Notes on Media Briefing by Akira Kiyota, Director and Representative Executive Officer, Group CEO, Japan Exchange Group, Inc., on September 26, 2018

I would like to express my warmest sympathies to all those affected by the recent typhoon and the Hokkaido earthquake and my hopes for a speedy and full recovery.

The only item on the agenda for today is the transition to standardized trading unit.

TSE and other stock exchanges across Japan have pushed for a single trading unit for domestic stocks since November 2007. The variety of trading units will be successfully reduced on October 1, 2018.

We had to change the schedule along the way in consideration of the impact of the Great East Japan Earthquake in 2011. With the profound understanding and cooperation of listed companies, we spent more than a decade in carrying out the plans carefully and gradually, aiming at improving convenience in the stock market.

We had to note marks that indicate trading units on stock market pages in the newspapers. Some say that different trading units could have made stock trading complicated in Japan. Standardization of the trading unit will resolve such inconvenience. It is also well-accepted by global institutional investors as it will make them find the minimum trading value more easily.

Minimum trading values of many issues have been raised according to the changes in the trading unit, which will also allow more investors to easily invest in the stock market.

Again, I greatly appreciate the understanding and cooperation of listed companies regarding this matter.

[Q&A]

Q: All trading in the Sapporo Securities Exchange (SSE) market was temporarily halted due to the earthquake and power outage. Can something like this happen at JPX? What are your countermeasures?

A: The trading halt at SSE was triggered by the Hokkaido earthquake, but the direct cause was the extensive and prolonged power outage across the entire island of Hokkaido. SSE uses TSE's systems, including arrowhead cash trading system. The systems themselves had no problem, but SSE was unable to monitor trading due to the power outage. As a completely separate entity from JPX, SSE determined to halt trading for the whole day based on its own judgment.

However, since SSE had no electricity, TSE sent notifications to investors and trading participants on behalf of SSE. It also informed them of the trading resumption of the next day.

Regarding your question about our countermeasures, JPX has developed solid business continuity plans for the last five years. As such, a similar incident is unlikely to occur at JPX.

Trading systems, the heart of the company, are located at our main data center. Even if it is affected, we have a highly robust secondary center, which enables us to continue our business and to run the systems as long as possible. JPX has a structure that enables the Osaka site to immediately take over Tokyo's market surveillance operations in the event the Tokyo site is damaged. Thus, I doubt there would ever be any chance for us to halt trading as SSE did.

In addition, to ensure safety, plans are underway to transfer the secondary data center to the Kansai region, a great distance from the primary center. The transfer will be completed within several years, which will further enhance safety.

Q: Ten years on from the global financial crisis, stock prices are highly favorable. Could you share your views on the current investment conditions?

A: It was ten years ago on September 15, 2008. I directly received a call from the second-ranking official under then U.S. Treasury Secretary Geithner. When the global financial crisis erupted, I worked for Daiwa Securities. In the face of tremendous risks, markets and economies across the world had gotten out of order for a long time since then.

Ten years later, today, Nikkei 225 has recovered JPY 24,000 levels with the exchange rate hovering around JPY 112.90 to the U.S. dollar.

After the collapse of Lehman Brothers, Nikkei 225 dropped to JPY 8,000–7,000 levels, and the yen rose to JPY 70 levels.

In addition to the bankruptcy of Lehman Brothers, Merrill Lynch was forced to seek assistance from Bank of America, and so was Morgan Stanley from a Japanese bank, Mitsubishi UFJ. Goldman Sacks was also rescued by becoming a bank holding company. The financial crisis spread to Europe, which suffered from the subsequent European debt crisis.

Financial institutions in Japan, such as banks and securities firms, managed to recover from the financial crisis and became financially stable with sufficient levels of capital at that time. They had written off bad loans for the 1990s to early 2000s all at once under a financial revitalization program led by then Prime Minister Koizumi and Financial Services Minister Takenaka. However, since the real economy was largely affected by the crisis in the U.S. and Europe, the overall Japanese economy was weak for a long time. In addition, as the yen continued appreciated further, performance of Japanese financial institutions dropped more than initially expected when the crisis occurred.

Ten years after the crisis, some economists are warning that the next one may already be underway. However, no one knows for now where the risks are and how the risks will arise.

It is critical for us to operate a market where appropriate prices are formed with appropriate price discovery functions in spite of market fluctuations. Trading volume often surges in a crisis. A recent example is the China shock. A large amount of orders intensively arrived in an instant. Our systems are capable of handling such conditions. In that sense, we are well prepared to endure such social shocks. We also have implemented sufficient business contingency plans against natural disasters.

I am personally paying attention to whether and how Trump risks emerge. Nikkei 225 hovered between JPY 21,000 and 23,000 levels a couple of weeks ago. Business performance at Japanese companies was good. However, their shares were sold when the prices rose even though the yen had slightly depreciated. This was attributed to an uncertainty over the U.S.-China trade dispute. Share prices struggled to soar, because investors were unable to foresee how the Japanese economy would be affected if Japan was caught in the crossfire of the dispute. Even when share prices went down slightly, investors were unwilling to sell them, because they thought Japanese stocks were undervalued given the current corporate value. Under these circumstances, Nikkei 225 hovered around JPY 22,000 levels. The exchange rate also hovered between JPY 110 and 112. It was slow to reach JPY 112 and rarely went below JPY 110.

However, the rate has reached JPY 112 levels for a week or two and been close to JPY 113 now. Nikkei 225 has exceeded JPY 23,000 with the closing price today exceeding JPY 24,000. Investors seem to have started to trade at higher prices, knowing President Trump acts with restraint and does not always escalate the trade row with China, because a third round of 10 percent tariffs will be imposed through the end of the year, and the rate will increase later.

If the U.S.-China trade dispute develops into a serious political conflict, risks might materialize. If they do, the market may be affected. Having said that, a crisis would not arise if we can anticipate it. Thus, as long as we are anticipating it, paradoxically speaking, the dispute will not develop into a real crisis.

Since Europe and Japan also have yet to bring zero and negative rates to an end, we cannot conclude that the event is a thing of the past. However, the conditions have greatly improved, although we are still in the extended aftermath of the global crises. After 10 years we can afford to reflect on the global financial crisis. In that sense, global economic conditions have certainly been improving.

Q: A company for which an MBO was conducted is scheduled to be listed once again on TSE in the latter half of this week. With respect to the MBO and re-listing of companies for which an MBO has been conducted, there are many issues including those related to protection of minority shareholders. I would like to ask you again to provide your thoughts on the MBO and re-listing of such companies.

A: The recent examples are WORLD CO., LTD. to be listed once again on the day after tomorrow and NARUMIYA INTERNATIONAL Co., Ltd. re-listed in the first half of this month.

The MBO is drawing a lot of attention, including talk of Mr. Elon Musk. I think the MBO is one of the important business operations for maintaining the vibrancy of the capital market. Specifically, with respect to companies that are struggling to produce good business results, corporate managers tentatively block opinions or demands from shareholders and manage the companies in their desired way, thereby improving corporate value, and then list their shares on exchanges once again to gain profits. This is one of the business activities to boost the capital market, which I think is good.

As such, I won't immediately say that the MBO and re-listing thereafter are problems. I think that WORLD CO., LTD. made a listing application based on confidence that it has improved corporate value through an MBO. JPX-R has also conducted adequate listing examination of the company, and TSE approved the listing accordingly.

However, we have to note that the MBO has the nature of conflicts of interest between shareholders and corporate managers to whom shareholders entrust management of their companies. For corporate managers (i.e., buyers of the company), the cheaper the price is, the more favorable the MBO is to them. On the other hand, the higher the price is, the better it is for shareholders who would be sellers of the company. In this sense, there are conflicts of interest.

Therefore, if corporate managers conduct an MBO, it is necessary for them to hold sufficient dialogue with shareholders and to adhere to fair protocol. At the time of re-listing, the difference between the corporate value calculated at that time and the actual financial performance will be clarified. As such, corporate managers should give due consideration to whether such difference can be fairly explained before considering re-listing. If the corporate value firmly improves and market participants and shareholders affirmatively give consent to re-listing, then such re-listing will be acceptable to the market.

As re-listing makes the company public once again, such company should put an emphasis on holding dialogue with shareholders. Consequently, we would expect such company to have effective corporate governance in place and conduct corporate management aimed at further improving corporate value.

Q: Currently, Toshiba belongs to the 2nd Section, in which its market capitalization is the largest. There is a huge gap between Toshiba's market capitalization and the second largest market capitalization in the 2nd Section, which is extremely abnormal.

Meanwhile, according the listing rules, as Toshiba had the issue of audit opinion, as a general rule, it cannot be transferred to the 1st Section for five years. Isn't there any problem if the market capitalization is abnormally huge? Can the rule be tweaked or can there be any loophole, whereby letting such huge market-cap company be transferred to the 1st Section?

A: As you pointed out, the market capitalization of Toshiba is enormously huge in the 2nd Section. Therefore, Toshiba stock certainly has an extremely huge impact on the Tokyo Stock Exchange Second Section Stock Price Index. However, Toshiba stock does not have any influence on market prices of the other 2nd Section-listed stocks. I also do not think that there is any particular problem because of the fact that Toshiba stock has a large weight among component stocks of the Tokyo Stock Exchange Second Section Stock Price Index.

According to the current rule, if falsehoods are included in the securities report, etc. or the audit opinion is not an unqualified or qualified one, a transfer to the 1st Section is not allowed for five years.

There are discussions on whether, where a company has not fairly disclose financial statements, etc. that are fundamental for investment decisions, it is appropriate that such company will be easily transferred back to the 1st Section. In consideration of such discussions, I think that the five-year suspension of the transfer to the 1st Section has been a rational rule since its institution and that; therefore, there has been no positive reason for amending such rule. As such, currently, we do not think that such rule should be amended.

Some have mentioned that, for example, delisting the stock followed by an application for re-listing could be an easier way for re-listing on the 1st Section. However, the listed company's own decision to delist its shares will temporarily deprive hundreds of thousands of shareholders of opportunities for turning stocks into money. Therefore, it is out of the question for the company to make such a decision.

However, it is untrue that JPX and TSE are not aware of such issues pointed out. Even though such a large company was reassigned to the 2nd Section due to having fallen into excessive liabilities as a result of the corporate scandals, there will be an issue of whether it is appropriate for such company to stay on the 2nd Section for a long period of five years. There also will be a further issue of whether the current framework of the 2nd Section is appropriate. I think that there are various points requiring consideration, including such issues

We absolutely have no intention of "tweaking the rule for the sake of Toshiba". As such, if Toshiba wishes to be re-listed on the 1st Section, it certainly has to wait for five years in accordance with the current rule. However, we would like to consider whether it is appropriate to maintain such rule as it is. Of course, there is a possibility that the current rule will remain unchanged as a result of such consideration.

Q: According to President Trump's tweet, he instructed the SEC to consider abolishment of quarterly disclosure. I understand that TSE-listed companies disclose quarterly earnings reports. What are your thoughts on the discussion over whether or not quarterly disclosure is necessary?

A: The issue of quarterly disclosure has already been discussed at the Working Group on Corporate Disclosure of the Financial System Council in Japan, and I understand that the conclusion is that quarterly disclosure is necessary at the moment. In other words, my understanding is that the majority of the working group members think that corporate financial performance and business development require fixed-point observations from a viewpoint of long-term investment.

Some seem to have been negative with respect to quarterly disclosure as it would facilitate short-termism. However, I think that very few corporate managers who are conducting quarterly disclosure might be managing their companies, filled with thoughts of making large profits in the coming quarter as a result of falling into short-termism. A few might be filled with such thoughts; however, I think that, basically, no corporate managers desire to increase quarterly profits because of quarterly disclosure, neglecting other important business matters.

In this sense, I understand that quarterly disclosure has been recognized to be necessary in Japan, while, as a matter of disclosure framework, streamlining informational redundancies and other such measures have been conducted.

My understanding is like this. President Trump asked several of his intimate corporate managers about whether they have any problem or issue and one of them issued an opinion that semiannual disclosure would be more preferable than quarterly disclosure, because having to issue quarterly reports pressures them to make profits in the short-term. As a result, President Trump instructed the SEC to consider the appropriateness of quarterly disclosure. This is the background of his tweet.

Mr. Warren Buffett and Mr. Jamie Dimon have commented that it would be better for earnings forecasts on a quarterly basis to be abolished, but they say that quarterly disclosure of actual financial performance also has its merits. There will be a discussion that quarterly earnings forecast might be difficult. In the case of Japan, there are companies that do not provide earnings forecasts, while there are those that do provide them. Even in the case of the companies that provide earnings forecasts, they generally provide forecasts for the full year, while there are few companies that provide quarterly earnings forecasts.

In this way, I think that, currently, discussions on quarterly disclosure have relatively calmed down in Japan. Of course, I think that we need to monitor discussions in the U.S. carefully. My impression at the moment, however, is that debates over quarterly disclosure will likely not be brought up again soon.