(Reference Translation)

# Comments Received from Market Participants in Response to the Review of the TSE Cash Equity Market Structure

## (Updated)

**Tokyo Stock Exchange, Inc.**

**March 2019**

**(Update May 2019)**

Published in March 2019 (Updates made in May 2019 are in *red letter*)

Contents

Published in March 2019 (Updates made in May 2019 are in *red letter*)

# I. About This Document

Tokyo Stock Exchange (hereinafter "TSE") has been studying and discussing the various issues regarding TSE cash equity market structure since last year, to consider the ideal market structure in the future. For the review, TSE conducted public consultation, from December 2018 to January 2019, on the main discussion points for review of the market structure, and has received approximately 90 responses. TSE has also conducted approximately 70 individual interviews aside from the above public consultation. This document is intended to summarize the comments received from market participants in the above process.

The summaries in this document do not include direct quotations of the original comments. Similar comments could have been combined or paraphrased to avoid repetition. Moreover, comments that only point out facts, those that refer to individual concrete cases, and those that run counter to the intent of the comment solicitation have not been included in this document.

Comments received in languages other than Japanese are translated into Japanese when preparing the official version of this document. Although every effort is made for accuracy of translation, there might be technical differences in nuance between the original text and its translation.

# II. Names of Respondents

The below lists those who have submitted their responses in the review of the TSE equity market structure. Only those who have agreed to have their names published are listed (excluding individuals). The names are based on the company name submitted along with the comments.

We have also received comments from accounting firms, professors and law firms. Below figure shows the ratio of types of all market participants who provided comments, please refer to the figure.

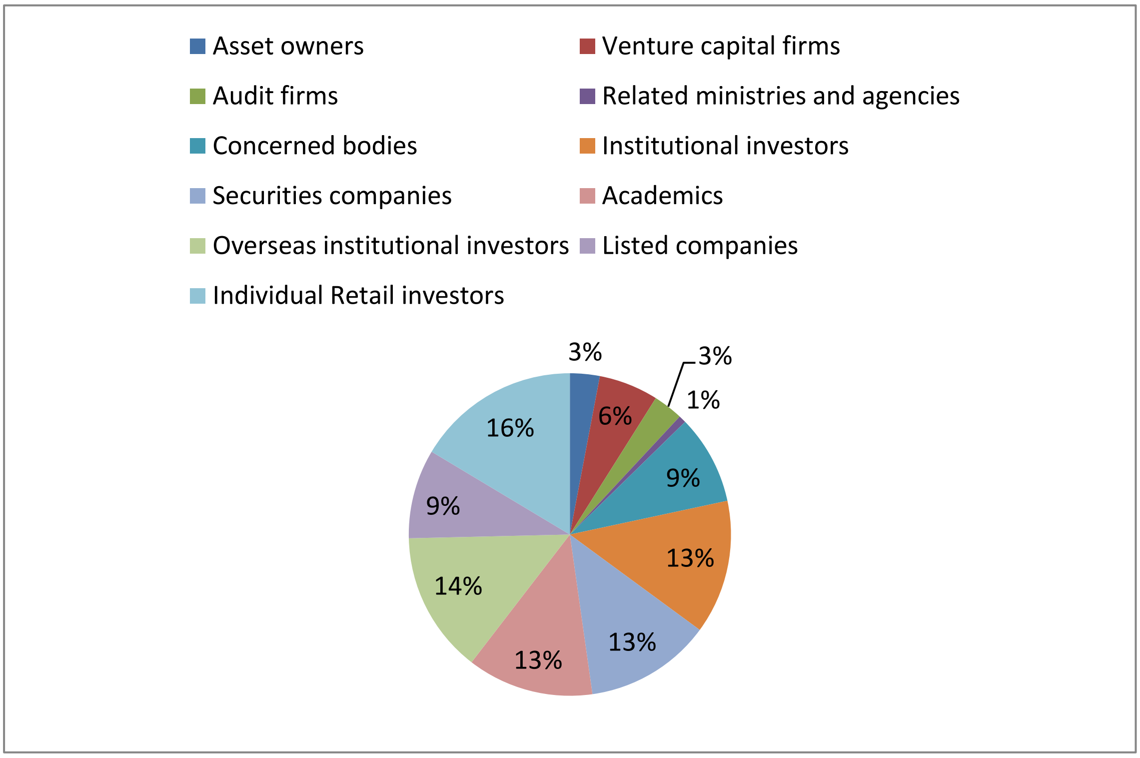
(Those who submitted their responses [Only those who have agreed to have their names published])

3D Investment Partners Pte. Ltd.
Apollo Investment Management Ltd
Asset Value Investors
BNP Paribas Securities (Japan) Limited
BrilLiquid LLC
Canyon Partners
Cornwall Capital
Fir Tree Partner
IFRS Foundation Asia Oceania Office
Kaname Capital
Sagami Holdings Corporation
Signifiant Inc
JAFCO Co., Ltd.
Institute for Legislation surrounding Listed Companies
Simplex Asset Management Co., Ltd.
Japan Stewardship Forum
Strategic Capital, Inc.
Daiwa Securities Co. Ltd.
Daiwa Asset Management Co.Ltd.

King Street Capital Management, L.P.
Monarch Alternative Capital LP
PointState Capital LP
RMB Capital
Swedbank Robur
Taiyo Pacific Partners LP
TOA Corporation
VARECS Partners Limited
Asset Management One Co., Ltd.
Ichiyoshi Securities Co., Ltd.
Pension Fund Association
Kita no Tatsujin Corporation KK
GLOBIS CAPITAL PARTNERS
Ministry of Economy, Trade and Industry
TOKYO ENERGY & SYSTEMS INC.
The University of Tokyo Edge Capital Co., Ltd.
The Investment Trusts Association, Japan
NAITO Securities Co., Ltd
Nikko Research Center, Inc.
The Japanese Institute of Certified Public Accountants
JAPAN ELECTRONIC MATERIALS CORPORATION
Japan Investment Advisers Association
The Institute of Internal Auditors - Japan
Norinchukin Value Investments Co.,Ltd.
FIL Investments (Japan) Limited
PEGASUS SEWING MACHINE MFG. CO., LTD.
Mitsubishi UFJ Trust and Banking Corporation
Mitsubishi UFJ Morgan Stanley Securities Co., Ltd.

(in Japanese alphabetical order)

Figure: Entities that provided comments



# III. Summary of Market Responses

## 1. Issues Regarding the Current Market Structure

### （1） The Concept of Market Segments

**Responses regarding market segment**

***a. Roles and functions of the current market divisions are overlapping and confusing. (21 comments)***

- Current 4 market segments (1st Section, 2nd Section, Mothers, and JASDAQ) are too complicated and fragmented. Especially the difference between 2nd Section, Mothers, and JASDAQ, is confusing for investors and therefore small and mid-cap companies are losing their appeal to and interest of investors.
- Having 4 different market segments do not increase the company's capability to raise capital. Also, from investors' point of view, it does not make it easier to invest.
- There is no need to have many market segments, as much as it has now, so clarification of each market's roles and simplification is necessary
- Because of the multiple market segments, the investment risk for small and mid-size companies is not clear to investors
- Current market structure has multiple small and mid-cap company's market segment and start-up company's market segment, what is especially confusing is that there are Mothers, JASDAQ and 2nd Section as markets for IPO
- Both Mothers and JASDAQ (Growth) are for companies with high growth potential. This confuses investors, because they cannot tell the difference and it adversely affects the motivation of emerging companies to grow.
- Mothers and JASDAQ (Growth) are markets for IPOs of start-up companies, but recently JASDAQ (Growth) has no IPOs and is not functioning as IPO market. (Mothers is for early-stage companies whereas JASDAQ Standard is for companies with a long history, in our understanding.)
- The difference of the 2nd Section and JASDAQ Standard is confusing.
- The 2nd Section and JASDAQ Standard is similar.
- Currently the 2nd Section and JASDAQ Standard co-exist, but there is no need to have both markets.

(Reference)

・Current Market Structure (Additional Material page 2)

・Number of IPOs (Additional Material page 3)

・Number of Years in Business at the Time of IPO (Additional Material page 4)

**Responses regarding the current state of market environment for start-up companies**

***b. Companies to be listed on the market. (10 comments)***

- Mothers, in comparison with other markets around the world, is an "open" market even to the small scale IPOs, and its presence and function is crucial to the growth of start-up companies and to the industrial development in Japan.
- Compared to similar cash equity markets around the world, Mothers is unique in that a wide-range of companies are listed and has very high liquidity thanks to high retail investor participation.
- Compared with other markets around the world, Mothers is a market where companies can be listed at the earliest of their life cycle. Also Mothers has high liquidity, so there are foreign companies that find those characteristics of Mothers appealing.
- The uniqueness of Japanese emerging company-market is the wide range of companies that are approved for listing.
- The width of companies that Mother accepts is appropriate (it will be difficult for companies to list earlier, due to the difficulty of examining their growth potential and capability of finance at an earlier stage).
- When venture capitalist' investment appetite is tight, as a way of exit, it is better to have a way to list small size companies, but recently venture capitalist's investments are increasing and therefore, it might be worth a consideration to raise the standard of listing criteria.
- As for market divisions for emerging companies, stocks that are not tradable in the market (not sold in the market) are included in the definition of "tradable shares."

***c. Listing opportunities for investment-intensive companies. (15 comments)***

- Companies with deficits have difficulties in listing regardless of their size or growth potential. They tend to fall into a vicious cycle where they are slow to grow because of difficulties in raising funds due to not being unable to list their stocks and not being able to list due to not showing enough growth.
- Even for emerging companies in fields such as biotechs, space industry, robotic, the industries which the government is trying to nurture, they receive unfavorable proposals to delay the IPO (until the prospect of commercialization becomes higher), so it is necessary to re-establishing an environment where raising fund (listing) is more accessible for those

companies.

- Investment-intensive ventures, especially drug discovery biotechs, raw materials, element start-ups, at their early and/or growth stage, are given very little opportunity to do an IPO.
- Technology oriented companies are welcomed with high expectation, but IPO timing is unpredictable. Currently, raising capital before listing is not too difficult so it is not a problem, but if the capital market environment changes it will become an issue.
- Biotechs cannot even start their sale unless they are approved by the relevant authorities, and they need capital to continue the development, so compared with other investment intensive companies, the period which they are not making profit is extended.
- Japan has far fewer corporate managers or CFOs than countries like the US. Unless this issue is resolved, you will not be able to obtain the results you expect.

(Reference)

・Listing Requirement for Emerging Companies (Comparison with other markets) (Additional Material page 5)
・Capital Raised by Listed Companies (Mothers) (Additional Material page 6)
・Industry Sectors of Listed Companies (Mothers)(Additional Material page 7)
・Industry Sectors of Recent IPO Companies (Additional Material page 8)
・Number of Companies Unprofitable right before IPO (Additional Material page 9)
・Ratio of Unprofitable Company IPOs in the U.S. (Additional Material page 10)
・IPOs in the U.S. (Additional Material page 11)
・Recent Rule Changes at Other Exchanges (Additional Material page 12)

**Responses regarding the current state of market environment for well-established companies**

***d. The appropriateness of listing criteria (liquidity etc.). (9 comments)***

- Listing criteria of the market for well-established companies are laxer than what they should be, for instance, because JASDAQ does not have tradable share ratio criteria. Therefore not all listed companies on these markets match the original market concept. (JASDAQ’s criteria for tradable share ratio and number of shares could be set at a higher standard.
- From the pre-IPO companies’ perspective, JASDAQ is chosen as a listing market because required standard is not too high, but there are too many small IPOs, so the listing criteria should be reconsidered to require growth potential and earnings standard. Also, market capital standard of JPY 2 billion is too low, even to consider second finance in the market.

- The listed companies on the 2nd Section have generally low trading volume. Some issues have extremely low liquidity, so the market is not functioning properly as secondary market.
- On the current market for established companies, there are companies that are reluctant to disclose information and their information disclosure track record is poor.
- There is no substance to the criteria that judges a company's track record based on the number of consecutive years in business, it is too formalist (requiring the company to have had a board of directors for at least three years).

(Reference)

・Listing Requirements (Quantitative) (Additional Material page 13)

・Listing Requirements (Eligibility Requirements）(Additional Material page 14)

・Daily Average Trading Value & Types of Investors（2018）(Additional Material page 15)

**Responses regarding current market environment for companies listed on the 1st Sections**

***e. The appropriateness of liquidity and governance structure etc. (47 comments)***

- The problem is not the large number of companies listed on the 1st Section but that there are some with low profitability, market capitalization, and liquidity; lower quality management and governance models; and insufficient information disclosure.
- Currently, there are differences in the 1st Section listed companies, some have high level of market capital, liquidity and foreign investor ratio, but some have low standard.
- TSE's problem is not the market divisions but liquidity. With passive investors increasing in number, substantive liquidity is becoming very limited.
- Assets under management linked to TOPIX are increasing. There is concern that price formation of stocks with low market capitalization and liquidity may be distorted, which needs to be reviewed promptly.
- The listing criterion of 5% or more tradable share ratio is extremely insufficient for securing high liquidity for investors.
- The current definition of the "tradable shares" is not effective and properly working, so often the case is that actual shares tradable in the market is extremely limited.
- It is a problem that many companies do not have appeal as investable instrument and simply not investable.
- Current market capitalization criteria are too lax.
- For market capital standard, it is unreasonable to require JPY 25 billion for direct listing on the 1st Section, but only JPY 4 billion for transfer from Mothers and the 2nd Section,

so it should be standardized to JPY 25 billion and raise the listing criteria of the 1st Section that could not be easily achieved.

- For small and mid-cap investment, investable instruments should have at least JPY 10 billion market capitalization. Considering the liquidity, it is difficult to invest in smaller stocks.
- From the perspective of small and mid-cap investor of the 1st Section listed companies, companies with less than JPY 10 billion market capital are excluded from the pool of investable stocks.
- On the 1st Section, both listed companies that are attractive as an investment instrument, and those that are not so much attractive co-exist, therefore losing interest from institutional investors.
- The issue with current 1st Section market is that it is a mixture of "wheat and chaffs."
- Companies with less than JPY 30 billion market capital have less consideration toward governance standard.
- We greatly appreciate the continued effort at TSE for introducing and revising corporate governance code, as well as listed companies' continued improvement of their corporate governance structure. However, regrettably, there is a residing issue that there are quite a few number of companies with low ROE.
- There is a concern that the 1st Section is not attracting investors who seek truly high quality investment opportunities. Companies with low ROE and weak corporate governance are excluded from the investment universe of sophisticated institutional investors who seek investment opportunities on a global scale.
- Currently, even the 1st Section listed companies' corporate governance structure and internal management standard are no different than other market segments.

(Reference)

・Number of Companies Listed on 1st Section & Total Market Cap. (Additional Material page 16)
・Distribution of Market Cap. of Tradable Shares (Additional Material page 17)
・Distribution of Ratio of Tradable Shares (Additional Material page 18)
・Distribution of Market Cap. (Additional Material page 19)
・Distribution of Foreign Investor Ownership Ratio (Additional Material page 20)
・Status of Nomination/Remuneration Committee Establishment (Additional Material page 21)
・Appointment of Independent Directors (Additional Material page 22)
・Number of Outside/Independent Directors per Company (Additional Material page 23)

・English Disclosure of the 1st Section Listed Companies (Additional Material page 24)

・Main Markets of Global Stock Exchanges (Comparing to the 1st Section) (Additional Material page 25)

**Responses regarding the current state of exit from the market**

***f. The exit criteria in alignment with market concept. (27 comments)***

- Currently there is a wide gap between listing criteria and exit criteria and exit from the market is not functioning properly.
- Overall, the delisting criteria are excessively modest, and it takes too much time for shares to be delisted.
- Current delisting criteria are set at extremely low levels in comparison to corresponding listing criteria. As such, there is a considerable imbalance.
- As a structural issue that needs to be reviewed, there are too few companies that exit from the market.
- (Retail) investors are not aware of the risks, because the delisting criteria are lax.
- Companies that are listed on Mothers launch IPOs at early stages of growth, which naturally can result in companies not performing well.
- Delisting criteria for sales and profits should be reviewed as they do not represent growth potential or market expectations.
- Financial performance standard, especially JASDAQ(Growth) earnings/cash flow standard should be reconsidered. For investment intensive companies, financial performance does not serve as an appropriate indicator of the success of business, in fact having exit criteria based on financial performance encourages investment intensive companies to halt their development (business). For start-up companies to achieve high growth, business risk would be higher, but such exit criteria sabotages taking higher business risk.

(Reference)

・Number of Delisted Companies & TSE Delisting Rules (Additional Material page 26)

・Trading Opportunities for Delisted Stocks (Additional Material page 27)

## （２） Insufficient Incentives for Sustainable Growth of Listed Companies

**Responses regarding the current state of growth of corporate value after listing**

***a. Growth of corporate value after listing. (20 comments)***

- Market divisions for established companies should also motivate such companies to achieve higher growth. Companies that have shown no growth for two decades are not suitable for listing.
- There are listed companies that neither grows nor gives payout to shareholders and just retain the cash, and those companies are usually reluctant to disclose information other than the quarterly financial statements and annual report (*yuka-shoken-hokokusho*). These companies likely are listed only to gain "status" as "listed companies", so those companies should be re-vitalized and incentivized to increase its corporate value.
- The 2nd Section and JASDAQ are similar markets and there are listed companies on these markets that do not exactly aim to "step-up" to the 1st Section, so it would be good to incentives these companies to improve their corporate value
- Especially amongst the "old-economy companies," there are companies that do not take major corporate actions after listing and so there are no apparent reasons for these companies to be listed on the capital market.
- For those established companies with business record, some seem to lack motivation to increase their corporate value.
- For maintaining sound market for start-up companies, it is an important policy matter how to encourage appropriate growth after listing. The growth of business itself should be what management of the company voluntarily aims for, therefore trying to influence these companies to achieve growth is like putting "a cart before the horse" and not acceptable. But if the market has become like "lukewarm water," where companies can remain for a long time once they are listed, then it gives wrong incentives and is a problem.
- It is good to allow emerging companies to be listed with ease. However, they should be expected to grow to the level of other fast-growing emerging companies around the world and not remain stagnant.
- There is varied opinion on the actual value of small-sized IPOs conducted by emerging companies. Such IPOs may serve as good incentives to entrepreneurs, but the problem is that some of those listed companies stay small even after listing.
- The issue is not the size of the companies at the time of IPO, but the fact that five years after IPO they have not grown in its size (market value).
- Listed companies at the entry-level market divisions, those that have not increased its

capital (have not made public offerings etc.) for a decade is not utilizing the capital market and should be incentivized to increase its capital.

(Reference)

・Distribution of Company's Age After Listing on Each Market Segment (Additional Material page 28)

**Responses regarding the current state of step-up**

***b. Listing criteria for step-up. ( 25 comments)***

- Criteria for transferring from Mothers to the 1st Section are too lax, resulting in little growth after the step-up and providing little incentive to companies to enhance their corporate value.
- Many corporate managers have a large sense of accomplishment after listing on the 1st Section. As such, there is concern that such companies may grow slower due to having stepped up too early.
- The market capitalization criteria related to step-up should be tightened in stages to motivate companies to grow even after transferring from entry-level market divisions.
- Market capital requirement for step-up to the 1st Section is too low, so it is reasonable to consider raising the amount required.
- The listing rule when transferring from Mothers to the 1st Section is too low, there are many companies that stop their growth after transferring to the 1st Section
- The market capital required for step-up (currently set at JPY 4 billion) needs to be higher, otherwise there is no incentive for companies to increase their corporate value
- The market capital requirement for transferring from Mothers to the 1st Section, JPY 4 billion, needs to be reviewed.
- There is no objection to having many companies listed on the 1st Section, however, the issue is that currently, the standard to transfer from Mothers to the 1st Section (market capital of at least JPY 4 billion) suggests companies can "step-up" without achieving much growth after IPO.
- Step-up criteria of JPY 4 billion is extremely lower than listing requirement for direct listing on the 1st Section, which is JPY 25 billion, and this causes problems. Therefore, new step-up requirements should be standardized to a consistent level, such as JPY 25 billion.
- That companies can step-up to the 1st Section with only a market capital of JPY 4 billion suggests that the standard is too lax. As such it should require at least market capital of

about JPY 25 billion, so that the standard will be the same level as direct listing to the1st Section.

- A one-year waiting period before "step-up" is too short.
- The market for start-up companies and the 1st Section are two different markets with completely different concepts, so it is strange that companies can step-up to the 1st Section one year after listing on Mothers.
- We have the impression that the time companies have to wait before being able to transfer to the 1st Section is too short. TSE 1st Section should be a much higher goal.

**c. *Inconsistencies of step-up criteria. (10 comments)***

- Some markets share similar concepts, but each market has different listing criteria and criteria for stepping to the 1st Section, which is inconsistent.
- Step-up criteria for the 1st Section should be the same as criteria for transfer from the 1st Section to the 2nd Section.
- TSE should change the criteria for transferring market division (transferring from the step-up market to the market for established companies), based on the standard required to step-up from the market for established companies. (Currently, there is a gap between the transfer criteria and the step-up criteria.)
- Inconsistencies between step-up criteria of different markets should be resolved.
- Inconsistencies between the market capital listing criteria for directly listing on the 1st Section and the step-up criteria to the 1st Section should be resolved.
- As for exit criteria, consistency and predictability are important, but transfer from the 1st Section to the 2nd Section and vice versa, lacks both perspectives.

**d. *Issues arising from tiered market structure. (10 comments)***

- Having a structure that assumes companies will or want to step-up can sometimes lead to price fluctuations that do not match those that may naturally occur for corporate value.
- There are negative image toward the name "2nd Section," so management cannot say out loud that they are aiming to be listed on the "2nd Section."
- If the purpose of listing is to gain access to a venue where companies can raise capital through issuing stocks (equity financing), then the concept of "step-up" is not appropriate.
- The notion that the listed companies on the "1st Section" are "good companies" distorts the Japanese cash equity market. Listed companies take corporate actions as a formality, with no significant impact on the growth of their corporate value, only because to remain listed on the 1st Section. (Listed companies should take proactive actions, under the uniform heading of "TSE listed", in order to obtain high valuation from investors.)

- It is questionable whether start-up companies need “incentives for growth”.

(Reference)

・“Step-up” to the 1st Section (Additional Material page 29)

・Mothers 10 Year Rule (Additional Material page 30)

・ Listing Requirement for Section Transfer (transfer to 1st Section) (Additional Material page 31)

・Listing Requirement for Section Transfer (transfer from 1st Section to the 2nd Section) (Additional Material page 32)

**Responses regarding the current state of investors’ market participation**

***e. Absence of institutional investors who support growth after listing. (15 comments)***

- Before listing, companies have pressure from venture capitalist firms; but, after listing, they lose discipline, because their stocks are mainly held by retail investors.
- Currently the main investors at start-up market are retail investors, but it is important to have model case stocks that grow and become investable by long-term institutional investors.
- Current Mothers listed companies, not only have higher business risk, but their stocks have very limited liquidity, so it is not investable for large-scale institutional investors.
- For new listings, institutional investors receive little allocation of the new issues, which makes it difficult for institutional investors to participate in the “start-up” market.
- There are no signs of anyone being eager to adopt crossover investing strategies in Japan.
- Venture capitalist do not take market risk, the strongly held idea is that they are positioned to be the one who do hands-on manages of the company.
- Whether or not venture capitalist firms can adopt crossover investment strategies depends on the investors of the firm. Investors generally demand quick and secured returns and do not expect longer-term investment returns from venture capitalist firms.

(Reference)

・Shareholder Ratio Per Market Segment (Additional Material page 33)

**Responses regarding the current state of information disclosure framework etc.**

***f. Burden of information disclosure etc. (10comments)***

- Many emerging companies have poor internal management systems. There is concern that they may be exhausted by the burden of an excessive obligation to disclose information.

- Costs for audit certification prepared by audit firms and an administrator of shareholder registry are a heavy burden on small companies. It may be advisable to require them to establish an accounting advisor system instead of audit certification.
- The current disclosure framework focuses on disclosure of financial performance. However, from the perspective of disclosure about the company's growth potential, TSE needs a framework that requires companies to explain in detail their business model and progress of growth.
- Although it is difficult to evaluate growth potential of a business only from recent financial result, it is a problem that start-up companies tend to explain only the recent financial performance.

(Reference)

・Listed Companies' Information Disclosure (Additional Material page 34)

**Responses regarding the current state of incentive mechanism for growth after step-up.**

***g. Lack of mechanism to incentivize sustainable growth after step-up. (20 comments)***

- The problem is that the entire business community has the illusion that once listed on the 1st Section, the companies will be secure in their positions. Schemes to raise the structural efficiency of companies or their businesses are necessary.
- Companies that have no further financing needs and are content with being listed on the 1st Section are unlikely to be reassigned to the 2nd Section and as such, there are no means to put pressure on such companies to achieve or aim further growth.
- Many companies use their status as "listed companies" for stronger creditworthiness of their employees and better recruitment, not for financing. At a minimum, they should fulfill their responsibility as public companies.
- Because of the impact of demand and supply due to ETFs and passive investment, there are concerns that small-cap companies would neglect efforts to grow and be content with the performance of their stock prices.
- Governance reform should, by requiring improved corporate value, result in higher stock prices. However, due to factors such as the wide-spread popularity of passive investment, stock prices of the 1st Section-listed companies fluctuate evenly. Such mechanism poses issues to governance reform.
- Listed companies are focused on how to achieve "step-up" to the 1st Section, not on how to actually increase their corporate value, and such structure is not a sound market

structure.

- It is a problem that shareholders have no influence over small-cap growth companies. As a shareholder, even when there is a better business model etc. that could improve their cooperate value, investors have no possibility of being heard of their proposal.
- In the US, there are listed companies with negative ROE but also with high growth potential, but in Japan, there seems to be less diversity in the market.
- There are concerns that because companies, once listed on the 1st Section, have very little likelihood to be transferred to the 2nd Section, they start to neglect accuracy of financial forecast and be reluctant to communicate with shareholders and investors.
- Investors' perspective is important and investors do point out the concern that some 1st Section listed companies' sole purpose of listing is being "listed" and nothing else.

(Reference)

・Capital Raised After Listing (Additional Material page 35)

・Number of years after listing on the 1st Section & distribution of Market Cap. (Additional Material page 36)

## （３） No Index Currently Functioning Properly as an Investable Index

***a. Convenience of TOPIX. (20 comments)***

- The number of constituents for TOPIX is large and most have little liquidity, so for both passive investors and active investors, following all these constituents as a benchmark is difficult. (For example, compared with overseas indices, such as S&P 500, DJIA, Euro Stoxx 50, FTSE 100 etc. have constituents of about 30 to 500 companies).
- TOPIX has too many constituents, and that is a problem
- Due to the increase of passive investment, TOPIX is expected to be an investable benchmark. Therefore, if the constituents have low liquidity, then ultimately the index replication cots will be increased and the price formation process will be distorted (volatility amplified). This trend has been evident, especially, within the recent four to five years, so the problem of having too many low liquidity issues as constituent of TOPIX should be taken seriously.
- As for TOPIX constituents, there are many companies with low liquidity, so as with FTSE or MSCI, if there are fewer constituents, then the benefit will increase while the cost will be reduced.
- Because TOPIX covers all the listed companies of the 1st Section, companies with low market capital and low free float ratio tend to be affected by the index-linked investment funds and receive higher valuation in comparison to their fair value.
- In the global literary comparison, usually, TOPIX and S&P 500 are compared, but there is concern that these two indices are not the same type of indices.
- The impact of BOJ's TOPIX-linked ETF investment is significant.

(Reference)

・Main Benchmark (Additional Material page 37)

## 2. Concrete Proposals

### （１） Revision of Market Concept

**Proposals regarding market structure**

***a. Clarification of roles and simplification of market structure. (33 comments)***

- TSE does not need many market divisions. These should be simplified, and each one should have a clear role. This can help TSE achieve its goal of attracting more foreign investors.
- From the investor's perspective, it would be beneficial to simplify the four market segments, which currently have separate listing criteria. If TSE were to have two entry-level market divisions, there should be thorough discussions about why two market divisions are necessary, the differences/roles of the two, and whether having two instead of a single entry-level market division has more benefits such as increased liquidity or fund raising capabilities.
- The role and function of each market segment should clearly be define and simplified.
- The 2nd Section, Mothers, and JASDAQ needs to be re-organized
- For the 2nd Section, Mothers, and JASDAQ, the criteria for divisions with similar concepts should be unified.
- Current market segments of the 2nd Section, JASDAQ and Mothers should be merged and re-structured, in order to establish new market segments with unique roles and functions.
- As an IPO market for start-up companies, there are Mothers and JASDAQ (Growth) but those should be merged into Mothers.
- JASDAQ (Growth) should be merged with Mothers, with 5 year transition period.
- Merging Mothers and JASDAQ (Growth) will serve the purpose of strengthening investment appeal to foreign investors.
- Mothers do not supplement JASDAQ. Simply unifying them may lead to serious problems in liquidity for the Japanese stock market.
- Given that the difference between the 2nd Section and JASDAQ (Standard), in particular, is unclear, TSE should consider consolidating these two.
- Consolidation of the 2nd Section and JASDAQ (Standard) makes sense, and it is better to unify the listing criteria to the standard of the 2nd Section.
- Consolidation of the 2nd Section and JASDAQ (Standard) would be beneficial in appealing to foreign investors
- The 2nd Section and JASDAQ (Standard) should either be consolidated or each market's

functions should be made clear and distinct

- JASDAQ (Standard)'s listing criteria could be reorganized and realigned with the 2nd Section's listing criteria. JASDAQ (Standard) is a listing market for companies with less of "emerging company" image, but if listing to Mothers is difficult for the company, it should wait and meet the 2nd Section's standard and list at the 2nd Section.
- For the 2nd Section and JASDAQ (Standard), which are both markets for established companies, it is reasonable to consolidate these two.

(TSE's Comments and Responses)

TSE's current market structure divides listed companies according to their risk profile, and aids investors in assessing the investment risk when making investment decisions, creating an accessible market environment. This current structure has developed over the years as TSE's cash equity market expanded by providing listing opportunities to various companies with different liquidity, business track records and other business characteristic. In providing listing opportunities to companies with different risk profiles than those of listed companies at that time, TSE had revised its listing requirements and set-up a new market section.

The hierarchical design of the current market structure and its listing rules, in practice, has played an important function in motivating listed companies to improve their total value as a corporation in the medium-to-long term, and to enhance their internal management structure.

On the other hand, as summarized in the "1.Issues Regarding the Current Market Structure," many listed companies and market participants have highlighted issues with the current market structure and the need for improvements.

In order for TSE to further contribute to the development of a sustainable capital market and, by extension, the wider Japanese economy, through the operation of the stock exchange and the financial markets, it is necessary that TSE continues to provide listing opportunities to various companies and further incentivizes listed companies to proactively improve their overall value after listing. Therefore, TSE needs to take the initiative and respond appropriately to the various issues identified. From TSE's viewpoint, it is appropriate to re-design the market structure and respective criteria, taking a fresh perspective on what the optimal market structure in the future would look like.

***b. The review of market concept. (27 comments)***

- These divisions should serve as venues where both emerging companies and established companies that are aiming to step-up can enhance corporate value, with a market concept that positively defines the listed companies (and where companies that have been transferred from a "step-up" market division can rebuild and reorganize itself to re-"step-up" to the "step-up" market division).
- There is a need for reorganization of and expansion of independent stock markets with separate role and functions that incentivizes the listed companies to achieve step-up.
- The market division should demonstrate that its listed companies have a certain level of quality despite their small size.
- The listing criteria and weight placed on approach to disclosure of market divisions for well-established companies need to be at a higher level then and clearly differ from those for startup companies
- As a market concept, it should clarify that though not at the standard of the top-tier market, the listed companies are excellent companies
- If investors' expectation does not rise after a while, then it might be better for the listed company to exit the market.
- It is appropriate to position well-established companies' market as a venue for companies aiming for sustainable growth, where mainly Japanese institutional investors can trade, and where such companies can conduct relatively large-scale secondary offerings.
- TSE should provide a market division for companies whose growth potential may be relatively low but that offers such companies a platform to raise funds and grow a pool of shareholders to whom to payout dividends.
- The market for established companies' should have a positive role and function, and should be given high priority in the deliberation, discussing the demand for such market and the restructuring of the listing criteria and guidance etc. of such market.
- The 2nd Section and JASDAQ could be given a more positive presence, by redesigning the listing criteria, for example, by requiring higher financial performance standard but lower liquidity standard.
- The image of the 2nd Section is not positive so the name of the market (1st Section and 2nd Section should be abolished).
- The market name of "1st Section", "2nd Section" and "Step-Up" should be changed according to the roles and functions of each market segment.
- The market concept of established market is appropriate to have the position of market for mid-size established companies who is willing to take the business risk with domestic investors.

- The problem is that currently, the 2nd Section has a negative image compared to other markets, therefore it should be reorganized so that it has the most listed companies among TSE market segments.
- Market divisions for emerging companies should serve as platforms where such companies can prepare before stepping up to the main board.
- The main theme of entry-level market for start-up companies should be “Growth” (how about requiring disclosures of mid-term business plans and other long-term visions and the progress of those plans).
- As a consolidated market for start-up and growth companies, it should be positioned as the market which requires sufficient disclosure of information about investment risk and business risk.

(TSE’s Comments and Responses)

Regarding the current market structure, as summarized in the “1.Issues Regarding the Current Market Structure,” many respondents highlighted that the difference in the market segments and their concepts are ambiguous, and thus impair the convenience and attractiveness for investors.

In reviewing the market structure and re-designing the market into multiple segments according to the type of company, it is critical to structure each market segment with a clear and positive concept. The Exchange Financial Instruments Market’s ultimate purpose is to provide a market place where various types of investors can execute their trades smoothly and fairly. Therefore, listed companies are required to disclose company information, which is necessary for investors to make informed investment decisions. In order for investors to value the company’s future cash-flow accurately, the historical information and business track record should be provided.

Therefore, for the main market that TSE operates (Market Segment “A”), a possible concept could be as a market for well-established companies with appropriate business records, as investment instruments for all investors, including retail investors and domestic institutional investors.

On the other hand, from the perspective of realizing sustainable growth of the Japanese economy through innovation, it is necessary and critical to nurture emerging ventures creating and leading innovative new industries. Such emerging companies require funding for their research and development (R&D) and other investments, since they could be investment-intensive companies. However, those companies tend to lack sufficient business track record during the R&D phase, and income-generating-businesses are rarely established in the growth stage. It is an important role of the Exchange Financial Instruments Market to provide opportunities for these companies to raise capital in the exchange cash equity market, though at the same time, investment opportunities in those companies present a relatively higher risk for ordinary retail investors. Therefore, in addition to the main market for well-established companies that TSE operates (Market Segment “A”), it would be appropriate to provide a separate market segment for companies with high growth potential (Market Segment “B”).

In addition, due to the globalization of the financial capital markets, international institutional investors hold a larger share of the TSE cash equity markets than in the past, and therefore, compared to the main market for well-established companies that TSE operates (Market Segment “A”), relatively higher liquidity would be required from companies that such large-scale investment institutional investors invest in.

Also global institutional investors, when managing diversified portfolios and comparing global companies, require a higher level of transparency (information disclosure), and the level of compliance with other requirement tend to be higher. On the other hand, for realizing sustainable growth of the Japanese economy, it is indispensable to increase investments from such global institutional investors and therefore having a market segment for companies that meet requirements as investment instruments for a broad range of investors, including international institutional investors, separately from the main market for well-established companies that TSE operates (Market Segment “A”), would be another appropriate response.

***c. Abolishing market segments and tiered market structure. (10 comments)***

- The market segment for the 1st Section and 2nd Section should be consolidated, and TSE should have only one market, as with in NYSE. Also, investors should utilize Nikkei 225, JPX Nikkei Index 400, small-mid cap index and other indices.
- Having multiple market segments for allowing different listing criteria is understandable; however, there is no need to have a tiered structure based on the concept of step-up.
- In reviewing the market segment, four points are essential. 1) Market concept should not be defined by negative form. 2) TSE should not adhere to the tiered market structure. 3) Efficiency and cost should be basis for evaluation. 4) Flexibility and choices should also be the basis for evaluation.
- No objection toward conducting a review to incentivize listed company's growth. However, it is unclear whether having tiered market segments for established companies will be function as an incentive for listed companies. There is benefit in categorizing the market segment according to the characteristic of risk of the listed companies and having the market segments in parallel structure, however vertical structure based on the size of the listed companies does not seem meaningful.
- The market segment should be based on the size of the company (market capital, financial performance, trading volume). For small and mid-size companies' market, to clarify that the market is only based on the size of the market and not the quality, the "2nd Section" segment should be abolished.

(TSE's Comments and Responses)

In practice, the majority of companies have applied to be listed on (transferred to) the 1st Section, within a few years after their initial listing on the 2nd Section, Mothers and JASDAQ. When transferring to the 1st Section, the listed companies are required to meet the 1st Section listing requirements; this standard has played a certain role in motivating listed companies to improve their total value as a corporation in the medium-to-long term following their initial listing, and to enhance their internal management structure.

On the other hand, as summarized in "1.Issues Regarding the Current Market Structure," there are comments that suggest because of "the low standard and listing requirements for step-up to the 1st Section," the incentives are insufficient for listed companies to realize a sustainable increase in their corporate value. Also, there are many comments that suggest "some companies cease to grow their corporate value after listing on the 1st Section." Therefore, the current structure needs to be reconsidered.

As seen from the introduction of the Corporate Governance Code and Stewardship Code in Japan in the recent years, constructive dialogue between the listed companies and institutional investors plays a vital role for listed companies to achieve medium-to-long term growth.

Therefore, with this understanding, instead of the hierarchical market structure used in the past, the market structure could be re-designed with a clear market concept for each market segment and it is important to provide an environment that supports the sustainable growth of listed companies.

**Proposals regarding market concept for well-established companies**

***a. Liquidity. (15 comments)***

- It is important that market concept for established companies should be positively defined (not as negative downgraded market) by requiring a certain level of market capital, liquidity, and fund raising etc.
- As a market concept for established companies, one idea is to make it a "standard" market, where small and mid-cap domestic companies with stable financial performance and established financial record lists.
- The levels of criteria for tradable share ratio and number of shareholders for JASDAQ should be higher.
- The current free float ratio for JASDAQ is too lax, so the appropriate standard will be around 25% as same as Mothers.
- Companies that lack liquidity are not suitable for listing. Companies should at least offer a majority of shares in their IPOs. Once listed, companies should not allowed merely reap the benefits of listing but also have to be held accountable to their shareholders.
- The financial performance criteria at JASDAQ's could be raised to a criteria requiring both JPY 0.1 billion profit and market capital of JPY 5 billion.
- With respect to markets for established companies, public offering etc. of over a certain amount could be requested.
- Regarding stocks with low liquidity, it is advisable to establish new criteria to boost trading in the market or require lead underwriters to engage in market making for a certain period after listing.
- For those start-up companies with high business risk, rather than incentivizing them to "step-up" to the 1st Section, maybe establishing a market for companies with high-business risk and low market risk, by requiring high liquidity so that long-term investors to invest in, such as NYSE and NASDAQ, might be better.

***b. Retaining current JASDAQ listing criteria. (5 comments)***

- In order to maintain hierarchical system functions on the main boards, TSE should have criteria that are appropriate and reasonable to give positive meaning in maintaining listing on the 2nd Section. However, it is also important to consider the types of criteria present in global markets and to flexibly incorporate some into JASDAQ's listing criteria.
- Although there is generally low demand for retaining the listing criteria of JASDAQ, there is some demand for maintaining the criteria for "tradable share ratios", so it might be better to keep the entry level and require higher liquidity gradually, after listing.

- Preparing for IPO, pre-IPO companies launch on system developments and expansion with new recruits which can increase cost, so JASDAQ's profit standard (recent year's profit of JPY 1 billion or more) may not be too low.

(TSE's Comments and Responses)

For well-established companies with appropriate business records as investment instruments for all investors, including retail investors and domestic institutional investors (Market Segment A), the listing criteria could be re-designed, with a focus on the companies' business track record (past financial performance).

Specific criteria could be based on governance structure of the companies' business management, sufficient liquidity of the listed shares, stability of the business record and financial situation (earnings), market valuation (market cap) and ability to disclose necessary and sufficient information etc.

These listing rules could have similar requirements as the current listing standards for the JASDAQ Standard, and the 2nd Section. However, issues summarized in "1.Issues Regarding the Current Market Structure" would be sufficiently reviewed even in such cases.

**Proposals regarding market concept for companies with high growth potential**

***c. Companies to be listed on the market. (10 comments)***

- For start-up companies' IPO, current Mother market's listing criteria should be kept unchanged, so that various types of companies can list and easily raise funds and capital. The market segment for start-up companies should aim to be "the best market in the world for start-up companies to raise capital."
- Entry-level market divisions should allow for a wide-range of companies to be listed. And these companies would be expected to show growth after conducting small-scale IPOs.
- The fund raising environment for unlisted companies in the U.S. is different from that in Japan. As such, it would be beneficial for the securities market in Japan to provide a fund-raising function similar to that which middle or late-stage unlisted companies enjoy in the U.S.
- In order to allow various types of start-up companies, listing criteria should not be stringent.

***d. Listing of investment-intensive companies. (50 comments)***

- Regardless of whether they are making profit or not, it is important to provide investment intensive companies with opportunity to list.
- Even companies with deficit, if they are scaling should be given opportunity to list
- When Mothers was established, it was very clear that companies with deficit were welcomed to list, so it is important to reestablish that vision.
- Basically, the issue is not whether companies are making a profit. More attention should be paid to whether governance is functioning at the corporate management level and whether such companies are making investments directed at growing their businesses.
- TSE needs to separately consider two types of companies:
    1) Those who have a solid business foundation but have deficits due to the size of their up-front investments, including tech companies such as SaaS solution providers and companies working on establishing customer bases
    2) Those in such areas as biotech, who have high operating costs and may not launch products/business until the distant future.
- For companies with deficit, growth potential depends on the business model of each company so it is it is understandable that assessment of such companies is difficult, but to assess, but it would be beneficial if listing criteria is predictable, so market capital standard would be appropriate.
- At the Hong Kong Stock Exchange, they have listing criteria specifically for biotechs and

at the Israeli Stock Exchange, they have listing criteria specifically for technology companies, so TSE should consider having a specific criteria for a certain type of company to make a statement to the world that it welcomes those companies.

- Instead of trying to list "good investment-intensive companies," TSE should introduce listing criteria based on the idea that it lists ordinary investment-intensive companies and investors will analyze and search for "good" companies.
- Though it is understandable, that none of venture capitalists, securities firms and stock exchanges can actually understand the core of the business of investment-intensive companies, it would be better to promote the listing of such investment-intensive companies.
- Mothers should be set up as a market specifically for investment-intensive companies.
- Listing companies with deficits require a mechanism where institutional investors and corporate venture capital firms participate. In order to do so, a certain level of amount of market capital may be required for such companies.
- For investment intensive companies, listing criteria should not include the submission of financial forecast for sales and profit, but instead require investments or commitments from investors who meet a certain standard.
- It is suitable to consider setting listing criteria that requires having an investment from a certain type of party who can properly assess the business of the emerging company.
- It should be realistic that valuation on companies with growth potential should reflect market valuation (market capitalization, sales amount, etc.), which will require support from major venture capital firms or good investor relations that lead to incentives for companies.
- For investment intensive companies, deficit accumulates before profit and so listing criteria should be specifically designed to take this uniqueness into factor.
- Whether the company has growth potential in the mid-term should be determined by checking, as necessary, third party evaluation on upfront investment targets such as technology, knowhow, and business models (revenue sources) and investment recovery time (e.g., within five years after listing).
- Evaluating the attractiveness of technologies or services of loss-making companies is difficult. In that sense, it would be difficult for TSE to bear such a responsibility.
- For listing examination of investment-intensive companies, four points need to be considered whether it is appropriate to be listed;
    1) Whether it has good management,
    2) Whether it has marketable research result,
    3) Whether it has growth potential that could expand in the future, which is already

evident, and

4) Whether its purpose to be listed is to achieve the above growth.

- In terms of listings of investment-intensive companies, careful thought needs to be given to whether it is feasible for investors trading on Mothers, primarily individuals, to take large, long-term investment risks of such companies.
- If TSE is going to tighten the criteria for market capitalization, it needs to be based on the assumption that corporate value is appropriately reflected in the share prices.
- For investment intensive companies, it is crucial to be provided with opportunities to list, but on the other hand, for those companies still in the development phase and have no product (not in the production phase), prospect of commercialization is very difficult to assess and therefore it would be more suitable for venture capitalist to support those companies.
- In light of risks for investors in investment-intensive companies, TSE should consider instating a scheme to disclose midterm business plans (including progress after disclosure at the time of IPO, achievement forecast, corrections, and updates) apart from the earnings forecasts disclosed every fiscal year.
- Risk profiles vary depending on the type of business, the company's growth stage, and its strategy. Thus, rather than considering criteria based on risk profiles, disclosing risk profiles in detail is necessary, and risk profiles should be judged by the market.
- Because of the higher investment risk of the investment intensive companies, it is appropriate to require disclosure of midterm business plans, forecast of the progress and achievements and revision of the plans, for the benefit of investor protection
- When start-up companies consider IPOs, reconsideration is required on the communication channel, so companies can have better communication with the exchanges directly.

***e. Optimization of governance and disclosure framework. (10 comments)***

- Small enterprises should also be required to meet a certain level of governance to the extent that it will not interfere with the flexibility necessary for start-up companies.
- Governance structure and company's need of capital change over the course of company's life cycle, so listing framework should reflect factors; governance, company's size depending on the maturity of the company, complexness, ownership structure.
- These market divisions should not be the venue where companies can come to avoid having to adhere to stricter corporate governance criteria.
- In the future, even those company's listed on the emerging market segments, should be required to "comply or explain" on the adherence to all the Corporate Governance Code
- Listing criteria and obligations after listing, taking into consideration the characteristics of

companies, could be more lax then those at the 1st Section.

- If the companies have appropriate governance structure according to their company size, small IPOs should not rejected.

***f. Exits criteria of market for companies with high growth potential. (28 comments)***

- Mothers should increase investor protection by requiring more information disclosure and stringent exit criteria.
- Having stricter criteria can raise awareness of risks and result in a sounder market.
- It is appropriate to encourage exit of companies that are not higher valued after listing。
- Generally, relaxing a standard invites listing of “low quality companies”. So TSE should make it clear, whether it will take the approach of 1) “many IPOs and many exits model”: allowing many company’s IPO but having more exits, or 2) “selective IPOs and few exits”: being selective in IPOs but having less exits. Allowing investment intensive company to IPO means the former “many IPOs and many exits” method is chosen, so TSE should allow many companies to go public but have reasonable number of exits.
- With regards to the higher risk of start-up companies, appropriate information disclosure is very important and inappropriate disclosure needs to be dealt with strictly.
- From the perspective of providing ample opportunities for listing, instead of changing the standard of listing criteria, having higher exit criteria seems more reasonable.
- After listing to the entry-level market, if the companies do not meet the standard to step-up and as lose growth potential, then the company should be delisted.
- TSE should consider the possibility of having companies exit via buy-outs by investment funds or delisting; otherwise, should have them aim for transfer to step-up market division.
- Companies whose businesses did not perform well after an IPO should have the option of entering M&A deals with other companies or deciding to have their stock delisted.
- If the business does not succeed after IPO, then it is appropriate to ensure their exit from the market.
- To encourage growth, companies that have yet to grow after a certain period need to be delisted.
- In the case of growing companies, the success or failure of their business can be determined within three to four years. As such, the 10-year rule can be shortened to. 5 years, for instance
- Having a market division for growing companies is essential, but the listing duration should be limited. It is unreasonable not to transfer companies that have shown sufficient growth to other divisions.
- After 10 years from IPO, if the company does not have certain size of market capital then

there should be mechanism to exit; it would work as an incentive to achieve growth within a certain time frame.

- For large companies that stay at Mothers or JASDAQ, it would be better for them to transfer to the 1st Section from investors' point of view.

(TSE's Comments and Responses)

If a market segment were to be set-up for companies with high growth potential (Market Segment B), separate from the well-established companies with appropriate business records as investment instruments for all investors, including retail investors and domestic institutional investors (Market Segment A), then the listing criteria could be re-designed with a focus on the future growth of a company (growth potential of the company).

In order to provide listing opportunities for companies with high growth potential, including investment-intensive companies, specific criteria for business track record (for past financial performance) could be less stringent than Market A and C, and appropriate additional criteria could be a requirement on future business plans (growth potential). However, if a listed company faces reduced growth potential, due to change in the business environment or for other reasons, then it could be appropriate for the company to exit from the market.

In considering the specific criteria and its standard, the rules could be similar to the current listing standards of Mothers and JASDAQ Grow. However, issues summarized in the "1.Issues Regarding the Current Market Structure" would be taken into consideration, even in such cases.

**Proposals regarding market concept for step-up market**

***g. Companies that match the market concept. (25 comments)***

- For the future of the Japanese economy, TSE needs to increase the number of companies that global investors want to include in their portfolio. An attractive capital market can attract foreign investment. The market will not work if capital is being channeled only in Japan.
- In order to attract sophisticated institutional investors who seek investment opportunities globally, it is crucial to ensure enough trading volume and liquidity and to maintain the number of listed companies to compete with global markets.
- It may be advisable to position the market division as "a platform where global large companies attract domestic and international investment as well as aim for further enhancement of corporate value."
- It is important to have the perspective of creating a market appreciated by investors, because as investment grows and expand, so will market capitalization.
- The 1st Section is an international market where companies that represent Japanese economies are listed, and therefore, from the view point of comparison with global main markets, it is reasonable to raise the standard of the 1st Section.
- There needs to be measure taken in order to bring back interest to Japanese stocks from foreign investors.
- The social status which can be achieved by listing on the "1st Section" must be backed by 1) high transparency of information disclosure, 2) measures taken to manage and diminish conflict of interest with the minority shareholders and 3) improvement of corporate value.
- Market concept should be "for companies that target world-wide business growth, that expect investment from institutional investors from around the world."
- Due to the decreasing population and other structural issues, in the eyes of foreign investors', the Japanese market has become "one of the main countries in Asia," so harmonizing market capital, free float share ratio, and parent-subsidiary listing and other requirements on the Asian standard is important.
- Review of the exit criteria based on the market concept of "international market where local and global large companies lists" is necessary.
- By strictly applying the exit (maintenance) criteria based on the step-up market concept, companies will be held to a high standard and be motivated to improve their corporate value.
- Listed companies need to feel the weight of "being listed on the 1st Section," and has to be motivated to improve its corporate value. Therefore, in addition to quantitative

requirements, TSE needs to take qualitative approach. Quantitative requirements need to include market capital and trade average. Qualitative approach should include such factors are "coolness."

***h. Liquidity etc. (42 comments)***

- In listing to the market, float-adjusted market capitalization and average daily trading volume should be the requirement.
- It is advisable that stocks held as cross-shareholdings or by the other party of cross-shareholdings be excluded to determine liquidity requirements.
- Instead of market capital, using liquidity requirements could be more effective to transfer very illiquid 1st Section listed issues to other markets(criteria could be daily average trading volume of less than 25 million JPY, or if 10% less than the market median trading volume)
- Free Float Weight should be calculated more precisely. Stocks held by loyal shareholders, such as parent companies, cross-shareholders, and related companies, should be completely excluded.
- Institutional investors' emphasis is not on market capitalization but on liquidity. It is crucial for them to be able to sell when they want.
- It is crucial to require sufficient liquidity as "step-up" criteria, in addition to market capital.
- Market capitalization of tradable shares needs to be reviewed, but in the case of IPOs of extremely large market capitalization, the tradable share ratio (35% of market capitalization) for the 1st Section can be improved in terms of supply and demand in the market.
- As a step-up market, listed companies should be required to meet a certain standard of market capital, liquidity, long term growth, capital efficiency, management's sufficient communication with shareholders.
- In order to incentivize growth of corporate value and for comparing with main international markets, it is appropriate to set the standard for step-up market, such as listing criteria for market capital, tradable market capital, earnings and net asset value.)
- It is crucial for the step-up market division to require market capitalization and tradable share ratios that will contribute to attracting domestic and international institutional investors, as well as motivating listed companies to further increase corporate value.
- Due to the increase of global institutional investors, growth of index-ETFs and index-linked funds, certain quantitative requirements, such as market capital, number of tradable shares, trading volume are appropriate.

- The criteria and obligations that the step-up market division requires should incentive companies to enhance governance further and create corporate value, and the fundamental requirement should be the standard for market capitalization.
- TSE should more proactively motivate companies to maintain and enhance corporate value (market capitalization).
- As listed companies on the "step-up market," market capital is the most important. It would be better if the financial performance results were also good, but the assumption of efficient market stands on that market should have priced in the financial results in the valuation of the company. So for companies with high market capital, the standard on financial performance could be lower than other companies.
- It would be meaningful to reconstruct the market, as a market for good global companies with larger market capital and sophisticated governance structure, which has comparable number of listed companies as the other international main premium markets in the world.
- Having only market capital rule is simple and clear-cut.

***i. Market capitalization. (56 comments)***

- There is an idea that stocks with little impact such as those with less than JPY 10 billion market capitalization should be excluded. Passive investment managers should appreciate it if stocks with less than JPY10 market capitalization are excluded.
- From the perspective of index-linked passive investment, excluding issues with extremely low free float share adjusted market capital from investment pool of the 1st Section is desirable, for example, exclusion of issues with less than market capital 10 billion JPY is appropriate.
- As for market capital requirement, raising the requirement to JPY 10 billion or more would be reasonable, since it will not effectively impact the market.
- In terms of liquidity levels, market capitalization of JPY 25 billion is a good benchmark.
- JPY 50 billion market capitalization may be too high to motivate emerging companies. JPY 25 billion should be appropriate.
- From experience, investable instruments for multiple funds have at least a market capital of JPY 25 billion or more and that is the smallest size that funds can invest in.
- As a global market, requiring IFRS accounting, recent sales of JPY 10billion or more, 30% or more foreign investor ratio, and market capital JPY 25billion or more is appropriate.
- Market capital requirements could be set at JPY 25 billion or more.
- Market capital requirement could start with JPY 10billion and gradually be increased to JPY 25 billion or more.

- Having a uniform standard for market capital, as the same as direct listing standard which is JPY 25 billion or more, is reasonable.
- For example, against a portfolio of JPY 1 trillion, investing in shares with less than JPY 25 billion market capital is not meaningful as a market portfolio.
- It should be a market for companies that are at least, covered by research analysts (companies with usually around at least JPY 50 billion market capital.)
- To create a market where institutional investors can trade with comfortably, market capitalization of JPY 50 billion is an appropriate standard.
- Setting the standard to JPY 100 billion or more is too extreme, so JPY 50 billion is more reasonable.
- Current market capital requirement is too low, so raising the standard to either the same as direct listing on the 1st Section, which is JPY25 billion, or JPY 50 billion is reasonable.
- To create a market where large companies are listed, a criterion for market capitalization of JPY 50 billion or more will be an option.
- One option is to set the market capital requirement of remaining on the 1st Section at JPY 50 billion, raising the bar from the current standard which is JPY 2 billion.
- Currently, the companies that have higher investor engagement are those that could have stronger impact on the investment performance, which means companies with market capitalization of JPY 100 or more.
- Overseas institutional investors (active management), basically, do not manage small cap equities (JPY 100 billion or less) in Japan.
- Market capital of JPY 100 billion or more is a good benchmark, for fostering growth of Unicorn companies.
- Setting the ultimate goal for “step-up,” as achieving more than JPY 100 billion market capital would be suitable for “excellent market.”
- As market capital standard that incentives improvement in governance structure and creating corporate value, JPY 100 billion is an appropriate standard. (Or combination of market capital JPY 50 billion or more and ROE of 10% or more.)
- Issues should not be selected based on market capitalization. To raise quality of companies, it is desirable that TSE thoroughly select companies that are ready to contribute to growth and stability in the securities market over the mid- to long-term.
- Instead of listing companies with a slightly larger market capitalization on the 1st Section, TSE should give priority to creating a mechanism that will give rise to more companies that can be considered large under global standards.
- Enhancement of corporate value should be left to companies (and investors), not by market divisions, so tightening market capitalization criteria alone will not solve the

fundamental problem.

- In order to properly determine corporate value, it is not appropriate to set only market capitalization as a criterion for determining which market division a stock belongs in.
- Setting only a standard for market capital would be a problem, so market capital, liquidity, governance structure, internal management structure should be comprehensively taken into consideration, and therefore, more non-financial information disclosure on governance and internal management is required.

***j. Criteria for number of shareholders should be reviewed. (5 comments)***

- In the western countries, shareholders have been institutionalized, but in terms of market efficiency (liquidly and price formation etc.) there is no issue, so it is advisable that the criteria for the number of shareholders be reviewed at TSE as well. There are concerns that companies may use the criteria as an excuse to have cross-shareholdings or to prevent institutional investors from buying their stocks.
- Corporate managements allocate too much resource on attracting retail investors, such as providing shareholder benefit program, so criteria for the number of shareholders should be reviewed.
- Shares are held by mutual funds and other funds, so criteria for the number of shareholders should be reviewed in light of the current shareholder types.

***k. Qualitative requirements such as governance structure etc. (25 comments)***

- For the internal management and governance standard requirements of the step-up market, the view point of global standard is crucial (however, application to the whole 1st Section will be over-burdening the listed companies, therefore application only to the upper tier market of the 1st Section might be worth considering), and also effectiveness of the structure should be monitored periodically after listing..
- Qualitative requirements such as governance structure should be considered and discussed, by taking into consideration comments from market participants as well.
- There are two ideas about the qualitative requirements on the step-up market, 1) The Exchange can add various qualitative requirements, or 2) it should be left with the institutional investors and the constructive dialogue between the listed companies. It is not a simple argument that the former is better, and it requires more in-depth deliberation and consideration.
- As for qualitative requirements, it is better to leave it to the investor’s engagement and encourage listed companies to take measures for substantial change (not just as a formality), then for exchange to set a uniform standard as a requirement (which could lead

to only formality change).

- From the perspective of "engagement," investors could put more resource into constructive dialogue with the top tier companies and increase the investment appeal of the market as a whole.
- It is important to require governance standard that foreign investors expect from the listed companies.
- Much emphasis should be put on good corporate governance of listed companies.
- In Japan, unlike in other countries, the exchange calculates the main stock index, so governance and disclosure listing criteria should be set at a high standard and applied strictly.
- For the review, three key factors should be considered. 1) Quality of corporate governance, 2) level of information disclosure and 3) liquidity.
- In designing listing criteria, it should include a perspective of standard for corporate governance.
- Step-up market listing standard should incorporate, not only market capital, but also qualitative requirements that indicates the financial performance too, such as corporate philosophy, motivation for growth, management quality, so that investors' can take a comprehensive approach in valuing the company.
- Listed companies standard and obligation should be, 1) not impairing corporate value and 2) not severely damaging the trust of the market in terms of corporate governance and internal management structure, and standardizing with other criteria uniformly is not appropriate.

***(a) Cross-shareholdings. (10 comments)***

- Companies whose total amount of deposits and cross-shareholdings exceed market capitalization (value destroyers) should not be listed on the 1st Section.
- The biggest issue for Japanese listed company is the cross-shareholding. Due to the cross-shareholder, even when there is no improvement in corporate value, management is not terminated and no hostile take overs occur, so cross-shareholdings should be have voting rights terminated.
- When the Corporate Governance Code was revised in 2018, the number of cross-shareholdings was reduced. However, there are many other companies that have yet to reduce the number. There is no substantial advantage of cross-shareholdings. In fact, it reduces productivity and accountability of corporate management, therefore, so it should be reduced further.
- Cross-shareholdings should be wound down, and TSE needs to create an environment to

enable corporate combination (M&As).

- Transparent and qualitative policies are necessary for cross-shareholdings. Limitations on the ratio of cross-shareholdings should be included in the criteria.
- Listed companies should disclose sufficient explanation/information on the reasons for cross-shareholdings.
- Many listed companies do not disclose their voting rights policy and still maintain that they are compliant with the Corporate Governance Code 1-4, however the listed companies should be required to disclose the voting rights policy as well as the actual compliance to the policy. Also the policy for reducing the cross-shareholding, and the actual issues that have been reduced (name of the issue and the number of shares), as well as issues expected to be reduces (number of shares etc.)

***(b) The board of directors, selection of CEOs etc. (25 comments)***

- Nomination of a lead independent outside director and independent outside directors should be included in the requirements.
- Nomination and compensation committees (excluding CEO involvement, etc.) should be included in the requirements.
- The number of outside directors (1/3, a majority in the future) should be included in the requirements.
- Set up of nomination and compensation committees should be encouraged.
- Checking the independence of outside directors, for example, if the director is originally from a client and when the board is discussing the details of the negotiation with the client, then making sure that that the director can represent the interest of the whole shareholders rather than the client.
- By looking through the meeting minutes, check that the discussions at the nomination and compensation committees are not led by the CEOs or the company secretary.
- Independent directors should represent the minority shareholders' interest, should be prepared to meet with shareholders occasionally, and should be selected according to the substantive qualification of the director, instead of boiler plate reason of having "business experience."
- For example, qualitative requirement should include one third or more outside directors, or nomination and compensation of CEO and his/her successor not being determined by the CEO or the successor as well as outside directors' involvement in the determination/nomination process.
- Requiring governance structure in compliance with global standard, such as one third of independent directors, would be appropriate.

- Listed companies with market capitalization of up to JPY 500 billion have a high growth potential depending on corporate managers. It is important to develop a good nomination process for selecting corporate managers.
- The quality of directors should be raised (in terms of gender, diversity, term including reappointment, and evaluation).
- A 75% or more approval ratio for representative director or chairperson for two consecutive years should be required in the articles of incorporation.
- There should not be discrepancies between the disclosed policy on appointment/dismissal of representative director, director, and auditors as well as the protocol and implementation thereof.

***(c) English Disclosure. (15 comments)***

- To facilitate communication between a wide-range of investors and secure global comparability, it would be appropriate for TSE to request more disclosures in English.
- For corporate governance and information disclosure, stricter standard should be applied, for example requiring English disclosure.
- It is better to require issuers to disclose information in English (capabilities and willingness), than to require a larger market capital, so that issuers can provide more information to foreign institutional investors.
- For transparency to foreign investors, sufficient information should be disclosed in English.
- At least all 1st Section listed companies should disclose all information in English. If there were more information disclosed in English, investment from foreign investors would increase.
- If the purpose of the review is to strengthen international competitiveness of the market, then rather than changing the listing criteria, it is better to require English disclosure to all 1st Section listed companies.
- Information disclosure in English is important factor in making investment decision.
- It must be required that all information be disclosed in English at the same time as anything is disclosed in Japanese.

***(d) Capital efficiency (10 comments)***

- For instance, companies can be selected based on the criterion of a ROE of 5% or more on a ten-year average.
- Actual shareholder returns should be clearly indicated. (This could be in the form of a predetermined dividend payout ratio. If companies have yet to achieve a certain level of

shareholder returns, they should be requested to proactively explain the reason.)

- We hope that TSE will change the system where listed companies that aim to maximize ROIC will be recognized while those who do otherwise are urged to change.
- Concerning market exit from the 1st Section, a limitation on PBR could be one idea.
- It might seem extreme to require, a certain level of ROE as a listing criteria to be listed on the 1st Section, however, for example, TSE should implement aggressive measures to further encourage listed companies to improve ROE, through further revision of corporate governance code etc.

***(e) Dialogue with shareholders. (8 comments)***

- Disclosure of Corporate Governance Reports, integrated reports, and quarterly reports should be required. (For the listing criteria on other market divisions, it is worth considering making these reports and English disclosures not mandatory.)
- It should be mandated that the CEO him/herself announce and explain the financial results at least once a year outside of the AGM (This pertains to Corporate Governance Code Basic Principles 3 and 5)
- Companies listed on the 1st Section should be fully compliant with the Corporate Governance Code in terms of meeting with investors, analyst meeting once a year, and fair disclosure (disclosing materials on briefing sessions).
- Meeting with shareholders who have 3 % or more stakes (twice a year) should be required.

***(f) Environment for executing voting right. (5 comments)***

- Developing an environment where shareholders can easily execute voting rights such as by using electronic voting platform.
- Clapping to adopt resolutions at a general shareholders meeting should be prohibited.
- Materials for AGMs need to be provided by post and electric means four weeks in advance.

***(g) TOB defense measures. ( 3 comments)***

- Companies with TOB defense measures should virtually not be unable to list on the step-up market.
- Instead of company size standards, the 1st Section should apply governance standard, such as “no poison pill article.”

(TSE's Comments and Responses)

With the globalization of the financial capital markets, the influence and presence of foreign institutional investors at the TSE's Exchange Cash Equity Market has grown. Thus, for the Japanese economy's growth and competitiveness, it is a critical to construct and maintain a market that is attractive for global institutional investors. Therefore, it would be one idea to set up a market segment for companies that meet requirements as investment instruments for a broad range of investors, including international institutional investors (Market Segment C), separate from the well-established companies with appropriate business records as investment instruments for all investors, including retail investors and domestic institutional investors (Market Segment A).

Specific criteria could be based on the governance structure of the companies' business management, sufficient liquidity of the listed shares, stability of the business record and financial situation (earnings), market valuation (market cap), ability to disclose necessary and sufficient information, etc. Each of these criteria would need to be considered as to whether it has the appropriate global comparability. In discussing the specific criteria, they could be similar to the current listing standards of the 1st Section. However, issues summarized in the "1.Issues Regarding the Current Market Structure" would be taken into consideration, even in such cases.

**Proposals regarding exit from market**

***l. Delisting criteria based on financial performance. (10 comments)***

- Exit criteria based on sales and profit should be replaced by a market capital standard.
- Exit criteria should be strict, but it should not be based on financial performance, but based on share price or whether it has expectation from shareholders and investors.
- Financial performance standard, especially JASDAQ (Growth)'s earnings/cash flow standard should be replaced by market capital, share price standard. Market capital should already be based on the financial performance and risk profiles of the company.
- Currently, the delisting criterion related to market capitalization is no more than JPY 1 billion. This criterion should be substituted by a criterion related to stock prices. (If a company can avoid delisting, because the number of issued shares is large, practically speaking, such company can avoid delisting by issuing shares by third-party allotment.)

***m. Delisting criteria based on excess liabilities (5 comments)***

- The current delisting criteria pertaining to excess liabilities should be abolished. Excess liabilities delisting criteria discourages appropriate actions that reduce shareholder equities, such as share buy-backs (acquisition of own shares by the company) and dividend payment, and also discourage investment such as takeover...
- Global investors calculate corporate value based on cash-flow and profits, not on book value. So if the company is still solvent, even if it has excess liabilities, it would better to give the company an opportunity to improve its financial situation and cure itself, rather than to penalize the company and its shareholders by delisting it.
- In considering an appropriate delisting standard, the factor that determines whether it is inappropriateness for the company to be "listed," is stability of the business, in terms of cash flow. From this perspective, net asset based indicators are not necessarily compatible with equity investments. Therefore, excess liability standard which could be triggered by huge amount of asset impairment is not a reasonable standard to delist companies.

***n. Securing opportunities for improvement and curing deficiency. (10 comments)***

- Establishing a grace period of at least two years, before delisting, to secure sufficient opportunities for companies to remedy violation of the listing rules or to cure the failure to satisfy the listing criteria will be one measure to minimize the confusion.
- With respect to the handling of companies in cases where such companies no longer meet the criteria required to remain listed on the step-up market division, there is some room for improvement in measuring the computation period and the level of fulfilment of criteria.

- If a company cannot satisfy the listing criteria within the two years after the initial failure of meeting the criteria, it should be delisted.
- If taking "exit" into consideration, from the viewpoint of investor protection, there should be a "special" segment where exiting companies will be placed for a certain period before delisting. (It corresponds to the current Securities Under Supervision and Securities to Be Delisted.)
- While establishing a certain transitional period, the venue for companies that have left either of the markets divisions should be consolidated into a "special market division".

***o. Venue where shareholders can exchange shares after exit. (18 comments)***

- In reviewing the exist criteria, there needs to be opportunities for the shareholders to convert shares into money.
- By increasing the number of delisted issues due to strict implementation of the delisting criteria, the Phoenix issues system could be utilized, because it is a venue on which delisted issues can be traded.
- In light of sufficiently securing opportunities for converting shares to be delisted into money, the period during which such shares are assigned as Securities Under Supervision, Securities to Be Delisted, etc. could be appropriately secured.
- If there was a market for delisted issues, then stock price just before delisting will not decrease below their fair price.
- For investor protection, it is important to alert the investors as well as provide a process in which shareholders can convert their shares into money.
- For minority shareholders to sell their shares after delisting, OTC market needs to be revitalized in Japan.
- If there is a venue where shareholders can convert shares into money after delisting, it is expected that stock price formation process just before delisting will be improved. However, in contrast to the situation in the US, the OTC market is not common in Japan and participation of institutional investors in such venue is not expected. As such, it is difficult to create such a venue in Japan.
- A venue for converting shares into money after delisting is unnecessary. If shareholders wish to sell shares, they should sell them by the time of delisting. Investors who wish to continue holding shares after delisting can remain if they so wish.

(TSE's Comments and Responses)

In re-designing the market structure, based on the concept of each market, it is important to implement new listing rules and delisting rules (exit rules) that reflect each market concept appropriately. Also, in establishing a clear market concept and maintaining it consistently with sufficient transparency, the standardization of listing rules and exit rules are important (unified criteria of the rules applied for listing and maintaining listing (i.e. if not met, delisted)).

Regarding the delisting criteria based on business performance or financial statement, such as delisting criteria based on excess liabilities (excess liabilities for two consecutive terms), delisting criteria based on the amount of sales at the Mothers (0.1 billion JPY), delisting criteria based on business performance at JASDAQ (negative profit and negative cash flow for five years consecutively (at JASDAQ Standard) or ten years consecutively negative profit after listing (at JASDAQ Growth)), because there is already a valuation by the market (i.e. market cap), it could be redesigned to take into consideration the valuation.

For those companies that exit the market without meeting the listing criteria, it is important to ensure there is a venue where such companies' shares can be traded after the exit. Therefore, based on the progress of the market review, discussions should continue with the market participants.

## （2） Complementing Incentives for Sustainable Growth of Listed Companies

***a. Higher standard of listing criteria for step-up and standardization. (20 comments)***

- The standard of step up to the 1st Section could be raised higher.
- The standard for market capital criteria for step up to the 1st Section should be raised to a higher standard.
- By raising the market transfer criteria for the 1st Section, companies could be incentivized to continue its growth after listing.
- In considering the listing criteria required to step-up to the 1st Section, as well as listing on the start-up market, the point of view for the amount of capital raised is important.
- The waiting period before step-up should be two or three years.
- The listing requirements for step-up to the 1st Section should be set as a higher goal.
- The criteria for transferring from the 2nd Section to the 1st Section should be the same as those for transferring from JASDAQ or Mothers to the 1st Section.
- The criteria for step-up to the 1st Section should be standardized and raised to the level that contributes to improvement of corporate value.
- The criteria for transfer from the 2nd Section to the 1st Section should be the same as the criteria for listing directly on the 1st Section.
- For fairness and legitimacy, the criteria for step-up to the 1st Section should be the same as the criteria for listing directly on the 1st Section.

(TSE's Comments and Responses)

In re-designing the market structure with a clear concept for each market segment, the listing rules and market transfer rules could be standardized according to each of the market concepts.

For example, currently, in order to list on the 1st Section, companies can list directly to the 1st Section or can transfer from the 2nd Section, but the market capitalisation required to list on the 1st Section differs between these two methods (4 billion JPY or 25 billion JPY). Also, depending on which market a company transfers from, the company may or may not be required to have a certain amount of trading volume. These differences could be reviewed and the rules for promotion and direct listing could be standardized into one single set of unified criteria, regardless of the route to listing on the 1st Section.

There are also differences in the required period for which companies must have appropriate company reporting and financial statements, (5 years, 2 years). These differences could be standardized as well.

***b. Market participation of institutional investors to support company growth after listing. (34 comments)***

- It is difficult to judge the business performance of growing companies because of their characteristically unique business models. Given that it takes these companies longer to become competitive, long-term participation by institutional investors is crucial to the continued development of such companies.
- Currently, the main investors at the start-up market are retail investors; however, it is crucial to nurture companies that would be investable by institutional investors with a long-term view.
- Since it is a public market, listing criteria for liquidity must be set at a high standard and by having stricter liquidity rules, institutional investors might be able to participation in the market.
- In order to promote long term investment by institutional investors, it is necessary to offer an amount of tradable shares commensurate with the amount of funding such investors can supply. The listing criteria should require companies to sufficiently scale their offering.
- The criteria of tradable share ratio and tradable share market capitalization should be stricter to attract more institutional investors.
- The market concept for "start-up market" should be a market for "fostering growth of new and growing companies." Therefore, it should be a market where institutional investors can participate and in order to be such market, creativity is required in formulating listing criteria for securing sufficient liquidity (by setting higher standard for tradable share ratios and such).
- For new listings on each market, if the scale of public offering is larger than a certain level, then there should be a process for which long-term institutional investors who accepts a lock-up period for a certain time receive allocation of new issues at the offering price (clarification of related statues and interpretation of such statues is necessary as well).
- There needs to be more flexibility on the allocation of new issues for IPOs based on the demand/supply.
- Securities firm should allocate more stocks to institutional investors at IPOs.
- Start-up companies themselves need to improve their corporate fundamentals and increase their market capital, in order to attract investment from institutional investors
- It is important to strengthen access to institutional investors who can be anchor investors before listing.
- For new listings at each market, providing an environment where cross-over investors,

who hold shares before listing and keep holding after listing, can participate is crucial.

- To nurture the pool of potential crossover investors, it would be ideal for venture capitalist firms to keep holding stocks even after their invested companies have listed. TSE could have a mechanism that facilitates continued shareholding by venture capitalist firms. For instance, venture capitalist firms could be allowed to sell their shares (redeem their initial investments) after a certain lock-up period of six months or a year has elapsed.
- As a structural problem for start-up company's market, there are few institutional investors who keep holding stocks before listing and after IPO. Because of the lack of such cross over investors, the price formation and company's growth after IPO are affected, so there needs to be an environment where institutional investors can participate.

(TSE's Comments and Responses)

According to the statistical information published by TSE, such as Trading Value/Volume of TSE by Investor Type and Shareholding at Market Value by Investor Category, currently, for the 2nd Section, Mothers and JASDAQ, the majority of the trades are by individual investors and foreign institutional investors, who are not necessarily long-term investors. Therefore, it may be difficult for the listed companies to achieve medium-to-long term growth through constructive dialogue with their shareholders.

In particular, if a separate market segment is set up for companies with high growth potential (Market Segment B), the presence and impact of institutional investors who can value and assess the growth potential of each company is critical. Those investors will contribute to the fair and smooth price formation process, resulting in expanded opportunities to raise capital. Thus, in order to provide an environment where long-term investors can participate in the market and support such companies, appropriate measures could be implemented. Responding to the issues summarized in the "1. Issues Regarding the Current Market Structure," such as liquidity after listing, access before IPO, nurturing cross-over investors, specific measures will be discussed.

***c. Disclosure of mid- to long-term information. (14 comments)***

- After listing, there are many shorter term clerical disclosure requirements. To change the mindset of companies, TSE should also request that companies disclose mid- to long-term visions and provide updates of the progress.
- Upon listing, companies are requested to submit "Written Explanation Concerning the Possibility of High Growth". They could also be requested to submit progress on the contents of said document.
- It is important to provide incentives to encourage corporate managers to commit themselves to achieving goals set in plans, such as mid-term management plans, they have disclosed.
- For disclosure requirement, JASDAQ (Growth) requires companies to form mid-term business plans, and similar requirements should be introduced at Mothers too. (It is better for start-up companies that should have higher growth potentials to disclose more information on how they are going to achieve that growth).
- It is important to require companies to disclose their progress on the achievement of future vision they presented at IPO.
- For example, disclosure of progress on "Written Explanation Concerning the Possibility of High Growth" which needs to be submitted at IPO could be effective, however, the management should not be held responsible for meeting the KPIs.

(TSE's Comments and Responses)

If a separate market segment is set-up for companies with high growth potential (Market Segment B), the listing criteria could be re-designed with a focus on the future prospect of the company's business (growth potential). Possible measures could include facilitating and encouraging company disclosure from the medium-to-long term perspective.

Additionally, an appropriate disclosure framework and other frameworks could be different for each market (segment), according to the listed companies' growth stage and investor types. Therefore, it is necessary to optimize the framework based on the concept for each market segment.

**d.** ***Utilizing new indices and new market segments. (31 comments)***

- In addition to clarifying the market concept, there is the option of leaving the step-up market division unchanged (i.e., as the 1st Section) and selecting top tier companies based on indices.
- While retaining the current framework, a new premium segment should be established within the 1st Section. Such system can measure up to expectations of stakeholders such as investors.
- Establishing a new framework, for example, establishing an upper segment within the 1st Section as a new step-up market division by setting forth specific requirements could be considered.
- If there were to be a major revision of the market structure, then it would be difficult to get consent from all the 1st Section listed companies that could potentially transfer to other markets, so it would be more realistic to create a sub-division as premium division.
- Transition can be smoother and companies can be better incentivized to step-up if there were a mechanism for them to step-up from the 1st Section to a market higher than the 1st Section, not by demoting companies from the 1st Section.
- If more stringent criteria are necessary, it will reasonable to establish a "premium market" as a market division to which companies step up to from the 1st Section.
- Creating a market division superior to the 1st Section will give the existing 1st Section-listed companies incentives to further step up from the 1st Section without diminishing the value of the 1st Section. This will lead to improvement of value for the entire market.
- The 1st Section has overwhelming brand value. If a company was demoted from the 1st Section, it will give such company great incentive to improve itself and go back to the 1st Section. Therefore, it is desirable to position the 1st Section as the step-up market division rather than making a new premium market as another step-up market.
- The need for investment in the top 500 large-cap stocks should be addressed by utilizing indices.
- Various indices should function as divisions of large, mid, small cap stocks.
- A new TSE 500 (TSE premium index) should be calculated. There are already TOPIX, and premium index such as TOPIX Core 30 and TOPIX Large 70, but in light of the number of listed companies on the 1st Section, these premium indices do not represent the trend of Japanese markets. So there should be a new index with top 500 market cap stocks from the 1st Section, 2nd Section, JASDAQ and Mothers.
- Before considering creating a new premium market, it is necessary to appropriately analyze and verify the pros and cons of JPX-Nikkei Index 400. It is also necessary to

examine why JPX-Nikkei Index 400 has not produced satisfactory results.

- If a premium market is created, there is concern about what the differences are between such market and JPX-Nikkei Index 400. We do not expect investor behavior to change with the creation of a premium market.
- Hasty and one-sided establishment of a new market division is utterly unacceptable. The issue of revitalizing the stock market cannot be settled by making revisions to the hierarchy of the securities market, i.e., market divisions.
- Transfer between market divisions affect the price formation etc., so there are concerns about adding new market segments.
- An increase in the number of market divisions will bear a heavy burden in terms of system development while an increase in the number of indices will be easily addressed. It is hoped that cost burden on the entire industry will be considered.

(TSE's Comments and Responses)

For companies that meet the requirements as investment instruments for a broad range of investors, including international institutional investors (Market Segment C), the listing criteria could be re-designed and reflect the perspective of global institutional investors. In considering the specific criteria, it is recognized that the perspective of many global institutional investors is under transition, such as the widespread interest and awareness of ESG investments.

Regarding the market segment, and the listing criteria for each segment, frequent changes in the listing rules could decrease the convenience for market participants and inhibit the medium-to-long term growth of listed companies. Therefore, for the smooth application of listing rules and to ensure transparency, for example, market structure should be redesigned as a whole, including the utilization of stock indices reflecting global institutional investors' requirements.

When reviewing the current market structure, it is necessary to thoroughly examine the usefulness and success of existing indices, such as the JPX Nikkei Index 400.

## （3） The Ideal of Investable Index

***a. The relationship between TOPIX and market divisions (20 comments)***

- The ideal forms for 1st Section as a market division and TOPIX as a benchmark should be deliberated separately.
- As for the relationship between listing framework and TOPIX, TOPIX does not necessarily have to be covering all the listed companies on the1st Section, and so exchange should consider and discuss what would be the ideal "1st Section" and what would be the ideal "TOPIX" as an index, separately.
- From the viewpoint of index governance, it is desirable to treat market divisions and TOPIX separately.
- Review of TOPIX should be a separate discussion from discussion on market segment, so the ideal of TOPIX should be reconsidered, taking into consideration how the other global index are designed, how the institutional investors are using the index, and how it will be affected by the changes.
- Instead of maintaining TOPIX as is and creating new index and index futures, there should be a new index into which TOPIX will be reformulated, as the new "TOPIX" that meet investors' need.
- At TSE, there are already premium index that focuses on ROE (capital efficiency) and governance, such as "JPX Nikkei index 400," so how to position TOPIX as benchmark for the market while maintaining the status of these premium index, and how to differentiate those index are discussion required to be held, along with the review on the market structure.
- TSE should encourage appropriate review of capital policies by reducing the number of TOPIX constituents to no more than 500. It is difficult for passive and active investors to follow all of the TOPIX constituents. As the number of TOPIX constituents is large, sufficient consideration is not paid to companies that have improved corporate value. As such, it does not contribute to incentivizing companies with low performance. (The number of constituents of major overseas indices ranges from 30 to 500.)
- Separating the index for passive investment, and statistical index, and having the "TOPIX" name and underlying of TOPIX futures succeeded to the index for passive investment, will optimize the index according to the purpose of its usage.
- Rebalancing the constituents of index should be based on market capital in principle, and there could also be other quantitative rules.
- For benchmark used for general purposes, it is very important that constituents actually have liquidity.

- From the perspective of large asset owners, in order to cover the whole market, a benchmark should have a certain number of constituents, covering the market.
- If TOPIX as a benchmark has less constituents, then tracking error is reduced and management cost will be reduced, but from the perspective of representing the market's movement and investment opportunities in the market, because small and mid-cap (growth) stocks' performance are better in the mid-long term, there needs to be a certain number of constituents.

(TSE's Comments and Responses)

For the TOPIX index, which is constituted of all the domestic companies listed on the 1st Section, various comments were submitted by market participants, as in the "1. Issues Regarding the Current Market Structure."

When reviewing the current market structure, the new market structure and each market segment could have different constituents from the current index constituents.

As part of the review of the market structure and further discussions, the continuity of the TOPIX index as well as the demand for a benchmark index functioning properly as an investable index, would be taken into consideration.

## （4） Transition Process: Considering Impact on Companies and Investors

***a. Considerations about the effect of the review. (30 comments)***

- In Japan, the leading benchmarks match up with the market divisions. So revision of the market divisions will have a huge impact.
- If the constituents of TOPIX are to be rebalanced due to review of the 1st Section, it is necessary to sufficiently take into account the impact on market users.
- It is necessary to pay attention to the continuity of TOPIX. It is also necessary to avoid confusion for investment trusts that could arise from considerable changes required in contracts and significant changes in management methods, etc...
- Since the BOJ began their purchase of ETFs, especially after the weight on TOPIX-link increased, small-cap stocks have outperformed the entire market. If the revision were to result in exclusion of small-cap stocks from TOPIX, stock prices will fall.
- Nikkei 225 constituent review in April 2000 largely impaired performance. There is concern that individual investors and pension funds might experience loss again from the current review of the market structure.
- Market divisions and impact on small-cap stocks should be deliberated separately. However, due to the spread of passive investment, there is concern that reviewing indices in connection with revision of market divisions will have an impact on small- to mid-cap stocks with low liquidity.
- It is also necessary to pay attention to the fact that the social status associated with being listed on the 1st Section-listed companies is well-established.
- There is concern that tightening listing criteria will lead to investor’s loss of investment opportunities.
- Although drastic revision of the criteria will send a strong message, there is a high possibility that such revision will be a great detrimental to the brand of the TSE market that have been accumulated to date.
- If the criteria for maintain listing is radically reviewed, many stocks might be excluded from the 1st Section. In such a case, the corporate value will be largely damaged. Such damage will take the form of, for example, (1) damage to the corporate brand as a 1st Section-listed company, (2) falling of stock prices due to forced selling by investors that have portfolios whose benchmark is TOPIX, (3) reduced capability to recruit new graduates, (4) reduced capability for transactions with banks, (5) rise in interest borrowing rate, and (6) reduced liquidity.
- The 1st Section listed companies include not only the large corporations, but established companies in respective fields that have unique business. As such, Japanese market is

unique in that it represents the trend of economy and industries of both types of companies. However, if those established companies are no longer to be listed in the 1st Section, then the 1st Section might lose its uniqueness.

- We strongly request that in terms of reconsidering the exit criteria (maintenance criteria), the detriment of the listed company be considered sufficiently.
- In 1975, listing criteria were raised (capital requirement increased from JPY 0.3 billion to JPY 0.5 billion) which caused many companies to take rampart actions trying to increase capital during the grace periods. So in reviewing the listing criteria, sufficient consideration should be given to the impact of the change and how it might cause market players' unexpected actions.

***b. Consideration about the continuity of TOPIX. (20 comments)***

- It is necessary to take into consideration the continuity and representation of indices.
- TOPIX has wide coverage and also market capital weighted average index, so it is a reasonable benchmark for Japanese stock market. However, if the number of the 1st Section listed companies is reduced, then TOPIX constituents will be reduced as well and continuity of the index will be greatly impacted.
- TOPIX is used as a target for major passive investment and a benchmark for many active investment managers. Thus, it is imperative to give consideration to its continuity. Moreover, if a new benchmark is created as an alternative to TOPIX, revisions to investment trust contracts and pension fund management agreements might be necessary. Consequently, it would be more realistic to, while maintaining TOPIX, gradually change its constituent companies to those that match large-sized transactions.
- While leaving the current TOPIX as an index, it is necessary to, via developing various new stock price indices, provide various investment opportunities to investors and at the same time give listed companies incentives to improve corporate value.
- We have an impression that, unless the market structure is reviewed without TOPIX being revised as a benchmark, such review itself will be considerably difficult.
- TOPIX signals investment opportunities in the stock market, and is used as a benchmark for many pension funds and ETFs, so transition from TOPIX to other index is unrealistic.
- In terms of the index (TOPIX), if low liquid stocks are removed, then the problems arising from passive investment will be resolved. Meanwhile, there are some views that, because TOPIX includes growth stocks, its performance is good.
- Revision to the 1st Section will give rise to concerns about cessation of continuity of TOPIX as an indicator, accountability to companies that will be excluded from TOPIX, and impact on market prices, etc. In particular, unless a reasonable period is secured for

adjusting portfolio allocation ratios for products such as index-linked funds, the impact on the market will become excessively large, and thus it will bring about a large problem in terms of investor protection.

- In Japan, TOPIX is one of the main index, second to Nikkei 225 index, used by many foreign investors as well, so it is likely to be used going forward as well.
- In reconsidering the ideal for step-up market, consideration of how the TOPIX should be must also be discussed. There seems to be comments to review them, but there is also strong support for keeping the TOPIX.

***c. Appropriate transition process. (20 comments)***

- TSE should sufficiently consider the impact on the market participants, and have appropriate transition measures and period in place for implementing changes (for example, at least 3 years transition period).
- TSE should put in place appropriate measures for reflecting changes in the TOPIX constitutions, so that it will not be rebalancing too often.
- TSE should take precautions, such as by reflecting the changes on TOPIX in phases, to not allow the transition process to adversely affect the market. (For example, if companies whose market capitalization is less than JPY 10 billion are excluded from the TOPIX constituents, rebalancing would be made in four installments.)
- After the review of the market structure, if the continuity of indices such as Nikkei 225 and TOPIX is not maintained, it will give rise to great confusion in the market. Therefore, appropriate transition measures and period should be established so as to avoid such confusion.
- Due to the impact on the investment instruments and listed companies, sufficient transition period is required, for example, implementing changes gradually and in phases.
- It is understandable that there are concerns about the impact of changes, but the corporate value does not depend on the market segment but on the fundamentals of the company, so a restructuring of the market segment should be conducted as soon as possible. However, there also needs to be sufficient notification period as well as transition period.
- From the perspective of giving listed companies enough time to cure and satisfy the listing criteria, there needs to be sufficient transition period. Also we request that the review and transition be satisfactory for both listed companies that remain in the market segment and also those that transfer to other market segment.
- Pre-IPO companies prepare for IPO by looking at the specific listing criteria for each market segment and considering the actual criteria they choose the market to list. So if the listing criteria are going to change, then there will be a great impact on the pre-IPO

companies as well. Therefore sufficient transition period is strongly requested.

- The passive investments that link to TOPIX has expanded, so tightening of exit standard will affect the market greatly. Therefore if exit standards are tightened, long term transition approach, such as incremental implementation, must be taken.
- We agree there is a need for review of the 1st Section listed company's standard and obligation in order to improve the market function. However, TSE is an infrastructure for stock investment, and so it should be considerate in drastically changing rules that is the basis of index and which could impact the number of constituents of such index. Therefore, the changes in the rules should be gradual for investor protection.

(TSE's Comments and Responses)

As the future market structure is reviewed, TSE will take into consideration the impact on listed companies and market participants, including domestic and foreign investors, to ensure an appropriate transition process. For example, if a new market segment is to be established, then to ensure a smooth transition, listed companies could voluntarily select and apply for the market segment in which they wish to be listed.

If the new standards might require listed companies' to take corporate actions, then a smooth transition could include having a multi-year transition period, or a gradual implementation of the applicable standards.

If any changes were to be made to the existing indices, such as TOPIX, then the potential impact on listed companies, as well as on investors, will be thoroughly analyzed.

## ３. Others

***a. Listing of parent and subsidiary companies. (10 comments)***

- In reviewing the market structure, from governance perspective, one discussion point could be about listing of parent and subsidiary companies in the same market segment.
- Where a specific shareholder holds a majority of votes, there is a possibility that the opinions of minor shareholders will not always be reflected in corporate management. Such a situation is not sound in terms of governance
- There is debate over the listing of parent and subsidiary companies. Some say that if we can say such listing is reflected in the market evaluation (i.e., stock prices are discounted.), then there is no problem. Others say that such listing should not be allowed. There are various opinions.
- There are many cases where the listed parent company has left the listed subsidiary company to do what it likes, and as a result, governance over the large shareholder does not function at all. Therefore, the management of such subsidiary company has come to be indifferent to improvement of shareholder value.
- I don't think that listing of parent and subsidiary companies should be prohibited. However, independency of the board of directors should be enhanced. For example, if independent outside directors occupy a majority of the board, such listing will be allowed. Unlike listing of parent and subsidiary companies, I am not concerned about cases where a company founder becomes a controlling shareholder.

***b. M&As and corporate combinations. (10 comments)***

- In foreign countries, M&A is widespread for corporate value improvement. However, Japanese companies do not make such efforts. As such, it is necessary to give incentives to such companies.
- The reason that there are many listed companies with small market capitalization is because, due to cross-shareholdings, corporate realignment (M&A) does not happen. From the viewpoint of maintaining and improving corporate value, it is important to develop an environment that facilitates M&A. (For maturing industries, M&A and other business combination will create scale merit and improve efficiency, and new and emerging industries receive the benefit from the resources that have been reorganized, and thereby the whole economy grows.)
- Currently, in Japan, exit of venture capitalists and owners are mostly IPOs, but there is room for 1st Section companies to conduct more M&A of start-ups. So for example, requiring the 1st Section listed companies to achieve a certain growth and having that

standard in the listing criteria might encourage start-ups to reasonably choose IPOs or M&A.

- In Japan, M&A and other business combination deals are done on the premise that companies do not get delisted, whereas in the US, usually they are to be delisted. Therefore in light of the uniqueness of Japan, incentives are needed to encourage more business restructuring.
- In the US, companies have repeatedly done M&A deals and therefore achieved growth (market capital increased). In Japan, strong companies should take the lead to do more M&A deals and grow to the scale of global-sized companies.

***c. Governance and disclosure framework based on market concept. (8 comments)***

- The characteristic of listed companies should match the concept of the market, so one idea is to clarity the required standard of governance accordingly to the characteristics of companies to be listed on each market segment.
- TSE should review whether the same level of compliance should be required for all companies regarding corporate governance reform, the J-SOX law, and quarterly disclosure.
- In reviewing market segments, in addition to factors such as company size (market capital), risk and return characteristics, liquidity, size of public offerings etc., it is important to consider the cost of listing and efficiency.
- For the overall review of the market segments, current listing requirements and criteria of the market segments should be reviewed and if there are any issues that need to be addressed, TSE should take measures as soon as possible.

***d. Exit from the market. (8 comments)***

- Delisting based on application should not be allowed. Once it is listed, the listed company should fulfill its responsibility.
- Instead of reassignment or delisting, new rules should be established for those that violate the listing rules, so as to prohibit corporate managers from becoming corporate managers or outside directors of other listed companies for a certain period of time. Thereby, corporate managers should be held responsible.
- With an eye on encouraging companies that have problems with governance to improve, the assignment as Securities on Alert can be added to the exit criteria.
- Criteria for major shareholders (whether a controlling shareholder exists or not) should be introduced. (For example, if a listed subsidiary company (whose majority of shares are held by the listed parent company that is its controlling shareholder) or a company whose

owner is also its corporate manager (whose majority of shares are held by company founders or corporate managers) cannot reduce the ratio of equity interest of the controlling shareholder to no more than one third of all the shares within a certain transitional period (three to five years), such company should be demoted to the 2nd Section.

***e. Price formation for IPOs. (6 comments)***

- There is a problem with IPO price formation. Companies have difficulties in raising fund after listing, with their prices initially soaring and then hovering around lower ranges.
- Institutional investors do not invest in start-up companies, because of the high volatility of their stock prices, which is considered a risk and thereby resulting in the start-up markets having less participation by institutional investors.
- Currently volatility of IPO is too high for institutional investors, so most of the shares are held by retail investors.

***f. Mothers index. (3 comments)***

- When a company steps up to the 1st Section, it is excluded from Mothers Index constituent, so the Mothers index has no appeal as index for growth stock.
- Currently, Mothers index does not cover the companies that step-up to the 1st Section, so it cannot reflect the growth of such companies, giving false impression that the start-up market less appealing

***g. Fairness in deals with majority shareholders. (5 comments)***

- A prior resolution approved by a majority of the minority shareholders (e.g., excluding related parties) should be required in the articles of incorporation.
- In TOB, majority of minority resolution must be required.
- If the deal has financial impact worth 10% or more of net asset, then majority of minority resolution should be required.

***h. Shareholder benefits. (3 comments)***

- Shareholder benefits should be abolished. (Those not related to core business should be abolished and benefits should be provided to institutional investors as well.)
- Currently companies use cash vouchers as shareholder benefits to maintain stock prices while there are no measures to be taken against it. Such situation should not be left intact.

***(Other)***

- The exchange should standardize listing application forms for each market division and allow emerging companies to flexibly plan choice of markets, such as changing the markets on which they wish to be listed.
- Overseas institutional investors pay attention to cash-flow. The exchange should request listed companies to appropriately disclose quarterly cash-flow statements.
- Tax regimes also have significance in terms of unwinding of cross-shareholdings. If tax is imposed on capital gains, reasons for holding shares are economically more justified.

(TSE's Comments and Responses)

The review of the TSE Cash Equity Market Structure has been discussed at many venues, including the Market Structure Special Group established under the Financial Services Agency's Financial Council. The points mentioned above would be taken into consideration and will be reviewed as part of the TSE's discussions regarding the future market structure and other discussions concerning the review of the listing rules and regulations.

END OF THE DOCUMENT