# Notes on Media Briefing by Atsushi Saito, Director and Representative Executive Officer, Group CEO, Japan Exchange Group, Inc., on December 16, 2014

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## 1. Corporate Governance Code

First, as you may know, the draft of the Corporate Governance Code has been compiled by the council of experts last Friday, and the Council is calling for public comments. The draft will be formalized after the necessary steps are taken.

The revitalization strategy of the government calls for a code that aims to attain international reputation while reflecting the circumstances of Japanese companies. Although this is an extremely high hurdle, careful deliberation has resulted in a well-balanced draft.

Previous discussions on amendments to the Companies Act stopped at encouraging the appointment of one outside director, whereas the Council recommends the appointment of more than one independent outside director. This is on par with that of the code's origins in the UK, and we should welcome the outcome of the discussions.

Compared with other countries, this development may have come slightly late, but it should still allow us to stand in the same arena. The Code is expected to be incorporated into the listing rules and require listed companies to provide explanations for non-compliance. Since the Code was drafted with the understanding of the business community, I believe that it is only a matter of time before we see listed companies appoint more than one independent outside director. However, we should remember that substance is just as important as numbers.

After appointing the appropriate people, it is important for corporate managers to adopt a mindset that sets out to effectively utilize the system in ways including listening to the opinions of independent outside directors in good faith. I hope the Code will help the spread of corporate governance driven by such a mindset among corporate managers. Companies used to be evaluated based on whether they appointed outside directors, which was a very superficial factor. Going forward, I believe that the market will move toward examining the substance and evaluating the attitudes of corporate managers toward governance.

2. Tick size optimization program

The next topic is about the tick size optimization program. On July 22, we introduced JPY 0.1 and JPY 0.5 tick sizes for issues priced JPY 5,000 or less for the highly-liquid TOPIX 100 constituents. We have decided on how to implement them for next-generation arrowhead, which is scheduled to launch next September.

The small tick sizes will continue to be applied only to TOPIX100 constituents. Tick sizes for certain price bands will also be changed. For example, for issues priced above JPY 3,000 up to JPY 5,000, it will be changed from the current JPY 0.5 to JPY 1.

Please refer to the handout for details. Analysis of the trading conditions shows that there were noticeable trading cost reductions for high-liquidity issues. However, the effect was limited for issues of lower liquidity, even though they were constituents of TOPIX 100. As such, we have decided not to expand the scope of issues subject to the small tick sizes. For example, for many issues priced above JPY 3,000 but less than JPY 5,000, the spread between bid and ask quotes was more than JPY 0.5. Therefore, we will change the tick size to JPY 1.

This concludes the pilot program. However, since smaller price increments reduces trading costs for a wide range of investors, and our calculations show estimated cost reductions of more than JPY 300 million every day, we will continue exploring appropriate tick sizes, taking into account investor needs, characteristics of listed stocks, and trading conditions. Further information will be provided after this briefing.

3. Looking back at 2014

Since today is the last media briefing for the year, I would like to take a quick look back at 2014. It has been almost two full years since JPX was established last January. Following the integration of the cash equity markets and consolidation of self-regulatory and clearing functions last year, we completed the integration of derivatives markets in March. The integration streamlined the market infrastructure in Tokyo and Osaka, which reduced usage costs and enhanced convenience for market users. I would like to express my sincere appreciation to all market users for their understanding and cooperation in helping us to successfully complete the integration as planned.

Stock prices, weak from the outset, were generally low in the first half of the year with the Nikkei Average dipping below JPY 14,000 (JPY 13,885.11, year-to-date low on April 11). The market then picked up and remained strong for the latter half of the year. Stock prices exceeded JPY 18,000 for the first time in about seven years and ten months since February 2007 (JPY 18,030.83 on December 8).

TSE 1st Section market capitalization was JPY 505 trillion at the end of last month, exceeding JPY 500 trillion on a month-end basis for the first time in about seven years and one month since October 2007. During this period, the market capitalization doubled from a low of JPY 246 trillion, which it shrunk to in February 2009.

Daily average trading value for the 1st Section, including off-auction, was about JPY 2.4 trillion. This was the second highest level since the Lehman Shock, after last year's approximately JPY 2.6 trillion achieved in booming conditions. Stock prices rose more than 60% since the inauguration of the Abe administration, the largest gain in the world.

The number of IPOs this year is expected to increase by 22 from last year to 80. The number has increased for five years in a row since bottoming out at 19 in 2009. Underwriters and market users are expecting around 100 IPOs next year.

Including today's five new listings, December has been the busiest month with 28 IPOs, and the momentum looks set to carry into next year. Moving away from IPOs, 114 stocks have moved up into a higher market section, such as from Mothers to TSE 1st Section. It is the first time that more than 100 companies have made the step up since the current rules were introduced.

For ETFs and ETNs, 21 issues were listed. Of them, five issues are linked to the JPX-Nikkei 400 index launched this year. The overall market capitalization of the 190-strong ETF market was about JPY 38 trillion, (domestic ETFs accounted for about JPY 10 trillion). With the growing use of leveraged/inverse ETFs, trading value grew rapidly, and the daily average trading value reached a record high of about JPY 130 billion. The value was roughly JPY 30 billion before the launch of leveraged/inverse ETFs, which means it has grown more than four-fold.

For J-REIT, six issues were listed, including the first healthcare REIT. The J-REIT market started with two issues in September 2001, and the assets under management were only office buildings. They gradually began to cover a wide range of facilities such as commercial, logistic, housing, hotel, and research facilities. Now, there are a variety of J-REITs with 49 issues and more than JPY 10 trillion in market capitalization.

That was a quick recap of the market. As for us, we made efforts to enhance the functions of the capital market in cooperation with market users. In addition to drafting the Corporate Governance Code and optimizing tick sizes, we launched the new JPX-Nikkei 400 index at the beginning of the year.

It has been extremely well-accepted as a new investment benchmark by institutional investors including GPIF, public pensions, and private institutional investors. As I said, five ETFs tracking the index have already been listed. If we include the 22 publicly offered investment trusts, the amount of assets tracking the index has grown to more than JPY 400 billion. It had already exceeded JPY 100 billion in May, which is quite high-paced growth.

Futures contracts began trading on Osaka Exchange on the 25th. More than 70,000 contracts were traded on the first day. Trading has continued to be active, with some days seeing more than 200,000 contracts traded. Only three weeks have passed since its launch, but it is a fairly good start.

As I have already talked about trading hours last month, I will not go further into the topic, but unfortunately, the decision was made to not extend trading hours. The report and comments gathered in thorough discussions are highly valuable, and I believe that they will serve as reference for the future. I am not sure when we will consider this matter again, but securing fair price formation while providing fair trading opportunity is an important issue that is worth revisiting in the future.

Next year will be the third year for the Abe administration. It can be understood that the results of the Lower House election the day before yesterday showed that the government had obtained a mandate for Abenomics. As such, future policies will draw people's attention.

The market has so far been driven by expectations for Abenomics. Henceforth, we will see conditions that reflect an assessment of the true value of Abenomics based on its substance and achievements.

GDP figures for the July-September period announced on the 8th last week were adjusted further downward from the preliminary figures released last month. The tankan (business sentiment) survey also seems to show that there is no reason for optimism in the economic outlook. However, the interim earnings reports of companies listed on the TSE 1st Section showed that net income exceeded the record high of JPY 14 trillion. The figure was about JPY 6 trillion before the Abe administration, so it has more than doubled, increasing by as much as JPY 8 trillion. During the period, the yen depreciated by about JPY 20. Economists say that the depreciation has boosted corporate profits by roughly JPY 1 trillion. As such, estimating the impact, actual profit has increased by as much as JPY 7 trillion. As the current share prices show, investor expectation for Abenomics is extremely high.

I hope that the Abe administration steadily implements the growth strategy to change investor hope for Abenomics into a firm belief. Moving forward, we will draft the Corporate Governance Code, aim to launch the next version of arrowhead smoothly, further strengthen efforts to attract new listings, and establish an infrastructure market.

Q&A:

Q: As you have just said, the ruling party won as expected, but for the stock market, another concern for the world economy is emerging due to the impact of falling crude oil prices, and the market outlook is drawing attention. Could you share your view, including the impact of such low oil prices, on the Japanese economy and the market?

A: I do not have a detailed analysis on low oil prices, but I understand that it can bring substantial benefits to the Japanese economy. Since there are issues with the import cost of oil for power and price negotiations, and the contract being long-term, the benefits to Japan should be enormous because natural gas prices are based on oil prices.

The market has been slightly weak these few days, but I do not think this is simply due to low oil prices. Different people have different views, but the election results reflect expectations and a renewed mandate for Abenomics, and the government now has to meet expectations, which is a daunting challenge. The government cannot rely on monetary policy forever. History proves that this situation is unsustainable. The government has to loosen the regulatory bedrock during its term. With such a seat majority, the administration should be able to do whatever it needs, even if it results in some pain or discontent.

Comparing the current situation to a book, the table of contents is now complete. You can see a very good list, but if you flip through the pages, some parts remain unwritten. The stock market will reflect sentiment from close scrutiny of how the story is written. A well-written story will be highly valued, whereas an excellent table with no content will face harsh criticism. The stock market is very realistic. Matters such as TPP, agriculture, employment, healthcare, and fiscal reform are what Japan has to truly tackle. Prime Minister Abe has to lead everyone to go through the painful process. I will highly appreciate Abenomics if there are moves to help people prepare for future generations.

Q: The Ministry of Economy, Trade and Industry has a committee on corporate information disclosure, in which TSE participates. There is opinion that companies should not disclose earnings forecasts, and securities companies definitely do not disclose earnings forecasts. Earnings forecasts are vital for making investment decisions, especially for retail investors who do not have much access to information. Could you share your views on this?

A: It is a very complex issue. Besides those on earnings forecasts, there is opinion that a wide range of exchange rules should be revised to enhance convenience. We want to respond as far as we can, that is why we take part in these sessions. In terms of being a tool for investment decisions, some companies say that earnings forecasts are unnecessary since they already disclose actual earnings every quarter, whereas analysts say it is necessary. Each side has its own position and it is not easy to comment on this. We ask companies to revise their forecasts if the deviation from the forecasted figures is likely to exceed a certain range. I think such revisions are necessary. At any rate, it is a difficult issue.

Q: My question is about the Governance Code. Will the TSE rules be written after the draft has been finalized? Is there a timetable or something similar to a schedule?

A: We would like to finish preparing the TSE rules by February. Some would like the rules to be ready in June. We will do our best to write the rules as quickly as possible. We need to consult the Advisory Group on Improvements to the TSE Listing System on matters such as the definition of independent directors. We will move to quickly discuss them and work to present the outcome around February.

Q: There is the issue of lack of people eligible as outside directors. Some say that the number of high-level public sector officers moving to the private sector will end up increasing. What are your views on this?

A: This may not applicable from a long-term perspective, but if companies are unable to find appropriate people next June, as the Code suggests, comply or explain, so they will have to explain. A proper explanation will gain the understanding of shareholders.

Q: How should we increase this pool of people?

A: There are various organizations offering a wide range of seminars. A staffing firm said that there are many people registered as outside directors and that there are many requests for such directors. I don't want to say that there are few people in Japan qualified to be outside directors because that's unacceptable.

Q: Finally, the Securities and Exchange Surveillance Commission recommended a fine based on findings from an investigation regarding closing price guaranteed transactions associated with the rebalancing of the Nikkei Average. Even though TSE has been closely monitoring price movements associated with index rebalancing and conducts self-regulation, the problem arose. Aside from individual cases, there are individual stock prices that rise significantly with Nikkei or other index rebalancings. What are your views on this?

A: It is normal fare for this industry to have various indices across the world that are rebalanced. Various accidents and incidents associated with them occur. Therefore, we are very careful in handling the related information and, especially, monitoring price movements. I understand that the matter in question was detected and reported by JPX Regulation. We conduct very careful monitoring, especially for significant market events such as index rebalancing.

Q: You mentioned that stock prices rose due to expectations and now those expectations have to be met. What do you think is the most important matter for which the bedrock regulations have to be cracked?

A: All the items that Prime Minister Abe has raised are very important, and it is difficult to rank them. Among them, TPP is probably the issue that the media is paying attention to. Unless the US and Japan handle it properly, there will be various consequences. Agriculture is another critical issue. If discussions return to the distribution theory, to be honest, it has no future.

Japan is suffering from an illness which cannot be treated solely with long-term public investment or monetary easing. It needs an operation. If it is left untouched, it will end up being inoperable. I believe the government won the vote of the people to conduct the necessary operation. Even though the policy will be unpopular, the government has to implement it to avoid passing on a negative legacy for the future of Japan and its children. The vote of confidence was given to Prime Minister Abe to allow him to do what needs to be done, even though it may bring some pain.