

Notes of Media Briefing by Mr. Atsushi Saito, President & CEO, Tokyo Stock Exchange Group, Inc. on January 31, 2012

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1. 3rd Quarter Financial Results for Fiscal Year Ending March 2012

The following is a breakdown of the financial results of Tokyo Stock Exchange Group, Inc. (TSE Group) for the 3rd quarter of the fiscal year ending March 2012.

Stock trading volume was down 12.5% on a year-on-year basis, trading participation fees declined 6.9%, and income from securities settlement also fell 7.3% from the same period of the previous year.

Listing fees were down 25.4% with the quarter seeing less activity than the same period last year when there were the IPO of The Dai-ichi Life Insurance Company and other large-scale capital increases. The amount raised in capital increases also fell by 70% from the previous year.

Income from information services remained at about the same level. As a result, operational revenue fell 7.2% to JPY 39.0 billion on a year-on-year basis.

Meanwhile, with respect to operating expenses, system maintenance and operating costs were down 10.2% due to reviews of system maintenance and other cost cutting measures. However, depreciation costs rose sharply by 8.6% as the useful life of the previous futures trading system was shortened in relation with the launch of Tdex+ System in November 2011.

Real estate rent expenses were down 6.9% due to slightly lower rent for the TSE building.

Therefore, overall operating expenses were up 1.9% to JPY 33.1 billion.

Overall, operating profit fell by 37.7% to JPY 5.9 billion from the same period of the previous year. With ordinary profit adjusted with dividend from Singapore Exchange, etc. down 33.6% to JPY 7.5 billion, net income for the 3rd quarter after taxes was down 37.4 % to JPY 4.3 billion from the previous year.

## 2. Development of Listing Rules and Frameworks to Increase Confidence in and Further Invigorate the ETP market, etc. in light of Global Trend

TSE constantly endeavors to offer a diverse lineup of ETF products on par with other markets around the world. With a view to maintaining and enhancing the competitiveness of the Japanese financial and capital market, we have decided to develop a set of rules to list exchange-traded products (ETP) tracking leveraged or inverse indices, which are actively traded overseas.

Recently, funds managed using swaps and other financial instruments other than cash equities known as "synthetic ETFs" have been a hot topic worldwide. We hope to incorporate views on these products into our rules and frameworks, and thereby make strides toward further growth and greater confidence in the ETF market.

Leveraged and inverse indices are indices which amplify the price movement of an underlying index by a set factor or invert it. There are about 500 ETFs tracking such indices listed worldwide. These ETFs have especially high liquidity.

In the U.S. and European markets, leaders in ETFs, leveraged and inverse ETFs are very popular. Even in Korea, 9 such ETFs were recently listed. Even though these ETFs make up less than 10% of total number of ETFs in Korea, their trading volume occupies almost 80% of the market. Despite us having about the same number of listed ETFs, trading is much more vibrant in Korea. One of the reasons for such success is their merchantability.

Leveraged and inverse ETFs possess characteristics different than those tracking traditional indices. Of course, we will maintain our standards on the objectivity and fairness regarding eligible indicators, but we will also request for extensive disclosure on aspects such as index characteristics and investment styles requiring caution.

We have already received many requests from market participants to create leveraged or inverse ETFs based on TOPIX and related indices. Once we implement the rules, I don't think we will need to wait for long before we see new ETFs on the market.

Let me give you an overview of the regulatory measures we have planned for synthetic ETFs.

The Japanese ETF market today is largely centered on ETFs based on traditional stock price indices. For cases where there are restrictions on cash equity assets, such as foreign investment limits on stocks in developing countries, we have ETFs managed using OTC swaps or linked bonds. Such ETFs contain swap counterparty

risk or credit risk of the linked bond issuer. We will implement rules which reflect the views being raised in the global discussion on such ETFs possessing a certain extent of credit risk.

Specifically, first, we will require the management companies of such ETFs to continuously maintain and improve their management systems and frameworks regarding the credit situation of the counterparty to, for example, the linked bond issuer. They will also be obliged to report this credit situation, and TSE will make such reports available for public inspection. In the event where the financial situation of the counterparty deteriorates, such as when it falls into liabilities in excess of assets, we will require them to disclose such fact in a timely manner. In addition, we plan to delist the ETF if the management company is unable to replace the linked bonds within a year, or if they can no longer maintain their management systems and frameworks regarding the credit situation.

We hope to implement these rules in early March after seeking public comment on the proposed rules and making the necessary amendments to our listing rules.

### 3. Corporate Governance Initiatives toward Restoring Confidence in the Securities Market

The result of the examination regarding the Olympus case, a topic of widespread attention, was released by our self-regulatory body, TSER, on January 20.

I think there are various views on the conclusion of "designating the company's stock as a security on alert and having them pay a listing agreement violation penalty". Until now, we have not heard about this being a wrong decision. I believe that from the view of the intent of the rules and previous cases, I think many may have expected something similar and the decision was duly accepted.

Now that TSER has finished its examination, I have no doubt that the eyes of both domestic and overseas investors will turn or have already turned toward how the corporate governance reform for TSE-listed companies will unfold.

Through continuously improving our listing rules and systems, we at TSE have dedicated efforts toward enhancing the corporate governance of our listed companies. However, it is regrettable that we continue to see cases. An analysis into the details of this series of improprieties will, unfortunately, gradually reveal that the response to our requests has not always been adequate.

We will learn the lessons from these cases which have actually occurred and use

them to improve our listing rules and systems. We realize that it is crucial to restore the trust of investors in TSE-listed companies and the market, and are earnestly working on measures to do so.

I understand that the Companies Act Subcommittee of the Legislative Council will resume deliberations next month, and will begin to discuss mandating the appointment of outside directors, tightening of requirements for outside officers in the Companies Act, and other related matters in earnest.

In these discussions, I think the roles of and burden shared by the Companies Act and the listing rules in the governance of public companies will become clearer to us. At that point, we must then begin considering actual measures in our listing rules.

However, this series of improprieties has led to increasing scrutiny of Japanese companies, and we do not have the luxury of waiting for the discussions to indicate the general direction. This is because the eyes of skeptical domestic and global investors is making it harder for those listed companies that work daily to respond to shareholder mandates and conduct business in a highly transparent manner to even gain a fair valuation in the market.

The key to improving the situation is, in a word, "independent outside directors". We believe that they are the most important aspect in restoring the trust of shareholders and investors is the appointment of not just "outside directors" but "highly independent outside directors". We, at the TSE, are already working to examine the early introduction of measures in our listing rules by reviewing our listing rules and enhancing our independent directors/auditors system.

We are in the midst of deciding on the details, but this series of incidents has already revealed one issue. That is, the current framework does not allow shareholders to identify the relationship of a person with the listed company, whether a person had previously worked at a client, is from a company to which officers are mutually dispatched, or is receiving donations or grants such as research funds from the listed company, even if that person is appointed an outside director and designated as an independent director.

Since independent directors/auditors are supposed to represent the interests of general shareholders, it is integral that they act purely in the interests of the company over the interests of all other stakeholders.

In the case of doubts arising over the independence of an independent director or auditor due to a superficial relationship with the listed company, we should enable shareholders access to such information. On top of that, I think we need to build a

framework where it is down to shareholders to decide whether or not an independent director or auditor can be trusted to do the job.

If this can be achieved, the company will be accountable for the director's independence and will select them with greater care. If questions are raised about independence and the independent director does not function properly, it is clear as to where accountability lies. It follows that companies will have no choice but to make considerations for creating an environment allowing independent directors to fulfill their function.

What I have highlighted today is only one of many issues revealed by the recent series of incidents that require immediate action. We will strive to paint a clear overall picture and move toward implementing measures all at once, so as to restore the trust of both overseas and domestic investors in Japanese companies.

#### Q&A

Q: I have 2 questions. The other day, Minister for Financial Services Jimi said he hopes to raise the bill on the concept of a universal exchange in the Diet after the Financial Services Agency (FSA), Ministry of Economy, Trade and Industry (METI), and the Ministry of Agriculture, Forestry and Fisheries (MAFF) agreed to consolidate regulatory oversight on exchanges. I believe this will have significant influence on the Japan Exchange Group which will come into being after the business combination between TSE and OSE. What do you think of this development?

A: This issue has been under discussion for quite a while. We and our related parties share the view that it would be hard to achieve without consolidating the framework for regulatory oversight is the key. I'll be glad to hear about specific and actual examinations on consolidating regulatory oversight being underway.

However, we have heard nothing about the contents of such developments. In any case, we are busy with our prospective business combination with OSE, and I will refrain from commenting at this stage where nothing concrete about the bill has been revealed.

Q: My second question is about Olympus remaining listed and being designated as Securities on Alert the other day. You mentioned that, in general, people have

accepted the decision. However, there are some who think that the criteria on whether or not there is material impact on the market are too ambiguous, and leaves too much to the discretion of TSE for any decision. I also hear doubts over the need to reach a decision so quickly, even as Tokyo District Public Prosecutors Office is still conducting investigations. I would like to hear your views on these opinions.

A: This system established at TSE for such cases involve the independent and self-regulatory handling of the matter at TSER by a majority vote of its governors. I understand that there was no fuss over the case and there was explanation as to the basis for the decision. While I believe there are a variety of opinions, as I said earlier, I have not heard very negative feedback on the decision.

However, as you have pointed out, while it remains a difficult issue, if we receive feedback seeking a more objective way, we will gladly listen to suggestions.

Q: I have two questions on enhancing the function of highly independent outside directors. In the previous media briefing, you mentioned clarifying the concept of independence and the role. First, I would like to know the progress on discussions to clarify the role of such directors.

I believe the discussion with the industrial circle on independent outside directors has gone on for long time. The incidents at Daio and Olympus present an opportunity to push for the introduction of independent outside directors. This leads me to my second question which is, do you have anything else to say to the industrial circle?

A: About clarifying the role, in short, as is often said, Japanese rules are not wrong in all aspects, but many of these people are from within the company. In addition, if an independent director or auditor can clearly voice his or her opposition, and that remains as a record in some form which can be used later, it will be of substantial concern to any ordinary top executive.

Of course, through my conversations with peers in the financial sector and as a top executive myself, I know that constant confrontation does not necessarily lead to progress. However, the point is the idea that legal

ownership in a stock company lies with its shareholders. While this idea is quite strong overseas, honestly speaking, the same cannot be said for Japanese companies.

As such, companies put very little effort into explanations to their shareholders. It is a case similar to "I made the decision and that's final". Shareholders are made up of a diversity of people and directors are supposed to conduct management as their representative. We would like to have a system where the director is always thinking in the interests of the company and, ultimately, its shareholders and can raise independent opinions to the executive president or CEO on the basis of social justice. The status of a director in such a position should also be protected.

As you have rightly pointed out, my conversations with the financial sector reveal the general feeling that we cannot continue with the current system. I have also spoken with leading figures in the Japanese economy. While such statements should probably not be mentioned in public, I have received some comments in support of TSE to be stricter or that the system is not working properly. However, since we are not a government agency with regulatory authority, we cannot issue orders. Instead, we will continue to be persistent in our requests. The key here is for us to gain the understanding and cooperation of the market.

Q: There are media reports that the European Commission is ready to reject the merger between NYSE and Deutsche Börse. What are your thoughts on this and how will this affect the examination by the JFTC of your business combination with OSE?

A: This is a difficult question. A lot is already being said in the media about NYSE and Deutsche Börse, so I guess it might be fine for me to offer my comment. While I don't often talk to Deutsche Börse, I am familiar with New York. I hear from them that it will probably be difficult.

One of the reasons is that, as mentioned in the media, the reason behind conducting the merger is to increase efficiency or, to put it differently, to build a strong business model.

If we look at the business models of both companies, they want to combine to raise efficiency but have instead been told to split up their operations. It is clear

then that there is no point in doing it.

I do not know how nationalistic this is, but according to a representative from Washington, they are supportive of the deal. However, in Europe, there is, in fact, quite a bit of resistance due to Euronext's extremely large presence suppressing northern Europe. While I have no evidence to back up my views, that deal seems rather difficult.

As for ourselves, I can only hope that we will not be adversely affected by a collapse of that deal. Ours is domestic and between Japanese counterparts while theirs is international and on a global basis, so there are slight differences. Still, I hope that there will not be any negative effect.

Q: I would like to return to the topic of independent outside directors. Beneath the prolonged discussions with the industrial circle, I think they may be trying to make the point that there is insufficient talent or cost issues. I would like to know whether this is any truth in this. You also mentioned earlier that you would listen to suggestions on the delisting rule. How serious or active are you seeking such suggestions? For example, are you thinking of setting up a working group?

A: First, even though the problem of a lack of talent is commonly raised, I think that it would be sufficient to find someone who doesn't know about the company. I don't think many shareholders know the details of the business of the companies they own a part of. What is important is the process of explaining to such a person. I, for one, think that running a business is taking the time to respond to questions from shareholders or outside directors that the company is taking risks, using a lot of money, investing in infrastructure, moving overseas, reorganizing, and why it is important for the company to do so.

For example, in the Olympus case, many directors were actually experts in the business. However, based on reports in the news and media, I remember something akin to being an expert in cameras, and not having any idea about finances. I do not think that a person needs to understand the company to be effective in corporate governance. In fact, complete outsiders often ask the best questions. Work that cannot be revealed in response to such questions should not be undertaken.

In this sense, since there is a lack of talent, then we turn to university professors or lawyers. Some people are actually independent directors at 5 or maybe even 10 companies. I really do not think this is desirable. Companies should seek someone of sound character, and it would probably not cost as much.

As for the delisting rules, I will refrain from making comments since I am not from TSER. There have been precedents and we also received feedback on making the process easier to understand. I think we should think of a way to address this. However, this will not be easy.

It is not a question of simply setting some figures to solve the problem. There is, obviously, a need to determine the state of the situation. How much of the determination process can be easily understood by an outsider such as yourselves is something that we have to constantly consider.

Q: TEPCO has come up with a policy to raise rates for electric power use by corporations. How do you think this will affect listed companies or manufacturers?

A: Everyone needs to use electric power, but there are a limited number of people with the technology to generate power. However, power companies have responsibilities stretching 30 to 40 years. This is an issue for Japan as a whole.

Maybe it will suffice to have an external party conduct checks, but the power company is already trying its best to streamline and reduce redundancies. There is already a trade deficit from importing fossil fuels and we cannot be optimistic about the oil situation if, for example, problems occur in Iran. To have TEPCO absorb and buffer the country from all these problems is a very difficult proposition.

The bottom line is revealing the process to the nation. TEPCO has done what it can on its own. Anything else is physically beyond them. It is at this point that the government comes out and says that this must be done. The clear intervention of the government on behalf of the utilities company will make people realize that the rate hike is absolutely necessary.

On the other hand, the general sentiment in Japan now is not in support of reactivating nuclear power plants. There are many highly contradictory and maybe even incoherent views. We need to make our stance clear. If we do not

reactivate other nuclear power plants, we will need to import more, and emit more CO<sub>2</sub>. It follows that the rates must be raised and that will no doubt hit the Japanese industry and blunt its competitive edge.

If things remain unchanged, Japan will run up her trade deficit, which will ultimately create a current account deficit. If this happens, it will affect the level of Japanese fiscal debt which now stands at around 200% (of GDP). This will cause a huge problem.