



## Revisions of TOPIX

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### Exchange & beyond

JPX Market Innovation & Research, Inc.

September 9, 2022

- The main comments regarding TOPIX in the report from the "Expert Study Group on the Structure of Capital Markets in Japan" under the Financial System Council Capital Market Working Group (published December 27, 2019) and JPXI's responses to these are shown in the table below.

## Comments in the Report (**Bold and underlines** are added by JPXI)

## JPXI Responses

- The composition of listed companies on the First Section and the composition of TOPIX are identical.
- It is considered appropriate **to delink the composition of TOPIX from market sections.**
- It is necessary to aim for an index which institutional investors (asset owners and asset managers) find **convenient** and which also comprising companies find **reasonable**.
- Since TOPIX is already widely used in pension management and mutual funds, it is appropriate to select companies in a way that places **more emphasis on their liquidity**, while also **ensuring the continuity** of TOPIX.
- Specifically, after **revising the definition of free float** currently used in calculating TOPIX, it may be considered to set the criteria **based on "market capitalization of tradable shares (free float market capitalization)"** which is calculated using the new definition.
- Based on the above points, the criteria may be set by **referring to the "market capitalization of tradeable shares" criteria for listing on the new Prime Market.**

- ⇒ The index was cut loose from market segments in April 2022.
  - Of 2,169 TOPIX constituents, 1,836 are on the Prime Market and 333 are on the Standard Market (as of end of August 2022).

Note: Measures were finalized in April 2021 after an index consultation in December 2020.

- ⇒ **The transition to the new index will be carried out in stages** to minimize impact on the market while **ensuring continuity**.
- ⇒ By cutting TOPIX loose from market segments, JPXI aims to **further improve its functionality as an investable index** in addition to its representation of the market.
- ⇒ The calculation method for Free-Float-Weight (FFW) Ratio was revised.
  - **Strategic holding shares have been designated as non-free-float shares and were excluded from free-float shares in stages** (completed by end of June 2022).
- ⇒ **The weighting of constituents with tradable share market capitalization of under JPY 10 billion will be reduced in multiple stages to ultimately zero.**
  - The weighting will be gradually reduced every quarter in ten stages starting **from October 2022 and ending in January 2025**, when the constituents will be ultimately removed from TOPIX.

Note: **Assets linked to TOPIX** including ETFs, investment trusts, and pension management amount to **approximately JPY 80 trillion** (as of end of March 2022).

## Comments in the Report (Bold and underlines are added by JPXI.)

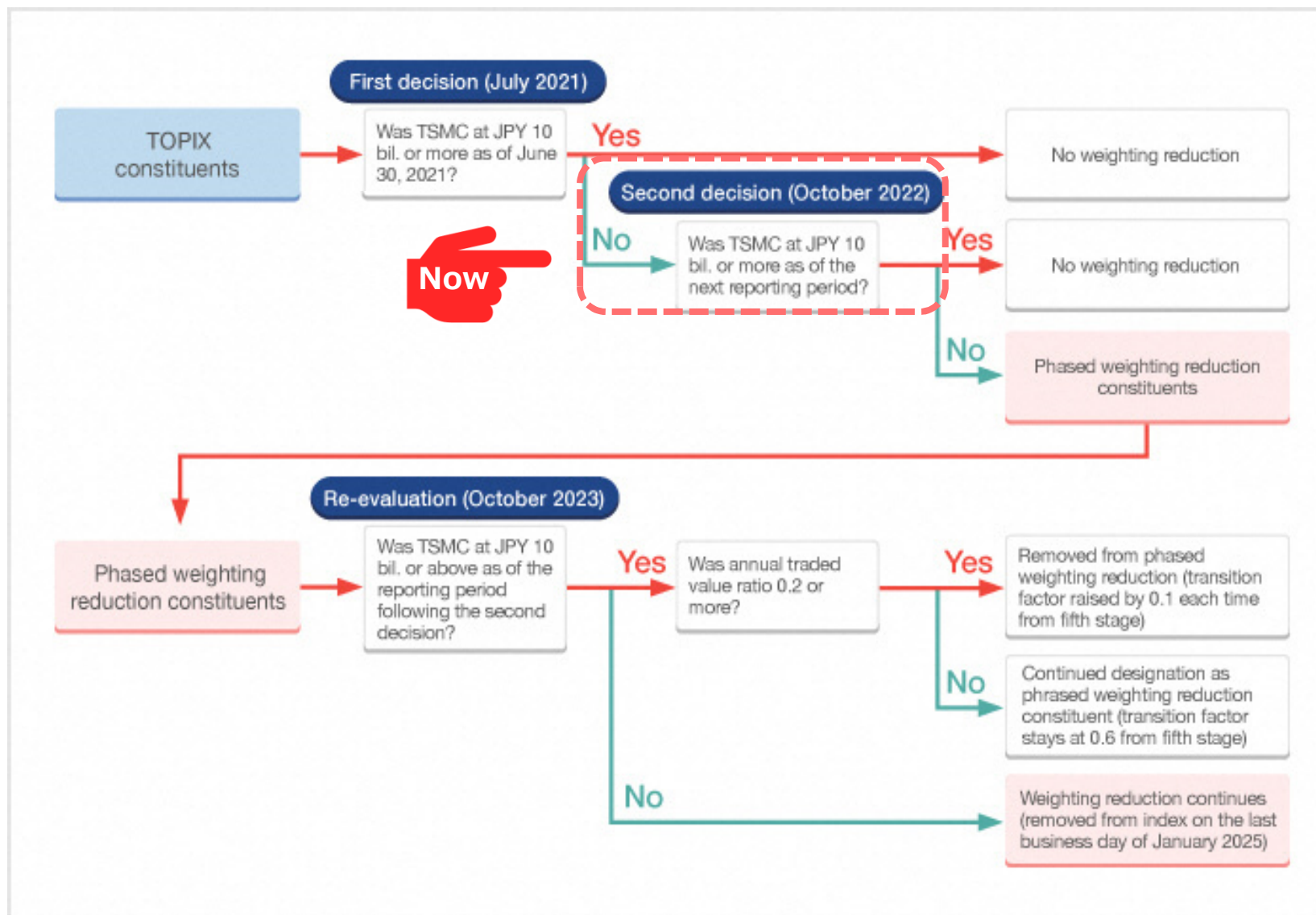
## JPXI Responses

- There were some comments on capping the number of constituents and **changing the composition of TOPIX on a regular basis** or **taking into account qualitative factors** such as sustainability from the perspective of those including, but not limited to corporate governance and environment when selecting these companies. **These issues may need to be discussed further.**
- **To eliminate concerns over conflicts of interest in Tokyo Stock Exchange,** it is considered appropriate to explore measures that **ensure independence and fairness of the process for calculating the index.**

- ⇒ Selection rules for TOPIX constituents after the phased weighting reduction is completed in February 2025 are under consideration.
- ⇒ After planned measures are drafted, these matters will be finalized through an index consultation.
- ⇒ An **Index Consultation** process and **Index Advisory Panel** were introduced in April 2020.
- ⇒ **The index department was transferred from TSE to JPXI** in April 2022.

# Designation and Re-evaluation of Phased Weighting Reduction Constituents

- The timeline for the TOPIX revisions was finalised following the index consultation held in December 2020.
- Phased weighting reduction constituents are designated and re-evaluated in multiple stages in order to reflect efforts of listed companies to **enhance tradable share market capitalisation (TSMC)**.



# Situation regarding Index Governance

Note: Items in red in the table below indicate actions taken by JPXI.

July 2013	Publication by International Organisation of Securities Commissions (IOSCO) of "Principles for Financial Benchmarks" (IOSCO Principles) to 'promote the reliability of Benchmark determinations, and address Benchmark governance, quality and accountability mechanisms'.
July 2014	Publication of statement of compliance with IOSCO Principles (in each year since)*
March 2017	Publication of "Policies Concerning Calculation of TSE Indices" and other documents*
July 2017	Publication of audit report by external audit on the statement of compliance with IOSCO Principles (in each year since)*
December 2019	Suggestion in the report from the "Expert Study Group on the Structure of Capital Markets in Japan" under the Financial System Council Capital Market Working Group that in order to eliminate concerns over conflicts of interest, it is considered appropriate to explore measures that ensure independence and fairness of the calculation process.
April 2020	Introduction of "Index Consultation" and "Index Advisory Panel" based on the initiatives of global index vendors such as S&PDJI, FTSE Russell, and MSCI**
April 2022	Transfer of index department from TSE to JPXI

\*Statement of Compliance with IOSCO Principles, their audit reports, the respective policy statements, and the respective regulations are posted on the JPXI website.

\*\*Regarding changes to index methodology, the IOSCO Principles specify that the method and timing for consulting or notifying subscribers (and other stakeholders where appropriate, taking into account the breadth and depth of the benchmark's use) of changes should be clearly defined (Principle 12. Changes to the Methodology).

## Index Consultation

- **Set aside opportunities to gather various opinions and improve fairness and transparency of process** when deciding on measures regarding the operation, etc. of TSE Indices
- Finalize measures based on comments and proposals

## Index Advisory Panel

- **Continuously improve** TSE Indices through **exchanges of opinions with index users**  
(The Panel will not discuss topics that could affect the stock market such as the selection/removal of individual component issues for an index or specific criteria for calculating indices.)
- Based on discussions, etc. at the Index Advisory Panel, if JPXI considers deciding on specific measures, JPXI will solicit opinions widely through Index Consultation

- Opinions on the future TOPIX from the Index Advisory Panel in June 2021 (1st meeting) and July 2022 (2nd meeting) are summarized as follows:

## Main opinions from the Index Advisory Panel on future TOPIX

### First meeting on June 10, 2021

- When reforming indices, significant changes should be avoided if they will not suit the convenience of asset owners including the individual investors behind management companies.
- TOPIX is a market benchmark. It is important to review the index from viewpoints such as market representation, comprehensiveness, transparency, and convenience.
- From the perspective of further increasing investment availability, it is reasonable to take liquidity criteria into account to a certain extent when selecting constituent stocks. Stocks whose liquidity drops should be removed from the constituents, even if they are listed on the Prime Market.
- There is a concern that as the liquidity criteria for the new TOPIX are the same as the listing criteria for the Prime Market, TOPIX will end up with the same constituents as the Prime Market.
- In the US, the CRSP US Total Market Index covers all US-listed stocks and has linked assets under management of more than JPY 23 trillion. The review should consider that there is also demand for investing in an entire market like this.

## Second meeting on July 8, 2022

- It is important to raise the liquidity criteria for TOPIX and increase functionality as an investable index while maintaining its level of representation of the market – extensive comprehensive coverage – and ensuring continuity as an index with many users.
- With highly transparent rules, constituents should be regularly reviewed based on liquidity criteria, using for example the criteria for the TOPIX transition period as the base.
- For full-replication TOPIX-linked funds, it would be preferable to enable creation even in small lots, so I think we need to gradually raise the liquidity criteria for constituent selection.
- While continuity should be considered to an extent, liquidity criteria should be reviewed as appropriate from the perspective of global managers, including the possibility of a strict rule-based system.
- It is necessary to look at whether tradable share market capitalization is appropriate as an indicator of liquidity. Instead of the respective criteria of market capitalization and trading value, criteria such as the turnover ratio could be considered.
- The index needs a certain number of component issues to maintain its level of representation of the market.
- The current rules for TOPIX give initial listing on the Prime Market as a criteria for new inclusions, but it would be acceptable for stocks from the Standard Market and Growth Market to be included if they meet criteria such as liquidity.
- While considering continuity, strict criteria need to be established such as selecting stocks with sufficient size and liquidity regardless of their listing market, and conversely excluding stocks if they are not large and liquid enough, regardless of their listing market.

## Second meeting on July 8, 2022

- As attitudes towards ESG are in flux and at a development stage, I think it premature to reflect ESG factors in the selection criteria for TOPIX constituents.
- ESG factors should not be introduced into the selection criteria for TOPIX constituents, given the current lack of assurance and auditing on the disclosure of ESG information.
- TOPIX is used as an index with extensive comprehensive market coverage, so ESG should be covered by a separate index. TOPIX should not include ESG factors, or if it does, they should be kept to a minimum.
- TOPIX is widely used for pension and investment trust management, for example, and can be regarded as 'everyone's TOPIX'. In order to increase investment attractiveness, it is also important for investors to be able to have dialogue with selected companies. In this sense, information disclosure on corporate value creation such as minority shareholder protection and integrated reports could be considered as selection criteria.




# Recent Index Initiatives

- Launch of **TOPIX 500-based ESG indices** (S&P/JPX 500 ESG Score Tilted Indices) and **environment-specific indices** (FTSE JPX Net Zero Japan Indices)

	S&P/JPX 500 ESG Score Tilted Index Series	FTSE JPX Net Zero Japan Index Series
Developed by	S&P Dow Jones Indices and JPXI	FTSE Russell and JPXI
Type	Composite ESG index	Environmental index (net-zero type)
Universe	TOPIX 500	TOPIX 500
Concept	<ul style="list-style-type: none"> <li>Based on S&amp;P DJI ESG scores, improves the ESG score of the index compared to the underlying index</li> <li>Adjusts (tilts) the weights of the constituents according to said scores, while maintaining GICS Industry Groups and/or Sectors neutrality</li> </ul>	<ul style="list-style-type: none"> <li>Adhering to the EU Climate Transition Benchmark (CTB) standards, aims for alignment with 'net zero' in assets under management by 2050</li> <li>Adjusts constituent weightings to meet respective targets for carbon emissions, fossil fuel reserves, green revenues, etc.</li> </ul>
Launch date	March 28, 2022	April 21, 2022

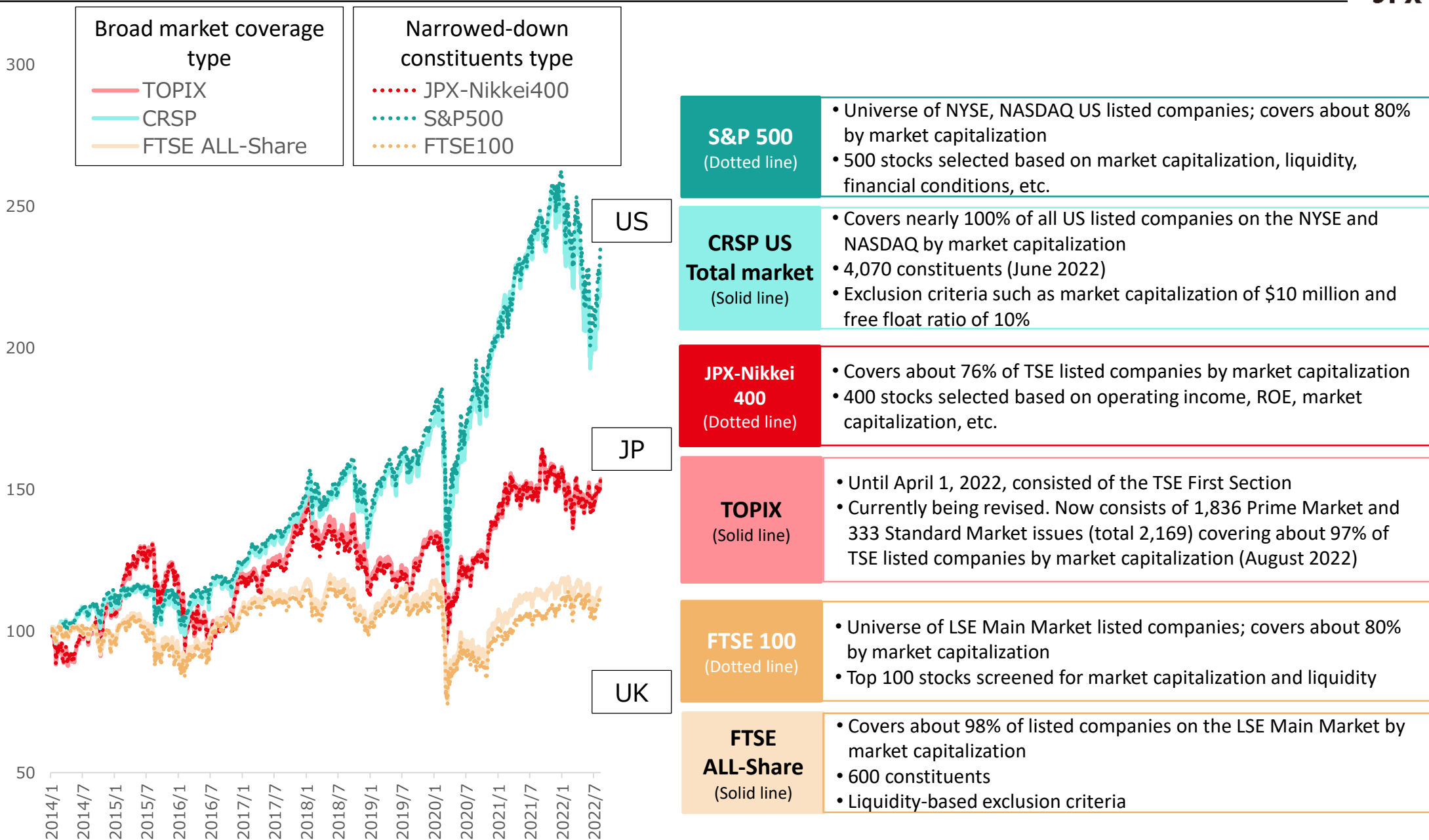
# (Reference) JPXI Index Line-up

TOPIX /Market	TOPIX 	TSE Prime Market Index		
	TSE REIT Index/TSE Infrastructure Funds Index	TSE Standard Market Index		
		TSE Growth Market Index		
Size market cap.	TOPIX Core30	TOPIX 100 (Large)	TOPIX 500	TOPIX 1000
	TOPIX Large70			
	TOPIX Mid400 (Medium)			
	TOPIX Small (Small)	TOPIX Small 500		
Sector	TOPIX Sector Indices (33 sectors/TOPIX-17 series)	TSE REIT Property Sector Index Series (offices, residential, retail & logistics, etc.)		
Co-brand	JPX-Nikkei Index 400/ JPX-Nikkei Mid and Small Cap Index	S&P/JPX Carbon Efficient Index		
	JPX/S&P CAPEX & Human Capital Index	S&P/JPX Smart Beta Index Series		
	S&P/TOPIX 150 series (e.g. Shariah)	FTSE JPX Net Zero Japan Index		
	S&P/JPX 500 ESG Score Tilted Index			
Other	TOPIX Value/TOPIX Growth	TSE Dividend Focus 100 Index		
	Currency Hedged Index/Leveraged and Inverse Index	TSE Growth Market Core Index/TSE Standard Market Top 20		
	TOPIX High Dividend Yield 40 Index	TSE REIT Core Index		
	TSE REIT Logistics Focus Index	TSE Mothers Index*		

\*To be renamed "TSE Growth Market 250 Index" (tentative) at the end of October 2023

Note: TSE Mothers Core Index and JASDAQ-TOP20 are to be discontinued on April 3, 2023.

# (Reference) Performance of Major Overseas Indices



Note: Movement of each index with January 6, 2014 as 100. Price returns.

Source: Bloomberg