TSE should actively promote understanding of stock compensation plans and recommend their adoption, provide training opportunities on capital markets and governance, and share best practices.

Page 6 is for Sub-section “b) Improve the Quality of Corporate Governance”.

Although progress has been made since the establishment of the Corporate Governance Code, there is still a lack of awareness of the need to improve

management skills, which means that the focus should also be on improving the 'quality' of governance.

As a specific initiative, TSE should reiterate the idea of the 'Comply or Explain' principle, explicitly provide examples of inappropriate "explanations", etc., and encourage improvement, as there are some companies whose response to the Code has become a mere formality.

Furthermore, while an increasing number of listed companies have established voluntary nomination and remuneration committees, the roles and functions of these committees are not clear in many cases.

The companies are required to disclose activities conducted by these committees currently in their Corporate Governance Reports, and also in their Securities Reports in the future. TSE should continue to encourage proactive disclosure, and after assessing the actual status of the activities, compile and publish the status and examples of such activities.

Page 7 is for Sub-section "c) Further Expansion of English Disclosure Practice".

As Mr. Koike made a presentation in the fourth meeting, one of the reasons why foreign investors avoid investing in Japan is because of a lack of information. Especially, in case of companies listed on the Prime Market, considering the concept of the market, further expansion of English-language disclosure should be encouraged, and possibly made mandatory in the future.

In doing so, it is necessary to consider the scope of mandatory disclosure, taking into account such factors as the burden on companies and the level of use by investors.

In addition, in case of companies listed on the Standard and Growth Markets, if they need financing [from foreign investors], they should naturally make disclosure. Although it is not mandatory disclosure as in the Prime Market, it is necessary to encourage the companies to make voluntary disclosure in English.

Page 8 is for Sub-section "d) Improve the Effectiveness of Dialogue with Investors".

The first issue on the corporate side is that there is still some reluctance on the part of companies. In particular, with regard to companies listed on the Prime Market, TSE should require them to clarify the implementation status of dialogue and its contents from the perspective of encouraging constructive

dialogue, taking into account the characteristics of this market segment.

Independent directors are also expected to actively engage in dialogue with investors when requested to do so. However, the number of independent directors who actually engage in dialogue is limited, and some independent directors are not fully aware of their roles. Therefore, it is necessary to conduct educational activities to help them understand their roles.

The last point is an issue on the investor side. At present, only a few investors are involved in dialogue, and it is important to encourage asset owners to be actively involved in dialogue.

That's all for my explanation of the draft summary of discussions at this Council, which we would like you to review. Next, I will explain Document 4, the draft of TSE's specific actions to be taken in response to the summary of discussions of the Council.

We would appreciate any comments or advice you may have on this as well.

First, page 1 is about the handling of transitional measures.

The table below summarizes specific actions to be taken. First, column a is about handling of transitional measures. Based on the Council's summary, we will promptly determine our policy and publish the outline of system.

With respect to publicizing information on companies to which the transitional measures apply, TSE plans to publish on its website a list of names of such companies, specific criteria to which they do not conform, and planned period. We will work out the details in the days ahead.

Column b is for securing opportunities for shareholders to sell their shares in question. As explained in the fourth meeting, TSE plans to extend the period of designation as Securities to Be Delisted, and publish the outline of system together with the handling of transitional measures.

The following pages summarize actions for promoting medium- to long-term improvements in corporate value. Page 2 describes three specific actions under the title of "a) Raise Awareness of Capital Efficiency and Stock Price".

First, column a is about disclosure. It is suggested that management and the board of directors should be asked to accurately identify the cost of capital and capital profitability, evaluate those status, and then, if necessary, disclose policies and initiatives for improvement.

It is not sufficient that a P/B ratio is above 1x, but it is important to raise the overall level of P/B ratios, so we expect to request disclosure regardless of whether the P/B ratio is below 1x or not.

In particular, we expect that we will strongly request disclosure from companies that are clearly in need of improvement, such as those with a P/B ratio below 1x on an ongoing basis.

The positioning of this request is related to Principle 5.2 of the Corporate Governance Code, which requires listed companies to present targets for capital efficiency, etc. when formulating and disclosing business strategies and business plans, and to describe specific measures to be taken in order to achieve such targets. Taking into account the intention of this Principle, TSE expects listed companies to take a principle-based approach in response to this request.

We are planning to implement this action in the spring of 2023, assuming that priority will be given to this action, but we would appreciate your comments on any particular points to keep in mind when making such a request.

As for the Growth Market, it is assumed that many companies are at a stage where growth rather than capital profitability should be emphasized, and since only General Principles of the Corporate Governance Code are applied, we will not include them in the scope of this request and will consider the approach separately.

In column b, it is suggested that the Code of Corporate Conduct should be reviewed overall and revised, as necessary, from various perspectives, including ensuring its effectiveness with clarifying the responsibilities of listed companies, such as awareness of capital profitability and respect for shareholders' rights.

Specifically, we'd like you to discuss this action, which we plan to implement during FY2023.

With regard to the action in column c, we intend to promote understanding of stock compensation plans and recommend their adoption, review and update training content, and compile and publish case studies, in parallel with actions a and b.

On page 3, two specific actions are outlined under the title "b) Improve the Quality of Corporate Governance".

The first suggestion in column a is based on your insight that companies seem to merely formally apply the 'Comply or Explain' principle, so it is suggested that the purpose of the 'Comply or Explain' principle should be reiterated and that examples of inappropriate explanations should be explicitly informed.

Since the Corporate Governance Code adopted the principles-based approach, our basic line of thinking is to encourage self-inspection by each company by making them aware of this approach. However, if there is a high need for improvement, for example, if there are clearly inappropriate cases in light of the purpose of 'Comply or Explain' principle, we assume that TSE should check the situation individually and encourage the companies to make improvements.

In terms of the roles and functions of the nomination committee and remuneration committee, the second suggestion in column b is to first conduct a fact-finding survey on the status of their activities, and to compile and publicize the status and examples of such activities.

We assume the following schedule: TSE will begin such a survey in or after July, when Corporate Governance Reports for the fiscal year ended March 31 are available, and will publish the results around this autumn.

Page 4 describes actions for "c) Further Expansion of English Disclosure Practices".

First, we would like to encourage companies listed on the Prime Market to expand the coverage of English disclosure practices and accelerate the timing of disclosure, with a view to making English disclosure of necessary information mandatory at the timing of the termination of transitional measures.

Specifically, as indicated in column a of the table, TSE will continue to reach out to individual companies and disseminate information.

At the same time, TSE will continue to work out the details of future mandatory disclosure, aiming at making a decision by the end of FY2023, while checking the progress of English disclosure by the Prime Market-listed companies and the needs of foreign investors.

On the other hand, in order to promote voluntary English disclosure in the Standard Market and Growth Market, we would like to compile and publish case studies of companies that are proactively making English disclosure in order to motivate other companies to implement such disclosure practices and to serve



as a reference when taking specific actions. The timing of implementation is estimated to be in the autumn of this year.

Finally, page 5 shows actions under the title of “d) Improve the Effectiveness of Dialogue with Investors”.

First, in case of the Prime Market, in order to promote constructive dialogue with investors, as shown in column a of the table, we propose that companies be required to include in their Corporate Governance Reports information on the implementation status of dialogue between the management and investors as well as the content of such dialogue.

Similarly to the request for disclosure on capital efficiency stated in 2. a) a, we are planning to implement this action in the spring of 2023, but we would appreciate your comments on any particular points to keep in mind when making such a request.

I'm moving on to column b. As Mr. Matsumoto suggested in the previous meeting, as a part of educational activities to promote understanding of the roles of independent directors, we should send out a booklet that describes the roles of independent directors.

Specifically, we are considering the use of the Ministry of Economy, Trade and Industry (METI)'s "Practical Guidelines for Independent Directors" or the equivalent. After considering what to send and how to send it, we would like to implement it at appropriate timing.

The last column c is on the investor side. With respect to actions for raising asset owners' awareness of and interest in dialogue with companies, TSE's efforts alone have limitations, so we would like to work with other stakeholders to plan necessary actions. We would like to start by interviewing asset owners.

That's what is stated in the draft of TSE's future actions in response to discussions at the Council.

That's all for my explanation.

[Kikuchi, Director, Listing Department, TSE]

Now, I would like to hear your opinions and comments. We would be happy to hear from anyone.

[Kumagai, member]

First, let me start with a general remark. Thank you for including the wording "a society where no one is left behind financially" and "financial inclusion" in the fourth point on page 2 of Document 3, which I mentioned in the first meeting. The Follow-up Council started in July last year; and at the end of last year, following discussions at the "Sub-committee for Doubling Asset-based Incomes" of the "Council of New Form of Capitalism Realization" [at the Prime Minister's Office], in which I was also a member, it was decided to fundamentally expand and make permanent the NISA, and the groundwork has been laid to actively shift household assets from savings to investments. While the fundamental expansion and permanent establishment of NISA will promote the supply of risk money, I'm aware that the discussion on the market restructuring in this Follow-up Council will play a very important role in supporting the efforts of listed companies, one of the recipients of risk money, to enhance their corporate value. We should aim to facilitate industrial and social renewal as well as innovation, increase productivity, and promote the growth of the Japanese economy, while ensuring that the benefits of the financial markets are widely available to the people, or, in the words of Konosuke Matsushita, "all the people in Japan should be shareholders". The fundamental expansion and perpetuation of NISA and the enhancement of corporate value of listed companies are, so to speak, two wheels of a cart, and I believe it is essential to combine them and make them work together.

Based on the above points, I would like to make some comments on the draft summary of discussions and TSE's future actions.

First, I would like to refer to Document 3. I think "Part I. Major Policies" is very comprehensive in general. However, while there may need to be a separate discussion on whether or not to include it in the major policies, I believe it is essential that after implementing this proposed response, the results should be thoroughly evaluated at this Follow-up Council. In the PDCA cycle, it should be C or Check phase. I'm not sure if something quantitative like KPIs would fit in as an evaluation method, but I think we need a statement of intent to evaluate the efforts at future meetings of the Council and take action for further improvement. If quantitative KPIs were to be used, P/B ratio could be considered, but it may not be appropriate because P/B ratio is affected by macroeconomic fluctuations in stock prices. On the other hand, ROE has aspects that can be improved through self-help efforts, and from the perspective

that capital profitability where the return exceeds the cost of capital is required, it may be considered as a KPI.

Next, I would like to discuss raising awareness of capital efficiency and stock price. As for response to companies with P/B ratios below 1x, in addition to seeking disclosure of and commitment to their policies and specific initiatives for improvement, I suggest that TSE should also emphasize the importance of disclosing the progress status. This will be a part of the system design regarding disclosure of improvement plans, so it may be something that TSE will consider or this Council will discuss in the future, but we should make sure that companies do not just make plans. It is necessary to make companies keenly aware that a P/B ratio below 1x is a serious situation in which the return on capital is not being maintained above the cost of capital, and that urgent action is required. In addition, although the discussions at this Council so far have emphasized the importance of efforts toward corporate autonomy, I believe that we need to be strongly aware of the need to incorporate fostering a spirit of autonomy among companies into the system design. In designing the system, I think it will be necessary to change the reactive (passive) mindset of companies to meet TSE's requirements and foster a proactive (active) mindset to meet or exceed what investors are looking for in order to increase corporate value. In other words, I believe that the key is to break through the current situation in which many listed companies place importance on satisfying the minimum requirements of TSE and lack the perspective of increasing corporate value, and to direct their eyes towards investors. Of course, disclosure of improvement plans has a certain effect, but disclosure of progress will lead to an even stronger awareness of what investors are looking for in fostering a spirit of autonomy, since investors will evaluate achievements over a certain period of time. I believe that this kind of awareness will lead to the adoption of a stock compensation plan, and to making it a system built on the enhancement of the company's corporate value, instead of merely introducing the plan. Some companies are serious about improving their corporate value and have introduced elaborate systems, so I believe that the compilation and publication of good examples will be very helpful for companies.

As for the contents of the improvement plan, one idea is to format the contents and items that TSE requires in the improvement plan. For example, it may be possible to determine the minimum information that must be included,

such as "Business Plan and Growth Potential Matters" which is required to be developed and disclosed by companies listed on the Growth Market. I believe that this will have the effect of increasing comparability between companies, and will also ensure that information needed by investors is disclosed without omission. The content would be to help companies understand their cost of capital, present how to allocate capital in order to generate return exceeding the cost of capital, and indicate a growth path for the company. Another possible approach would be to disclose management's evaluation of the current growth strategy and other factors, as well as the valuation of the stock price. In this regard, I'd like to ask TSE to confirm whether the discussion on the contents of the improvement plan will take place at the Follow-up Council or at TSE. I would also appreciate it if you could provide us with a general outline of the contents to the extent permissible.

Next, I'd like to discuss the improvement of the quality of corporate governance. Companies have made progress in formal corporate governance efforts, for example, as observed in an increase in the number of voluntary nomination and remuneration committees. However, if such formal efforts do not lead to sustainable growth of companies and enhancement of corporate value over the medium- to long-term, the objectives of the Corporate Governance Code have not been achieved. To be more specific, in addition to investigating activities of nomination and remuneration committees, it is necessary to verify whether they are contributing to sustainable growth and medium- to long-term improvement of corporate value. If they are not contributing to sustainable growth and medium- to long-term improvement of corporate value, we should consider alternatives such as reviewing the roles and methods of nomination and remuneration committees.

Furthermore, I mentioned at the last meeting that it is extremely important for TSE to encourage companies to promote self-inspection of their approaches to the 'Comply or Explain' principle, which has become a mere formality. I believe that we must also consider mechanisms to change the mindset of companies so that they do not merely respond reactively to TSE's efforts, but rather seriously consider ways to improve their corporate value and other aspects of their business.

With respect to the further expansion of English-language disclosure, I have

no major comments on the content in general. However, the corresponding actions proposed in Document 4 may require further consideration and prioritization of target documents, given the future mandatory disclosures in the Prime Market. During the last meeting, each member expressed a variety of opinions about the scope of disclosure documents, such as earnings summary, IR presentation materials, timely disclosure documents, and the integrated version of annual report. I think some may have pointed out that the results of TSE survey of foreign investors may not necessarily reflect the actual situation. In light of these considerations, I suggest that you consider researching documents that are actually used frequently by foreign investors. Although I'm not sure whether it is feasible, TSE could, for example, ask for cooperation from companies with many foreign investors or companies that are active in English disclosure, and survey the access/download history of English documents posted on their websites, or the access/download history through vendors that handle English text data of documents. Based on this data, it would be worth considering further review and prioritization of documents to be disclosed in English, taking into account the burden on companies.

Next, I'd like to discuss improving the effectiveness of dialogue with investors. Given the market concept, I think it is necessary to require companies listed on the Prime Market to disclose the implementation status of the dialogue between management and investors and its content. As mentioned earlier, mere disclosure of such information is not sufficient. We need to ensure that it leads to the improvement of corporate value, etc. As discussed during the previous meeting, although it is not easy, it is worthwhile to examine what kind of dialogue has contributed to the improvement of corporate value. More specifically, TSE should compile good practices and expand them horizontally, or, as Mr. Matsumoto suggested in the last meeting, the creation of a bulletin board is worthy of consideration. My understanding is that only a few asset owners, such as corporate pension plans, currently engage in dialogue, and there should be a great deal of room to encourage them to have dialogue. Although codes targeting institutional investors, such as the Stewardship Code, are outside the scope of TSE, the Corporate Governance Code establishes Principle 2.6 "Roles of Corporate Pension Funds as Asset Owners", and it is one idea to require companies to take further action.

That's all from me.

[Ikeda, Senior Manager, Listing Department, TSE]

Regarding your question, I think it is an important issue to decide what to be described in the improvement plan, so TSE will prepare it based on the advice we received today, and then have it reviewed at this Council.

[Sampei, member]

With respect to financial inclusion stated in “Part I. Major Policies,” point fourth in Document 3, I think what Mr. Kumagai mentioned is true, but as far as the expression is concerned, I felt that I had to read between the lines. I think it is a natural role of the government to ensure that “no one is left behind financially,” but when it comes to companies, they should contribute in areas that are compatible with their respective businesses. For example, the Marui Group has been developing a business differentiation strategy based on financial inclusion for several years now, and I think there is a way to utilize such a strategy. On the flip side, I think that TSE is encouraging those that match the differentiation strategies of individual companies, but if it sounds like TSE is putting up a safety net, it doesn't seem to fit with the strict requirements in the transitional measures. It would be good if you could write something so that we can understand that.

On pages 4 and 5, the wording “raise awareness of capital efficiency and stock price” is used, but I got an impression that the wording “raise awareness” is weak. Since the issue here is about literacy and competence, I thought “reform of literacy in capital efficiency and stock prices” would be appropriate.

Regarding page 5, the third point is the action sought, the fourth point is the norm, the first half of the fifth point is incentives, and the second half is support. The sequence may have been arranged according to the timing of implementation of actions described in Document 4, but I think it would flow better if the order was as follows: first, there are the basic norms, then what kind of support is provided, then what are requested as specific actions, and then the incentives for those actions.

Regarding the first point on page 6, if you read the latter part, after “but,” there is “...skills is still low.” It seems as if companies that are doing it properly are being told that they are still lacking by the whole group, but in reality they

are polarized, so I thought it would be better to add the phrase “the polarization is becoming more pronounced, and that many companies in terms of numbers are still doing it and,” after “but.” It would be easier to convey the message that the companies that are doing it are recognized as doing it.

Also, regarding the third point, the focus is only on inappropriate cases, but it would be better if you could show both cases, including adequate explanations at the same time.

Regarding the fourth point on page 7, it is right that "(it is necessary to encourage) voluntary disclosure to progress in the Standard and Growth Markets as well", but I was wondering if this is properly conveyed when I read it. When we say “if companies have capital needs, those listed on the Standard or Growth Market also should do it”, we often hear that their market is the domestic consumer market, not the global market, so they do not have to make disclose in English. However, from an investor's point of view, even if the business is domestically oriented, if it is expected to grow, foreign investors are naturally interested, so I am concerned about whether this context will be properly conveyed.

Regarding the fifth point on page 8, the reason why corporate pension funds have been reluctant to sign up to the Stewardship Code is that they cannot do so many things by themselves, and I believe they have sorted out what they can do directly and what they can do indirectly. I am, therefore, uncomfortable with the description that appears to be encouraging corporate pension funds to have dialogue with companies directly. On the other hand, page 5 of Document 4 uses a different expression, with which I am comfortable.

These are my comments on Document 3.

Regarding Document 4, the timing of implementation varies, but "to be implemented at appropriate timing" is vague, although it seems somewhat understandable. I would say it is neither good nor bad.

Regarding page 1, the handling of transitional measures will be decided after our next discussion, but before such a decision is made, how will TSE respond when a company that has read this document rushes to apply for an extension to its plan? I'd like to check with TSE now.

On page 2, the note in column a reads, "Approach for companies listed on the Growth Market in which growth potential is important will be considered separately", I understood from the previous explanation that what is meant by "considered separately" is that the scope of application of the Corporate Governance Code is different. As I mentioned in the last meeting, in the Growth Market, for example in the U.S., even if a company has a negative ROE, if there is an expectation of growth, its P/B ratio can be many times of book value. Therefore, a negative ROE is not necessarily a problem, and the company should successfully communicate that it should show future growth before showing capital efficiency. I think such a point should naturally be included here as well, but it is difficult to describe it concisely, so I am not sure what to do.

Regarding the action in column b, I believe that awareness of capital profitability and shareholders' rights is also referred to in the current Code of Corporate Conduct, but what should be clearer in the Code is the protection of "minority shareholders' rights". It would be more meaningful to update it to emphasize respect for minority shareholders' rights.

Regarding the reiteration of the purpose of the 'Comply or Explain' principle on page 3, it says that it will be implemented in autumn 2023, but given that most Corporate Governance Reports come out after the annual shareholders meeting, the reiteration of the purpose is not reflected on the reports when companies with a fiscal year ending in March submit their reports by the end of June. This would mean that we will not see the effect until one year later. In the meantime, since the new disclosure format of Securities Report will be effective from the fiscal year ending March 31 this year, perhaps the burden on companies in terms of disclosure in Securities Report was taken into account, but since Corporate Governance Reports can be updated at any time, companies that can respond in time should do so. For companies that do not have the resources to do so, it may be possible to have them disclose tentatively in the conventional format and then update it later.

I do not understand what the intent was in dividing the timing of implementation of actions a and b on page 4 as well, specifically, "during FY2023" in case of the Prime Market and "autumn 2023" in case of the Standard and Growth Markets. While saying the same timing for all markets, I think it would be good to compile and publish examples not only for the



Standard and Growth Markets, but also for the Prime Market when good examples emerge.

Regarding the request for inclusion of information on dialogue in Corporate Governance Reports on page 5, I think it might be difficult to write about the contents of dialogue due to the layout of the paper. Since a website would allow for greater flexibility and in-depth disclosure of specific details, I would suggest that the website be used as a reference.

[Kikuchi, Director, Listing Department, TSE]

We believe that we will have to accept any changes that are made prior to the implementation of the revised rules in the event that some companies extend the implementation period of their plans for complying with the criteria for continued listing. While I do not intend to encourage them to rush in a certain way, I believe that it is also quite difficult to strongly refuse to do so. Of course, we would not accept the extension without first asking about reasons, but if the company still believes that the extension is necessary, we would confirm whether they provided sufficiently convincing explanation to investors and other external parties.

[Sampei, member]

Please check reasons for extension as you said.

[Matsumoto, member]

First of all, regarding the general remark, I think it is important to make clear what we are trying to do and what our objectives are, so as you can see in the first and second paragraphs on page 2 of Document 3, it is very important to clearly state the objectives of promoting social renewal and innovation, or improving productivity of the Japanese economy as a whole, and I think it is good to state them. Also, the fifth paragraph states that the handling of transitional measures should be clarified immediately. Considering the purpose and stability of the listing system, I think it is a good idea to state such an idea, as it should be clarified as soon as possible.

Now I'd like to discuss specific actions. As Mr. Sampei mentioned regarding action b on page 2 of Document 4, the protection of minority shareholders'

rights would be an important topic. While the dissolution of parent-subsidary listings is taking place, there are some instances where the interest of minority shareholders of subsidiaries are being impeded. The fact that listed companies must consider the interest of minority shareholders is also written in METI's guidelines, but it seems that awareness of this issue is inevitably low, or is understood and ignored. So this issue should be clearly pointed out.

Next, on page 3, in case appropriate explanations have not been provided, or if a committee has not been functioning as it should, I have a doubt about whether publicizing such a situation will lead to improvements. To improve the quality of corporate governance, the essential point is how to make governance effective, in other words, how to make it actually work. When there are some examples where the 'Comply or Explain' principle has not been properly followed, or where a voluntary committee is not appropriately utilized, I am not sure whether pointing out these cases will really improve the situation, and I do not think that it will make any difference. Therefore, if companies do not provide well-thought explanations, or if nomination and remuneration committees are not functioning as expected, we need to consider another mechanism to make them effective, such as removing them from the Prime Market, for example. Otherwise, nothing will change after all.

Finally, with regard to "improving the effectiveness of dialogue with investors" on page 5, as Mr. Sampei mentioned, I am concerned about the wording "to be implemented at appropriate timing". We should avoid being left with "to be implemented at appropriate timing" after so many years. In particular, with regard to action b, coupled with the previous point about improving the effectiveness of corporate governance, there are cases where independent directors are the last resort from the minority shareholders' point of view. In such cases, if independent directors do not function well, minority shareholders will have nowhere to go. Communicating the expected role of independent directors should be done sooner anyway, and should not be implemented at appropriate timing, but in the spring of 2023, for example. This does not mean that we are going to do something new, but only to reiterate what is obvious within the various frameworks of our country, and we believe that this should be done promptly, as there is no need to wait for anything.

[Koike, member]

I would like to make comments on generalities. First of all, it has been pointed out that TSE's market restructuring itself is difficult to understand by foreign investors, etc. Therefore, I think it is important to put forward effective measures for the reform, and for that purpose, it is important to put forward a more organized communication and stronger commitment by TSE. I suppose this depends on how it is presented and publicized, but I think the key is how to put forth what is being discussed at this Council.

Looking at the materials compiled this time, I think it is easy to see that the focus is on improving the corporate value of listed companies in a general discussion that could be described as a market revitalization plan or revitalization following the market restructuring. On the other hand, the term "characteristics of market segments" appears in the material, and many people say that it is difficult to understand the characteristics of the Prime, Standard, and Growth Markets, and that it is difficult to invest in the Prime Market because companies are not differentiated. We, as investors, also feel this way.

Before putting these documents out into the world, I feel that it would be good to send out a strong message once again, as a premise for the summary of our discussions, as to why the market restructuring was undertaken, what the purpose was, and what the characteristics of each market segment are. And I think one message is that different market segments have different requirements depending on their characteristics, so it would be good to clarify this point. If simply increasing corporate value is required, there will be hesitation as to "what our company should do" and "what we should do in this market", so I think it would be easier to understand if we could clarify this point. I feel that the content will also be a key point for gaining understanding of investors around the world.

As for the implementation phase after the release of the Summary of Discussions, as was commented earlier, I believe that it is necessary to question the effectiveness of the implementation by checking the progress of the implementation by indicating "done", "partly-done" or "not done", etc., and at the same time, to foster a climate for improving corporate value by introducing case studies and sharing best practices.

[Kanda, member]

On page 3 of Document 3, we can see the term "*katsuyo* (Japanese

equivalent to “utilize”)" the framework of the Securities to Be Delisted, but it is a bit strong, so I think it would be better to use the word "*riyo* (Japanese equivalent to “use”)" or something similar.

Also, regarding page 6, as another member pointed out earlier, I think the term "inappropriate cases of explanations" is also too strong. If you are saying that the application of the ‘Comply or Explain’ principle is inappropriate, I understand, but I think basically it is the market, not TSE, that determines whether an explanation is inappropriate, so I think it would be better to use the term "insufficient" instead.

Next, regarding the English disclosure on page 7, I would like to make two points. First, as for the third paragraph about the scope of documents to be disclosed, I would like to see statutory disclosure documents included. However, it does not have to be all of them, and it should be determined, taking into account the burden on companies and the use by investors. Secondly, timing also seems to be important, although it is not mentioned in Document 3 and is mentioned in Document 4. Since it is a problem if the English disclosure is made six months after the Japanese disclosure, I would like TSE to mention encouraging English disclosure at a time as close as possible to the Japanese disclosure.

And then, regarding page 2 of Document 4, it says "with a P/B ratio consistently below 1x". I think this wording is fine in Document 3, but in Document 4, which shows TSE's actions in response to our discussions, I think we should focus on cases where a company has made no efforts although its P/B ratio has been below 1x, rather than cases where a P/B ratio has consistently been below 1x. There may be various situations where there is no improvement despite efforts being made, or where the situation is left unchecked, etc. I think it would be better if you could nuance your expression here better.

Also, as Mr. Sampei mentioned, I think it would be better to have another wording instead of "Approach for companies listed on the Growth Market ... to be considered separately". For example, I think it should be "separately considered based on the characteristics of companies listed on the Growth Market, etc."

Then, I was also concerned about the wording "to be implemented at appropriate timing" as other members pointed out. I believe that this is to do with what can be done first, and is not intended to be a postponement.

Therefore, it can be described as “to be implemented in or after the spring of 2023” or something like this.

Regarding page 3, as I mentioned earlier, I would like to point out that the use of expressions such as "insufficient" instead of "inappropriate" would be fine, and that this should be applied starting with Corporate Governance Reports to be submitted in July of this year, as was also mentioned earlier.

Finally, regarding the booklet mentioned on page 5, which refers to the roles of independent directors, etc., it is very good that you refer to the METI guidelines. However, TSE, based on the discussion at the Advisory Group on Improvements to TSE Listing System, introduced the independent director system in December 2009, and then in March 2010, issued a document entitled "Expected Role of Independent Directors/Auditors". Although the emphasis at that time may have been on defensive governance, I believe that there are points of reference that can be used today as well.

One point, which does not need to be included in the Summary of Discussions, but I would like to make a general comment: although I think the content is basically very good, I feel that all the arguments are sound, but not necessarily practical. When I think about how foreign investors would view this in English, I am concerned that they would say that this is for self-satisfaction of those who created it, or that it is just a government-led and/or TSE-led effort and that companies will not actually move.

What is written in this draft summary is not something that should be done under the initiative of the government or TSE, but something that should be handled by each company and private sector on their own judgment, and if not handled well, it will come back to them, so it would be good if we could give a little more nuance of expectations to the private sector. Otherwise, I feel that it would be seen as a document for self-satisfaction.

What is important in what we are issuing this time is, I think, a change in the awareness of management. On page 4 of Document 3, it refers to management's awareness of capital efficiency and stock price as Section 2. a), but the key points of b), c), and d) are the same. I think that without management's understanding, it will not be possible to ensure that independent directors have dialogue with investors or that committees function properly. The same is true for English disclosures. It is important for corporate managers to think by themselves and make changes if they want to change not only in case

of 2.a), but also in case of 2. b), c) and d). I got an impression that it would be better to make a sound argument while leaving the rest to the private sector. I am not asking you to write the text, but I am just expressing my opinion as a reader of the draft.

[Nagami, member]

First, in general, what we have discussed so far is incorporated into these drafts, and although there are some minor issues, such as the wording, I think they are well organized.

On the other hand, as Mr. Koike pointed out earlier, going back to the discussion at the first meeting, I think the biggest issue is communication and delivery, that is, the purpose and contents of this market restructuring were not firmly communicated to investors in the first place. I think it is very important for TSE, in formulating its policy in response this time, to communicate and deliver firmly and to steadily disseminate the market restructuring so as not to make the same mistake again.

First, as the name of this Council suggests, this is a follow-up on the market restructuring, so I think it is important to clarify the characteristics of each market segment and what the differences are, how differently TSE require each market segment to take actions, as mentioned in the draft of the future actions in Document 4, and communicate and deliver them.

Secondly, as other members commented, the question of what will be implemented and by when is naturally very important, especially from the perspective of foreign investors, and I think it is necessary to specify the time frame for actions expressed as "to be implemented at appropriate timing" as much as possible.

Third, this is again about communication and delivery, but I think it is important to present and communicate TSE's Future Actions proposed in Document 4 in a well translated English version, which I am sure TSE is naturally planning to do. I think it is naturally important to present the information in an easily understandable place so that investors will see it.

Finally, as to the fourth point, I am aware that foreign investors rarely ask TSE

directly about the contents of the proposed Actions, and in fact, they generally first ask questions to strategists and analysts at investment banks and securities firms. In this light, I think it is very important for TSE to gather strategists and analysts from investment banks and securities firms, hold teaching sessions, and ensure that the communicators who serve as intermediaries in the market are aware of and understand the contents, and that these people are able to communicate and respond to questions from foreign investors.

In this way, I believe it is important for TSE itself to make a solid effort in communication and delivery, and for the communicators who serve as intermediaries to communicate with foreign investors after informing or obtaining the assistance of market participants. I would like to ask you to keep in mind that the publication of the draft Actions in Document 4 is not the end of the process, but rather a start.

[Ando, member]

As a whole, I believe that Documents 3 and 4 summarize the main points of our discussions from the first to the fifth meeting very well. I would appreciate it if you could modify expressions pointed out by our members, as necessary.

I would then like to emphasize a point that I would like to make. Since the purpose of this Council is to follow up on the market restructuring, I recognize that it is natural for companies to be the subject of all items. However, despite the considerable number of years that have passed since the introduction of the Corporate Governance Code in June 2015, members still pointed out that the literacy of corporate management is insufficient or that efforts to create corporate value are polarized. Our discussion was based on this recognition.

On the other hand, for a company, the quality of autonomy can be greatly improved by having specific pointers to what and how management itself and business operations should be reformed.

So the question I would like to raise is, are active investors adequately fulfilling their stewardship responsibilities? Despite the fact that investors have dialogue with companies, three or four times a year in case they frequently have such opportunities, there are many companies with P/B ratios that are consistently below 1x. Aside from passive investors, if you are an active

investor, assuming that you have the ultimate option of selling your shares, I feel that the current engagement is not working well enough. Of course, compared to 10 years ago, the ratio of passive investors has increased, so it may be that there are relatively fewer opportunities for active investors to play an active role. However, when looking at the investment chain as a whole, while the principle-based Corporate Governance Code is in fact binding every move of the companies, we should examine once again whether the Stewardship Code, which is the flip side of the mirror, is really functioning.

Again, this is the Follow-up Council on the market restructuring, so I am not asking you to include what I have just said in the Summary of Discussion, but I think it is necessary to be aware of this as an important issue for the future.

There is a concern that simply pointing out inadequate responses on the part of companies will not improve the current situation. However, we have high expectations for the evolution of corporate management capabilities, since it is natural that companies, especially listed companies that have corporate governance responsibilities, should at least have a sense of crisis about the current situation of P/B ratio below 1x and voluntarily come up with measures to improve the situation.

Finally, I would like to comment on the last paragraph in Document 3, page 8, II.2. d) Improving the effectiveness of dialogue with investors. As pointed out by Mr. Sampei, the content is uncomfortable from the perspective of corporate practice. This part enlightens that corporate pension funds should actively engage in dialogue, but page 4 of Document 4 does not have such a description.

The OMRON Corporate Pension Fund announced its acceptance of the Stewardship Code in August 2020, and has since published details of its dialogue with its entrusted investment managers. In fact, the main reason why corporate pension funds are reluctant to accept the Stewardship Code is that they do not manage their own funds (in-house investment management). Of course, as an asset owner, you have an obligation to fulfill your stewardship responsibility regardless of whether you are managing the asset in-house or not, but you need to be aware that the way you fulfill your stewardship responsibility is different from that of an asset manager, and you need to consider specific measures.



I will then comment on the new form of capitalism as pointed out by Mr. Kumagai, plus its relationship to human capital management. Omron has already consolidated its working employees into a defined contribution pension plan in FY2019. Going forward, Japanese companies will need to revise their old personnel systems in the country, as well as their various systems, including retirement allowances and corporate pensions. For example, a defined benefit pension plan that requires many years of service to receive benefits is not appropriate for diversity and inclusion. In this sense, it may be too superficial a discussion that merely disclosing the ratio of female managers will promote the diversification of human capital, so we hope to organize and educate the public on the options for measures to promote the new form of capitalism and human capital management. This is not the main theme of this Council, and it is an issue for the future, but it is extremely important, so I dare to add it.

[Kikuchi, Director, Listing Department, TSE]

Thank you very much. As a side note, we had the same recognition of how asset owners such as corporate pension funds should fulfill stewardship responsibilities as pointed out by our members today, and that is why we intentionally use different expressions in Document 3 and Document 4. In light of the points raised today, we have confirmed that the intent of this Council is not to encourage corporate pension funds to have dialogue directly with companies, so we will revise the wording of Document 3 as well.

[Kumagai, member]

In closing, I would like to say what I thought after listening to the members, there are two pillars when making policy recommendations: the first is to raise an issue, and present a sound argument or a theory of what should be done from the standpoint of a good nature. The other, more important, is to put the reforms into institutional theory and force them into a situation where they have no choice but to do so. As Mr. Matsumoto pointed out earlier, I also hope that we can make one more push, or rather, incorporate the issue to institutional theory and create a situation where companies are compelled to take action.

To put it another way, when you put out something like this, you still need to have a centerpiece. As Mr. Nagami talked about communication and delivery earlier, I think it would be better if we could make a further push in some way in the area of institutional theory, while being aware of how the Japanese media

reports, what headlines the Financial Times publishes, how sell-side strategists write their reports, and so on.

[Kikuchi, Director, Listing Department, TSE]

Thank you very much. Now, we will conclude today's meeting.

Finally, we would like to explain the schedule for the next meeting.

[Ikeda, Senior Manager, Listing Department, TSE]

Thank you very much for your active discussion today.

In the next meeting, we would like you to review the revised drafts of the Summary of Discussions and TSE's Future Actions, which will have been modified based on the feedback we have received today. We would also like you to review a draft of specific transitional measures.

We would like to discuss the Growth Market, which we have not been able to discuss so far, after sorting out issues to be discussed.

That's all from me.

[Kikuchi, Director, Listing Department, TSE]

Now I declare the meeting adjourned.

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

END