

May 14, 2021  
Tokyo Stock Exchange, Inc.

Outline of Comments Submitted on "Revisions of TOPIX and Other Indices"

Tokyo Stock Exchange, Inc. (TSE) implemented an index consultation to solicit public comments on "Revisions of TOPIX and Other Indices" from December 25, 2020 to February 26, 2021. As a result, TSE received many comments on approaches for future revisions of TOPIX, etc. We appreciate the valuable comments of all respondents. Below is an outline of these comments.

Item	Outline of comments
1	· The method of the periodic reviews of constituents after the transition as of the end of January 2025 should be conducted in ways such that it maintains the enhanced liquidity due to this TOPIX review. We ask that the policy for such reviews be announced at an early timing.
2	· We would like you to guarantee that future versions of TOPIX will maintain its original intent of reflecting the trend of the entire stock market.
3	· We think that TOPIX should not just be an index whereby investors buy the entire stock market, but also have constituent companies with potential for sustainable growth and exhibit a certain level of liquidity. This could be achieved through TOPIX periodic reviews that instill discipline among listed companies and generate dynamism in companies and the overall economy, which then lead to the growth of the overall economy. · We think that TOPIX can contribute, through maintaining the sustainability, etc. of TOPIX constituents, to allowing investors to invest

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	<p>confidently in TOPIX as a financial instrument for a long period of time and enjoy the growth of the stock market and the overall economy at low cost.</p> <ul style="list-style-type: none"> <li>· We think the adoption of a certain level of rules for TOPIX constituent reviews such that it is comprised of stocks with potential for sustainable growth will send a strong message to companies that they are called upon to seek sustainable growth and lead to more effective dialogue between investors and companies that want to attract investment via TOPIX.</li> <li>· Based on the above reasons, we agree with the periodic review of TOPIX constituents. We want TSE to consider establishment of a substantive framework for constituent reviews that leads to the realization of the above effects. In addition, as a responsible investor in the investment chain, we would like to continue contributing to the improvement of TOPIX and other indices.</li> <li>· In addition, we think it desirable that TOPIX should be comprised of a certain number of stocks. Main reasons are as follows; (i) maintaining investment possibilities for the large pool of funds that are already invested in TOPIX, (ii) maintaining the representativeness of TOPIX as an indicator of the trend of the entire market and its nature as a financial indicator that serves as a barometer of the economy, (iii) securing a certain degree of diversified investment effects and investment opportunities, (iv) ensuring diversity of investment in companies that meet certain criteria, and (v) maintaining the balance in the sizes of companies subject to investment via the index.</li> </ul>
4	<ul style="list-style-type: none"> <li>· We understand that, among others, post-transition rules for exclusion from TOPIX will be separately established. We request that such rules be strict so as to incentivize sustainable improvement of corporate value by companies.</li> </ul>
5	<ul style="list-style-type: none"> <li>· We think that excluding stocks whose tradable market capitalization is less than JPY 10 billion will make TOPIX constituents very easy to handle in -operations. We ask TSE to, even after the completion of the transition period, maintain the characteristic of TOPIX constituents as a "group of stocks that are tradable" and channel efforts toward developing the various sub-indices. We think that, if sector-indices (a tiered structure is desirable), size-based indices, style-indices, ESG indices and smart beta indices which are in</li> </ul>

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	line with actual conditions are developed, the base of the Japanese stock market will be broadened and convenience for investors will be improved.
6	<ul style="list-style-type: none"> <li>· We ask that you maintain the nature of TOPIX as an indicator and its continuity while letting other needs be satisfied by sub-indices. (For example, with respect to ESG investment, ESG elements should not be incorporated into TOPIX but be covered by sub-indices as needed.)</li> </ul>
7	<ul style="list-style-type: none"> <li>· We want TSE to, in future, exclude stocks whose tradable share market capitalization is JPY 10 to 25 billion from TOPIX. This is currently a condition for continued inclusion in TOPIX.</li> <li>· Determining TOPIX constituents based on tradable share market capitalization will, depending on stock market trends, affect the number of stocks that will be subject to investment via the index. Therefore, tradable share market capitalization should be used as supplementary criteria.</li> <li>· The approach for the review (i.e., exclusion of low market cap stocks and low liquidity stocks, and weight caps) is appropriate. However, we request you to take it one step further. For example, the review should also cover how you will handle stocks whose market capitalization is JPY 20 billion or less and trading turnover ratio of XX% or less.</li> </ul>
8	<ul style="list-style-type: none"> <li>· "Tradable shares" and "free-float shares" are mainly utilized in examination of listing eligibility, etc. and TOPIX calculation, etc., respectively. However, the substance of these two criteria is similar and has common aspects. As such, we think that it will be easy to understand if the criteria are consolidated into either of them, which will maintain consistency.</li> <li>· These two criteria have similar definitions and applying them at the same time will lead to confusion.</li> <li>· Tradable share market capitalization functions as a criterion for determining "phased weighting reduction constituents". In addition, for example, stocks that will be listed on the Prime Market during the transition period (i.e., those with tradable share market capitalization of JPY 10 billion or more) will be included in TOPIX. Tradable share market capitalization is utilized not only for listing</li> </ul>

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	<p>eligibility but also as criteria related to TOPIX.</p> <ul style="list-style-type: none"> <li>For example, the number of tradable shares is not disclosed while free-float weight is disclosed via disseminated information. Even though these two aspects are essentially the same, there is asymmetry in terms of the level of information transparency.</li> </ul>
9	<ul style="list-style-type: none"> <li>As the criteria for TOPIX constituents (remaining stocks) during the transition period, tradable share market capitalization is set to JPY 10 billion. While this is inevitable in light of maintaining consistency with the listing criteria for the Prime Market, after the transition period, the TOPIX universe should not be based on the absolute value of market capitalization. Instead, relative criteria such as the ratio of coverage of the market capitalization (of free-float shares) of the entire market should be established. If the absolute value of market capitalization is used, there are concerns that there will be large fluctuations in the number of TOPIX constituents depending on stock prices in the entire market. Since more than a handful of stocks that do not satisfy the listing criteria and continued listing criteria would still be expected to be migrated from the 1st Section to the "Prime Market", it would be inappropriate for the TOPIX universe to cover the entire Prime Market.</li> </ul>
10	<ul style="list-style-type: none"> <li>In the future, as criteria to include (or keep) stocks in TOPIX, the market capitalization and liquidity levels should be revised to more stringent criteria.</li> <li>When the market capitalization criteria are made permanent in the future, if, for example, the market capitalization decreases by two thirds as in the case of the Lehman Brothers crisis, the number of constituents will drastically decrease. Conversely, if a bubble happens, the number of constituents will increase. In other words, the number of TOPIX constituents will be affected by stock market trends, won't it?</li> </ul>
11	<ul style="list-style-type: none"> <li>The proposed revisions mention that the transition rules this time are in response to the changes to the market segments and that consultations on TOPIX periodic selection rules, etc. will be conducted after the transition is completed. With the rule revisions, "TOPIX will be separated from market segments and aimed at further improving functionality as an investment target, in addition to</li> </ul>

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	<p>market representativeness". Currently, as long as a company is listed on the TSE 1st Section, it is a TOPIX constituent, which means easing the listing criteria is equivalent to easing of the criteria for selecting TOPIX constituents. Accordingly, there are some cases where the question remains about whether TOPIX constituents satisfy a certain level.</p> <ul style="list-style-type: none"> <li>Also, if you set an absolute criterion of tradable share market capitalization of JPY 10 billion, the functionality as an investment target may be damaged in the future as the number of TOPIX constituents increases. As such, after the transition period, we want TSE to consider introducing mechanisms, for example, that set a limit for the maximum number of constituents, or allow the criteria for tradable share market capitalization to be changed flexibly so as to maintain the quality of the index.</li> </ul>
12	<ul style="list-style-type: none"> <li>The role of TOPIX is, like the US's S&amp;P 500, considered to be an incentive for listed companies to constantly increase their value. If "securing the means to recover invested capital by transferring shares owned" is a prerequisite for listed companies and the function of the cash equity market, it is not possible to fulfill this function simply by securing venues for transferring shares. Investors buy shares in expectation of returns because they expect the value of shares to increase, and shareholders can smoothly transfer shares when they want to recover the invested capital. If the value of shares is not expected to increase, there will be only those who buy shares that they think would rebound from short-term excessive selling or make short-term gains due to certain developments. As such, shareholders will have limited opportunities to recover their invested capital. In other words, there is no sense to make medium- to long-term investment when enhancement of corporate value is not expected, and the cash equity market will only be a venue for short-term trading. Therefore, for indices that are representative of the asset classes and serve as benchmarks for institutional investors, an upper limit should be placed on the number of constituents, which would continuously and comparatively evaluate companies that aim to be included as constituents, and that would encourage competition for higher evaluations. The criteria for selecting constituents should, of course, include enhancement of corporate value, and the examination on capability to enhance corporate value should be simple, transparent, and objective. We expect that these matters will be</li> </ul>

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	<p>considered based on the report by the Expert Study Group on Capital Markets in Japan of the Financial System Council. In addition, the number of eligible stocks to be selected requires to be limited to a certain extent so that the criteria can function as an appropriate incentive for listed companies. For example, for S&amp;P500, approximately 500 companies are selected as constituents from among 5,000 to 6,000 US-listed companies. As such, in the case of Japan, since there are approximately 4,000 listed companies, approximately 500 would be an appropriate number of constituents. It is necessary to note that if this number exceeds 1,000, index inclusion will not be expected to function as an effective incentive.</p>
13	<ul style="list-style-type: none"> <li>· We request that criteria for market capitalization and liquidity should be established for the TOPIX constituent review, so that stocks with low investment appeal for some reason are excluded and the number of constituents is 1,000 stocks or less. If possible, how about fixing the number of constituents, instead of selecting constituents based on market capitalization? Moreover, in terms of investment possibility, reducing the number of shares per Share Unit would be a reasonable way.</li> <li>· We question the need for indices other than TOPIX. For example, as indicated by the fact that even JPX-Nikkei Index 400 has only a small amount of net assets if we exclude those for ETF operations, to what extent have demands for indices other than TOPIX increased?</li> <li>· We suspect that one reason why demand for JPX-Nikkei Index 400 has not increased is that, regardless of whether it is good or bad, it is difficult for the index to be differentiated from TOPIX. In the light of market segments, we think that, rather than putting an emphasis on a market segment for large-cap stocks, markets that simply bundle together recently-listed stocks or small-cap stocks will be attractive.</li> </ul>
14	<ul style="list-style-type: none"> <li>· TOPIX, one of Japan's representative stock market indices, is an important indicator for domestic and overseas investors to determine whether or not they will invest in the Japanese market in comparison with markets in other countries. We think that the new TOPIX should be attractive to its customers, meaning investors, rather than simply being an index comprised of all companies</li> </ul>

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	<p>listed on the Prime Market. In light of this, we think that the lack of tension such as constituent reviews for listed companies is detrimental. In fact, with respect to, for example, the US's S&amp;P, the UK's FTSE, and German DAX, their constituents are basically subject to review.</p>
15	<ul style="list-style-type: none"> <li>· The Final Report by the Expert Study Group on Capital Markets in Japan of the Financial System Council published in December 2019 stated, "There were some comments on capping the number of constituents and changing the composition of TOPIX on a regular basis, or taking into account qualitative factors such as sustainability from the perspective of those including, but not limited to, corporate governance and environment when selecting these companies. These issues may need to be discussed further". However, the actual result of detailed studies on this issue is not clear. Is it correct to understand that this issue is included in the statement in the fourth item of the overall plan for revising TOPIX that "A separate index consultation will be conducted later with regard to rules ..., such as rules for periodic reviews of TOPIX constituents, or the possibility of including stocks listed on the Standard Market or the Growth Market as TOPIX constituents", and that a separate consultation will be conducted later?</li> </ul>
16	<ul style="list-style-type: none"> <li>· We have concerns that, despite revising the listing segments, the Growth Market will become a preparatory market where companies wanting to list on the Prime Market are listed. The Growth Market should be a market for companies with high growth potential even in a mature economy like Japan. Like the Nasdaq market in the US, the brand image of high growth should be the incentive for companies to wish to remain listed on the Growth Market. Since the Growth Market is a market where domestic and overseas investors seek high growth companies, we think that the market should be an attractive one that is comprised of companies, from small to large, that are growing.</li> <li>· As such, the new TOPIX should target companies listed on the Prime, Standard, and Growth Markets, and as a widely investable benchmark for investors, its constituent universe should be, for example, comprised of stocks that occupy 80% or 90% of the total market capitalization, which are selected in the descending order of tradable share market capitalization. That way, there will be a</li> </ul>

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	<p>shift from the idea of obtaining a listing on the Prime Market via the Growth Market as an indication of status to the idea of achieving market capitalization growth while listed on the Growth Market and being included as a constituent of the new TOPIX as an indication of status. In this sense, we think that there will be two benefits: (1) constituent reviews will serve as an incentive for companies to improve corporate value, i.e., market capitalization; and (2) the Growth Market can be nurtured as an attractive market on par with the Prime Market.</p>
17	<ul style="list-style-type: none"> <li>· Based on the findings and analyses included in the Final Report by the Expert Study Group on Capital Markets in Japan of the Financial System Council, for the new TOPIX, the number of constituents should be capped and such stocks should be selected not only from the Prime Market but also from the Standard and Growth Markets. From this perspective, specific measures to ensure appropriate market discipline is instilled should be put under an index consultation.</li> </ul>
18	<ul style="list-style-type: none"> <li>· I agree with the proposal to separate TOPIX from the market segment (i.e., TSE 1st Section). In consideration of TOPIX being a general benchmark for institutional investors, etc., I think that both TOPIX itself and the improved performance of active investments benchmarked by TOPIX are indispensable for Japan's growth strategy and enhanced asset management.</li> <li>· As it is highly probable that funds to support universities that the government is now considering will be passively managed based on TOPIX and actively managed and benchmarked by TOPIX, I make the following proposals: (1) TSE should clarify a roadmap for approximately the next 10 years and narrow down the number of constituents to approximately 500 in stages; (2) constituents should be limited to stocks listed on the Prime Market and the Growth Market; and (3) instead of selecting constituents based on quantitative scores, etc. in the case of indices such as JPX-Nikkei Index 400 which cannot outperform Nikkei 225 or TOPIX, TSE should commission constituent selection to a third-party committee to avoid conflict of interests and prevent market participants from pre-emptive trading by separating the function of such selection from TSE.</li> </ul>
19	<ul style="list-style-type: none"> <li>· We agree with the proposal to include corporate governance and ESG responses, etc. in the listing criteria. However, TSE should</li> </ul>

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	be cautious about excessively reflecting those elements into TOPIX, which is a market capitalization-weighted index, because this would make TOPIX lose its continuity.
20	<ul style="list-style-type: none"> <li>· ESG includes various elements (emissions, social contribution, controlling structure, etc.). Since the scores of all the elements do not necessarily lead to higher returns in the long run, first of all, it is necessary to conduct in-depth deliberations on what are important for investors (i.e., corporate value). In such deliberations, ESG scores must not be considered for TOPIX.</li> </ul>
21	<ul style="list-style-type: none"> <li>· By separating TOPIX from market segments, low liquidity and investment eligibility issues that TOPIX has faced can be addressed, and there are expectations for further improvements to the functionality of TOPIX for investment. In addition to formulating TOPIX calculation rules and operations, we expect that even some stocks listed on the Standard Market or the Growth Market might possibly be included in TOPIX if they meet certain criteria that are high enough for stocks listed on the Prime Market.</li> <li>· We request further sophistication of index governance including objectivity and transparency for formulating TOPIX calculation rules and operations going forward.</li> </ul>
22	<ul style="list-style-type: none"> <li>· The revisions of TOPIX do not mention a governance perspective. It would seem that this point is being considered in conjunction with criteria for each market segment (Prime Market, Standard Market, and Growth Market) after revisions are made to Japan's Corporate Governance Code which are scheduled for this spring. In the future, since the Prime Market will not be the equivalent of TOPIX, a mechanism that guarantees high levels of governance for TOPIX constituents after the revisions is required, which we recognize is an important issue for deliberations.</li> </ul>
23	<ul style="list-style-type: none"> <li>· For calculating stock price indices such as TOPIX, giving incentives of some sort should be considered depending on the degree of application to the Japan's Corporate Governance Code.</li> <li>· It is true that it would be difficult to apply all the principles for start-up companies that have short histories with a poor management base. However, unless TSE requires companies, especially those with market capitalization of over JPY100 billion, to strengthen</li> </ul>

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	<p>governance comparable to that required for Prime Market listed companies, development of the emerging market could be hindered by companies making false statements, etc. which would discourage overseas investors that have been entering the emerging market.</p> <ul style="list-style-type: none"> <li>· In terms of market capitalization, criteria to remain listed on the Growth Market has become stricter than those for the Mothers market. However, in terms of calculating stock price indices, etc., it might be a good idea for TSE to give preferential treatment to companies that proactively apply principles in addition to basic principles of the Japan's Corporate Governance Code. It is also beneficial to focus attention on start-up companies that actively apply the corporate governance code and TSE should encourage analysts to actively publish reports on such start-up companies.</li> <li>· In connection with restructuring of the market segments, the JASDAQ index and Mothers index will be discontinued. We expect that by evaluating companies whose active use of voluntary Japan's Corporate Governance Code under the Growth Market index that these companies that incorporate and strengthen ESG initiatives will in turn be rewarded by market capitalization and also spread the impact to other start-up companies which would lead to development of SDG initiatives.</li> <li>· With respect to Japan's Stewardship Code and Corporate Governance Code, follow-up meetings are held continuously. Business circles should not be on the sidelines regarding the issues related to the Olympic Organizing Committee as someone else's problem, and we strongly request that JPX encourage listed companies to address challenges that include making the board more effective and ensuring diversity in the board of directors through for example promoting gender equality.</li> </ul>
24	<ul style="list-style-type: none"> <li>· The Final Report by the Expert Study Group on the Structure of Capital Markets in Japan of the Financial System Council published in December 2019 mentions that "capping the number of constituents and changing the composition of TOPIX on a regular basis", "taking into account qualitative factors such as sustainability from the perspective of those including, but not limited to corporate governance and environment when selecting these companies", and "these issues may need to be discussed further". What will be</li> </ul>

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	the approach for these issues?
25	<ul style="list-style-type: none"> <li>· We think it might be a good idea to provide a limited remedy for those companies that get demoted due to failing to meet the continued listing criteria of the Prime Market (such as the number of shareholders and tradable market capitalization ratio). (Responding to an unexpected situation)</li> </ul>
26	<ul style="list-style-type: none"> <li>· During the revisions of TOPIX in April 2022, it has been proposed that only the Securities on Alert are to be excluded from TOPIX constituents. However, for the next review, we think that it might be a good idea for TSE to consider determining investment eligibility from a broad perspective that includes ESG (environment, social, and governance) elements.</li> </ul>
27	<ul style="list-style-type: none"> <li>· In the future, when an issue with a mega market capitalization enters the universe, the index inclusion timing and inclusion in stages should be done while taking into consideration market liquidity. (and vice versa)</li> </ul>
28	<ul style="list-style-type: none"> <li>· We request that issues eligible for futures be expanded. For development, we request that TSE tries to maintain liquidity that guarantees hedging function and investability, and to be traded at a fair price.</li> </ul>
29	<ul style="list-style-type: none"> <li>· For the market segments, we think it should be enough to have more stringent listing criteria in terms of market capitalization, profit, and the number of tradable shares.</li> <li>· If TSE establishes new market segments of Prime, Standard and Growth at the same time as listing new TOPIX constituents on more than one market segment, then TSE does not need to define each market segment separately since we think it would cause confusion. If TOPIX constituents are separated into multiple markets, market segments are not necessary. If TSE establishes the market segments, appropriate index constituents of "TOPIX constituents is equal to the Prime Market listed issues", according to the market segments.</li> <li>· The revisions of market segments give us a strong impression that each market of Prime, Standard and Growth is connected seamlessly. If TSE clarifies the characteristics of each market, we think it could become a market that contributes to investor</li> </ul>

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	preferences.
30	· We request that TSE provide a market that can trade stock acquisition rights for new shares and preferred shares that have been issued by companies to shareholders. (We have difficulty in judging whether a trade price is fair for off-market trading.)