

Revising the Code of Corporate Conduct

Tokyo Stock Exchange, Listing Department

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1. Code of Corporate Conduct on MBOs and Subsidiary Conversions

- At previous meetings, we received the following comments when discussing how the Code of Corporate Conduct should look in relation to MBOs and conversions of listed subsidiaries into wholly owned subsidiaries by controlling shareholders.

General remarks

- ✓ **Based on the Fair M&A Guidelines and recent court precedents, it can be assessed that fair procedures are seeing progress.**
- ✓ On the other hand, **some investors have also stated that fair procedures and prices are still not being achieved in some cases, and that the Fair M&A Guidelines themselves are more relaxed than in the US, so as an exchange, we should aim for a level that is comparable to the US when viewed by global investors.**

Detailed points

Further demonstration of the functions of special committees

(Opinions that the transactions do not undermine the interests of minority shareholders)

- ✓ **MBOs should be subject to obtaining opinions.** It would then be appropriate for special committees to seek opinions not just from the perspective of “not being detrimental”, but also from the perspective of **appropriately considering the interests of general shareholders.**
- ✓ **TSE should clarify points to be considered and sufficient explanation of the content of the consideration regarding it and the reasons for the decision should be sought:**
 - In particular, if measures exemplified in the Fair M&A Guidelines, such as the setting of **majority-of-minority conditions, are not implemented, it may be possible to promote the securing of fairness in the procedures by seeking an explanation of the reasons for this and alternative measures.**
 - In addition, **from the perspective of increasing the transparency of the review process and ensuring a certain level of oversight, it is also possible to request that the minutes of special committees be made public** (although there are concerns about how much content will be included and whether it will have a negative effect).

Enhancing disclosure of assumptions for share value calculation

- ✓ To enable general shareholders to judge the fairness of prices, **it is extremely important to improve the disclosure of assumptions and other information used in calculations.**
- ✓ In addition, from the perspective of increasing the effectiveness of the verification of assumptions by the special committee, **the appointment of independent financial advisors and the acquisition of valuation reports should be encouraged.**

Proposed Direction for Revision

- Based on opinions received, the secretariat will proceed to consider revision in the following direction.
- * In particular, the areas colored in gray should be coordinated with market participants, taking into account the impact on operations.

Further demonstration of special committee functions (review of opinions regarding whether or not it is disadvantageous to minority shareholders)

Activities subject to receiving opinions	<ul style="list-style-type: none">✓ In addition to significant transactions with controlling shareholders, MBOs are also covered.* Further, could tender offers by other associated companies be considered as examples within the range of tender offers equivalent to these? (While not subject to receiving opinions, disclosure is required in the same way as for activities like MBOs regarding the implementation of measures to ensure fairness.)
Sources of opinions	<ul style="list-style-type: none">✓ Under the listing rules, the establishment and consideration of a special committee and the obtaining of opinions from that committee are mandatory.
Content of opinions	<ul style="list-style-type: none">✓ From the perspective of whether the legitimate interests of minority shareholders are being secured (whether the increase in corporate value is being fairly distributed in proportion to the number of shares held), it is mandatory to obtain “opinions on whether transactions are fair for minority shareholders and general shareholders”.✓ The listing rules also stipulate that the points that should be considered when forming an opinion should be clearly stated, and that the content of the consideration and the basis for the judgement should be fully explained in the opinion (*1, 2).*1 If measures such as setting majority-of-minority conditions or appointing a unique financial advisor are not taken, is it possible to request an explanation of the reasons for this and how it has been compensated for?*2 Regarding the content of deliberations and the basis for decisions, can we consider making it clear that it would be useful to make public the minutes of special committee meetings and the main points of discussion on each issue?

Enhancing the disclosure of assumptions for share value calculations

- ✓ We will consider the details of concrete expansion of disclosure, taking into account the **opinions of investors** below.
 - The level of disclosure is not sufficient from the perspective of verifying the rationality of calculation results, and there are cases where the rationality of some calculation content is questionable. Therefore, in addition to the **content indicated in the Fair M&A Guidelines**, **we should also seek to enhance disclosure**, including the **disclosure of the approach that forms the basis of business plans and specific figures in the calculation process for free cash flows.**
 - Currently, **when listed shares are used as consideration, there is no requirement to disclose specific business plans**, but there is a concern that the valuation and disclosure content are inferior compared to cases where money is used as consideration. **The same level of disclosure should be required.**

2. Review of Other Codes of Conduct

Proceeding with Future Deliberations (Matters to be Observed)

- In light of the occurrence of **corporate behavior that impedes the function of the secondary market and the rights of shareholders, the matters to be observed** are composed mainly of **matters to regulate such corporate behavior**.
 - * In addition to the individual provisions, a “basket clause” has also been set up with the aim of regulating any actions that are equivalent to those prohibited by the Code of Corporate Conduct (prohibiting actions that damage the secondary market or shareholders)
- Violation of matters to be observed may result in becoming the target of **measures to ensure effectiveness**.

- While maintaining the provisions **necessary from the perspective of regulating corporate behavior that impedes the functions of the secondary market and the rights of shareholders, a general review will be conducted based on developments since the formulation of the Corporate Governance Code and current corporate behavior**.

Matter to be observed (current provisions)

- **Matters to be observed for third-party allotment**
 - Prohibition of share splits, etc., that are likely to disrupt the secondary market or infringe upon shareholder interests
 - Matters to be observed pertaining to issuance of MSCBs, etc.
 - Exercise of voting rights in writing, etc.
 - Framework improvement to facilitate exercise of voting rights for listed foreign companies
- **Securing independent directors/auditors (at least one)**
 - Explanation of reason for compliance or non-compliance with Corporate Governance Code
 - Organs of listed domestic companies
- **Securing outside directors (at least one)**
 - Certified public accountants, etc. (to be the same as those defined under the FIEA and Companies Act)
 - Development of system and structure necessary to ensure appropriateness of business
 - Matters to be observed pertaining to introduction of takeover defense measures (terminology changed after the acquisition guidelines were formulated)
- **Matters to be observed pertaining to disclosure of MBOs**
- **Matters to be observed pertaining to significant transactions, etc. with controlling shareholder**
 - Prohibition of insider trading
- **Exclusion of anti-social forces**
 - Prohibition of actions damaging to the functions of the secondary market or shareholders' rights (basket clause)

Points of Review

- ✓ Consideration of revisions in light of **the progress since the formulation of the Corporate Governance Code and the obligation to appoint outside directors** under the Companies Act
- ✓ Examining **the ideal way to handle cash-outs** (currently under discussion)
 - * The Study Group on the Protection of Minority Shareholders in Quasi-Controlled Listed Companies will also consider issues such as **ensuring the independence of independent outside directors, procedural regulations for transactions and actions with a risk of conflict of interest, and rules for listed parent companies**.
- ✓ Examination of the need for a general **review based on recent cases**

- The matters desired to be observed are composed of recommended items for listed companies.
 - * Listed companies are **obliged to work towards implementing each provision** (in the case of the Corporate Governance Code, there is no obligation to observe or work towards compliance if an explanation is provided).
 - * However, **they are not subject to measures to ensure effectiveness**, and there is no systematic requirement for disclosure of the status of initiatives, so **the issue is how to encourage listed companies to take action**.

- While revising the current provisions, taking into account any overlap with the Corporate Governance Code, we will also consider adding provisions to encourage listed companies to secure the minimum required stance and systems, such as “ensuring IR functions”, which has been discussed at prior meetings.
- In addition, from the perspective of encouraging autonomous efforts by listed companies, we will systematically require disclosure of corporate thinking and the status of efforts, etc. (in addition, the content of the Corporate Governance Report will be reorganized as a whole, taking into account duplication with the Annual Securities Report, etc.)

Matters desired to be observed (current provisions)

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

Points of Review

- ✓ Consideration of revisions in light of **the progress since the formulation of the Corporate Governance Code and the obligation to appoint outside directors** under the Companies Act
- ✓ Consideration of a review in light of **overlap with the Corporate Governance Code**

* Disclosure of the company's approach and status of initiatives is required in the Corporate Governance Report, etc.

Differences in format

Category		Format
Code of Corporate Conduct	Matters to be observed	Observance is required (subject to measures to ensure effectiveness)
	Matters desired to be observed	Effort is required (not covered by measures to ensure effectiveness)
Corporate Governance Code		Comply or explain (an explanation is required where there is non-compliance)
Requests to listed companies (e.g., management that is conscious of capital cost or share price)		— (Requests outside of the rules)

(Ref.) Differences in target markets

Category	Prime Market	Standard Market	Growth Market
Code of Corporate Conduct	Applied (including Prime-only items)		
Corporate Governance Code	All principles applied (including Prime-only principles)		Only general principles applied
Requests to listed companies (e.g., management that is conscious of capital cost or share price)	Scope of application varies depending on content of request		

3. Matters for Discussion

(MBOs and subsidiary conversions)

- What do you think about proceeding with the review as shown in **Page 4 (Proposed Direction for Revision)**?

(Review of other codes of conduct)

- Based on **Pages 6 and 7 (Proceeding with Future Deliberations)**, what are your thoughts regarding proceeding with a review of matters to be observed or complied with and matters that are desirable?
- In addition, we would like to hear your opinions on the **necessity of reviewing individual provisions and the content of** such reviews.