

Minutes of the Seventh Council of Experts Concerning the Follow-Up of Market Restructuring

Date: Wednesday, January 25, 2023 17:30 – 19:05

Place: Tokyo Stock Exchange, 15F Special Conference Room

Attendees: See member list

[Kikuchi, Director, Listing Department, TSE]

The time has now come to begin the seventh Council of Experts Concerning the Follow-Up of Market Restructuring.

Thank you for gathering here today at this late hour. We are looking forward to talking with you today.

Now, I would like to begin proceedings straight away. First, let us explain today's agenda.

[Ikeda, Senior Manager, Listing Department, TSE]

Thank you for gathering here today. I will now explain today's agenda.

First regarding Document 3, as at the previous meeting, we would like to continue today's discussion by hearing your opinions on the draft summary of our past discussions, including measures to encourage listed companies to improve their corporate value over the medium to long-term by effectively utilizing the characteristics of the three market segments and the handling of transitional measures in the future. We would like to summarize your opinions.

At the same time, regarding Document 4, based on the Summary of Discussions, we revised the draft of the TSE's Future Actions in Response based on comments received at the previous meeting, and we would like you to review the revisions.

In addition, based on Summary of Discussions, we would like to present the specific proposal for transitional measures that TSE is considering. We would appreciate your comments and suggestions on this proposal.

In Document 5, we have again included data that we used as a reference when considering specific proposals for transitional measures, in case you missed it.

That covers everything.

[Kikuchi, Director, Listing Department, TSE]

Now, we would like to start by explaining the drafts of Summary of Discussions and the TSE's Future Actions in Response. As we have already explained them in the preliminary explanation, we would like to keep this explanation short.

[Monden, Manager, Listing Department, TSE]

I will now explain the documents.

First, I will explain the Summary of Discussions in Document 3.

Please proceed to page 2, Part I. Major Policies. First, as a whole, the policy emphasizes that the role of TSE is to create a framework that encourages "autonomous" efforts by companies, and reflects previous discussions on the importance of enhancing corporate value to achieve the third point, financial inclusion. The last arrowhead states that we should continue to evaluate and further improve our response in the future.

Moving onto the transitional measures listed on page 3, firstly, regarding the title, the content has been substantiated to "clarification of the end date" and the wording of the fourth point has been updated. The specific proposed timing for the termination of transitional measures is described in the TSE's Future Actions in Document 4, which I will explain later. In this Summary of Discussions, we have added a summary of the previous discussions, which we also presented last time, as a reference.

Turning to page 6, regarding section 2, enhancing medium- to long-term corporate value, the title has been updated to add "Motivate Efforts" from the perspective to clarify that it is the company that is responsible for improving corporate value, and the content has also been updated from the same perspective.

The title of section 2.a) on page 7 was "Raise Awareness of Capital Efficiency and Stock Price," but when we say that companies should be aware of capital efficiency, it could mislead companies into thinking that they should reduce capital in the denominator or that they should be reduction-oriented, which is not what we mean and so we have replaced the term "Capital Efficiency" with

“Cost of Capital” from the perspective of clarifying the purpose of this issue, which is that while it is acceptable to invest new capital and step on the accelerator, such decisions should be made with a firm awareness of the cost of capital. In addition, based on previous discussions, as it is not just about raising awareness, we have added the phrase “Raise Literacy”. In terms of the content, we have added something to the effect that, in encouraging disclosure for improvement, we will also encourage disclosure of progress, and we have added a standpoint regarding the protection of minority shareholders’ rights, with regard to the review of the Code of Corporate Conduct.

Moving on to page 8, “2.b) Improve the Quality of Corporate Governance,” we have updated the content. To the first point we have added that the awareness of listed companies is polarized, to the third point we have added that we will give both good examples of explanations and examples of insufficient explanations, and to the last point, regarding nomination committees and remuneration committees, we have added that we will look not only at their activities, but also their roles and functions.

Regarding 2.c) about English disclosure on page 9, we have updated the wording to reflect the importance of not only the scope of English disclosure but also the timing of disclosure.

Lastly, regarding dialogue with investors in section 2.d) on page 10, the last point states that we will encourage asset owners to increase their awareness of and interest in dialogue with companies, based on the role they are expected to play.

That is all the updates to the Summary of Discussions. I will now explain Document 4, which is the draft of TSE’s Future Actions in Response.

First, we have added an “Introduction” slide on page 1 to reiterate the purpose of the market restructuring and the TSE’s policy based on the Summary of Discussions. The third point relates to our major policies. First, we will immediately clarify the termination date of transitional measures from the perspective of making market metabolism function, and we will take prompt action to create a framework that will motivate autonomous initiatives, such as promoting management that is conscious of the cost of capital, focusing first on

the Prime Market and the Standard Market, which have been the main areas of discussion. In terms of the Growth Market, there are some issues that have not been fully discussed from the perspective of following up on initiatives to realize high growth potential, and so we plan to continue our discussions and deliberations while holding hearings with related parties.

Regarding the specific details, first, we have added a specific proposal on page 4 regarding the clarification of the timing of the termination of transitional measures.

First of all, as a premise, these transitional measures refer to the use of relaxed criteria for the time being in determining conformity with the Continued Listing Criteria. If judged to have failed to comply with the criteria, there is a one-year improvement period, but this improvement period is provided in the original regulations, regardless of whether there are transitional measures.

Therefore, when the transitional measures end, the question is from when the original criteria for continued listing should be applied to judgment. In discussions to date, there have been two opinions on this point: March 2024, two years after the transition, and March 2025, three years after the transition. Of these, first of all, the reasons given for two years after transition is that the transition should be completed as soon as possible in order to promote market metabolism, and that it will also convey to investors that TSE is responding with a sense of speed. On the other hand, the reasons given for three years after transition include the difference in the distribution of the plan lengths among the companies and evaluations by the market. More specifically, page 1 of Document 5 shows the distribution of plan lengths, and indicates that many companies are setting a period that is linked to their medium-term plans, and that they can commit to as management, within a three-year period. Page 2 shows the change in market capitalization of companies applying transitional measures. Companies that try to make improvements within three years are positively evaluated by the market, while companies that try to make improvements over a longer period of time are negatively evaluated by the market.

As I mentioned, there have been two arguments regarding the timing of the termination of transitional measures, either two or three years after the transition. However, given that the purpose of the market restructuring is to encourage listed companies' efforts to enhance their corporate value, the TSE

believes that it would be appropriate to wait until three years after the transition to end transitional measures, when many listed companies have committed to meeting the criteria during the three-year period, and such a plan length has received a certain level of recognition from the market.

To be more specific, the transitional measures will end in March 2025, and the original stricter criteria will be applied from a subsequent record date.

As you can see at the top of the chart at the bottom of the page, under this proposal, if a company fails to meet the original criteria after March 2025, it will enter a one-year improvement period, and if it fails to improve within that period, it will be designated as Securities Under Supervision and Securities to Be Delisted.

On the other hand, the issue in this case is what to do with the company that set a plan deadline after the end of the improvement period or March 2026. Regarding this point, as you can see in the chart below, we would like to continue the designation as Securities under Supervision until the status of conformity at the plan end date is confirmed. This is an attempt to appropriately inform investors of the possibility of delisting, while at the same time ensuring that there are opportunities for improvement for companies that can be improved through management efforts. In addition, if this design is adopted, as discussed in the last issue, we anticipate that some companies will rush to extend the planning period before the revised rule is finalized after the public comments. So, as stated in the smaller bullet point in the middle, we would like to send out a message that this is “not appropriate” and to also carefully check the practical reasons for the change (i.e. extension).

In addition, there is one more point, the second bullet point. Based on these details, again, some companies may find it difficult to maintain their listing on the Prime Market and so we would like to set a cut off period of six months from the implementation date and to provide an opportunity to select the Standard Market without an examination.

The above is our concrete proposal for the timing of the termination of transitional measures. Page 5 shows the extension of the period for designation as Securities to Be Delisted.

As we have already indicated during past meetings, currently, the period for Securities to Be Delisted is one month from the decision to delist, and from the viewpoint of ensuring investors’ redemption opportunities in the event of

delisting, as shown in the figure, the period for Securities under Supervision and Securities to Be Delisted will be six months from the end of the fiscal year.

From the perspective of ensuring opportunities for redemption, it is appropriate to apply measures without waiting for the transitional measures to expire, and we intend to begin applying them quickly. With regard to the note, as for other delisting criteria, such as companies that are delisted for making misstatements, there will be no change to the existing delisting criteria.

We will promptly announce the outline of the system for the extension of the period designated as Securities to Be Delisted in conjunction with the termination of transitional measures mentioned earlier.

Moving on to the section 2 and motivating efforts to enhance medium- to long-term corporate value, starting on page 7 titled “2.a) Raise Awareness and Literacy regarding Cost of Capital and Stock Price,” it has been updated in the same way as the Summary of Discussions, and we have clarified the timing of implementation and target market segments for each action.

Regarding 2.b) on page 8, “Improving the Quality of Corporate Governance,” this too has been updated in the same way as the Summary of Discussions, and the timing of the dissemination of the purpose and examples of ‘comply or explain’ principle in item a has been moved forward from the autumn of 2023 to the spring of 2023.

Regarding 2.c) on page 9, “Further Expansion of English Disclosure Practices,” first, we have clarified the timing of the decision and publication of the mandatory details for the Prime Market in item a as the autumn of 2023; and regarding the compilation and publication of examples in item b, this will not be limited to the Standard and Growth Markets, but include all market segments. On top of this, we will encourage listed companies in the Standard and Growth markets to make English disclosures by introducing relevant examples.

Regarding 2.d) on page 10, “Improve the Effectiveness of Dialogue with Investors,” first of all, with regard to the description of the status of dialogue, etc. in item a, we have clarified that both describing all details in the governance report and referring to other disclosure documents or websites are acceptable.

We have also clarified that educational activities for outside directors in item

b, and the study on actions for asset owners in item c will be implemented at appropriate timing from spring 2023.

That completes my explanation of the materials.

[Kikuchi, Director, Listing Department, TSE]

Now, I would like to hear from our members. Who would like to start?

[Kumagai, member]

I am aware that the drafts of Summary of Discussions and the TSE's Future Actions in Response both reflect the detailed discussions that the Follow-up Council has had to date. I would like to thank the Secretariat from the bottom of my heart and make a few brief comments and ask some questions.

First, I basically agree with the specific proposal for transitional measures on page 4 of Document 4. I also agree with allowing companies that set a plan deadline after April 2026 to remain listed until the plan deadline, and to then place them under supervision until it is confirmed whether the company meets the criteria at the plan deadline.

For listed companies, designation as Securities under Supervision may have a serious negative impact, but I believe that this is a response that contributes to promotion of a healthy metabolism emphasized at this Council. This will also link to creating a situation in which listed companies are forced to move autonomously to increase their corporate value. Furthermore, the TSE's explanation of the rationale behind the ex post facto timing of the termination of the transitional measures in March 2025 makes sense, and I believe that a certain amount of time is needed for "autonomous" efforts by companies.

I also agree that providing Prime Market-listed companies that belonged to the TSE First Section on the day before the transition date with the opportunity to choose the Standard Market without examination, is a realistic response. In addition to standard IPO examinations, examinations related to the reclassification from the Prime Market to the Standard Market are expected to place an enormous practical burden on TSE and securities firms. As a temporary measure, I believe it is appropriate to provide an opportunity to choose the Standard Market without an examination procedure.

I'd now like to ask one question. My question relates to the small bullet point [on page 4 of Document 4] and the so-called rush to change the plan deadline. I would like TSE to respond properly by carefully confirming the reason for the change, etc. Would it be possible for TSE to indicate certain policies or criteria for this? Could you please tell us whether you plan to indicate a policy or criteria.

Next, regarding the wording on pages 7 to 10 of Document 4, I have no specific comments.

In terms of our future meetings, I would like to comment on the response to companies with Price to Book Ratio (P/B ratio) below 1 in action item a on page 7 of Document 4. Since the implementation timing has been set for spring 2023, companies with a fiscal year ending in March may be unsure about whether they need to take action between the end of April and mid-May, when settling their accounts. Of course, I understand that this is a "strongly requested disclosure" that is not at the level of an obligation, and I believe that we need to discuss this as soon as possible at the next or a subsequent Follow-up Council meeting and announce the response.

In addition to the discussion of the content of the disclosures which TSE responded to at the last meeting, I believe that the form of disclosure sought must also be discussed, if necessary. For example, companies are expected to react to this requirement differently depending on whether it was intended to be disclosed independently, such as in "Matters concerning Business Plans and Growth Potential" disclosed by companies listed on the Growth Market, or whether it was intended as content and essence to be included in presentation materials for investors.

So I would appreciate it if you could tell us what, if anything, you are considering at this time with regard to the timing and form of disclosure that I just mentioned.

Finally, I would like to remind you about the importance of communication aimed at institutional investors, securities firms, the media, and other stakeholders, which I mentioned at the last meeting. Ultimately, it is entirely up to TSE, but I truly hope that you will communicate with these stakeholders

carefully and strategically.

[Ikeda, Senior Manager, Listing Department, TSE]

First, I would like to properly indicate the TSE's major policies for dealing with so-called rush companies.

We would like to discuss the specifics of the disclosure requirements for companies with P/B ratio below 1 at the next meetings. Since it relates to the principles in the Corporate Governance Code, we assume that it will be explained in Corporate Governance Reports, while the content itself will be linked to the company's management plan. For example, we currently assume that disclosure will be made in a medium that makes it easy for the company to explain the information and we expect companies to indicate where the information is posted in their Corporate Governance Reports.

[Kuronuma, member]

I basically agree with the drafts of the Summary of Discussions and the TSE's Future Actions. I would like to skip the parts I agree with and only ask questions about the parts I do not understand.

Regarding the part starting "or" that has been added in red regarding P/B ratio below 1 on page 7 of Document 3, does this mean that it [i.e. future growth potential] is not expected or that it is not evaluated? In other words, if the P/B ratio is not below 1, but it is too low compared to the company's ability, then the expression "not evaluated" is appropriate, while the expression "not expected" feels a little out of place. I would appreciate hearing more about this.

In addition, companies disclosing plans with deadlines that are after the termination of transitional measures in Document 4 will be uniformly designated as Securities under Supervision, which in a sense is clear-cut and easy to understand, and companies that do not like this will probably make a decision before then, so I think this is an excellent proposal. However, some companies have set the maximum length of their plans to 10 years, so does that mean that you will continue to designate the stocks as Securities under Supervision for about seven years? I wonder if that is really a good idea. It is also unclear what action TSE will take if companies rush to present a plan with such a deadline. First of all, I would like to ask whether seven years is too long a period for

designation as Securities under Supervision, and then as Mr. Kumagai asked earlier whether you can indicate criteria regarding the treatment of companies that re-set their plan period by the effective date, I would like to ask what TSE has in mind regarding this question.

[Monden, Manager, Listing Department, TSE]

First, regarding the P/B ratio below 1, there are cases where the P/B ratio is below 1 because the company has failed to achieve a return on capital that exceeds the cost of capital, as originally stated, as well as cases where the company has achieved a return on capital that exceeds the cost of capital with an ROE of 14% to 15%, but the P/B ratio is below 1, such as 0.7 to 0.8. In such cases, it is conceivable that future growth potential is not fully expected by investors and so we added this point. We would be happy to revisit the question of whether “expectation” or “evaluation” is more appropriate as an expression, and to make revisions as necessary.

[Kuronuma, member]

I understood that the failure to achieve a return on capital that exceeds the cost of capital does not inherently equal a P/B ratio below 1, and so I understood it to mean that you added a supplementary explanation for this, so I think it is just a matter of wording. Thank you very much.

[Ikeda, Senior Manager, Listing Department, TSE]

We assume that a company that has a long-term plan, 10 years for example, the designation of Securities under Supervision will continue for that period of time, and we believe that this will have a considerable impact on listed companies, as there will be trading for such a long period of time while investors have been informed of the possibility of delisting for such a long period of time. In this context, we believe that the company will consider whether to continue to work toward conforming to the Prime Market, whether to consider changing the market segment to the Standard Market, or whether to explore other avenues. So we expect the company to consider what is appropriate for the length of time, in other words, we do not expect to place restrictions on the treatment of Securities under Supervision based on the length of the period under supervision.

Also, as a response to the rush issue, we would like to send a strong

message that basically it is not appropriate, but we believe that it depends on the reason for the change, and so while we can indicate a policy, we think it will be difficult to provide formal criteria such as a time frame. At TSE, we would like to conduct checks from the perspective of whether the reason for the change is not just an insurance extension/setting, but a change that can be properly explained to investors from the perspective of promoting a plan for conformity.

[Kuronuma, member]

I understand the importance of sending out a message when operating as a system, but I think that alone will not make it possible to go so far as to delist a company which has developed a new plan in order to avoid delisting, even if you find that the plan is sloppy after careful confirmation. If the listed company changes the time period with the intention of ramming it through no matter what they are told, does this mean that it is unavoidable?

[Ikeda, Senior Manager, Listing Department, TSE]

Basically, we would like to ask companies if they are able to explain reasons for the changes to the plan period to investors, and we would like them to be able to explain the changes. Through such requests we would like each company to go through a process of reconsidering whether the changes and settings are appropriate. We would like companies to take the action I have just mentioned from the perspective of what is realistic at the stage before the system itself comes into effect.

[Ando, member]

The current discussion is exactly what I wanted to hear members' honest opinions on.

Regarding page 4 of Document 3, I would ideally like to see measures terminated in March 2025 as proposed in section 1, and uniform termination (no exceptions) with regard to section 2.

However, even if, after deliberations at a council meeting, TSE concludes that an exception should be granted, it is not a good idea to accept the status quo as it is. Specifically, it may be necessary for TSE to reach out again to those companies that have disclosed plans due with a deadline after March 2025 to encourage them to reconsider whether they can meet the criteria ahead of schedule. As was pointed out earlier regarding the reputation of a company in

relation to its status as Securities under Supervision, conversely, it is something of a shame that a company that takes responsibility for disclosing an improvement plan while the termination date of the transitional measures is not clear is uniformly labeled by the market as being backward-looking in its management reforms.

I am a new member of this the Follow-up Council, and so I would like to ask those members who participated in the discussions on the market restructuring to give their views on the ideal timing for the termination of the transitional measures as an extension of the previous discussion.

[Sampei, member]

Thank you for compiling these materials. I think they reflect what we have discussed so far and what I said during the preliminary explanation.

I was the one who wanted to add the wording to the part explaining that the P/B ratio has consistently been below 1 on page 7 of Document 3, that Mr. Kuronuma referred to earlier. The secretariat has already provided a pertinent explanation, but I would like to make some additional comments. It is easy to understand that a company whose profitability is below its cost of capital has a P/B ratio below 1, but in addition to that, as explained earlier, there are a surprisingly large number of companies in Japan whose P/B ratio is consistently below 1 even though their ROE is around 14 or 15%. Such companies are also concerned by this situation and sometimes consult with us directly about why their ROE is adequate but their P/B ratio is valued at less than 1. The reason for this is that the market does not believe that such companies will grow in the future. Such companies may think that they are explaining their growth strategy in their medium-term business plans, but the market may think that the explanations are insufficient or that the contents of the plans are unrealizable. It is not that the P/B ratio is below 1 because the market is misjudging what it should be evaluating, but because explanations are inadequate and the market has not yet reached the point where it is convinced of growth and so there are no expectations in the company. I suggested that this point be added to the document.

And pages 4 and 5 of Document 4 contain the words “transitional measures” and “improvement period”. I have checked the Securities Listing Regulations,

the Enforcement Rules for Securities Listing Regulations, and the explanation on the TSE's website and so on. In the section on transitional measures related to the continued listing criteria in the Securities Listing Regulations, there is a provision that states that, "during the period from submitting the plan until meeting such criteria, the company shall submit the documents describing the progress of the plan prescribed within three (3) months calculated from the end of each business year", that states the "initiatives and implementation date thereof for the purpose of meeting the criteria". This essentially gives companies the option to maintain their listing. On the other hand, there are separate delisting criteria, which specify the procedures to be taken toward delisting. In other words, the TSE regulations have a process for continued listing and a process for delisting. Currently, the system is designed to give these two options to companies that are already listed.

In addition, the "Details of Continued Listing Criteria" page on the website gives two example schedules for cases of non-compliance with the criteria, one for companies that are subject to transitional measures and one for companies that are not (in principle, companies entering a one-year improvement period), but the examples are worded exactly the same. This means that although the terms "transitional measures" and "improvement period" are used differently, they are positioned and are aiming for the same thing in terms of being a grace period for companies that are not in compliance. I understand that deciding when to end the transitional measures means merging these two concepts together. Consequently, I acknowledge that there is essentially no need to separate the transitional measures and the improvement period, but since they are defined separately in the regulations, the process of establishing a one-year improvement period after the completion of the transitional measures is necessary. In this respect, I think it is most reasonable to consider the "three years" that we have been discussing as the end of the transitional measures, as three years to cover both of them [i.e. transitional measures and subsequent improvement]. Since the title of the discussion relates to transitional measures, it seems that if we decide on three years for transitional measures, it would be three plus one, but since the roles of the transitional measures and improvement period overlap from the outset, apparently we have to have transitional measures followed by an improvement period, as indicated on page 4 and I think it is appropriate to set the total period to three years. If that happens, in principle, if we were to use the terms "transitional measures" and

“improvement period” differently, it would be a two year transitional period and a one year improvement period. We have been presented with evidence so far, but I think that such treatment is consistent with the understanding of those who normally listen and the intentions of those who say that three years is appropriate.

Regarding the treatment of companies that have submitted plans that go beyond the termination deadline, as Mr. Ando said earlier, I think it would be good to designate their stock as Securities under Supervision so that their positioning can be better understood. One more thing, regarding companies that want to give up their listing on the Prime Market and move to the Standard Market if that is the way they are treated. I don't think “transfer” is the right word since each market is independent, but I think there should be special consideration for them to reconsider as the transitional measures end. In terms of the details, there should be no screening if it takes place within a specific six-month period, given that the rule was changed after-the-fact.

With regard to the earlier point made by Mr. Ando, I was involved in the discussion on reforming the market structure, and I recognize that the first important topic to discuss is what the goal should be. However, when moving toward the ideal goal, if there is a significant discrepancy between that goal and reality, then transitional measures will inevitably be required. In establishing transitional measures, the period such measures is usually limited, but as it turned out, there was no fixed period and so I was honestly very surprised. So, although I did not originally expect this Council to be set up immediately to discuss the deadline for the transitional measures, I believe it was highly appropriate for us to be able to discuss this and to come to a decision on the deadline as quickly as possible.

In addition, once transitional measures have been established for the Continued Listing Criteria, and on the assumption that the end date for transitional measures has not yet been decided, I do not know whether it is a good idea for a company that chose the Prime Market based on its long-term improvement plan to suddenly be pushed into leaving the market just because the end date for transitional measures has been decided, but I think it is up to the listed companies themselves to figure out what to do. If they are really

serious about being designated as Securities under Supervision for a long period of time, that may be fine, but objectively I don't think it is a good idea. Institutional investors do not invest in such companies. So thinking about it, I am not sure if it is reasonable to use transitional measures for a long period of time. That said, I believe that companies have a responsibility to make their own choices about such matters.

[Matsumoto, member]

I have a few things I want to say, but first, I agree with what Mr. Sampei said about whether the transitional measures deadline should be two plus one or three plus one. Generally, I think it should be the total of both periods, and therefore, the transitional period should be until March 2024 and the improvement period should be until March 2025.

In fact, while this Council has discussed this matter, I was contacted by someone responsible for one of the largest asset owners, who also said that shorter is better. We should check with the investors and asset owners to see what they actually think, but at least that is what I've heard and I think that is the way to go.

I feel that while the country is trying to make various changes, although we are having these meetings about market restructuring, in terms of the results we will see, if the transitional measures end two years from now, and if there will be another one year improvement period after that, the impact will be quite small. I think it would be better if the transitional measures end after one year in March 2024 and for there to be a one-year improvement period after that, which would convey the message that Japan is determined to revitalize and change the capital market.

Second, regarding the phrase "carefully check" on page 4 of Document 4. We just heard a statement from Mr. Ikeda, a manager at TSE, to the effect that TSE will basically do not accept anything that is rushed and not thought through, and I think that is very important. However, there is a big difference between not willing to accept something and not accepting something due to the rules. This point may not be technically easy, but I think companies should be told that misuse of the system will not be tolerated under objective rules and judgments.

My third point relates to the part about eventually being designated as

Securities under Supervision. On page 4 of Document 4, it says, “If a company does not meet the relaxed [continued listing] criteria [currently applied as a transitional measure], the securities are delisted promptly.” Conversely, if TSE is unable to shut out rushed misuse, and if a company that discloses a long-term plan, spanning 10 or 20 years for example, is just about able to meet the relaxed criteria for continued listing, the company will continue to be listed as it is, albeit as Securities under Supervision. Earlier, someone said that no company would choose this if it were to think rationally. Given that it is actually possible for a company to act without thinking rationally, TSE would end up allowing such a zombie company to remain as Securities under Supervision for many years, and state of the capital market in Japan would be seen by the outside world as a sloppy and somewhat unusual.

I have been thinking about how we could get around this. We could, for example, place Securities under Supervision in this manner and then, over a period of years, raise the relaxed continued listing criteria to criteria that have not been relaxed. Someone mentioned earlier that we must encourage companies whose securities have been placed under supervision to achieve their plans as soon as possible, but we cannot expect such activities if there is a possibility that they are not acting reasonably, and so if we create a slope for the criteria, companies will surely strive to exceed them. In this way, we must somehow avoid having a large number of companies continue to be listed as Securities under Supervision for many years.

Mr. Sampei also mentioned that there could be a problem if the rules are suddenly changed, and I think that is partly true, but as I said before, I think it is natural for TSE to change the rules and listing criteria, and there is no reason why the rules should not be changed just in this case. The market is always moving, and while some companies may not have intended it that way, I believe that rules can be updated as long as they are reasonable.

My fourth point relates to Mr. Ando’s question as to why this Council was established immediately, I was not present at the meetings regarding market restructuring, but I did participate as a member of the Market Operating Committee that consulted on the proposal after it was developed. A large number of members of the Committee gave their opinion on what they understood transitional measures to be and what “for the time being” means. As a result of TSE consulting with the Market Operating Committee to see if this

proposal was viable, many questions and concerns came to light, so I proposed that given that, the Market Operating Committee should meet annually to discuss the matter, rather than TSE deciding when to terminate the transitional measures. As a result, I understand that a decision was made to continue discussions at this Council, rather than at Market Operating Committee meetings. Mr. Sampei said he was surprised that the original proposal stated “for the time being,” but the Market Operating Committee had the same idea, and then further discussion at the Committee was suspended, and, instead, discussions have taken place at this Council.

Finally, page 2 of Document 3 states that “These measures should be evaluated on an ongoing basis for further improvement,” and I think this is spot on. We have had a very fruitful discussions at these Follow-up Council meetings, and the draft of Future Actions that has been compiled is excellent, with improvements made to its content, timing, and wording during our discussions. Ongoing evaluations and discussions are very important, and it is very valuable to include not just people within TSE but also outsiders in this way. I strongly request that these meetings continue in order to make further improvements through continuous evaluation.

[Koike, member]

First of all, regarding transitional measures, I feel that the two plus one approach, the two previous speakers mentioned, is a good way to tighten things up. In terms of practical operations from the perspective of institutional investors, I do not think that a one-year difference between 2025 and 2026 will have a significant negative impact, but I think that it would be good for those looking in from the outside, such as overseas institutional investors for example, to be given a clear statement regarding discipline and balance.

Outside of transitional measures, regarding awareness of cost of capital and other issues, rather than simply requesting companies to disclose such information, I think it would be good if there was an opportunity to provide best practices as a company. There are various definitions of best practices, and I would like to indicate, for instance, examples of companies that have improved their stock price and corporate value as a result of disclosing their cost of capital and profitability, or, as mentioned in the earlier discussion, examples of

companies that have disclosed information and engaged in dialogue but are having trouble increasing their corporate value. Ideally an opportunity should be created for listed companies to understand that such cases exist. Simply asking for disclosure does not allow companies to conjure up an image of what is being asked, which is fine for companies who are well versed on engagement and corporate value, but it leaves those who are in the dark and so something needs to be done to help them understand the request.

I also think it is a must for companies with a P/B ratio below 1, but I think it is important to require disclosure for companies with P/B ratios above 1 as well. If the target is only companies with a P/B ratio below 1, it would appear from the outside that they are aiming for a P/B ratio of 1. If that is the case, it will not enhance the international competitiveness of the stock market, so I think it would be preferable to have companies with P/B ratios above 1 proactively disclose information [on policies and initiatives for ensuring capital efficiency] to lead the capital market as a whole.

Also, in the corporate governance section, the market segments covered are limited to the Prime and Standard Markets. I am aware that there will be discussions on the Growth Market at this Council in the future, and I believe that the companies in the Growth Market need to think about how to improve their corporate value. As institutional investors, we naturally manage funds that target the Growth Market. In order to be eligible for such investment, we need to be sure that companies understand our approach to engagement and corporate value and will respond to it. Otherwise, the real problem is that such companies will not be considered for investment. In the new capitalism, nurturing startups and providing growth financing are major themes, but even after conducting an IPO, which is the process, the value of the company often does not increase, as has been shown in data in previous meetings. If we are to avoid creating stagnant companies and increase market metabolism in the future, I would very much like to see a discussion about the Growth Market.

One more thing, regarding the TSE's website, when I went to look at it from the standpoint of an institutional investor, I could not find a page that presented an easy-to-understand overview of the Japanese capital market and its approach to corporate value. In some cases, companies are trying to increase their corporate value but they do not have the capability or knowledge to do so,

and so it would be a good idea to communicate this on the TSE website.

[Kanda, member]

First of all, the materials have been put together well, and I think both Documents 3 and 4 are fine in that they reflect what I have presented.

Second, regarding the background to discussions on transitional measures, I participated in the previous study on market segment restructuring. This point reiterates what Mr. Sampei mentioned. Although I was aware of the need for transitional measures, I do not think we discussed the specific details of the transitional measures. Hence, I am aware that after the actual start of the measures, as Mr. Matsumoto mentioned, a decision was made to discuss this matter at the Follow-up Council.

My third point concerns the specifics of transitional measures. There are some aspects I do not really understand. In terms of whether it is possible to say that a listing will be delisted on this date based on the relevant regulations, I initially thought that the regulations were written in such a way that it could not be said, but I don't think it is necessarily clear either. To give a simple example, if we were to go ahead and declare that transitional measures will end on April 1 of this year, can we then say that a company that has submitted a plan that goes beyond April 1 but does not meet the Continued Listing Criteria will be delisted prior to the expiration of the plan period? I thought that could not be said, but be that as it may, even if we stand by the idea that it can be said institutionally, even so, it would not be appropriate to delist the company immediately, so I think we end up talking about terminating in at least a year or two. So, although this is a very complicated issue, I have concluded that the approach described on page 4 is the way to go. I think it is right to point out that this may be a bit naive, but once started, I think retroactive application should be avoided as much as possible.

In relation to this, I think it would be good to take appropriate action if there are any companies that intend to submit a plan or to make changes to a plan after the announcement of the outline of the system. Also, as Mr. Ando pointed out earlier, I would like to ask that TSE make as much effort as possible to encourage companies that have already submitted their plans to bring forward the plan.

My fourth point is a general one. As Mr. Matsumoto pointed out, ongoing reviews are very important, and if possible, it would be good to cover as wide a

range of related issues as possible. For example, the review of the Code of Corporate Conduct, and principles established for the Prime Market in the Corporate Governance Code have a mutual influence on each other. I think it would be good to discuss these issues as broadly as possible, introducing the situation in other countries as well as the actual situation in Japan.

I also think that fulfilling functions as asset owners is an important issue, but I think that the listing regulations have their limitation in that they are intended for listed companies and not for investors. On the other hand, as Mr. Ando mentioned at the last meeting, there are aspects that not only companies but also investors must work on. For example, there are examples of shareholders who are not behaving well, such as those shareholders operating a formalistic approach to the criteria for exercising voting rights and shareholders who do not properly file large shareholding reports. From this broad perspective, since TSE is in charge of the stock market, I wonder if it would be possible to send a message to shareholders. I think this is something that goes beyond the jurisdiction of the Follow-up Council, but since members have gathered here, I think it would be good to discuss such points and I hope you will consider this.

[Okina, member]

Regarding transitional measures, I also participated in the previous discussions on market structure, and I thought that certain transitional measures were necessary, as mentioned by Mr. Sampei and Mr. Kanda. On the other hand, I later learned that the measures were established without a set deadline, and I was very aware of the problem, so I believe it is a very important to properly enforce discipline in this manner.

As Mr. Ando mentioned earlier, I think it is important to come up with a way to encourage initiatives as far in advance as possible.

I am totally undecided as to whether to set the end date for the transitional measures as March 2024 with a one year improvement period or March 2025 with a one year improvement period. Personally I think measures should be ended as soon as possible. However, if companies try to meet this deadline, they effectively have only one year to do so from the announcement of the deadline. Given this, I think the TSE's proposal would be acceptable if the improvement period is positioned as an exceptional measure, and by stating that the transitional measures will end in March 2025.

Based on my experience from my involvement with business revitalization at

the Industrial Revitalization Corporation of Japan and other organizations, I know that it is difficult to revitalize a company in a little over a year, and that it takes two or three years to revitalize a company. I think there are some criteria, such as the ratio of shares in circulation, that can be met immediately, which is why I am not sure what is best, but I think that the TSE's proposal of moving in the direction of ending transitional measures in March 2025, is acceptable. But, basically, I think it is vital to move forward as a whole and to set a direction that stagnation will lead to decline.

I also have some questions and comments regarding Document 3. On page 7 of Document 3, there is a reference to P/B ratio "consistently" below 1. Roughly how long do you expect "consistently" here to be?

I also think that the perspective that some companies with P/B ratio below 1 may have achieved a return on capital that exceeds their cost of capital, but may not be expected to have future growth potential, is very important. I think this means that the company is not positively rated by investors, and from the perspective of future growth potential, there are various factors such as insufficient disclosure of intangible assets and sustainability. In any case, I agree that the description should be added.

Also, on page 8, it says that TSE will give good and bad examples of "explain" under the Corporate Governance Code. Basically, it is investors who make decisions, so I hope that you will take their views into consideration before presenting the examples.

Regarding the asset owners on page 10, I am aware that there was a lot of discussion last time, but first of all, regarding the wording, I think that the phrase "*takamete itadaku*" should be "*takamete morau*" [note: both phrases in Japanese mean "increase", while a degree of politeness differs]. As for the substance of the discussion, the same discussion is taking place in the Customer-Oriented Business Conduct Task Force of the FSA. I believe that rather than simply having them increase their awareness and interest in dialogue with companies, it is more important to have people increase their awareness and interest in dialogue with companies, including the selection of asset managers, with the understanding that they should firmly promote the interests and asset formation of the ultimate beneficiaries, and I think it would be better if those intentions were conveyed a little more clearly.

[Kikuchi, Director, Listing Department, TSE]

As for saying P/B ratio “consistently” below 1, this is based on the opinion that it is not necessary to cover the period when P/B ratio temporarily falls below 1, and at this point, we have not reached a consensus here on the specific number of years.

We will change the wording on page 10 as you suggest. Thank you for pointing this out.

[Nagami, member]

First, I would like to thank you again for the speed with which discussions at the Follow-up Council meetings are progressing, even though meetings started less than six months ago.

In terms of the flow of discussions since the first meeting, we recognize that the basic philosophy has been to place great emphasis on the market’s reform stance, corporate renewal, and ease of understanding from the outside, especially from the perspective of foreign institutional investors.

From this perspective, we think that the discussion of transitional measures should basically be brought forward if it indicates a reform stance, and no exceptions should be made from the standpoint of ease of understanding.

As I mentioned before, companies are supposed to work on improvements during both the transitional measures period and the improvement period, and quite honestly, it is difficult to understand the design [of the timeframe]. If there is an option, I think it would be better to start with March 2025, including the improvement period, as it is easy to understand. In other words, March 2024 as the end of the transitional measures; and for companies subject to transitional measures, March 2025 as the end of the transitional measures without no improvement period.

Also, to reiterate, I believe that exceptions should be avoided wherever possible, and that so-called “rushed” change in the plan, as discussed earlier, should not be acceptable in principle. If we start off discussing these issues, we will end up with a very detailed discussion about whether it is OK in principle or not OK in principle, and how and by whom this will be decided. In which case, we thought it would be better to create a document that explains what the principles are, based on the principles.

Finally, although the discussion has mainly focused on transitional measures, looking again at the Continued Listing Criteria as an issuer, the level of the criteria is not significantly high, and in the case of the Standard Market, I think it

is a minimum level of 1 billion yen in market capitalization of tradable shares. In light of that sense of level, I believe that we are talking about having companies make improvements toward that level with a firm timeframe, and that termination in March 2025 is appropriate. That said, in terms of the message, as I mentioned earlier, it seems to me that there are two options, either include the improvement period and terminate measures in March 2025, or do not include the improvement period and terminate the transitional measures in March 2025.

[Kuronuma, member]

Regarding the transitional measures, members are divided on whether two years plus one year for improvement or three years plus one year for improvement would be better, and so I would like to make two additional comments.

First, regarding when to terminate the transitional measures, this will be a case of looking at the record date and so the timing will vary depending on when a company's fiscal year ends. The shortest period, for companies whose fiscal year ends in March is used here as an example, and the longest period, for companies whose fiscal year ends in February, would result in a delay of nearly one year. I think this would be one reason for supporting two years plus a one year improvement period.

On the other hand, ultimately where the difference between two years plus a one year improvement period and three years plus a one year improvement period comes into play is whether the number of companies ultimately designated as Securities under Supervision will increase. In short, with two years plus a one year improvement period, there will be an increase in the number of supervisory designation because the number of companies disclosing plans that exceed the said improvement period is larger [compared to three years plus one]. We should consider how it will look and the resulting impact.

Personally, I do not think it has to be one or the other, but looking at the actual distribution of plan lengths, if we assume two years plus a one year improvement period, nearly half of the companies will not be covered and will be designated as Securities under Supervision and this is a key point.

[Ando, member]

I expressed the opinion that the transitional period should end in March 2025,

for one reason only, and that is the fact that it is already the end of January, 2023. Assuming that this discussion is finalized and announced by March, there is only a little over a year left if measures are to end in March 2024, which does not leave us with enough time to inform the public. As mentioned in previous meetings, there are items in the Continued Listing Criteria that cannot necessarily be improved by a company's self-help efforts alone, and one year is too short considering the market situation and other factors. There has been some discussion about whether to separate the transitional measures and the improvement period, but assuming the process on page 4 of Document 4, I would judge it appropriate to terminate the transitional measures in March 2025.

[Nagami, member]

As a somewhat minor comment, I think the data in Document 5 is an important logic in showing the transitional period in Document 4 and so it should be included in Document 4, even if it is attached at the end as reference material.

The intended audience for the message in the document itself is existing listed companies, but I think it needs to be properly communicated to companies that are about to be newly listed as well. If a company is listed just above the listing threshold and then immediately delisted, there will be confusion in the market, so I think it would be desirable to have firm communication with IPO candidates or through a securities company regarding this treatment.

[Sampei, member]

There was a comment about whether the number of Securities under Supervision would increase if the transitional measures were two years plus one year compared vis-a-vis three years plus one year, but that was based on the assumption that there would be no change in the company's initiatives. I believe that two years plus a one year improvement period would light a fire under companies, and more companies would rush to take action to avoid being placed under supervision.

Also, regarding the point that there is effectively only one year remaining for the transitional period from the announcement when it is two years plus one year for improvement is certainly true, but on the other hand, there was also a process of self-selection from the stage when the market classification changed

and the criteria were made known, and an announcement was made that a certain grace period will be provided even if a company does not conform to the criteria from the beginning. Therefore, even if no deadline is set, efforts should have been made as soon as possible in the event of non-compliance, and I don't think this is an issue of companies not knowing about this. As for this one year, companies should have been going all out in their efforts and so I have my doubts as to whether it should really be thought of as there only be one year left. I don't think it is case of TSE being lenient by not setting a deadline, and I question whether it is okay for companies to rely on the minimum criteria to continue being listed and its transitional measures, and not to make efforts on our own. Efforts include M&As, and so if a company really wants to remain listed, they would also consider such efforts. On top of this, if the cost of continuing to be listed is considered too high, then the question of whether to continue to be listed itself should be reconsidered.

[Matsumoto, member]

I recall that the Follow-up Council started meeting in July, 2022, and the Market Operating Committee met first in the spring of 2021, which means that the proposal submitted to the Market Operating Committee was decided between the end of 2020 and the spring of 2021. That means that, as of today, two years have already passed since the outline of the new market segmentation system was announced. Even if we go with March 2025, including the improvement period, that means that about four years will have passed since the outline of the system was revealed, which again, I think is a sufficient period of time to make people aware of the system.

In addition, as mentioned at the top of page 2 of Document 3, there are various ways to increase productivity, not only by individual companies but also by exchanging production factors with other companies, and I believe that the Japanese capital market expects TSE to encourage such efforts and so I think it would be better to create a slope, so that companies can make a concerted effort to improve themselves.

[Ando, member]

It was not my intention to participate in the Follow-up Council from the standpoint of a corporate manager, but as someone who is involved in corporate management, I think it is a bit unreasonable to count the period from

the starting point of the discussion as Mr. Matsumoto suggested.

Also, although at the end of 2022, 269 companies in the Prime Market and 200 companies in the Standard Market were not in compliance with the criteria for continued listing, I do not think it is appropriate to assume that many companies have not been trying hard enough in their efforts since April 2022.

Looking back at the business environment since the start of the new market segmentation, companies have had to focus their attention on various risks, such as COVID-19 and heightened geopolitical risks. And while it is reasonable to point out that corporate managers should have been aware of the progress being made in discussions on market restructuring and should have taken preemptive action, I believe that it is difficult to expect all companies to make such an insightful effort.

On the other hand, TSE is both a regulator and a supporter of companies. I would like to ask all members, as well as TSE, to be fully aware of this point when reaching a conclusion on transitional measures.

[Kanda, member]

I would like to add some additional thoughts on the transitional measures. If we think in terms of substantive arguments, I fully agree with what Mr. Sampei and Mr. Matsumoto have said.

However, and this may be a minority opinion, I believe that this case is a matter of due process and is not possible on a substantive basis. Specifically, there were many ways that TSE could have said that the transition to the new market classification would end after X number of years. On the other hand, in light of the fact that companies themselves actually undertook the process of setting the plan period and having it submitted, to say no to their plans now would be a bit late in the game and difficult from a due process perspective.

So from this perspective, I feel that the proposal on page 4, while not ideal from a substantive standpoint, is acceptable.

Be that as it may, I think it is vital for TSE to take the stance of discussing with companies, and if even one company moves up their planning period during discussions with individual companies, that would be a plus. In that sense, I think it is very important to follow up on transitional measures.

[Kikuchi, Director, Listing Department, TSE]

Thank you very much.

I would like to ask a representative of the Ministry of Economy, Trade and Industry, who is participating today as an observer, to comment.

[Director Asano, Industrial Finance Division, Ministry of Economy, Trade and Industry]

As an observer, I would like to make two comments.

First, regarding the timing of the termination of transitional measures, as stated in my written comments submitted to this meeting and as discussed at the 5th meeting, I believe that “the sooner the better”, and in terms of today’s discussion, my position is two plus one. I have been listening to the discussion today and felt that this is an issue on which opinions are divided. There is a gap in actual operations between when it is explained as “ending in March 2025” and when it is explained as “the original criteria for continued listing will be applied from the record date which falls in or after March 2025,” and it took me some time to digest the explanation from TSE. I believe that this will be decided in the future, taking into consideration factors such as ease of understanding, simplicity, due process, and realistic speed for companies. As Mr. Matsumoto pointed out earlier, I think the message itself will be about the speed at which Japanese stocks are changing and how TSE is trying to encourage that change.

Secondly, regarding the issue of P/B ratio below 1, I appreciate that fact that you addressed the issue head on, and I share the stance you have taken on what kind of discipline to provide with regard to this as a market. However, the Japanese corporate system has changed significantly over the past decade, including the Corporate Governance Code, and while this has undoubtedly had an impact on the market, I believe that the text expresses the TSE’s commitment to further improve its effectiveness in the future. Rather than finishing here, I would like to see an ongoing evaluation of the measures taken by TSE and follow up of them by this Council with regard to what further steps may be necessary.

[Kikuchi, Director, Listing Department, TSE]

Thank you.

Thank you very much for giving us your opinions again today. In light of your comments, we would like to discuss our draft of Future Actions as TSE. Finally, I would like to explain what will happen in the future.

[Ikeda, Senior Manager, Listing Department, TSE]

Thank you PRB again for your time today.

First, we have presented the draft of Future Actions for the transitional measures in today's meeting materials, and according to the protocol where meeting materials will be published on the TSE website after each meeting, today's meeting materials and our draft of Future Actions will be published on the website after the meeting on the assumption that "discussions were held at the meeting based on these materials". Naturally, we understand that there will be media coverage, etc., and we would appreciate your understanding on this point.

Regarding the timing of the termination of the transitional measures, I think we have been able to hear both sides of the argument, that measures should be terminated after two years, and that measures should be terminated after three years. Regarding this issue, you have all expressed your unanimous view that measures should be terminated as soon as possible. Regarding which option to choose specifically, TSE will consider the arguments and make a decision. After today's meeting materials have been published, I am sure that the listed companies will be very interested in the specifics of what we will do, and so TSE will promptly consider and make a decision based on the opinions we have received today. We will notify all members as soon as possible once we have made our decision.

Finally, as I said at the beginning, during the next the Follow-up Council meeting, we would like to discuss issues in the Growth Market, which is a topic that we have not been able to discuss so far.

[Kikuchi, Director, Listing Department, TSE]

With that, I hereby declare today's meeting adjourned. Thank you very much for your participation today. We look forward to talking to you all again at the next meeting.

(End)