Minutes of the 18th Council of Experts Concerning the Follow-Up of Market Restructuring

Date: Thursday, October 31, 2024 12:00 - 1:45 p.m.

Place: Tokyo Stock Exchange 15F Conference Room

Attendees: See member list

Watanabe, Director, Listing Department, TSE:

Now that the scheduled time has arrived, I would like to open the 18th Council of Experts Concerning the Follow-up of Market Restructuring. First, regarding attendance today, Mr. Kanda and Mr. Koike are absent.

With that, let's proceed with today's agenda. First, we will provide an overview of today's items.

Ikeda, Senior Manager, Listing Department, TSE:

Thank you for joining us today.

Today's agenda consists of two main points: initiatives for Management that is Conscious of Cost of Capital and Stock Price, and the revision of the Code of Corporate Conduct. Additionally, we will report on the discussions of the Study Group to Review Minority Shareholder Protection and Other Frameworks of Quasi-Controlled Listed Companies.

Firstly, regarding management with a focus on capital cost and stock price, we have attached Documents 1 through 7, covering the progress so far and updates on investor cases and key points, which we plan to publish in November.

We would appreciate your feedback on the content of the investor cases and key points, as well as any comments on how best to present this information, including the order and methods of delivery, to make it more impactful for companies.

For Document 8, concerning the Code of Corporate Conduct, including aspects of privatization, we would be grateful for your comments on the direction of these initiatives.

Additionally, Documents 9 and 10 detail the discussion status of the Study Group to Review Minority Shareholder Protection and Other Frameworks of Quasi-Controlled Listed Companies, which is related to today's agenda, so we would like to share these as well. Please feel free to provide any insights or questions you may have.

Lastly, we have attached comments from Mr. Koike, who is absent today, at the end of the Document set for your reference.

Watanabe, Director, Listing Department, TSE:

Now, let's proceed with an explanation of the Documents. Since we have multiple topics to cover today, we will provide explanations and gather your opinions for each theme.

Let's begin with the initiatives for management conscious of capital cost and stock price.

Monden, Senior Manager, Listing Department, TSE:

I will explain the initiatives for "Management that is Conscious of Cost of Capital and Stock Price."

Following the discussion at the last meeting in August, we finalized and published the future policy and initiatives at the end of August. We are now sequentially implementing these initiatives.

Regarding the revision of the disclosure company list, we published it on September 27 to listed companies and market participants, as shown in Document 1.

Specifically, to promote communication between companies and investors, we have made three major revisions detailed on page two.

First, we have added an update date to the list to make it clear when companies have updated their disclosures.

Second, we indicate companies on the list that are open to investor contact. This targets companies that are actively working on their initiatives but have had limited interaction with investors. Such companies can apply to express their desire for more active contact and provide relevant information on their readiness to engage in dialogue, which is displayed on the list. Investors, in turn, can use this information to reach out to companies of interest.

Third, for companies listed under the "Under Consideration" status, we have introduced a six-month period limit. For these companies, we are also requesting updated details on the review status and expected disclosure timing.

These revisions will be reflected in the list published on January 15 of the new year.

This concludes my report on Document 1.

Next, regarding the updates on "Key Points and Examples Considering the Investor's Point of View" from Document 2 onward.

Document 2 provides an overview of the updates. Initially, "Key Points and Examples Considering the Investor's Point of View" was compiled and published in February of this year based on feedback from investors up to that time, as a reference for companies' internal review.

Since publication, we have shared this through seminars and other opportunities for companies, including through the Listed Company Support Group established this year, to promote awareness. We have received considerable feedback from companies indicating they are using this as a reference.

On the other hand, since publication, we have received additional feedback from both domestic and overseas investors pointing out further key areas and new case studies. Additionally, companies have requested more examples related to smaller companies or Standard Market companies. Therefore, we intend to update the key points and cases to include these aspects.

Specifically, for Document 3 on "Key Points and Examples Considering the Investor's Point of View," we have added two new key points. Additionally, we have expanded the case studies in Documents 5 and 6 from the original 29 companies to over 50 companies.

On the right side, we have newly created Document 4 titled "Points and Examples Where Companies Are Not Aligned with Investors' Perspectives." This document is intended to help companies, including those already making disclosures, to self-assess their status and refine their approaches.

This was compiled based on feedback from numerous discussions with both domestic and international investors at TSE.

Next, I will briefly introduce the content of these updates.

First, in Document 3, under "Key Points and Examples Considering the Investor's Point of View," we have added two new points. The first addition is Point 1 on page 15, under "Consideration and Disclosure of Initiatives."

For goal-setting, it is suggested that companies combine indicators based on P&L, such as revenue and profit levels, with those related to capital efficiency and market valuation, which are highly valued by investors. Furthermore, it is expected that companies aim for further improvement rather than merely achieving profitability that exceeds capital costs or a PBR above 1x, in line with investor expectations.

The second added point is Point 4 on page 26, under "Dialogue and Updates."

When disclosing progress, companies are encouraged not only to update figures but also to analyze the reasons for any discrepancies between plans and actual performance and refine their initiatives accordingly. Moreover, they should be flexible in revising mid-term plans or other published frameworks if improvements are needed, rather than rigidly adhering to them.

We have also added recent case examples to points raised in the previous meeting.

Next, I'll discuss Document 4, titled "Points and Examples Where Companies Are Not Aligned with Investors' Perspectives." This document consists of ten key points and case examples.

On page six, under "I. Analysis and Evaluation of the Current Situation," each slide presents anonymized examples based on actual disclosures on the left side, and investor comments on the right side. For these, each point of misalignment is marked with a "✓," followed by suggestions for improvement with "⇒." The blue text references points from Document 3, "Key Points and Examples Considering the Investor's Point of View," which may serve as a guide.

This case example highlights a misalignment in companies' evaluation of their current situation. The upper example shows that the shareholder capital cost recognized by the company falls below the level expected by investors, and while the ROE slightly exceeds the shareholder capital cost and the PBR is just above 1x, the company considers this acceptable. However, there is a call for aiming for further improvement.

The lower example attributes a low PER to a lack of investor understanding and insufficient IR activities. However, it is also possible that fundamental business and growth strategies are not being adequately evaluated, and an analysis of essential issues is expected.

On page seven, Point 2 concerns instances where companies' analysis and evaluation of their current situation remain superficial. In the upper example, while it states that the Board of Directors has "confirmed that a capital return exceeding the capital cost has been secured," it lacks specifics on the verification process or references to the company's future objectives.

The lower example provides a link to a previously published mid-term management plan to demonstrate its initiatives; however, upon reviewing the link, it becomes clear that sufficient analysis has not been conducted.

Additionally, since investors assess companies based on periods extending beyond the mid-term management plan, companies are expected to perform current evaluations and prepare initiatives for improvement without being overly constrained by the plan's timeframe.

On page eight, Point 3 highlights that although more companies have committed to strengthening shareholder returns and reducing cross-shareholdings over the past year, many have not sufficiently considered the ideal balance sheet and capital allocation policies that should form the foundation of these actions. Without proper evaluation, strengthening shareholder returns or reducing cross-shareholdings may appear to be temporary or short-term responses.

On page 10, under "II. Consideration and Disclosure of Initiatives," Point 1 addresses goal-setting misaligned with investor expectations.

The upper example sets an ROE target below the cost of capital, while the middle example sets a target far into the future that is only marginally different from the current status. The lower example sets goals exclusively based on P&L indicators.

As described in the additional points in Document 3, companies are expected to set targets that align with investor expectations as a basis for developing specific initiatives.

On page 11, Point 2 notes that although more companies are considering a review of their business portfolios, many of these reviews focus solely on business expansion and profitability improvements, with insufficient examination of options such as downsizing or exiting unprofitable businesses.

Fundamental actions, including reducing or withdrawing from unprofitable operations, are expected to enhance long-term profitability.

On page 12, Point 3 addresses executive compensation. Although more companies have introduced performance-based compensation in recent years, there are concerns that these structures do not always function as incentives for enhancing corporate value.

Specifically, the upper example links compensation metrics to P/L indicators such as sales and profit, which can discourage efficient capital use by obstructing the withdrawal from unprofitable businesses. In the lower example, the achievement rate is tied to forecasted performance targets, potentially creating an incentive to set lower targets.

To establish a sound incentive structure, it is expected that companies carefully design executive compensation by linking it to metrics that investors value, such as TSR and equity spread.

On page 13, Point 4 highlights common disclosure issues, noting that many disclosures simply list initiatives without clarifying how each contributes to corporate value enhancement.

For the expected points and examples, a logic tree approach to disclosures is recommended to show the connections between initiatives and corporate value improvement. Investors want clarity on how each initiative, including ESG and other non-financial efforts, contributes to corporate value growth.

On page 15, under "Dialogue and Updates," Point 1 notes that some companies still refuse to engage in investor dialogue without reasonable justification.

The upper example concerns general meetings, where companies may deny meetings citing an inadequate IR structure, or reject all requests from foreign investors and individual meetings based on fair disclosure concerns.

Despite claiming compliance with the Corporate Governance Code's principle of shareholder dialogue, the refusal to engage without valid reasons is seen as mere formal compliance. Additionally, investors are not seeking insider information in individual meetings, so refusing dialogue based on fair disclosure concerns is misplaced. Listed companies are therefore expected to establish a system to facilitate dialogue as a minimum requirement.

The lower example concerns dialogue with outside directors. While some companies actively provide opportunities for dialogue between outside directors and investors, as noted in the case studies, others refuse such interactions without specific reasons.

Given the intended role and position of outside directors, positive communication with shareholders and investors is expected.

On page 16, Point 2 notes that in March of last year, Prime Market-listed companies were requested to disclose the status of their dialogue efforts and explain how feedback received from investors has been incorporated into management practices, as part of an initiative to promote "Management that is Conscious of Cost of Capital and Stock Price." However, some companies' disclosures lack specificity, which detracts from the intended purpose of deepening the dialogue.

On page 17, Point 3 raises concerns that, although companies disclose the status of their progress, they often fail to analyze issues or consider additional actions when certain aspects are not progressing as planned.

To gain investors' trust, it is expected that companies analyze any areas of divergence from the plan and promptly consider additional actions as needed.

These are the contents of the newly created document, "Points and Examples Where Companies Are Not Aligned with Investors' Perspectives." By presenting these examples of misalignment, we hope that companies that have already made disclosures will also conduct a self-review of their initiatives. Where relevant, we encourage companies to refer to Document 3, "Key Points and Examples Considering the Investor's Point of View," and the updated case study collections to refine their initiatives.

Returning to Document 2, we would like your opinions on the updates to the key points and case studies.

Additionally, as the volume of these materials has increased with this update and now includes more detailed content, we would appreciate your suggestions on effective ways to present and convey this information so it can be widely utilized by companies.

The key points and case studies document will be published on the website with today's meeting materials, with all company-specific information removed. Once we obtain permission from each company, we plan to release the finalized version in mid-November.

Additionally, in Document 7, we have summarized the changes in market evaluation (stock prices) based on disclosure status to serve as a reference for companies advancing their initiatives; this information was also included in the initiatives published in August.

For both the Prime Market and the Standard Market, we have compiled stock price performance since the end of March 2023, categorized into four groups based on disclosure status and the companies covered in the case study collection.

While disclosure alone does not directly cause a stock price increase, the general trend shows a difference in performance order: "companies included in case studies," "disclosing companies," "companies under consideration," and "non-disclosing companies" in both markets.

We plan to share this as a reference for companies pursuing similar initiatives when we release the finalized key points and case studies document.

That concludes my explanation.

Watanabe, Director, Listing Department, TSE:

We would now like to invite your questions and comments.

Also, please note that the microphone system has been updated. To speak, press the button with the picture of a person speaking located on the lower right of the microphone. When the light on the top of the microphone turns red, please proceed with your remarks.

Thank you.

Kumagai, Member:

I recall emphasizing the importance of "learning from failure" in a previous meeting, so I would like to thank you for not only compiling examples that investors value but also for detailing cases where there is a gap between companies and investors. Additionally, I appreciate that comments provided during the preliminary explanation were well-reflected in the materials. I believe this information will serve as a valuable reference for many listed companies and will be widely used in dialogue with investors.

At Daiwa Institute of Research, we frequently engage in discussions on "Management Conscious of Cost of Capital and Stock Price" with both listed companies and institutional investors. Based on these experiences, I would like to share two points.

The first point is that few companies carefully consider how to allocate management resources while being sufficiently mindful of capital cost and capital efficiency. While this was also highlighted in the examples of gaps with investors' perspectives, there are still a significant number of companies using capital costs far below investor expectations, resulting in a major discrepancy in the analysis of the current situation.

This may stem from companies assessing their current structure and business situation and concluding that they lack businesses capable of generating returns above the capital cost assumed by investors. They may believe that, if they were to use these capital costs, they would be forced to consider exiting certain businesses, raising concerns about business continuity. However, this approach cannot be seen as fulfilling their responsibility as a listed company, tasked with raising funds from a diverse group of investors.

Furthermore, some companies do not leverage capital cost or capital efficiency in the planning and disclosure of business portfolios or capital allocation. It is expected that companies apply capital cost as a hurdle rate for assessing their business portfolios, use it as an investment standard for M&A or capital investment, and disclose these standards. Although some companies mention plans for proactive M&A to enhance profitability, it is also essential to clarify their investment criteria and evaluation processes. Engaging in M&A in unrelated sectors carries considerable risk, so specifying investment criteria is equally important.

The second point concerns the approach to ESG initiatives. Many companies have presented their efforts, but frequently, these appear as a mere list of initiatives without clearly demonstrating their connection to corporate value enhancement. While this was also discussed in today's materials, it remains a challenging area for many companies, suggesting the need for further in-depth exploration going forward.

Sampei, Member:

Thank you for preparing and compiling the materials.

First, overall, I want to acknowledge that over 300 interviews were conducted with both domestic and international investors, as shown on page four of Document 3. I believe this has led to a very comprehensive compilation. I hope you will continue to expand the gap analysis and case studies. Conducting more than 300 interviews must be a considerable burden, but including examples provided by investors allows them to see that their input has been reflected, which could act as a form of incentive for them. By fostering such a positive cycle, I hope the burden will not rest solely on TSE and that you can continue to enhance these materials, which will lead to increased trust and expectations across the market.

With that said, I have some brief comments on the documents.

Regarding Document 1, I find Revision 2, which highlights companies open to contact from institutional investors, to be an intriguing initiative. Initially, I was curious about how many companies would actually come forward, but I heard during the preliminary explanation that around 60 companies have already applied, which is encouraging. Since the companies that apply are proactive, investors would likely be interested in speaking with them and providing input. These companies may also have good potential for improvement, and the list could serve as a valuable screening tool.

However, if only some investors are aware of this information, it could lead to information asymmetry. While domestic investors are likely following TSE's initiatives, overseas investors might only learn about this later, which could create an issue. Therefore, I suggest that this information be published in both Japanese and English simultaneously.

Additionally, it is essential that companies understand that once they have applied, they should not selectively engage with only domestic investors while refusing foreign investors.

As for Document 2, I mentioned during the preliminary explanation that given the substantial number of documents created this time, such an overview document is extremely helpful in maintaining clarity regarding the overall content.

Among the newly created documents, I believe Document 4, which addresses gaps from the investor's perspective, is particularly important. In various contexts, there are frequent gaps between investor expectations and corporate perceptions. Logically, it would be beneficial to guide companies to first understand the gaps with investors as presented in Document 4 and then refer to the points and examples already valued in Document 3 as directions for improvement.

On page six, in the second investor comment, the phrase "Just because ROE is slightly above the cost of capital or PBR is slightly over 1 does not mean consideration of further improvements is not necessary" could be clarified to specify "further improvements in market valuation."

On page seven, in the lower section, the phrase "medium- to long-term investors" should, I believe, be "stock price." Stock price inherently reflects a company's future potential. For instance, in valuing a company using DCF methodology, we consider not just three to five years of future cash flows but 30 to even 100 years in more rigorous models. Such long-term analysis doesn't rely solely on financial statements but also examines factors like whether the company can sustain itself over time, exhibit mean reversion, or maintain competitive advantages. Communicating these insights to investors is critical, and it is the CEO's responsibility to present a vision for the company's future, detailing why, where, and how it is headed. This includes prioritizing the necessary challenges and embedding these initiatives internally. While a mid-term management plan typically covers up to five years or three years in some cases, it is essential that the document conveys that evaluations are not limited to these shorter timeframes, and that specific plans, though useful, do not encompass the entire evaluation.

On page 15, in the section regarding companies that do not engage in dialogue, I also raised this during the preliminary explanation. This relates to Principle 5-1 of the Corporate Governance Code. The document states that this "makes compliance seem superficial," but in some cases, I believe it no longer meets the compliance criteria. In the lower section, since this specifically addresses meetings with outside directors, it would be helpful to clarify that this relates to Supplementary Principle 5-1 (i). Many companies disclose that they comply fully with the principle, yet do not permit meetings with outside directors.

On page 16, in the upper section, this was mentioned in previous follow-up meeting materials, but some companies view Q&A sessions at earnings briefings and IR meetings as dialogue. From an investor's perspective, however, these are venues for information gathering, not genuine dialogue. As defined in the Stewardship Code, dialogue serves as a forum for addressing and improving issues.

Matsumoto, Member:

Regarding the revision of the disclosure company list in Document 1, I believe this is a solid initiative, and I fully support it.

As for Document 2 and beyond, as Mr. Sampei mentioned, the content is very well-researched and comprehensive. However, given the substantial volume, it may be useful for those who can read through it thoroughly but might feel cumbersome for many others. I believe that including a clear introductory message, like in Document 2, will help avoid uneven dissemination of information, so I would appreciate any efforts to improve accessibility.

Uchida, Member:

I am generally in agreement and appreciate the tremendous effort that went into this valuable initiative.

Regarding Revision 2 in Document 1, "Add columns for companies that wish to be contacted by institutional investors," I am encouraged to hear that around 60 companies have already applied. However, applying may be a significant hurdle for some companies, and even after thorough preparation, some may struggle with effective dialogue with investors. I also assume that some companies may not yet be ready to engage with both domestic and foreign investors. I hope that the progress of this initiative will be tracked to increase opportunities for dialogue.

Documents 3 and beyond will also provide beneficial material not only for issuers but also for financial institutions that interact with these issuers. From a corporate perspective, regarding ease of adoption, in Document 4, on page 10, the investor comment in the middle section reads "targets are not that high." I suggest rephrasing it as "target levels are not appropriate" to reflect the considerable efforts many companies are making to improve their metrics. My apologies for the detailed comment on phrasing, but I hope it will be considered.

Okina, Member:

First, I support the contents of Document 1.

For the key points and case studies, I believe it would be helpful to structure the materials with a guiding overview like in Document 2. As Mr. Sampei suggested, starting with Document 4, which focuses on gaps from the investor's perspective, is a good approach. Rather than expecting everyone to read all of Documents 3 to 6, it might be more effective for companies to first identify points relevant to their own circumstances, then review detailed examples. I also think it would be helpful to clarify in the overview that these documents serve as reference materials, showcasing the market's perspective.

Document 4 addresses valid points on page eight, such as "Insufficient consideration given to ideal balance sheets and capital allocation policies" and on page 13, "Disclosures are just a list of initiatives." Addressing these areas is beneficial, as they warrant attention. It is also essential to present the materials in a way that does not create an undue burden for companies and to structure them so that management and CFOs can readily gain insights.

In terms of dialogue, I participated in the Financial Services Agency's Expert Committee on the Stewardship Code, where we discussed the burdens of dialogue for both investors and companies and how it connects to corporate value. I think it's crucial to explore effective and efficient ways to link disclosure and dialogue to corporate value enhancement. The stock price trends presented as reference materials demonstrate improved market evaluation through disclosures, which could be a valuable resource. I hope you will continue testing effective methods to enhance corporate value through dialogue.

Kuronuma, Member:

Thank you for compiling the points and examples in Documents 3 and 4. Document 4, in particular, provides valuable practices that will serve as a useful reference for many companies going forward.

Regarding the dissemination method for these points and examples, I wonder if it might be beneficial—or perhaps not advisable—to individually contact companies whose disclosures served as examples in the gap analysis. As this is just a personal thought, I would like to hear the views of TSE and other members on whether this should be done or avoided.

Nagami, Member:

I think the materials are excellent, and I would like to suggest three ideas for TSE's approach to disseminating this information to the market.

First, Document 7, which shows stock price trends, is very easy to understand. I think it could be beneficial to have media outlets feature this as an article. My reasoning is that once the Follow-up Council on Market Restructuring began to address the "PBR below 1x issue" with such a clear and compelling phrase, the topic was covered frequently by the media. This led many corporate executives to take action. Media marketing could be highly impactful, so I would appreciate your consideration of this approach.

Second, while this may seem somewhat forceful, many companies may not review these materials unless prompted. It might be useful to request that executives of newly listed companies or newly appointed outside directors review these materials as part of their onboarding or appointment process.

Finally, while the materials are excellent, I suspect the large volume of slides may deter some from reading them. I believe that video may be a more effective dissemination method. For people in their 30s and 40s, videos are viewed far more widely than written materials, and they have significant influence. I suggest that TSE representatives consider communicating key points through videos on platforms like YouTube.

Watanabe, Director, Listing Department, TSE:

Regarding the question raised by Mr. Kuronuma on whether to individually contact companies that served as examples in the gap analysis, I would first like to ask for the secretariat's response.

Monden, Senior Manager, Listing Department, TSE:

The examples highlighting gaps from the investor's perspective are compiled by referencing disclosures from multiple companies, combined and edited to avoid identifying any specific company. As such, the examples are not necessarily tied to any individual company's disclosures. Since some companies might feel uneasy with such feedback, I believe we should carefully consider whether and how to provide individual feedback.

Uchida, Member:

Since the examples do not directly reflect any single company's disclosure, I believe the materials have been edited to be more comprehensible, focusing on the main points. However, if companies receive individual feedback, it may lead to in-depth discussions on specific circumstances, which could divert the secretariat's resources away from the primary objectives of these initiatives. Considering the direct impact, I question whether individual feedback from the exchange would be the best approach.

Sampei, Member:

Listening to Mr. Kuronuma's comments, I understand his point. I've also encountered situations where, even when feedback was indirectly aimed at a specific company, the company didn't recognize itself as the subject. Providing feedback from investors about where gaps exist could be beneficial. However, as Mr. Uchida mentioned, if TSE itself were to communicate directly, companies might worry that they're being viewed negatively or that they were identified by name at meetings. To avoid unnecessary concerns or speculation, it's essential to communicate the background and intent carefully if this feedback is conveyed to companies. While ideally, companies should receive feedback on their gaps, very careful communication would be necessary.

Matsumoto, Member:

Given that Document 4 has been anonymized, I believe it would be challenging for TSE to provide feedback directly to individual companies. Instead, making listed companies aware that these anonymized examples represent common gaps in investor expectations is probably the most that can be done.

If feedback were ever provided directly, it might be more effective to include company names, although such an approach would be quite different from the current one. For now, I think raising awareness through these generalized examples is sufficient.

Kumagai, Member:

I generally agree with Mr. Sampei's perspective and believe that feedback should ideally be communicated to companies. There's a concept in Japan known as the "culture of shame." In a slightly different context, when governors of prefectures with low venture startup rates were informed of their rank, many addressed this in their election pledges, leading to rapid improvements. Similarly, some companies may not recognize that they are the subjects of these cases. It is essential that top management, rather than just the CFO, understands the feedback and leads improvements from the top down. While I believe feedback should indeed be communicated, it must be done with the utmost care and a very meticulous approach.

Okina, Member:

I agree with Mr. Matsumoto's opinion that it might not be ideal for the exchange to convey this information directly to companies. If companies remain unaware of cases where they align poorly with investor expectations, they will ultimately receive a poor market evaluation, so it might be best to let the market handle this aspect.

Ikeda, Senior Manager, Listing Department, TSE:

Thank you for the various opinions. As members have pointed out, there are often cases where IR representatives or CFOs understand the feedback, but it does not reach top management. Thus, rather than addressing companies individually, we have been creating more opportunities to share TSE initiatives directly with executives. We aim to leverage such occasions to ensure that top executives understand and internalize the issues as their own, communicating our initiatives effectively to the companies.

Watanabe, Director, Listing Department, TSE:

Thank you very much.

Now, I would like to proceed with an explanation of the review of the Code of Corporate Conduct.

Yamawaki, Manager, Listing Department, TSE:

I will explain Document 8, "Revising the Code of Corporate Conduct."

Starting from page two, we address the Code of Conduct regarding MBOs and the conversion of listed subsidiaries into wholly-owned subsidiaries by controlling shareholders, a topic we have discussed in previous meetings.

Page three summarizes the discussions from the previous meeting.

In general, based on the 2019 Fair M&A Guidelines and recent court rulings, we recognize progress in fair procedures. However, investors continue to express concerns about fairness, and as the guidelines are comparatively more lenient than those in the US, there was feedback suggesting that the exchange should aim for a higher standard.

The specific points for revision are listed below. First, from the perspective of enhancing the functions of special committees, we will review the framework surrounding opinions required under listing regulations to ensure that minority shareholders are not disadvantaged. Second, regarding the disclosure of assumptions used in stock valuations, we received numerous opinions on the importance of enhancing disclosures so that general shareholders can adequately assess the fairness of prices.

Based on these opinions, page four outlines the direction for revisions. Particularly for the gray-shaded sections, given their significant impact on practice, we plan to proceed with detailed examinations and consultations with market participants based on this framework.

First, regarding the approach to special committee opinions, we propose to expand the scope to include MBOs in addition to wholly owned conversions by controlling shareholders. For cases involving other affiliated companies holding 20% or more, although they would not be required to obtain opinions, it may be possible to require disclosures similar to MBOs regarding the implementation status of fairness assurance measures.

Regarding the source of opinions, while it is customary to obtain them from special committees, we are considering specifying this requirement under the listing regulations as well.

Additionally, concerning the content of these opinions, we envision mandating opinions not only on the absence of disadvantages to minority shareholders but also on whether the fair value due to minority shareholders is secured. The exchange would clarify the key perspectives to be examined, and companies would be required to provide thorough explanations of their review process and the rationale behind their judgments.

Furthermore, related to Note 1 (*1), we are considering requiring explanations in cases where certain fairness assurance measures, such as the majority-of-minority condition mentioned in the Fair M&A Guidelines, are not implemented, along with a description of alternative measures taken to address fairness based on the unique circumstances of each case.

In the previous meeting, opinions were also raised about disclosing the special committee's minutes. This point has been included as Note 2 (*2).

Additionally, regarding disclosure of assumptions in stock valuations, during recent hearings conducted by the secretariat, investors expressed the need for more detailed disclosures. In addition to the information suggested in the Fair M&A Guidelines, investors sought specific figures on business plan assumptions, free cash flow calculations, and other valuation details. Concerns were also raised about the use of stock as consideration, where valuation may lag compared to cash considerations, and investors requested similarly enhanced disclosure in such cases. We plan to explore specific measures to address these points in the future.

Continuing from page five, we discuss the approach for revising other aspects of the Code.

Starting with page six, it addresses the "Matters to be Observed."

These items primarily consist of actions aimed at regulating corporate behavior that could hinder market functionality or shareholder rights. If violated, these items are subject to measures that ensure compliance.

As noted in previous meetings, these standards may help to prevent problematic corporate behavior. Moving forward, we aim to maintain necessary provisions while conducting a comprehensive review in light of recent cases, developments following the establishment of the Corporate Governance Code, and amendments to the Companies Act.

Page seven discusses the "Matters Desired to be Observed."

These are recommendations for listed companies, defined as voluntary efforts rather than mandatory requirements, and are not subject to the "comply or explain" approach found in the Corporate Governance Code.

Since these are neither enforceable measures nor require systematic disclosure of the progress in these initiatives, the challenge lies in finding ways to encourage listed companies to engage actively.

Given this, the gray-highlighted section outlines our future policy. First, we plan to conduct a thorough review of the Code's content to avoid overlap with the Corporate Governance Code. Additionally, we aim to establish standards that ensure listed companies maintain a minimum level of attitude and infrastructure, such as the IR functions discussed in previous meetings. We may consider adding new standards to the Code for these essential aspects.

To ensure effective compliance, we are considering requiring systematic disclosure of companies' approaches and their initiatives.

At that time, we aim to minimize the disclosure burden on companies. Since governance information in annual securities reports has become more comprehensive, we plan to reorganize the content to reduce redundancy across different reports.

Page eight provides a reference chart outlining the differences between the Code of Corporate Conduct and the Corporate Governance Code.

Alongside these, we also maintain external requests that are not part of the regulations, such as promoting "Management that is Conscious of Cost of Capital and Stock Price," with the intention to preserve this overall structure.

The final discussion points are presented on page 10.

The first item seeks your opinions on advancing the proposed revisions to MBOs and wholly owned conversions by controlling shareholders, as outlined on page four.

Furthermore, for the second item, we invite your views on the approach to revising other areas of the Code, as discussed on pages 6 and 7, as well as feedback on whether further revisions to individual regulations are necessary and, if so, their potential content.

That concludes my explanation.

Watanabe, Director, Listing Department, TSE:

We would now like to hear your questions or comments on these points.

Kumagai, Member:

First, regarding the Code of Corporate Conduct as it pertains to MBOs and wholly owned conversions by controlling shareholders, I understand that many aspects covered in the proposal to enhance the functions of the special committee are already widely implemented in practice, and I believe a review of these items is necessary.

However, as noted in the Ministry of Economy, Trade and Industry's (METI) "Fair M&A Guidelines," it is not always essential to establish a majority-of-minority (MoM) condition. Where such measures are not implemented, companies could instead be required to explain the reasons or provide alternative safeguards.

We should also consider ways to communicate the deliberations and basis for decisions made by the special committee, though it will be essential to determine the best format and disclosure methods to avoid stifling open discussions within the committee.

For enhanced disclosure of assumptions in stock valuations, I believe it would be beneficial to expand the scope of information available to the market in line with the "Fair M&A Guidelines." Furthermore, from the perspective of protecting minority shareholders, we might consider requiring the special committee to obtain a valuation report to support its discussions thoroughly.

Regarding revisions to other areas of the Code of Corporate Conduct, as noted in the secretariat's documents, a review is necessary in light of developments following the establishment of the Corporate Governance Code. It will be important to approach this in a way that considers companies' operational burdens.

Moreover, ensuring the independence of outside directors, who act on behalf of general shareholders, is crucial. We should consider adding criteria to the standards of independence that account for relationships with controlling shareholders, including transactional, economic, and other influential connections.

Matsumoto, Member:

Although I generally have an optimistic view of human nature, I feel we must take a more cautious approach in this matter. Unfortunately, in cases of MBOs or conversions into wholly-owned subsidiaries by controlling shareholders, there are many instances where minority shareholders' interests are deliberately undermined.

When a controlling shareholder attempts to complete a buyout, the high percentage of shares they already own makes the transaction feasible, and in cases where they aim to acquire the company at a low price, merely disclosing assumptions behind the stock valuation often results in a low offer that concludes the deal.

Regarding the enhancement of the special committee's functions on page four it is natural to expand the scope to include MBOs among the covered actions. However, even if the committee is tasked with ensuring that "the fair value due to minority shareholders is secured," there is a risk that the outcome will simply be an opinion stating, "it is secured."

Therefore, I believe it is essential to specify the perspectives for consideration, require thorough explanations of the content of the committee's review and its rationale, mandate disclosure of reasons for not implementing safeguards such as the MoM condition noted in Note 1 (*1), and require publication of the committee's minutes as noted in Note 2 (*2).

Some may argue that publishing the minutes could suppress open discussions, but I would point to the example of these council meetings, where the minutes—including speaker names—are made public without hindering lively debate. On the contrary, I believe that accountability actually improves the quality of discussions, and I expect the same effect for special committees.

Ideally, directors would be bound by fiduciary duties as seen in the US, but this is a matter of law. Although METI's M&A guidelines are excellent, they lack enforceability. Given that intentional undermining of minority shareholder interests frequently occurs in MBOs and controlling shareholder buyouts, we must consider how much protection the Code of Corporate Conduct under listing regulations can provide in such cases.

Nagami, Member:

I don't see any issues with the proposed process outlined on page four, but I believe the responsibilities, burdens, and required expertise of special committee members have increased considerably. It is important to address the composition and qualifications of these members.

Critical aspects to consider include whether the committee has adequate budget allocations for thorough review, if the compensation aligns with the responsibility level, and if the committee has the authority to appoint financial advisors or make decisions. I would like to see a system in place that ensures the special committee and its members can neutrally represent minority shareholders' interests. This should also be discussed thoroughly with market participants.

Additionally, regarding other revisions to the Code of Corporate Conduct, I believe that the recommended item on appointing female directors, noted under "Matters Desired to be Observed" on page seven, should be elevated to a "Matter to be Observed." This would align with current social expectations and could be applied as a requirement, particularly in the Prime Market.

Sampei, Member:

On page four, as I believe will be introduced later, the Study Group on Minority Shareholder Protection at Quasi-Controlled Listed Companies has discussed not only controlling shareholders but also other affiliated companies. Although there is a gradient in the level of involvement, focusing solely on controlling shareholders is too narrow given these discussions, as conflicts of interest exist more broadly. I believe that other affiliated companies should naturally fall within the "range of tender offers equivalent to these actions" as targets for obtaining opinions. Consequently, the heading "opinions regarding whether or not it is disadvantageous to minority shareholders" should be broadened to "opinions on actions not detrimental to minority and general shareholders," and we should consider it within this scope.

In terms of opinion content, while Note 1 (*1) refers to the majority-of-minority (MoM) condition, using "MoM condition" as terminology seems somewhat limiting. The Fair M&A Guidelines emphasize the importance of "confirming shareholder intent," and what matters is explaining how the intentions of minority and general shareholders were confirmed. MoM is just one common method among others. Naturally, any reason for not implementing certain measures must be explained, and the committee's minutes should ideally be disclosed to ensure transparency.

Regarding enhanced disclosure, I believe that providing all specific numerical details of calculation processes is not something every investor expects and may be excessive. What is more critical is the "approach" behind the valuation, not only the assumptions underlying the business plan but also details such as the type of DCF model used, the length of the terminal value period, whether the business cycle is taken into account, the basis for the discount rate, and the extent to which expected value improvements from the acquisition are reflected. Rather than granular numerical disclosures, these considerations should be emphasized.

On page seven, as Mr. Kumagai mentioned, I believe it may be necessary to revise the standards for independence, not only to ensure independence itself. The 2019 amendment to the Companies Act explicitly states that, in MBO and similar situations, outside directors may engage in negotiations regarding transaction terms to avoid conflicts of interest without losing their independent status, which reflects the law's intent to assign significant roles to outside directors. It is essential to have outside directors with a level of independence that allows them to fulfill such responsibilities.

However, in some cases, companies have disclosed that, while they claim to have independent outside directors, not one of these directors meets the criteria necessary to join a special committee when it is established. Such cases overlook the intent of the Companies Act and the Corporate Governance Code. This calls for a review of the independence standards to ensure there are truly independent outside directors who, in critical situations, can take on negotiation roles in line with the Companies Act.

Kuronuma, Member:

I support mandating the establishment of special committees and the requirement for obtaining their opinions in MBO and controlling shareholder buyout situations under listing regulations. Although special committees and opinion gathering are already standard practice for these transactions, formalizing it as a "matter to be observed" under listing regulations would be meaningful.

I also agree that listing regulations should specify the need for sufficient explanations of the special committee's review content and rationale. However, the term "sufficient" can vary, so it may be necessary to structure this requirement in a way that allows for enforcement.

Regarding opinions, I support the requirement for explanations if fairness assurance measures outlined in the Fair M&A Guidelines are not implemented, and for alternative measures to be proposed. However, I believe explanations alone are insufficient, and there should always be some form of alternative measures.

Lastly, on the publication of special committee minutes, I am somewhat hesitant. For instance, if the minutes openly detail comparisons of multiple options, there is a risk that dissenting shareholders could exploit this information, possibly leading to lawsuits challenging the validity of the resolutions. My concern is that requiring publication could inhibit thorough deliberation by the committee. However, this is based on my general impression, as I am not familiar with the specifics of practical application.

Okina, Member:

I also support the proposal on page four to mandate the establishment of a special committee and the requirement to obtain its opinion under listing regulations. I agree that the committee's opinions must include sufficient explanations of their content and rationale, especially on pricing, which is consistently a critical issue. It is essential to appoint an independent external financial advisor to evaluate the price, as outlined in the materials, and to implement the MoM condition as a standard approach, with an explanation required if not applied.

While there are concerns about the special committee becoming superficial or constrained, I believe increased transparency is necessary to some extent. Regarding the stock valuation criteria, it is crucial to disclose the underlying assumptions of the business plan. Considering that special committee members are generally independent outside directors, as discussed, revising independence requirements is also essential.

In terms of aligning the Corporate Governance Code (CG Code) with the Code of Corporate Conduct, it's vital to minimize redundancy. Important elements unique to the Code of Corporate Conduct should remain, while items that can be absorbed into the CG Code should be integrated.

Uchida, Member:

While some aspects may be unavoidable, I am concerned about the risk of placing an excessive burden solely on the special committee and independent outside directors. In cases where there is a controlling shareholder or a controlling shareholder "and others," each represents a unique environment, and although I don't have specific ideas to offer, I think it would be helpful to consider how to make this framework function effectively.

Additionally, in situations involving a controlling shareholder "and others"—such as other affiliated companies—the earlier reference to a "gradation" of influence is relevant, as these scenarios could readily lead to situations where the interests of minority and general shareholders are compromised. Therefore, measures to ensure that the interests of minority and general shareholders are not adversely affected should be as stringent as those applied when a controlling shareholder is involved. In any case, as these considerations are reviewed, I believe it will be necessary to incorporate this perspective in some form.

Matsumoto, Member:

The Ministry of Economy, Trade, and Industry's (METI) "Fair M&A Guidelines" imply that our country relies on independent outside directors to address these issues, so I believe we should strengthen efforts to raise the awareness and capabilities of independent outside directors.

Regarding the disclosure of meeting minutes, since special committee members are generally independent outside directors, and Japan's Companies Act requires that board meeting minutes include the remarks of outside directors for listed companies, if discussions are held thoroughly at the board level, shareholders should be able to understand the content of these discussions by requesting access to the board minutes. From my observations, the critical issue is whether or not genuine discussions are taking place. I'm concerned that in some cases, the valuation reports submitted by the financial advisor (FA) on the acquirer's side are accepted without debate, effectively disregarding the interests of minority shareholders on the selling side. By creating pressure to disclose special committee minutes, I believe it will prompt thorough discussions on whether there are indeed concerns for minority shareholders. And since such discussions should also be reflected in the board minutes, the risks highlighted by Mr. Kuronuma regarding the exposure of special committee members may not be significantly affected.

Watanabe, Director, Listing Department, TSE:

Thank you very much.

Next, we will provide an update on the discussions of the Study Group on Minority Shareholder Protection at Quasi-Controlled Listed Companies.

Yamawaki, Manager, Listing Department, TSE:

Please refer to Document 9, which contains materials from the most recent meeting on October 17.

Page four summarizes the history of parent-subsidiary listings.

In 2007, TSE issued a policy statement on subsidiary listings, recognizing the potential for conflicts of interest between parent companies and minority shareholders and began implementing a listing framework to protect minority shareholders in stages.

More recently, as the need for adequate minority shareholder protection has increased, there is a growing need to reevaluate group management to ensure optimal group-wide practices.

Page five provides the 2007 "Guidelines for the Listing of Companies with a Parent Company" for reference.

At the time, amid instances of subsidiaries being listed for short-term purposes, such as assisting with the parent company's accounting strategies, TSE expressed concerns that subsidiary listings involving potential conflicts of interest with minority shareholders might not constitute ideal capital policies. The guidelines thus called for increased consideration for minority shareholder interests and accountability to investors.

Moving on to page six, this page outlines the trends in the number and proportion of listed subsidiaries.

Listed subsidiaries have been gradually declining due to recent moves toward making them wholly-owned or selling subsidiary shares.

However, the number of listed companies with major shareholders holding 20% or more, despite not being parent companies, continues to rise, reaching nearly 1,000 companies as of 2024. Concerns have been raised that these shareholders may exert significant influence through voting rights or governance agreements, yet the actual state of these relationships remains unclear.

Skipping ahead to page 10, in light of this situation, TSE organized and published key disclosure points regarding minority shareholder protection and group management at the end of last year, specifically for listed parent-subsidiary relationships and equity-method affiliates. This effort aimed to enhance predictability for minority shareholders in their investment decisions.

Following the June shareholders' meetings this year, we conducted a follow-up assessment of these disclosures based on the Corporate Governance Reports submitted afterward, as indicated in the green box at the bottom of the page.

From page 12 onward, we review the disclosure status of parent-subsidiary relationships.

Given the existence of minority shareholders in listed subsidiaries, parent companies are expected to explain to shareholders and investors how they achieve group-wide optimization, considering the necessity of protecting minority shareholders, and whether there is a rational basis for maintaining subsidiaries as listed entities.

On page 12, while 80% and 50% of parent companies disclosed the rationale for retaining and listing subsidiaries and their business portfolio strategies, respectively, the content often highlighted benefits like expanding business partnerships and securing talent due to the listing.

On the other hand, many disclosures focused on benefits such as expanding business partners and securing talent through listing, while few mentioned comparisons with potential disadvantages or examined the rationale relative to other ownership structures, such as holding the company as a wholly-owned subsidiary.

For subsidiaries, as shown on page 14, only 20% to 30% disclosed information on group management policies, such as their role in the parent company's business portfolio. Subsidiaries reported challenges in making such disclosures, particularly when the parent company was not proactive in disclosure.

Finally, regarding governance measures to protect minority shareholders, including policies on the selection and dismissal of subsidiary directors and voting rights, pages 16 and 17 show that only around 20% of both parent and subsidiary companies provided such disclosures. This remains an area of significant interest.

Moving ahead to page 19, we note that at the end of last year, TSE also began recommending disclosures on minority shareholder protection and group management for listed companies that are equity-method affiliates.

However, looking at the actual state of disclosures, only 61 listed companies with related listed affiliates and 144 companies with other affiliated companies have made disclosures. Considering that around 1,000 companies have major shareholders holding 20% or more without being parent companies, disclosure remains limited at this point.

Reflecting on these disclosure trends, page 21 outlines the discussions from the recent meeting.

Specifically, some market participants, including listed companies, have voiced concerns that the TSE's stance and policy direction on parent-subsidiary listings are unclear, making it challenging to advance disclosures or explore group management strategies. In response, TSE is discussing plans to clarify and communicate a formal message on its position and future policies regarding parent-subsidiary listings to encourage proactive efforts from listed companies.

The secretariat's proposal presented in the meeting is summarized on page 22. It reaffirms that protecting minority shareholders in subsidiaries, an area to which we have already devoted significant attention, must continue to be addressed appropriately. TSE is committed to ongoing consideration of necessary listing framework adjustments to safeguard minority shareholders.

Additionally, as stated in the third bullet point, we aim to send a message highlighting that parent company governance itself is a critical factor. Specifically, beyond simply achieving synergies in group management, it is vital to protect minority shareholders adequately and ensure that boards of directors consider how to optimize the group holistically to enhance corporate value over the medium to long term. Companies are expected to demonstrate accountability to shareholders and investors by clearly articulating these considerations.

As shown in Document 10, members of the meeting provided various opinions on this approach, which will be incorporated into revisions before formal publication and announcement.

We also plan to continue following up on group management disclosures. After conducting hearings with investors, we aim to compile and publish a case study collection early next year, outlining key disclosure points to further guide companies.

This concludes my explanation.

Watanabe, Director, Listing Department, TSE:

Thank you. I would now like to invite any questions or comments.

Okina, Member:

On page 22, the third bullet states that "the need to suitably protect minority shareholders," but I believe that minority shareholder protection should be ongoing, not limited to particular situations. For example, in cases where a listed parent and listed subsidiary engage in transactions, whether these transactions are conducted at appropriate prices should be thoroughly discussed by both companies' boards with minority shareholders in mind.

I also have some doubts as to how well outside directors are aware of these issues, so efforts should certainly be made to raise their awareness. It might even be worth requiring companies to disclose their policies on how they handle intercompany transactions between parents and subsidiaries. There are types of listed subsidiaries that have routine business dealings with the parent company, so at minimum, companies should disclose their approach to such matters, and it would be beneficial if outside directors' monitoring role in these transactions were clearly visible to external observers.

Sampei, Member:

As a member of this study group, I observe that while certain items have seen progress in disclosure following TSE's requests, others have not. It's concerning that, despite the critical nature of these discussions, there is still significant lack of disclosure.

We discussed the Code of Corporate Conduct earlier, and currently, the key disclosure points requested here are not generally included in mandatory items under listing regulations or the Corporate Governance Code, aside from a few exceptions. Given that minority and general shareholders are the most numerous participants in the stock market, the inability to protect them is a significant problem. I believe a substantial portion of these key disclosure points should be incorporated into the "Matters to be Observed" under the Code of Corporate Conduct. However, if we were to implement this abruptly, it might cause confusion. Therefore, it would be advisable to announce this intent while encouraging companies to prepare seriously, and eventually integrate a substantial portion into the "Matters to be Observed." If we do not take this approach, companies may continue with selective disclosure, where they only disclose favorable items while disregarding less favorable aspects. Allowing this selective approach without enforcement would be a serious issue.

Watanabe, Director, Listing Department, TSE:

Thank you very much.

With that, we will conclude today's meeting.

Lastly, we would like to provide some information about the schedule for the next session.

Ikeda, Senior Manager, Listing Department, TSE:

Thank you all for another active discussion today.

Although this may overlap with what was explained in the preliminary briefing, I would like to provide an update regarding the publication of our meeting schedule.

Until now, the meeting date was announced on the website the day before each session. However, we have received many requests from market participants who would like to know the schedule further in advance so they can review materials on the day of the meeting in a timely manner.

Therefore, starting with the next meeting, we plan to announce the meeting date on the website one week in advance. This decision incorporates the feedback received during the preliminary briefing.

As for the agenda, we will consult with you again in the preliminary briefing. Since we have been conducting discussions with various parties on the Growth Market, which was skipped this time, we hope to cover it in the next session.

Watanabe, Director, Listing Department, TSE:

With that, we will adjourn today's meeting. Thank you very much for your participation, and we look forward to seeing you at the next meeting.

[END]