

Minutes of the Ninth Council of Experts Concerning the Follow-Up of Market Restructuring

Date: Friday, March 31, 2023 9:00 – 10:40

Place: Tokyo Stock Exchange 15F Special Conference Room

Attendees: See member list

[Kikuchi, Director, Listing Department, TSE]

It is now time to begin the ninth Council of Experts Concerning the Follow-Up of Market Restructuring.

Thank you for gathering here early today, despite your busy year-end schedules. I appreciate your attendance.

First of all, I would like to mention that Mr. Nagami is not attending today due to personal reasons.

Now, I would like to begin proceedings straight away. First, let us explain today's agenda.

[Ikeda, Senior Manager, Listing Department, TSE]

Thank you for gathering here today.

First, before we get into the proceedings, I would like to give an update on the institutional amendments concerning the "handling of transitional measures." After the meeting in January, the outline of implementation was published for public comment. Since this was presented at an early stage, we have received a lot of feedback that is basically in favor of the details of the revisions. Therefore, we will proceed with the revised rules as planned, and these will come into force tomorrow (April 1).

Today, I would like to invite your opinions on TSE's responses to the Summary of Discussions published at the end of January, which are due to be implemented by spring 2023. We are interested in hearing your thoughts on "Action to implement management that is conscious of cost of capital and stock price," "Disclosure of dialogue with shareholders" in Prime companies, and "Key points and examples of "explanation" that contribute to constructive dialogue."

The details of these, especially the "Action to implement management that is conscious of cost of capital and stock price," have been covered in the media, with listed companies and investors waiting with great interest for more

commentary. Based on today's discussions, I would like to give listed companies an update as soon as possible.

Although there are no materials available as yet, with respect to sending out a booklet to independent directors on the role of independent directors, which was scheduled to be carried out in spring, we have decided to distribute the Ministry of Economy, Trade and Industry's "Practical Guidelines for Independent Directors" to the independent directors of all listed companies. This is currently being printed and prepared so it should be available to everyone by the end of April.

I also hope that we can have a focused discussion on the Growth Market, which we talked previously, from April onwards.

That's all for now on the agenda.

[Kikuchi, Director, Listing Department, TSE]

I would now like to start with an explanation of the accompanying documents. Today, we would like to divide the discussion into two parts. The first half will be an explanation concerning "Action to implement management that is conscious of cost of capital and stock price," based on Documents 2 and 3, and after this we would appreciate any comments.

In the second half of the meeting, we will have explanations on the remaining topics of "Disclosure of dialogue with shareholders" and "Key Points and Examples of "Explanation" That Contribute to Constructive Dialogue." There will be an opportunity for any feedback comments afterwards.

Finally, I plan to refer back to the previous opinions on the Growth Market and the approach to this in the future.

Let us begin the first half of the discussion.

[Monden, Manager, Listing Department, TSE]

I will now explain the documents.

First, Document 2 is a draft press release and notice for listed companies.

The first page of the press release states that, although compliance is not mandatory, listed companies are encouraged to implement it actively in light of investor expectations. Institutional investors are also expected to engage in

constructive dialogue with companies based on the disclosures in response to the request.

The second page lists the main points regarding the request concerning management that is conscious of cost of capital and stock prices in order to properly inform market participants and the media about the purpose of the request. Specifically, as the first point, from the perspective of promoting management that is conscious of cost of capital and stock prices, companies are requested to implement a series of continuous measures including analysis of their current situation, formulation and disclosure of their plans for implementation, and updates on these initiatives. Secondly, in implementing the initiatives, management should take the lead in promoting investment in growth, including intellectual property and intangible assets, and reviewing their business portfolio, with due awareness of cost of capital and profitability, and should allocate management resources appropriately. Thirdly, by way of a reminder, we expect more than a one-off response, such as a share buyback or increase in the dividend, as so-called “denominator measures.” Instead, we expect companies to adopt a more fundamental approach. In terms of the timing of companies’ response to this request, there is no specific time limit, since setting a uniform deadline may lead to a formalistic response. However, we request that companies should respond as promptly as possible.

These details have been put together based on discussions at the follow-up meetings and comments received ahead of the meetings. We would be very grateful for your feedback, including on the contents, since we believe this is an extremely important part of the message to listed companies, investors and other market participants.

Please turn to the next page, which is the draft Notice for Listed Companies. We envisage that Documents 3 to 5 will be attached as an annex to this notice for distribution to the listed companies.

Please refer to Document 3.

The first page gives the background and purpose of this policy, but the key points were explained for the press release earlier, so I will skip this.

Moving on, page 2 is the details of request. First, the target group is all companies listed on the Prime and Standard Markets. We will ask them to continue to implement the series of measures described in the middle section of the report. Regarding the start date below, as mentioned earlier, there is no

uniform deadline, but companies are asked to respond as soon as possible. For example, if a company has its fiscal year ending in March, it might be appropriate for the company to make a disclosure on these matters at the time of the financial results briefing for FY03/23 or together with its regular update of corporate governance report between June and July. Alternatively, if this timing is not possible, the company could manage its disclosure in stages, first by providing an update on the status of review of these matters and its expected timing for disclosure, and then by making a formal disclosure once the plan is formulated.

In the following section, we summarize the key points to consider for implementing each step of the response. First, page 3 is the key points to consider for the 'analysis of the current situation.' To begin with, we have shown some typical examples of indicators used for analysis of the current situation. Next, we suggest two perspectives concerning analysis and assessment. The first point is whether a company has achieved profitability in excess of its cost of capital, and if not, the reasons behind this. The second point deals with situations where companies are still lowly evaluated by the market (for example, a P/B ratio below 1x), even if they have achieved enough profitability. The key aspects concerning these points are listed on the right.

Next, regarding "Planning and Disclosure," on page 4, we have the three major items for which companies are expected to provide disclosures: assessment of the current situation, policies/targets, and initiatives and timing of implementation, along with the key points for each based on previous discussions at meetings. On point 3 regarding policy and targets, a P/B ratio below 1x, which has been a previous focus of discussion, is viewed as an indicator that a company has not achieved profitability that exceeds its cost of capital or that investors are not seeing enough growth potential. This can be considered as a reference for setting a policy and targets to improve profitability and market value. Targets may also be set for further improvement even if the P/B ratio is currently above 1x.

Page 5 refers to the format of disclosure. Based on our discussions so far, TSE does not stipulate a specific format, but allows companies some discretion in their disclosure of this information. For example, it could be in their medium-term management plan or their financial results presentation materials, or, if they do not currently comply with continued listing criteria, in their plans for compliance with these criteria. We also anticipate that companies will state their

intention to make the disclosures and the format for viewing them in the corporate governance report in order to aid investor understanding.

Finally, page 6 refers to the “Implementation of initiatives” and the “Update”. When proceeding with its initiatives, companies are requested to engage in an active dialogue with investors based on these disclosures and to provide an update on progress at least once a year.

The pages that follow are reference materials on the principles of the relevant Corporate Governance Code and the disclosure requirement for companies in the Growth Market regarding growth potential and other information.

That completes my explanation.

[Kikuchi, Director, Listing Department, TSE]

Now, I would like to hear from our members.

[Kumagai, member]

First, I would like to talk about measures to promote management that is conscious of cost of capital and stock prices. In other words, disclosures that take account of the so-called PBR. My impression is that this topic is the subject of an unprecedented level of attention by market players, including listed companies and institutional investors, as well as the media. I was a panelist at the 12th Japan Securities Summit held in New York on March 1st. This was a gathering of some 200 foreign investors, financial professionals, journalists and others for an extremely lively discussion on the Japanese market, securities markets generally and other matters. We are keenly aware of the extremely high level of expectation placed in the Japanese market - it is unprecedented by the standards of recent years. In particular, Prime Minister Kishida, the first Japanese prime minister to send a video message, emphasized the attractiveness of the Japanese market. TSE CEO Yamaji referred to the need for share prices to rise and for an improvement in capital efficiency. He made a clear commitment to take steps on both of these. I believe these comments have deepened foreign investors’ understanding of the Japanese market and led to heightened expectations for the stock market in Japan.

Based on this, I would like to express my opinion on Document 2, “Action to implement management that is conscious of cost of capital and stock price.” Regarding the overall content, I agree that the discussions in previous follow-up

meetings have been carefully incorporated. However, we have seen instances where some market participants have misinterpreted these disclosures, so I think the detailed wording of the text needs to be managed to ensure there is a clear message to the market. In the “note” to the Purpose section on page 1, “TSE is not necessarily expecting companies to use only these (share buybacks or increase in the dividend) or solve issues with a one-off response” cast share buybacks and dividend increases in a somewhat negative light. The meaning is that we do not expect one-off measures to achieve sustainable growth and a medium- to long-term improvement in corporate value. We should be clear about the fact that this purpose is about more than just raising the PBR in a short-term manner. We should not reject share buybacks and dividend increases where the decision to allocate management resources is based on the company's own growth stage and business environment. For example, how about saying “There are cases where share buybacks and dividend increases can be effective, but we do not expect the metrics that are set to be achieved solely through one-off measures.”? Also, the meaning of the text in the “note” to the Purpose section on page 1, “if shown as such by the company's analysis of whether the balance sheet effectively contributes to value creation” is quite difficult to understand. If possible, I would suggest this should be clarified further.

In addition, at the bottom of page 1, the phrase “specific details in whatever way they see fit” suggests that some companies are unsure what sort of disclosures they are required to make. In particular, I feel that there are many opinions from companies that do not have much contact with institutional investors. This is a topic to be dealt with after companies have made their disclosures, but it may be necessary to share best practices in disclosure and investor relations with them. In addition to compiling a collection of best practices, it might be an idea to organize lectures or study groups on management policies, the external environment and on how to present and communicate growth strategies by representatives from companies that set a good example on disclosure and IR practices, as well as any points of interest on the part of institutional investors.

Also, as I have said before, I believe that the delivery and communication of information regarding these disclosures will be important. Naturally we need to be aware of how this is reported to listed companies and investors, but we

should also consider how it is reported to the media, both in Japan and abroad, not only in terms of communicating our intentions correctly, but also in terms of clarifying and emphasizing the main points of the initiatives.

In addition, although this may be something to discuss at a later date, as I said at the beginning, in terms of conveying correct information, promoting understanding, and fostering expectations, I think we need to review these initiatives at a follow-up meeting once companies have made a certain level of disclosure. Looking at the stock market of late, as reported by major media, stock prices are rising due to positive expectations on this initiative. It is likely that companies will shift to a phase of active engagement in dialogue and implementation of the PDCA cycle. At the stage when companies issue their disclosures, I think it would have a positive impact on the stock market if there is a clear commitment at a follow-up meeting to follow through on this initiative using the same sort of PDCA cycle that is requested of listed companies to ensure that we can maintain our momentum for reform.

[Sampei, member]

First of all, I am not talking about the content itself, but the press has already got hold of the details and written that these will be published later today. If they have already written this, it implies that a decision has already been made. If that is the case then what is the point of having this meeting? It feels like a formality, so I would like TSE to be more careful about how it handles this kind of information, as I have mentioned before.

Aside from that, this document reflects the details of the comments made at the time of the original explanation and the details of the revision draft that I submitted, so I am grateful for that.

As Mr. Kumagai pointed out earlier, in Document 3, for the note to Purpose section, I submitted a draft of the revised text and the revisions made were broadly in line with this, so I felt largely responsible for this text. As Mr. Kumagai pointed out, thus far these proposals have made quite an impact in terms of press coverage and market reaction. It means that TSE has finally indicated that it will not let the overall PBR of the market drop below 1x. The market reaction suggests it anticipates share buybacks, but I think this is short-sighted. If that happens, the ratio will improve for a while, but the main reason why the PBR is below 1x is because companies are just carrying on as they are

without utilizing their balance sheets effectively. Share buybacks on their own do not lead to growth. Capital efficiency may appear to improve slightly, but that will not be enough to raise the PBR above 1x. So, although it is natural to start with balance sheet adjustments like this, I think there needs to be a more fundamental review. Therefore, I think that share buybacks and dividend increases “alone” will not work. What we want to see is fundamental reforms rather than one-off measures.

In the third point of the Purpose, best practice examples were also suggested, but there many reasons why a company may have a PBR below 1x and it depends on the company. Of course, there is also the simple reason that ROE is below the cost of shareholders’ equity. There can be various reasons for a PBR below 1x, for instance, if there is significant volatility and future growth expectations are limited, even if ROE exceeds the cost of equity, or if ROE is above the cost of equity now, but corporate value is not rising because there are no prospects that this will lead to growth or successful reinvestment in future. There are also different ways of resolving this. In that case, I do not think it is essential to rely on one-size-fits-all best practices, disclosure methods and formats and techniques.

In terms of the timing for starting these initiatives on page 2, I think what is written here is important, but the only part in bold is “as prompt a response as possible.” I think that “analysis and discussion of the current situation must be carried out sufficiently before” should also be in bold. Bearing this in mind, on the other hand, we emphasize “as prompt a response as possible” because companies should not delay on this, so I think it is a matter of balance between the two.

The style of the text on page 3 has been corrected, but I would like to add the reason for making the correction as it may not be so clear. The figure in brackets in the cost of equity is “rate of return expected by investors.” Since the revision of the Corporate Governance Code in 2018, cost of capital has received a lot of attention, and companies revisited CAPM at that time. However, although CAPM is a textbook method for calculating cost of capital, it is not actually used by investors when making investment decisions. If only it were that easy to find the appropriate value with CAPM. Managers at least know how to calculate it. For example, they know that when they carry out impairment tests they have to discount future cash flows to the present value using the cost of capital, but there is no sense this is a “real” measure. Because

they don't feel it's real, it is hard to have a dialogue. There is no appreciation of having to respond to dynamic change in circumstances, or there is no sense that the cost of capital is rising. If that is the case, dialogue will not work. Therefore we need to make this more intuitive and easier to understand. There needs to be more discussion about what kind of returns investors expect and require, and the reasons for this. I assume that is the meaning of "rate of return expected by investors."

[Ando, member]

I read the draft text objectively someone who is involved in corporate management, putting aside my role as a member of the follow-up meeting panel. In conclusion, I agree with the draft text since it is extremely concise and easy to understand. In particular, I felt there should be no room for misunderstanding by business managers, nor scope for them to twist the meaning and interpret it to suit their own devices.

I will now comment on the statements relating to shareholder returns highlighted by Mr. Kumagai and Mr. Sampei. I think the original proposals should be left as they are. This is because, looking back at corporate behavior immediately after publication of the Ito Review in August 2014, excessive shareholder returns were rife that were not in accordance with the aims that were set out. The intention of the follow-up meetings is to promote sustainable growth in corporate value. It is absolutely essential to avoid making corporate managers adopt a short-sighted approach and focus solely only on improving shareholder returns. In order to resolve the problem of a P/B ratio below 1x, the objective is to change the mindset of company management itself so that it exercises greater autonomy, as I explained in my presentation at the third meeting. Therefore, rather than dictating every move, the first step is to determine whether the issue of these requirements will lead to immediate changes in the way that company management behaves. If the demands on companies are excessive and broad, it is highly likely that the end result is a overly generalized initiative with no guarantee of effectiveness. In that sense, ideally we should create a virtuous cycle in which improvement of a company's management capabilities is appreciated by shareholders and investors who then hold the stock for the long term. I expect TSE not only to issue notices but also to provide specific support and follow-up, including seminars and

information briefings.

[Koike, member]

Given that the premise of the market restructuring is to raise and review the standards of the capital markets, corporate disclosure and investor engagement needs to work well as a condition for this. In this respect, I generally agree with the purpose of the original proposal.

In terms of the details, it is easier for investors to engage if they can utilize WACC, cost of capital, ROIC, ROE and so on as “examples of possible indicators” on page 3. However, assessments should not be made on the basis of a single year, but on a medium-term view, such as over three or five years. The figures can go up or down for various reasons, so it would be good to have some guidance on how this should be disclosed.

On page 4, it says: “provided in a form that is easy for investors to understand.” As such, it would be very helpful to have guidance on both a format that is easy for investors to understand, and on what sort of details investors are expecting. As was mentioned in the discussion on transitional measures, some companies make clear disclosures on how many years it will take to comply with the transitional measures, but if it is six to seven years, this is at odds with investor expectations. On that basis, we need to have a good understanding of what investors are looking for. We need engagement for that, but if the expectations of the two sides are too far apart to begin with, it is not practical to have a dialogue. I believe that disclosure is an excellent opportunity to promote engagement, so I would like to make proper use of this opportunity. On the other hand, we need to proceed efficiently, including in terms of what is practical, so it would be helpful to come up with a solution for this.

Page 6 mentions asking companies for updates. As was mentioned in the comments earlier, I think TSE should provide updates, whether via a follow-up meeting or some other format, to ensure that the PDCA cycle is in place to achieve the objectives, and to disclose progress against the objectives. CEO Yamaji’s commitment at the Japan Securities Summit was mentioned earlier, and English-language materials are available for the follow-up meetings. I understand and agree with the approach of communicating with overseas investors. We should think about how we can communicate these initiatives to investors and we need to create an environment for funds to come into the stock market. It is easier for us all to participate if engagement with investors on

the initiatives is strengthened.

[Matsumoto, member]

I agree with what Mr. Kumagai said about share buybacks and dividend increases. In fact, if you look at listed companies, there are some companies whose market capitalization consists entirely of their cash or liquid assets, such as securities, or who are almost in this position. Although it is true that share buybacks and dividend increases are not the only way for a company to grow, the reality is that many companies have built up an excess cash pile and do not derive a return from this. To express this, I think we cannot overemphasize that it is not just about share buybacks and dividend increases. We need to do what needs to be done. In that light, I think that the way in which today's documents have been written, or the way that Mr. Kumagai has referred to, is appropriate.

[Kanda, member]

I think this is fine as a document, but I would like to make two points from an institutional perspective.

The first point concerns the institutional position on this notice. For now, I think it is fine to position this as a request, but I think it would be better to eventually make this a regulation as part of the Corporate Code of Conduct. The second point is regarding the main points of "Action to implement management that is conscious of cost of capital and stock price" on page 2 of the press release in Document 2. I think the first paragraph is fine, but with respect to "management team is expected to take the lead" in the second paragraph, if we consider the role of the board of directors in terms of governance, I think it might be better to follow the wording of the Companies Act and say, "based on the basic management policy established by the Board of Directors." For example, why not put this before "management team is expected to take the lead"?

[Ando, member]

I would like to reiterate with full understanding of Mr. Matsumoto's position as an investor.

The priority for cash-rich companies should be investing for growth. Also, giving the wrong message to management is something to be avoided. No matter how much a company improves shareholder returns, this does not lead

to the creation of intrinsic corporate value.

Rather this is what investors should do through dialogue and engagement. If the strategies and policies disclosed by a company are inadequate, that company will not be a target for investment. But if the methodologies and means are wrong, this is exactly what investor engagement is for. Again, this measure is about shifting the mindset of companies towards autonomous value creation. If all they do is return profits to shareholders, the measure will be completely meaningless.

[Okina, member]

Thank you for reflecting the comments I made previously. I would like to make two additional points.

First, I would like to add the word “sustainable” to “contribute to growth” in the second paragraph of the Purpose on page 1 of Document 3. Investments in aspects such as intellectual property and human capital may not produce results in the short term, but they are extremely important, especially from the perspective of sustainable growth. Given the recent need for innovation in areas such as GX, I believe that initiatives related to intellectual property and human capital will ultimately lead to corporate sustainability. I think it would be good to include the word “sustainable” to convey this meaning.

The second point is related to Mr. Kanda’s comment. On the second page, the board of directors is described as the entity responsible for “analysis of the current situation.” I think it would be better to clearly state that it is also the entity responsible for “planning and disclosure.” Since “board of directors” is written in the press release in Document 2, it is important that the board of directors considers matters such as those described. I think it is also important to clarify the entity concerned so they can consider these issues to be within their own remit.

Also, in the last paragraph of the Purpose on page 1, it says “based on this disclosure.” I think that part should also be in bold.

[Kuronuma, member]

In the previous briefing, I said that everything was appropriate, including the wording. However, there have been some further revisions made, and I would like to share my thoughts on these.

With regard to the Purpose section on page 1 which states “While share

buybacks and dividend increases are considered effective means of improving profitability, TSE is not necessarily expecting companies to use only these or solve issues with a one-off response," I think it is good to sound a note of caution in the document because the market is expecting share buybacks and dividend increases on a short-term view and share prices are rising, but that is not the intention of these current measures. Ultimately, it is up to the companies to decide whether or not to buy back their own shares based on their own circumstances, so I do not think a slight change in the wording of the document would have a significant impact. However I do not feel that the way the draft is written gives a negative impression of share buybacks or dividend increases.

[Sampei, member]

I would like to talk in more detail about the Purpose on page 1.

If the text reads negatively about share buybacks and dividend increases, then the wording needs to be carefully reviewed, but I do not believe that these connotations are in there.

Firstly, with regard to the opinion mentioned by Mr. Ando that cash-rich companies should prioritize investment in growth, I do not think this is always the case from the market's point of view. There are respectable companies in the market with large market capitalizations where cross-shareholding stakes account for, say 30% of net assets, with investment securities making up the largest asset in the assets section of the balance sheet. Many companies, even in the manufacturing industry, have larger cross-shareholdings than tangible fixed assets. These companies have sufficient funds available for capital investment, but they retain cross-shareholdings, which are a very inefficient form of investment, with ROE of, for example, 2-3%. These companies need to restructure their balance sheets first, and sell cross-shareholdings to generate cash. However, if that cash cannot be used to invest in growth, then it makes sense to use it for shareholder returns and share buybacks. They should do this first, improve the efficiency of their balance sheets, and when they have decided where to invest, they should invest appropriately. If they have not yet identified where to invest and continue to review it, the option of holding cash or investment securities should not be overlooked.

For example, if the share price of a company with an EPS of 4, book value per share of 100 and ROE of 4% is 40, the PBR is 0.4x. An EPS of 4 and a stock price of 40 means an earnings yield of 10% on the market price, which is

the return expected by the market. In other words, as an investor, if you want a 10% return on a company with earning power of only 4, you can only buy it when the stock price falls to 40. The point of debate is that if the company halved its book value of 100 to 50, the ROE would be 8%. Would that be appropriate? Although the company has adjusted its balance sheet, if we consider whether this has essentially made it stronger or led to growth, that is not the case, so more fundamental change need to be made. This is not to rule out that companies should buy back their own shares. Companies that think they ought to do this should go ahead, but this should not be the only initiative. Even the company forces its ROE up to 8%, its prospects are limited if it does not carry out the reforms that need to be done. The market does not believe that 8% is sustainable on a long-term view, so the P/B ratio will not rise above 1x.

[Matsumoto, member]

For the avoidance of doubt, I am not saying that companies should just return profits to shareholders. It is hard to express clearly, but the meaning is that if a company is unable to invest in growth, it should return profits to shareholders. What Mr. Sampei said just now is important. I wish it could be written down as he said it, but since this would be quite long, I think the current text is fine.

[Kikuchi, Director, Listing Department, TSE]

Thank you all for your comments.

We will now move on to the second half of the discussion. We will explain about Documents 4 and 5.

[Monden, Manager, Listing Department, TSE]

I will now explain the documents.

First, Document 4 is about the disclosure on the status of dialogue with shareholders. To start with, this also provides the background and purpose of the objectives. As in the Purpose at the bottom, the request for disclosure is part of a response to improve the effectiveness of dialogue with shareholders. We expect that the parties concerned will cooperate through development of measures and organizational structures aimed at promoting constructive dialogue.

Page 2 contains a specific request, and we would like to propose that all

companies listed on the Prime Market provide continuous disclosure of the status of their dialogue with shareholders. The area outlined by the dotted line summarizes suggested disclosure items, taking account of details in the Corporate Governance Code. Not all of these need to be disclosed, but the expectation is that details will include, for example, who is handling the dialogue, what are the attributes of that person, what kind of content was discussed and what insights and feedback were gained from the discussions. It is envisaged that there may be cases where there is no actual record of any shareholder dialogue in the most recent financial year. In this case companies may be asked to disclose the status of their systems and initiatives to promote dialogue with shareholders.

Please go to page 3. Firstly, regarding the format of the disclosures, there is no fixed format here either. On the basis that the disclosures are made in the annual report or on a company's website, for example, we envisage that the fact that the information is being disclosed and how to view this will be stated in the corporate governance report. The same applies to the timing of implementing the initiative. We ask that this is implemented as soon as possible. What follows are the details of the relevant principles of the Corporate Governance Code for reference purposes.

Document 5 continues with the key points and case studies of "Explain." Page 1 has the Purpose, the second point is that there are some cases where "comply or explain" has become a formality, and the third point is that this document is intended to provide listed companies with material to encourage them to conduct voluntary reviews, including points to consider for their use of "explain" and case studies that can be used as a reference.

On the next two pages, to begin with we have three main points to be considered by companies for their use of "explain." Specifically, the first point is to clearly indicate what is not being implemented in terms of the principles of the "explain." In particular, where some aspects that are being implemented and some are not for certain principles, these should be clearly indicated. The second point is that where companies are not implementing measures, they should clarify their reasons for not doing so at the moment and why this is appropriate for them, taking into account their own individual circumstances. If alternative measures are being taken, these should be described along with the reasons for them. The third point is that, if a company plans to comply with the

relevant Code in the future, they should specifically indicate the status of their review for implementation of the measures.

These can be considered as key points for the “explain.” TSE carried out a survey on the actual use of “explain” by listed companies from the perspective of whether the explanations are in accordance with these points. The “Types of explanations considered insufficient” that were found in the survey are summarized on the next four pages. There are three specific points: Firstly, (1) The text does not allow clear understanding of why the company chose to “explain” because the description of what part is not complied with is unclear. (2) The text simply says that the measures are “under consideration” without stating the reasons for non-compliance or the specific circumstances. (3) The text is an abstract explanation that links together phrases from the Corporate Governance Code from start to finish, with no mention of individual circumstances.

The slides that follow present sample explanations, both insufficient examples as referred to just now, and, conversely, best practice examples which avoid the pitfalls described. Page 5 shows examples where there is no mention of the measures that have not been implemented and the status of compliance is unclear. Page 6, on the other hand, shows examples that clearly indicate which measures have been implemented and which have not. As shown on page 6, if there are details that are not implemented for a particular principle, and details that are implemented, investors can get a better understanding of a company’s status of compliance if these are clearly highlighted.

Page 7 shows examples where a company simply says the measures are under consideration without stating any reasons for non-implementation. It would be hard to say these explanations are adequate. As shown on page 8, it is preferable for a company to specifically describe the reasons for non-implementation and the specific status of its review, taking into account its own individual circumstances.

Also, page 9 shows an example of exactly the same explanation being given for three consecutive years, as was pointed out at a previous meeting, without any update on specific progress, while stating that these matters will be considered in future. On the next page, Page 10, we show the aggregate results of how many of these cases were found. Around 10% of the explanations were in this category. Page 11 shows some best practice examples. If, as is the case here, a company decides to conduct a review at some point in the future, we

would like it to provide an update of status and progress of specific reviews in subsequent updates.

Page 12 shows examples of the third type of insufficient explanation, namely an abstract description with no reference to specific circumstances, which makes the explanation less convincing for investors. Page 13 shows best practice good examples. We think these explanations are easy to understand for investors, with specific references to the companies' own situation and to alternative approaches. These are the key points and examples of explanations, which we are making available to all listed companies as preliminary material for internal review purposes. Rather than simply providing a guide to listed companies, TSE would like to also follow up with listed companies on a regular basis to ensure that the Code's "comply or explain" approach is a tool that promotes a constructive dialogue.

That is the end of my explanation.

[Kumagai, member]

Firstly, with regard to Document 4, "Disclosure on the status of dialogue with shareholders," the opinions of the follow-up meetings to date have been carefully incorporated, and I generally agree with them. Although this is quite detailed, I would be interested to know what "overview" of the shareholders you are assuming in the outline on page 2. For example, in terms of attributes, what about considering investment style, net assets and shares held?

Based on feedback from listed companies, they seem to be struggling with the details of these disclosures, so it would be good to have a review of this in follow-up meetings and to hear from company representatives once more progress has been made on the disclosures in corporate governance reports. In particular, companies that do not have much dialogue with investors or that do not have a system in place need more support. I do not think that many of the 1,800 companies listed on the Prime Market are able to get the opportunity for dialogue, so it would be useful to tell them how to get this dialogue going. For example, I think that improving IR and disclosure materials can pique investors' interest and help lead to a dialogue. We could also consider sharing best practices for establishing a dialogue from both companies and investors.

Next, I also agree with using "explain" to contribute to constructive dialogue in Document 5. It would be useful for companies to take a close look at their "comply or explain" status again. TSE should also review the situation on an

ongoing basis by thorough analysis of text from companies and by other means in order to encourage improvement. In addition to TSE's review of corporate governance reports, we ought to let listed companies know the assessments and perspectives of investors and analysts. This is more of a topic for later on, when companies' corporate governance reports are available, but we could consider, for example, including analyst and investor assessments when compiling a collection of best practices for corporate governance reports. Sample disclosures of matters concerning business plan and growth potential, which are a requirement for the Growth Market, include the views and assessments of analysts and investors. It would be of great help to listed companies to show how corporate governance reports are used for making investment decisions.

[Monden, Manager, Listing Department, TSE]

Regarding your question on page 2 of Document 4, with reference to the "Overview of shareholder (attributes, etc.)," the first assumption is that the disclosure of the names of companies or individual shareholders is not required. On that basis, "attributes, etc." covers a wide range of details. Specifically, for example, we envisage that classifications such as domestic or foreign investor, or institutional investor, should be identified. I do not think points such as value of net assets or investment style, as pointed out earlier, should be mandatory for inclusion, but these can be considered useful, so I assume these are the kind of details that could be included.

[Matsumoto, member]

Firstly, with regard to Document 4, the first part of the document contains Principle 5-1 of the Governance Code, which states that "To the extent reasonable, the senior management..." However, the issue is that often this is not done properly. In fact, people often say that investors cannot really have a dialogue with independent directors or corporate auditors. I think the intention is to remedy this and bring this in line with Principle 5-1 of the Governance Code.

On that basis, in the Purpose at the bottom of page 1, there is the phrase "not simply for the purpose of making disclosures." This is similar to the earlier discussion of share buybacks and shareholder returns, although the meaning is slightly different here. In this case the meaning is that just making disclosures (and nothing else) is out of the question. I do not think that making the

disclosures should be all that is required. The way that the Purpose are written is to promote dialogue, and the second half of the section says that the intention is establish a review of the development of systems and initiatives to promote a constructive dialogue. Disclosures are a measure to encourage this, so I think the main and secondary points are reversed here. It would be too much to correct the whole document, so it is fine as it is from page 2 onwards. However, the title of the document is “Disclosure on the status of dialogue with shareholders” which implies that there is something that needs to be disclosed. I believe that the cover should be changed to say something like “Promoting dialogue with shareholders” and the current Purpose section should be reordered so that it conveys a clear message that “Dialogue is important” and that companies should “act as appropriate in line with Corporate Governance Code Principle 5-1.”

I would like to comment on the “explain” of Document 5. I have served as a representative of a listed company for 23 years. I have to say that the explanation section is not necessarily a section that management focuses its attention on. I pay a lot of attention to the use of capital and dialogue. However, this might just be my own problem, but I do not think that the explanation section of the “comply or explain” comments in the governance report gets a lot of attention, since there are so many other things to be getting on with. Surprisingly, this section is often prepared by whichever officer or department is assigned to do it, and the senior managers just let the text go through as it is. With respect to the notification sent out to representatives of listed companies by the president of TSE, which was referred to at the start, this was not properly read by company managers. It was just left to the person or department assigned to do this to deal with. However, this is also a very important part of the reforms we are working on, so it is important that we highlight this to company managers. It is hard to express this, but based on experience I think it would be good to emphasize this in some way, for example by stating clearly during the press conference, that company managers should pay close attention to this explanation.

[Sampei, member]

I would like to make three points regarding Document 4. Overall, I think the document is very well organized.

On page 2, for the “Overview” section, which we talked about earlier, I would

like to make a point on the section called “Overview of shareholders (e.g. Attributes)”. I think it would be good to clarify in the notes what is meant by “Attributes,” such as was explained by the Secretariat earlier. This is because, as described previously, the distinctions between domestic and foreign investors, investment style, and passive or active investment are important in this context. In addition to that, although investors are a cohesive group, the dialogue will vary depending on who participates and who we talk to. It depends if you speak to a fund manager, an analyst, an ESG manager, or a proxy voter. For example, if the only “dialogue” we hear of is with proxy voters when voting takes place, this would be quite different. It is not always necessary to put these aspects writing, but I think it would be good to state these kinds of distinctions as attributes. By stating details like this, companies would be able to get a picture of who they are engaging. These days companies are often not particularly interested in who they are actually speaking to, and do not look into this any further. They just say “We had a good meeting today” or “We did not have a good meeting today”. Therefore, to make it easier for companies to understand who they are talking to, I think it would be good to make note about, for example, what they understand as the key characteristics of the people they speak to. One of the most important attributes is investment style, for example Growth, Value or Dividend-oriented.

The other point to make is on the section marked as Note 1. Here, it says, “This is a summary of matters that may be disclosed.” I think the meaning is that this is not an exhaustive list. Therefore, it would be better to clarify “These are examples of items that can be considered for disclosure”, or to indicate from the outset that “there is no requirement to limit disclosures only to the stated items, since other disclosures are useful” as it is good to have different perspectives. You mentioned best practice earlier. I think that best practice will increasingly develop with these kinds of initiatives. I think it would be good to have these details and then follow up by saying these are “not necessarily all the items...”

The text on Page 5 is from the Code, so there is nothing to correct here, but there is a section that I would like to see highlighted by putting it in bold. It relates to “support” in item (ii) of 5-1.2, “with the aim of supporting dialogue” Although the wording states “support”, some companies say, “These are IR matters” or “Voting rights are a matter for our General Affairs Department (=SR).” IR staff and others are there for “support”, and the section above that says “senior management and directors, including independent directors” is

very important, so it would be helpful if you could emphasize "support" and put this in bold, to stress again that (ii) only refers to "support".

And I would like to make a point on page 2 in the explanation section of Document 5. I do not think that the definition and purpose of the explanation has been clearly stated since the establishment of the Corporate Governance Code. I read the section again, including the introduction, and I did not think that the definition of the explanation was clearly described. I think that it should be defined somewhere. For now, in the title "Using "explain" to contribute to constructive dialogue," it would be good to write something like "Based on principles, where a company aims to achieve the objectives using a method or means that differs from the recommended method, it should give an explanation of this." The meaning is that "The objectives apply for all companies as a principles-based approach, and the Code describes the method. However, this method is only a principle. So if a company can achieve the same objective with a different method, that is fine." Non-compliance with the Code because of not wanting to attempt to achieve the objectives is not the original point of the explanation. We need to clarify this before requesting companies to explain their own individual circumstances. If a company says it is moving in a different direction to the objectives, this is not an explanation based on the principles. I think clearer guidance could be given on these points.

[Koike, member]

Looking back at this discussion, it really seems to be a review and summary of the Code, and it reminds me how important our efforts on this are. Regarding the documents, the details are as have been pointed out, and I agree with the general opinion. Based on this I have a few comments.

First, as institutional investors, we are required to undertake a dialogue. Furthermore, there is a need for effective dialogue. Here, too, I think it is necessary to pay attention to the disclosure of initiatives and corporate information that lead to effective dialogue. I may have commented on this before, but there is a marked polarization between companies that engage in dialogue and disclosure and those that do not. One major point is whether we should focus on companies that are ready to comply with this, or whether we should target those that are not. For example, there are probably three broad categories: companies that engage in disclosure and have a dialogue with

shareholders; companies that make disclosures but do not have a dialogue; and companies that do neither of these. After all, we need to help those companies that are not doing these things. We need to give them guidance, potentially using a very different message to that used with those who are already engaged in disclosure and dialogue. In fact, my own impression is that, in terms of numbers, there are a quite a lot of companies that are not doing these things. I feel that finding a way to efficiently and effectively provide guidance to this group of companies is potentially a key part of this initiative.

I would be very grateful if TSE could think of some way to provide such a forum. For example, the Securities Analysts Association of Japan, of which I am chairman, together with TSE, set up a corporate IR forum for more than 1,000 companies before the COVID-19 pandemic, and approximately 500 companies during the pandemic itself. Even if it is 500 companies, or 1,000 companies, this is still well below the number of companies that we assume need to use this facility. However, if a lot of these companies wanted to participate in this type of initiative, there could be capacity issues and other problems. Whether or not TSE also provides these companies with IR or engagement opportunities, if there was a forum for guidance and developing an understanding of the situation to trigger a dialogue with investors, this would be helpful for investors, and would give them an opportunity to participate.

It is also my impression that there are many different ways to look at this, but companies' and investors' opinions vary significantly, so I do not think they are necessarily all consistent. That is why we think it would be helpful if TSE could also conduct reviews as part of the PDCA cycle mentioned earlier. And if there were any misunderstandings on the part of the companies, TSE could issue a warning to highlight this, and communicate with them and the market to convey the message that this is not what was originally intended.

[Kanda, member]

In terms of the dialogue, as I said before, since this is addressed as much to the institutional investors as to the companies, it would be excellent to have a paragraph at the bottom of the press release in Document 2.

On that basis, I would like to make two points about Document 4, although these may be irrelevant since I do not know the full picture.

The first point may be linked with what Mr. Koike has already mentioned, but there are 1,800 companies on the Prime Market. In terms of communicating all

the content of Document 4 to 1,800 companies, it may be that half of the companies are not engaging in any dialogue. There is a risk of striking out, so we need to be a little careful about how we go say this. Anyway, we need to take this step-by-step. You could say that, first of all, we need to establish a system, or something similar. It would be impolite to describe companies as being inferior or subordinate. There is no good way to describe them. I think that the notion that all 1,800 companies should comply with this is an aspiration and is consistent with the concept of the Prime Market, but my sense is that it is not realistic. However, I think the document should be left as it is.

The second point, and again I do not know the full picture here, is about whether dialogue and engagement are initiated originally by the company or by the investor. I understand that this was also a point of discussion when Corporate Governance Code and the Stewardship Code were established. From the companies' point of view, approaching investors is traditionally the area of investor relations; however, approaching companies from the investor side is more important in relation to the Code, if that is the right way of putting it. So I think the main point is that if an investor makes an approach, the company should respond appropriately. I think both sides are important, but it is difficult to distinguish between the two in the document.

Also, one comment about the explanation. The fact that "to be considered in future" remains unchanged in the explanation for three years, and that this explanation applied to 10% of the companies is puzzling. The principle of "Comply or explain" in the Code is set out as something that must be complied with in the corporate Code of Conduct, so failure to comply or explain is a violation of listing rules. At least this is how the procedure works. Although I think that when the Code was first introduced, this principle was applied a little more loosely, I think it is fair for the exchange to say that a company is not complying as it should be if the matter is described as "to be considered in future" for three years in a row. Regardless of whether or not to implement measures to ensure effectiveness, my sense is that this point could be emphasized more strongly.

[Ando, member]

First, regarding the first of these latter themes, dialogue with shareholders, given that companies engage with disclosure of information and IR matters to varying degrees, one wonders if there is any point in disclosing the status of

implementation of dialogue with shareholders. First, it is important to make company management aware of dialogue and the engagement that follows this as a way of recognizing their strengths and issues. Otherwise, it is possible that measures on disclosure related to shareholder dialogue will not be effective. Therefore, it is a good idea to try them first and then assess the results.

Furthermore, as Mr. Kanda pointed out, there is also a need for a perspective on how investors should approach the issues in accordance with the objectives of the Stewardship Code. This is not a topic for a follow-up meeting, but I would request that it is discussed another time, since it is a vital component for improving corporate value.

I would like to make a second point concerning the explanation section. Since the Corporate Governance Code was introduced in June 2015, it has already been revised twice, every three years. It is true that in some companies there is a reality that can be called “compliance prioritization.” This is the desire to find a basis for compliance as a formality. In this sense, we need to put the spotlight on the explanation, in other words, to encourage a shift in thinking, that compliance in itself is not necessarily a good thing so much as being aware of the circumstances of your company, and if there are issues, providing an explanation. However, it may be difficult to immediately change items that were previously complied with and incorporate these in the explanation.

Nevertheless, both of the measures described here are processes to improve the quality of corporate management in line with the aims of the Corporate Governance Code. As I said before, it is a good idea to try these out first.

[Okina, member]

Firstly, for Document 4, as Mr. Matsumoto has mentioned, it is better to clearly state “promotion”, as in “Promotion and disclosure of dialogue with shareholders.” I think the objective is not only to request disclosure.

Moving to page 2. With regard to attributes, I am also an independent director. As you have already mentioned, there will always be debate about what we need to write. There should be specific examples of attributes, such as passive/active, international/domestic, and so on.

It is also important to note that, as Mr. Sampei said, it should be stated that not all items have to be disclosed. Overall, it is important for TSE to clearly

communicate what it is looking for in the explanation section. In particular, it should communicate in an easy-to-understand manner to companies that do not engage in dialogue that it is urging them to start a dialogue and that they can improve their corporate value by doing this.

As other members have mentioned, we expect the same kind of approach from institutional investors. This is mentioned in the press release, but I would like to ensure that this to be properly communicated.

Regarding the point about “explain” in “Comply or explain,” I totally agree. There are quite a few companies that tend to take an easygoing attitude to compliance. Rather than that, I think it would be better to explain this properly in the explanation section. It would be good to send out a clear message that with 1,000 or 2,000 companies they do not have to think exactly the same way, but rather that a proper explanation needs to be provided in the explanation section. In order to avoid a decline in quality of explanations, it would be good to communicate that “comply or explain” is a fundamental principle, and that a clear commentary is expected in the explanation section.

[Sampei, member]

I would like to make a data-related point in relation to Mr. Kanda's earlier comment. It was pointed out that it is difficult for 1,800 companies listed on the Prime Market to engage in dialogue. GPIF published a report on its stewardship activities just yesterday. Between January and December 2022, 946 companies were engaged in dialogue with investment managers entrusted by GPIF. I think they worked hard on this, covering 946 companies (representing 94% of the market in terms of market capitalization). I think that GPIF has largely achieved its goals from the perspective of an investment manager. So, I do not think it is a realistic expectation that all 1,800 companies engage in dialogue.

In terms of whether the approach should come from the company or the investor, I think the approach can come from either side. However, the first step if approached by an investor is to respond properly, as stated in Principle 5-1 of the Corporate Governance Code, and not to refuse.

My experience is that when companies approached me, it often seemed to be something like a request for feedback on the quality of the integrated report, for example. However, it is not possible to respond to all of these kinds of approaches. The point of the dialogue is not the quality of the integrated report,

but the actual measures implemented. To be honest, I sometimes had to decline dialogue if this was the only feedback requested.

Unfortunately, we are encouraged to give this kind of feedback, but if asset management companies end up having to respond to requests like this, we will end up with a lot of pointless dialogue and it will be difficult for asset managers to run their own businesses. I have made this comment because I wanted clarification from the perspective of which approaches to accept and what to prioritize.

[Kuronuma, member]

With regard to Document 4, as we have already discussed, the main objective is to promote dialogue with shareholders, and disclosure is simply the end-result of this. However, there is no point in simply making companies disclose their policies concerning whether or not they promote dialogue with their shareholders. There are good reasons to ask companies that have a track record of dialogue to disclose their status of implementation of dialogue, and, if they have no track record of dialogue, to ask them to disclose the status of their efforts to promote such a dialogue.

I also think you are right that not all the items that could be requested are required for disclosure purposes. However, I do not think there are any issues with stating these items, for example a summary of the main participants and shareholders, main themes, and the status of implementation of feedback. Therefore I think it would be good idea to request disclosure of these items. However, even if disclosure is not requested, I believe that companies that engage in dialogue will supply information voluntarily, so I think that the text in the original proposal should be left as it is.

I think the points and examples in the explanation section are well summarized and I hope that the explanation can be further enhanced in future. For many of the companies listed as having their disclosure policy “under consideration,” this is probably because they would like to comply in future, but do not have a system in place.

I believe that if the explanation section is properly set out, that is fine. I think that we need to improve the content and get rid of the phrase, “under consideration.” I do not think that all companies are requested to comply with the principles of the Code.

[Koike, member]

I would like to thank all the members for their opinions. I am keenly aware that the investors as well as the companies need to make a considerable effort on dialogue. I think there is a disparity in levels of engagement among different investment management firms depending on their size. Also, as Mr. Sampei pointed out, I also feel that there is a capacity issue, but I do not think that we will suddenly receive calls from all 1,800 companies asking to engage in dialogue. As Mr. Kanda mentioned, I would like to see a workload set out for promoting this approach in stages, and for the companies to think about this.

I also feel strongly the investors need to make an effort to turn this in the right direction to ensure that our discussions at the follow-up meetings are not meaningless. However, I would like to ask for the provision of the forum that was mentioned earlier in order to promote an efficient and effective dialogue.

I believe that the original purpose of this project is to promote a process of regeneration and improvement, by seriously promoting these initiatives on the part of both companies and investors, with companies dropping out if they do not buy into them or comply sufficiently.

[Kikuchi, Director, Listing Department, TSE]

Thank you very much.

To conclude, we will have an explanation on the outlook for the Growth Market in Document 6.

[Monden, Manager, Listing Department, TSE]

Document 6 summarizes the opinions gathered in the previous meeting by category regarding the points of debate concerning the Growth Market.

Page 3 summarizes the comments on future actions and the plans based on these. As you can see below, at the previous meeting, from the perspective of demonstrating the capabilities of the Growth Market, a number of points for discussion were raised, such as eligibility criteria for listing, support of growth after listing, information disclosure, and utilization of the professional market.

As for the future actions, we would like to take the discussion further by conducting a questionnaire survey of listed companies in the Growth Market regarding post-listing issues, as well as doing interviews with institutional investors, venture capitalists, and start-ups in relation to the issues raised in the

previous discussion. We also expect that the questionnaire for listed companies will be launched some time after April and the results will be reported at the follow-up meeting. Those are my brief comments.

[Kikuchi, Director, Listing Department, TSE]

Do you have any questions about what has been explained?

[Okina, member]

This does not have to be at the follow-up meeting, but I would like it if there were interviews with overseas investors as well as domestic investors, and if we could share the views of the foreign investors.

Also, in order to proceed, I think it would be good if we stick to what we are actually able to achieve as the basis for reforms. I would like us to proceed on this basis rather than waiting until the final report comes out.

[Sampei, member]

I would be very grateful if we can proceed with the stated measures concerning the plans for dealing with these matters.

In this context, regarding the questionnaire for companies listed on the Growth Market, I assume that we will have a discussion of the results after conducting the questionnaire. I would just like to check if there is any scope to discuss the actual content of the questionnaire at the follow-up meeting before it is sent out to the companies.

[Ikeda, Senior Manager, Listing Department, TSE]

As you have indicated, the content of the questionnaire will serve as the premise for our future discussions. To ensure we have a constructive discussion we should proceed on the basis of confirming/discussing the actual content of the questionnaire at the next meeting, and then carrying out the survey.

[Matsumoto, member]

The importance of involvement on the part of institutional investors outside the Growth Market has already been highlighted. I agree with that completely, but in Japan, the Stewardship Code and other codes have been established for institutional investors. The Financial Services Agency is also participating today, and I hope that TSE will not only put measures in place for, but also promote

initiatives in cooperation with the related parties.

[Kikuchi, Director, Listing Department, TSE]

Now I declare today's meeting adjourned.

Finally, I will explain the schedule for next time.

[Ikeda, Senior Manager, Listing Department, TSE]

Thank you very much for the lively discussion again today.

First of all, regarding Documents 2 to 5 that were discussed today, as usual, after the meeting ends (at 11:30), these will be made available on the website as reference materials.

We would also like to promptly reflect your comments on the press release and notice to listed companies and, if possible, contact all listed companies today by way of the notice. The finalized version will be sent out to you by email.

The agenda for the next meeting will be explained to you separately.

[Kikuchi, Director, Listing Department, TSE]

With that, I hereby declare today's meeting adjourned.

Thank you very much for your participation today. We look forward to talking to you all again at the next meeting.

END