



# Discussion on Corporate Governance for Review of TSE Cash Equity Market Structure

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Tokyo Stock Exchange, Inc.  
November 2020

# **Summary**

## **Review of TSE Cash Equity Market Structure**

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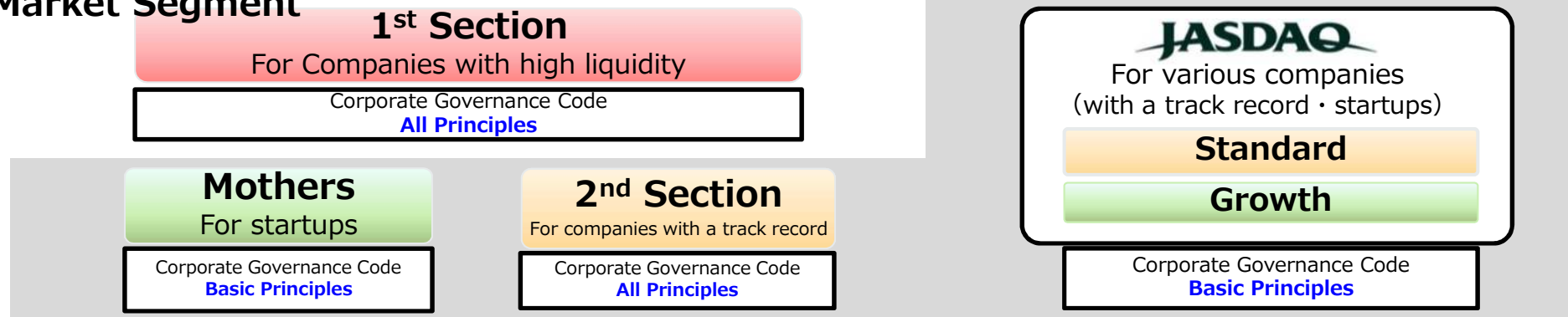
- After discussion and deliberation, the Expert Study Group on Capital Markets in Japan of the Financial System Council published a final report at the end of 2019
- Upon publication of the final report, TSE published “Overview of Market Structure Review and Outline of the New Market Segments” in Feb. 2020

| Time      | Item  |
|-----------|---|
| Oct. 2018 | <ul style="list-style-type: none"> <li>■ “Expert Study Group on Cash Equity Market Structure” established at TSE</li> <li>✓ Discussion starts at TSE</li> </ul>   |
| Mar. 2019 | <ul style="list-style-type: none"> <li>■ Publication of Comments Received from Market Participants in Response to the “Review of the TSE Cash Equity Market Structure” etc.</li> <li>✓ Around early 2019, TSE conducted public consultation on the “Review of the TSE Cash Equity Market Structure” then published “Summary of Current Issues” based on comments received</li> </ul>                        |
| May 2019  | <ul style="list-style-type: none"> <li>■ The Expert Study Group on Capital Markets in Japan of the Financial System Council Established</li> <li>✓ Listed companies, investors and experts from academia discussed (6 meetings held)</li> </ul>   |
| Dec. 2019 | <ul style="list-style-type: none"> <li>■ Final Report by the Expert Study Group on Capital Markets in Japan published</li> <li>✓ Basic Outline of the New Market Segments published on Dec 27<sup>th</sup></li> </ul>   |
| Feb. 2020 | <ul style="list-style-type: none"> <li>■ “Outline of the New Market Segments”(Overview of Review) published</li> <li>✓ In order to assist listed companies, companies preparing for IPOs and market participants in their preparation for the transition, the outline of the new market segments, the process of transition to the new market structure, and the planned schedule were published</li> </ul> |
| Nov. 2020 | <ul style="list-style-type: none"> <li>■ First set of revisions pertaining to Cash Equity Market Restructuring becomes effective</li> <li>✓ Revision of the Initial Listing standard etc. in accordance with the New Market Segments</li> </ul>   |

# Summary of the New Market Segment

- Cash Equity Market Segment to be restructured to 3 new segments in order to support **sustainable growth and mid-to long-term corporate value creation of listed companies**, so that the markets will further attracts **various types of investors, both domestic and foreign**
- Application of Corporate Governance Code to be revised in accordance with the new market concept for each segment

## Current Market Segment



## New Market Segment

※All names of the new market segments are tentative



## “Final Report by the Expert Study Group on the Structure of Capital Markets in Japan”(excerpts)

### 2. Market Sections

#### (1) Prime Market

##### (i) Concept

The concept of the Prime Market may be defined as "a market for companies whose market capitalization and liquidity are large enough to attract investments from many institutional investors, that also have **a high quality of corporate governance**, as well as **commitment to sustained growth and medium-to-long term improvement of corporate value with a focus on constructive dialogue with investors**, thus, being a market for institutional and individual investors investing in those companies."

##### (ii) Listing Criteria, etc.

(Market Capitalization Criteria (Market Capitalization of Tradeable Shares))

(Liquidity (Tradeable Share Ratio) Criteria)

(Corporate Governance)

For companies listed on the Prime Market, it is **necessary to require a corporate governance standard appropriate for such market, where investors could expect to find good investment opportunities in Japan.**

In order for listed companies to achieve sustained corporate growth and medium-to-long term increase of corporate value, it will be **necessary to continue pursuing a higher standard of governance compared to other market sections, each time the Corporate Governance Code is revised in the future.** Furthermore, it is strongly expected that companies listed on the Prime Market will **duly comply with the relevant principles and sufficiently explain where needed**, in a manner appropriate for the Prime Market, based on the selection of their own market section. Additionally, it is also considered important to recognize the possible changes on business brought by the rapid progress of digitalization, which corporate governance might need to accommodate accordingly.

(Revenue Criteria)

##### (iii) Transitional Measures (Grandfathering)

## “Final Report by the Expert Study Group on the Structure of Capital Markets in Japan”(excerpts)

### (2) Standard Market

#### (i) Concept

The concept for the Standard Market may be defined as “a market for companies which have a base-line, standard level of market capitalization and liquidity representing appropriate investment opportunity as a public company, basic corporate governance standards as a listed company, and which are committed to sustainable growth and medium-to-long term enhancement of corporate value, thus, being a market for investors investing in those companies.”

#### (ii) Listing Criteria, etc.

Companies listed on the Standard Market are not necessarily required to meet the listing criteria that institutional investors expect from companies listed on the Prime Market, such as the level of market capitalization and liquidity, and higher corporate governance standards. In light of the above concept, however, it is appropriate to require companies to be committed to having a base-line, standard level market capitalization and liquidity, **achieving basic corporate governance standards, and striving for sustained growth and increase of medium-to-long term corporate value in a way that is appropriate for each company.** …With regards to the governance criteria, companies listed on the Second Section are currently subject to all the Principles of the Corporate Governance Code, whereas companies listed on JASDAQ Standard are only subject to the basic Principles of the Corporate Governance Code. For companies transferring to the Standard Market, it is not appropriate to lower the level of corporate governance which has been required so far, and therefore, **going forward, it would be appropriate to apply all the Principles of the Corporate Governance Code to the entire Standard Market.** For companies currently listed on JASDAQ Standard, it is necessary to pay due attention to the possible additional burden on these companies in the course of transition.

### (3) Growth Market

#### (i) Concept

The concept for the Growth Market may be defined as “a market for companies which have a business plan to realize their high growth potential, which appropriately disclose their progress in a timely manner, and have obtained a certain level of market value, but at the same time, have a relatively higher risk from the viewpoint of business performance, thus, being a market for institutional and general investors investing in those companies.”

#### (ii) Listing Criteria, etc.

Regarding the corporate governance criteria, **applying only the General Principles of the Corporate Governance Code would be appropriate**, even after the Corporate Governance Code is revised.

- Taking into consideration the details of the requirements for the new market segments to be published by the end of 2020 **and Corporate Governance Code to be revised after next spring, listed companies** will choose the new market segment for listing after **September 2021**.

| Time                     | Item  | Note  |
|--------------------------|---|---|
| By the end of 2020       | Outline of Revision Published (Re: New Market Segment) ※Public Comment  | <ul style="list-style-type: none"> <li>■ Details of the listing requirements for the new market segments</li> <li>■ Details of the transition process for listed companies</li> </ul>   |
| <b>After Spring 2021</b> | <b>Revision of the Corporate Governance Code</b>  | <ul style="list-style-type: none"> <li>■ <b>Higher standard for the Prime Market to be included</b></li> </ul>  |
| End of June 2021         | Base Date for Transition: Date for evaluation of listed companies' status in relation to new market segment standards | <ul style="list-style-type: none"> <li>■ Whether listed companies have met the continued listing criteria of the new market segments or not will be confirmed at the end of June, with notification provided around the end of July</li> </ul>        |
| Sep. - Dec. 2021         | Listed Companies to choose their market segment   | <ul style="list-style-type: none"> <li>■ Market segments to be chosen based on the listing requirements and revised CG Code</li> <li>■ Plans to meet the continued listing requirements submitted by listed companies (publicly disclosed)</li> </ul> |
| April 2022               | New Market Segment (transition)   | <ul style="list-style-type: none"> <li>■ Transition completed</li> </ul>  |

# **Governance of Prime Market Listed Companies**



- Comments suggest **higher standard** are required for board independence and **establishing independent Committees**

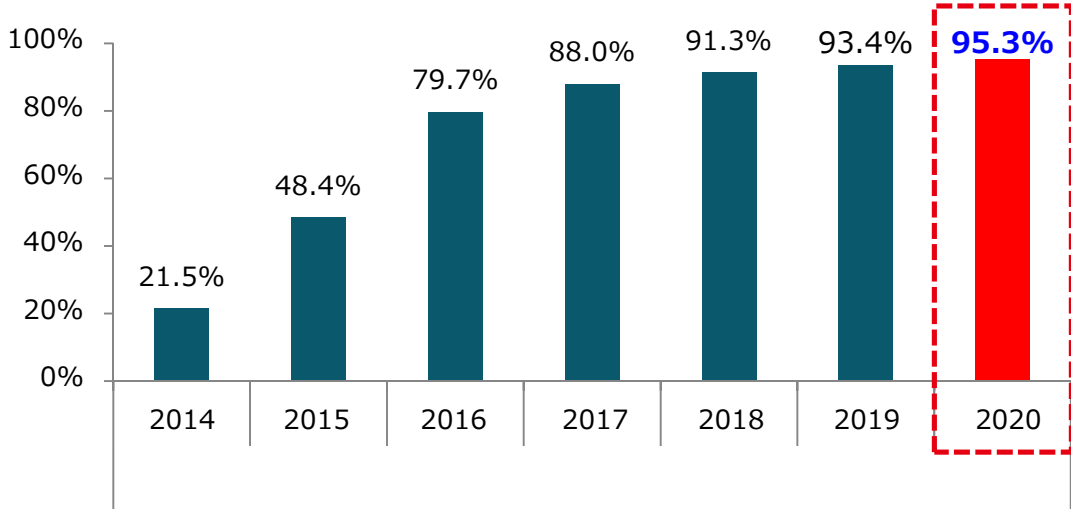
## Discussions at the Expert Study Group on Capital Markets in Japan (excerpts)

- In light of the market concept to be an investable market from the perspective of international institutional investors, **number of independent directors** and **independence of committees** which receives attention from investors **are importance**
- Currently, **appointment of more than 1 outside director** is the consensus between **listed companies and investors**
- One idea is to incorporate **what institutional investors require in the Proxy Voting Policy/Guidelines, such as “at least one-third of independent directors”** etc.
- The Governance standard outside of Japan is **establishment of nomination/renumeration committees** and **more than 50% of independent directors**
- **Establishment of nomination/renumeration committees is important**, and it is necessary to **review how the effectiveness of those committees are ensured**

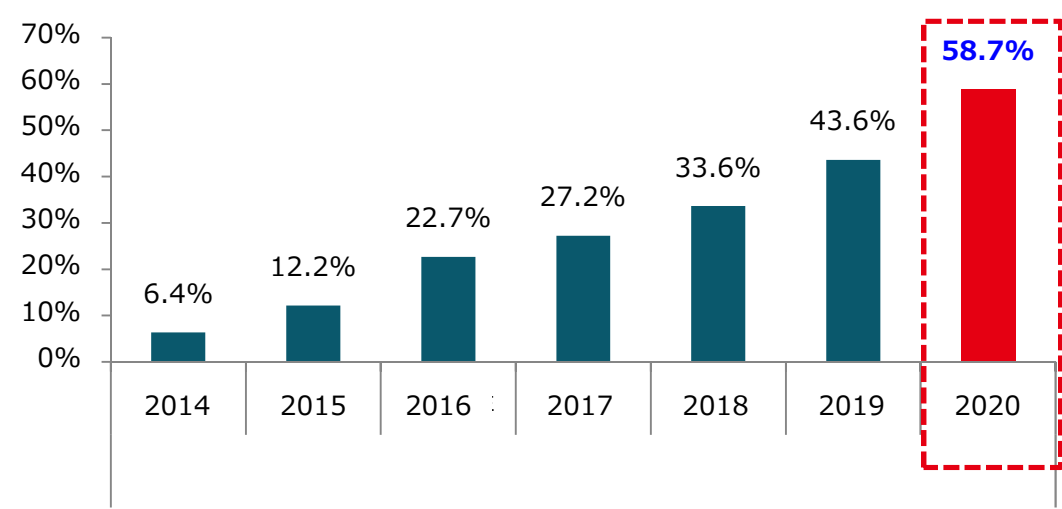
# Appointment of Independent Directors (1<sup>st</sup> Section)

■ 95.3% companies with more than 2 Independent Directors Companies, 58.7% companies with 1/3 or more Independent Directors, whereas 6.0% companies with 1/2 or more

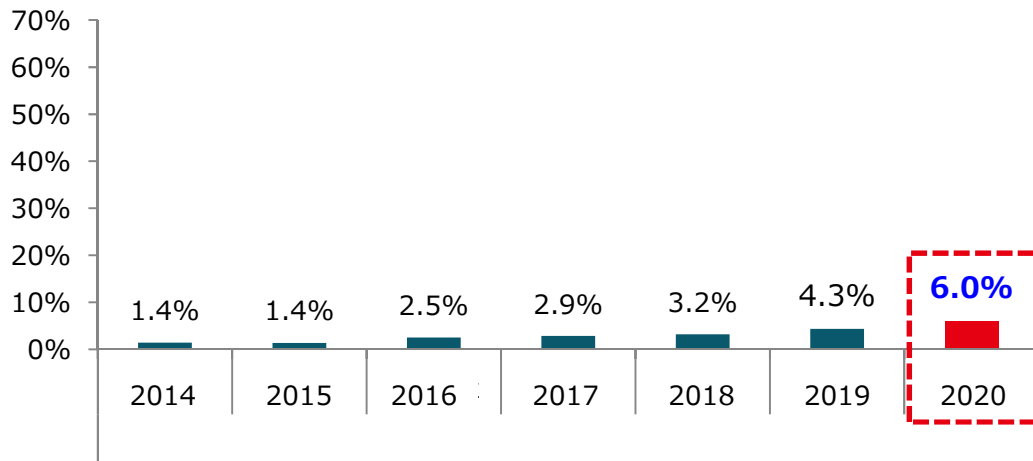
Companies with more than 2 Independent Directors



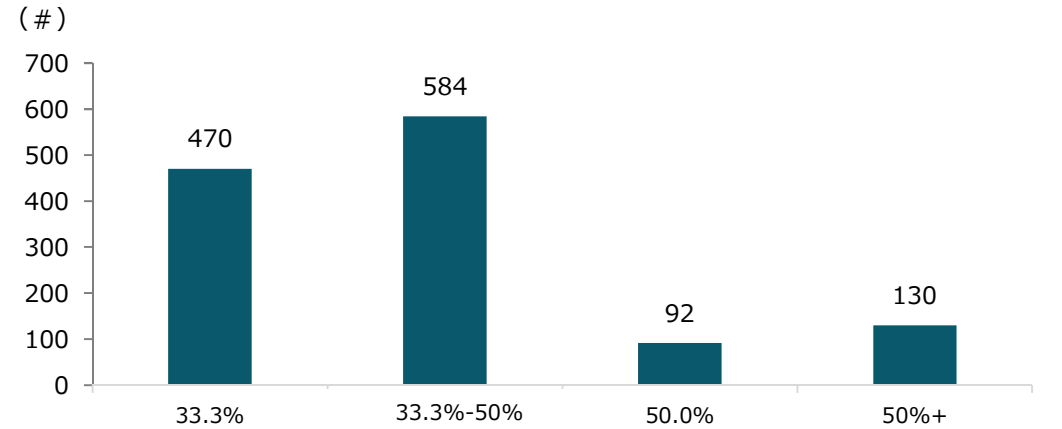
Companies with 1/3 or more Independent Directors



Companies with 1/2 or more Independent Directors



Ratio of Independent Directors (For companies with 1/3 or more independent directors)

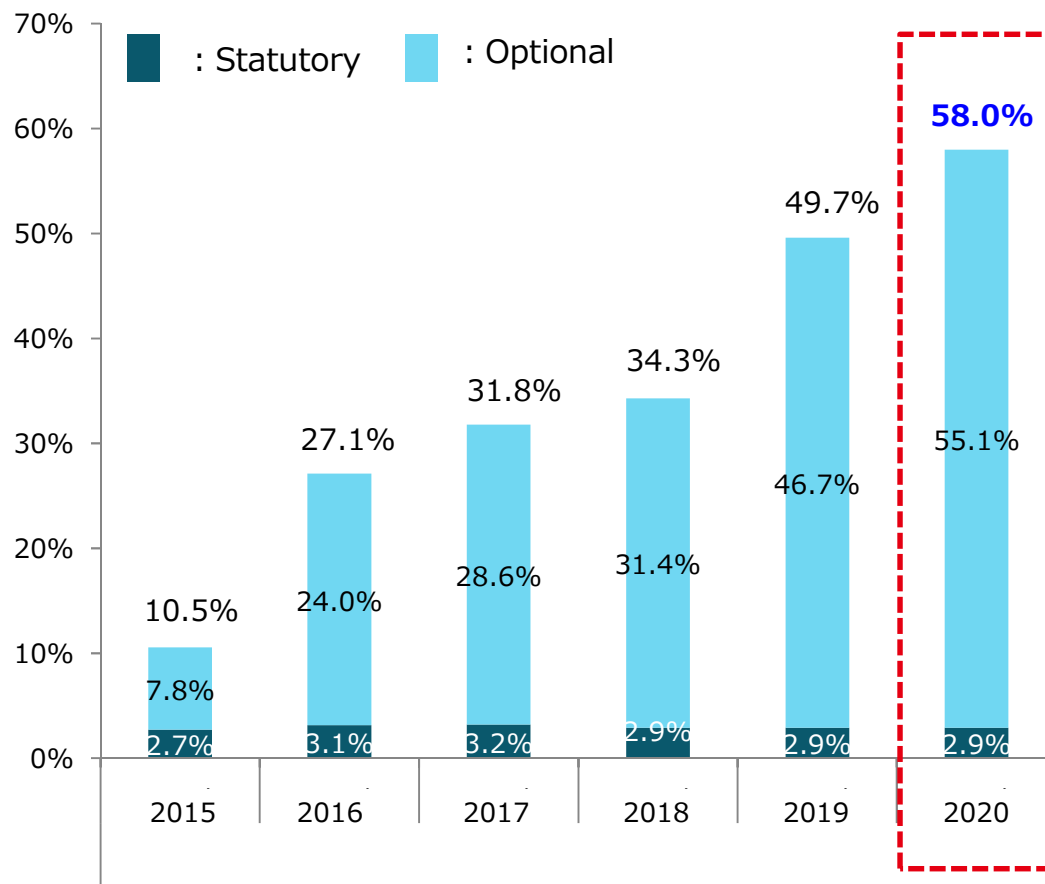


All are 1<sup>st</sup> Section Listed Companies

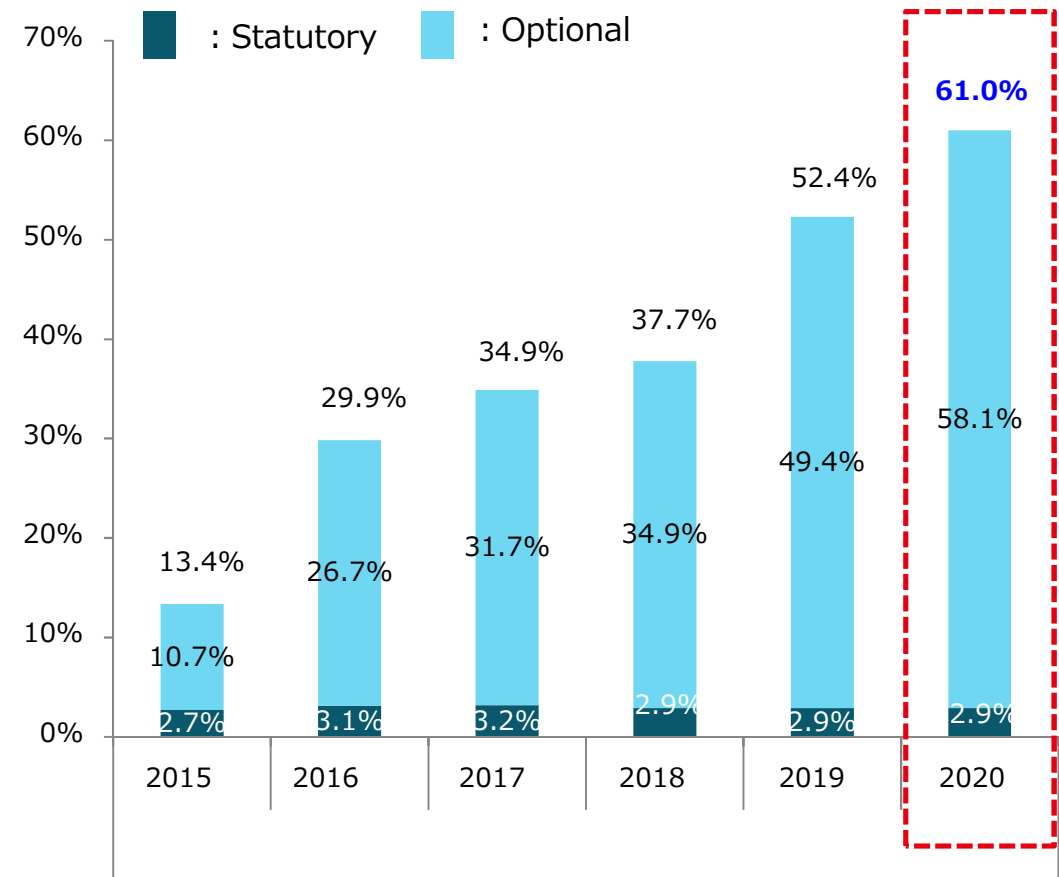
# Nomination / Remuneration Committee (1<sup>st</sup> Section)

■ 58.0% companies has established Nomination Committees (Statutory and Optional) and 61.0% companies has established Remuneration Committees (Statutory and Optional)

## Nomination Committees

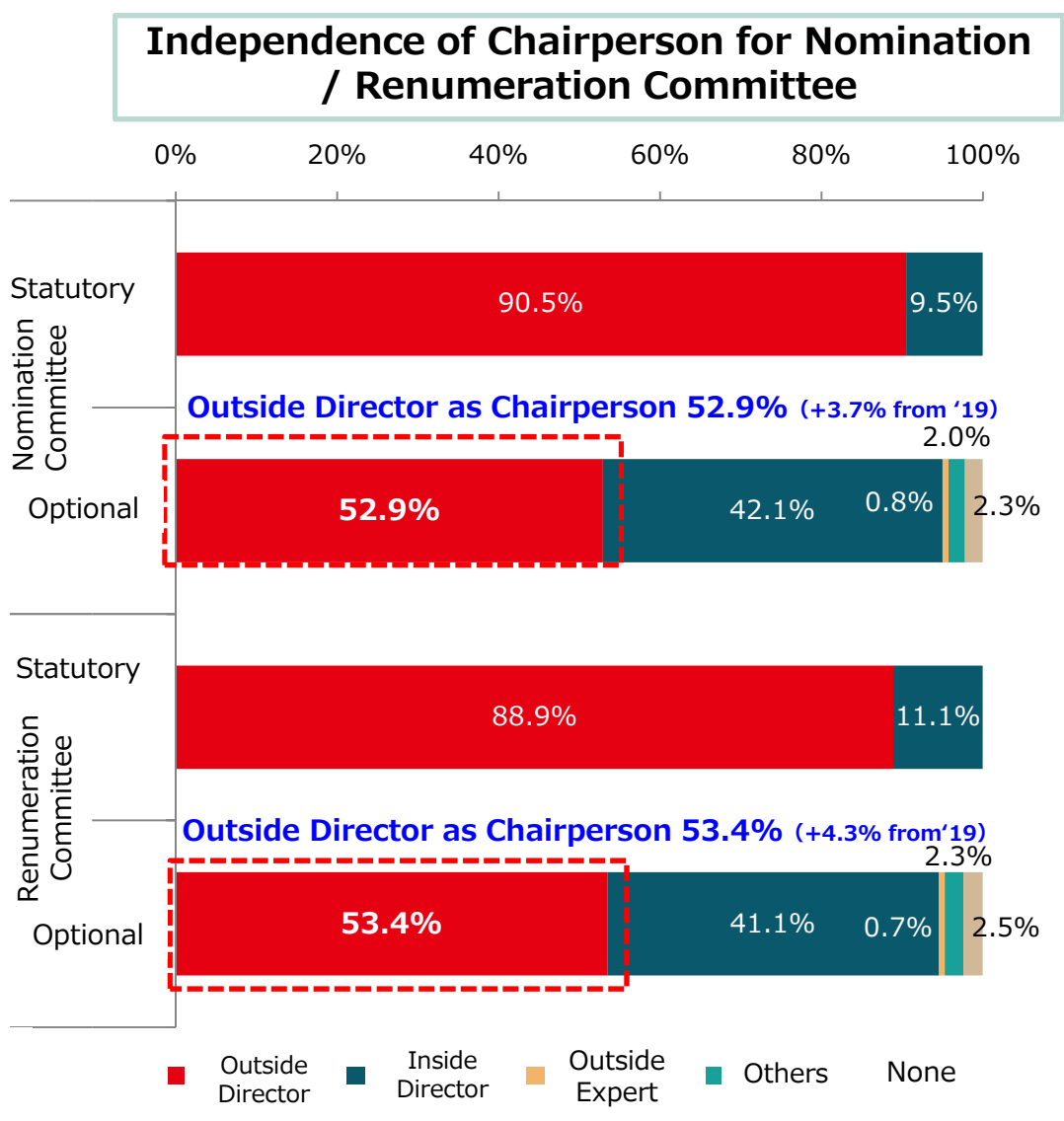
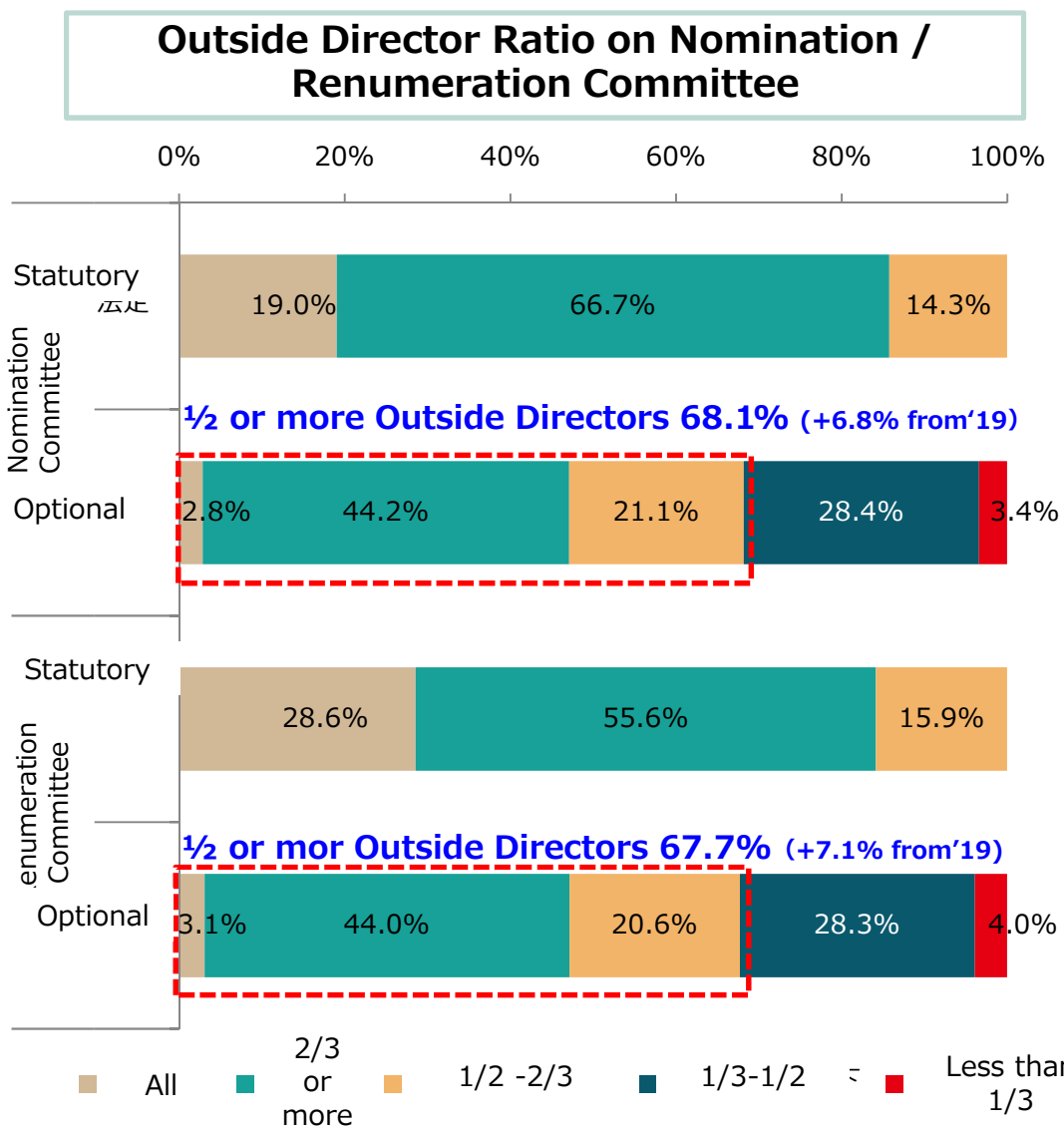


## Remuneration Committees



# Independence of Nomination / Remuneration Committee (1<sup>st</sup> Section)

■ More than 60 % of companies has 1/2 or more outside directors on Nomination Committee (same ratio for Remuneration Committee) , also more than 1/2 of companies appoint outside directors as chairperson of the committee



# **Constructive Dialogue with Investors expected to Prime Market Listed Companies**

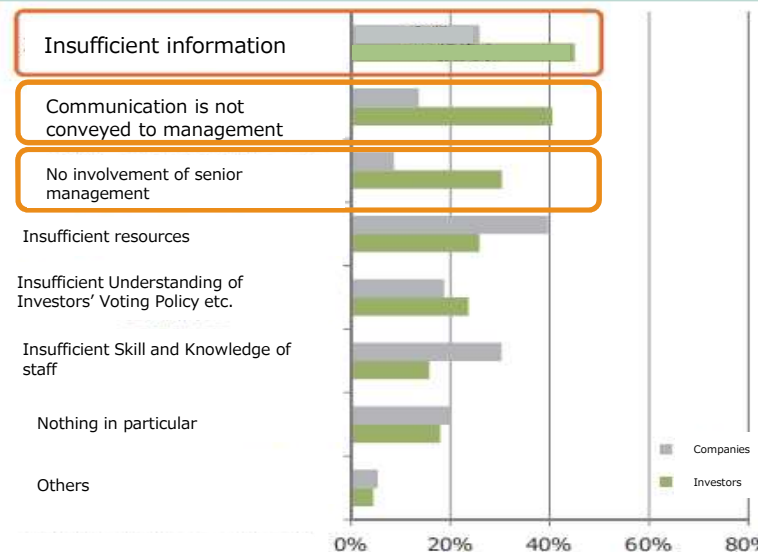
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- Information disclosure which is the basis of dialogue between investors, is important in order to foster constructive dialogue with investors
- Currently, investors point out that **disclosure is insufficient**

## Discussions at the Expert Study Group on Capital Markets in Japan (excerpts)

- At companies committed to constructive dialogue with investors and higher governance standard, quality standard is also critical and **governance or disclosure becomes important**
- Listed companies on step-up market are **required a higher transparency in terms of information disclosure**, exclusion and monitoring of minority shareholders, and increase in corporate value
- **Disclosure is required on a level that would deepen communication with domestic and foreign investors, such as English disclosure**
- **From the perspective of dialogue with shareholders**, necessary for CEO to appear at Financial results briefing at least once a year

(Companies) Issues and Challenges when communicating with investors/  
(Investors) Issues and Challenges when communicating with companies



From "The Life Insurance Association of Japan Survey "Efforts toward" realization of a sustainable society and revitalization of the stock market "through asset management of life insurance companies""(FY 2019)

# Items expected to be explained to investors

- **Guidelines for Investor and Company Engagement and Corporate Governance Code** expects below items to be clearly explained to investors in an understandable manner

## 【 Guidelines for Investor and Company Engagement 】

| Items   | Content   |
|---|---|
| Management Decisions in Response to Changes in the Business Environment | ◆ Setting targets on profitability and capital efficiency to generate sustainable growth and increase corporate value over the mid- to long-term, and reasons on such targets |
| Determination of Management Remuneration                                | ◆ The appropriateness of the remuneration system and of the actual remuneration amount  |
| Cross-Shareholdings   | ◆ The purpose of each cross-shareholding and the status of its cross-shareholdings, including any changes in its cross-shareholdings  |

## 【 Corporate Governance Code 】

| Items  | Content  |
|--|--|
| Basic Strategy for Capital Policy (Principle 1 – 3)                                  | ◆ Basic Strategy for Capital Policy  |
| Anti-Takeover Measures (Principle 1 – 5、 Supplementary 1 – 5 ①)                      | ◆ Necessity and rationale of the adoption or implementation of anti-takeover measures<br>◆ In case of tender offer, the position of the board, including any counter-offers  |
| Capital Policy that May Harm Shareholder Interests (Principle 1 – 6)                 | ◆ Necessity and rationale of capital policy that results in the change of control or in significant dilution, including share offerings and management buyouts   |
| Mid-Term Business Plans (Supplementary 4 – 1 ②)                                      | ◆ When failed to deliver on its mid-term business plan, the reasons underlying the failure of achievement as well as the company's actions   |
| Dialogue with Shareholders (Basic Principle 5)                                       | ◆ Business policies (management and directors, including outside directors, themselves)  |
| Establishing and Disclosing Business Strategies and Business Plans (Principle 5 – 2) | ◆ When establishing and disclosing business strategies and business plans, articulate earnings plans and capital policies, and present targets for profitability and capital efficiency after accurately identifying the company's cost of capital |

- For items not directly required to be “disclosed,” some companies **proactively disclose** their “compliance” and **foster constructive dialogue with investors**

## (Ref) Voluntary Disclosure on Basic Strategy for Capital Policy (Principle 1-3) ⇒Specify the Basic Strategy for Capital Policy

The Company's Articles of Incorporation stipulate that it will "strive to increase the value of its principal stakeholders, namely, patients, consumers, shareholders and employees, and to develop and maintain good relations with them." Our capital policy is also based on this philosophy. The Group's capital policy for day-to-day operations is based on medium- to long-term ROE management, sustainable and stable shareholder returns, and investment criteria for growth, all of which contribute to increasing shareholder value, while ensuring financial soundness. The Group regards ROE as an important indicator for creating sustainable shareholder value. Under our medium- to long-term ROE management, we aim to achieve ROE (positive equity spread\*1 ) that exceeds our cost of capital over the medium to long term by constantly improving our return on sales (margin), financial leverage and asset turnover (turnover). We will provide sustainable and stable shareholder returns to shareholders based on a sound balance sheet, taking into account consolidated operating results, DOE and free cash flow, as well as signaling effects. In addition, the Company has positioned repurchase of treasury stock as an indicator that reflects its capital policy. The Company may repurchase treasury stock from time to time, taking into account market conditions and capital efficiency. The Company uses the equity-to-ownership ratio and the net debt-to-equity ratio (Net DER) as indicators of a healthy balance sheet. In order to ensure value creation through growth investments, the Company has adopted the Value-Creative Investment Criteria (VCIC) for strategic investments, and has adopted a risk-adjusted hurdle rate of net present value (NPV) and an internal rate of return (IRR). We have set a hurdle in the spread of our investments and are very selective in our selection of investments. Through these capital policies, the Group strives to achieve both growth investment and stable shareholder returns, and to enhance shareholder value on a sustained basis. 1 Equity spread = ROE - cost of equity.

Translation by TSE for reference

## (Ref) Voluntary Disclosure on Succession Plan (Supplemental Principle 4-1-3) ⇒Process of Formulating Succession Plan (Involvement of Nomination Committee) and Requirement for Senior Management Clearly Stated

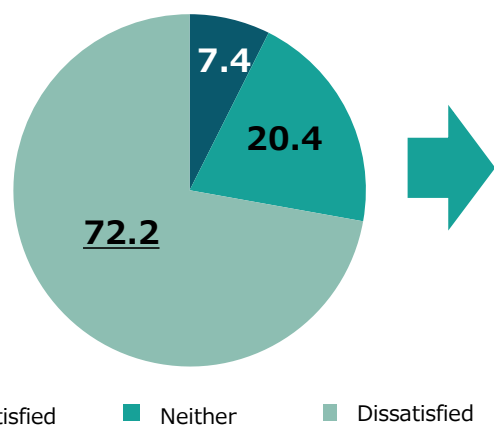
(1) Basic Concept and Outline The Company will spend sufficient time and resources on succession planning to ensure that the most suitable personnel are appointed to the positions of Group CEO, key management team (such as company heads) to support the Group CEO and the heads of the three core companies, etc., in order to achieve sustained growth and enhance the medium- to long-term corporate value of the Group as a whole. We are working on this. At the same time, we prepare for unforeseen circumstances of the Group CEO and consider the candidates for the "next" Group CEO. At the same time, the Company also prepares for unforeseen circumstances of the Group CEO succession plan and considers the "next" candidate for the Group CEO position. In the succession plan for the Group CEO, etc., the following issues are addressed: (1) the human resources requirements, (2) the timing of the replacement, (3) the establishment of the candidate pool and appropriate development of candidates over time (including important career selection of candidates), (4) the identification of candidates by members of the Nomination Committee and other committees, and (5) the selection of candidates. Our basic approach is to deliberate at the Nomination Committee and other meetings, taking into account the opinions of the Group CEO. At the Nomination Committee and other meetings, the Nomination Committee conducts thorough profiling of candidates by utilizing multifaceted personnel evaluation information such as 360-degree evaluations and third-party evaluations by an external evaluation organization, and after obtaining the opinion of the current Group CEO, conducts thorough discussions on the selection of candidates on a person-centered basis that eliminates the need for formal personnel management such as annual postponement. The current Group CEO The current Group CEO will cooperate with the Nomination Committee and other committees to the maximum extent possible in understanding the character of the candidates by setting up a process whereby each member of the Nomination Committee and other committees directly understands the abilities and qualifications, etc. of the candidates. As for the Group CEO, who is a director who also serves as an executive officer, the Nomination Committee will make decisions while ensuring objectivity and transparency in the process. (2) Human resource requirements for the Group CEO As the head of "Japan's leading global financial services group," the Group's CEO must have the following qualities -1 Strong will and humility, open and fair, sincere and honest, and someone who is trusted and credible by a diverse range of global stakeholders. 3 Being a challenger with a wealth of knowledge and experience, a global perspective and the ability to think ahead, and a passion for change and the creation of new value that contributes to our customers, the economy and society's future In addition to the above, in appointing the Group CEO, the Company considers the qualifications and competency requirements that should be emphasized or considered in addition to those mentioned above, based on such factors as the perception of the times at that time, changes in the management environment surrounding the Company, and the direction of the Group's strategy for the future.

Translation by TSE for reference



■ **More than 70% of foreign investors were dissatisfied with the English disclosure by listed companies (requests for more companies to disclose information in English, more information disclosed in English, and concerns about the timing of disclosure in English)**

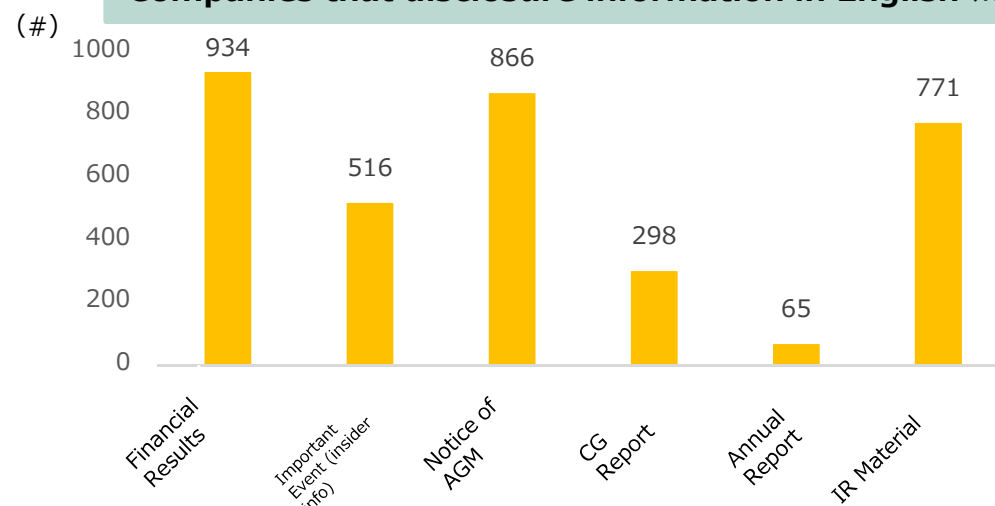
Comments from foreign investors ※ 1



**Requests from foreign investors**

- More companies disclosing English information
- More information in English
- Smaller time gap of Japanese and English disclosure

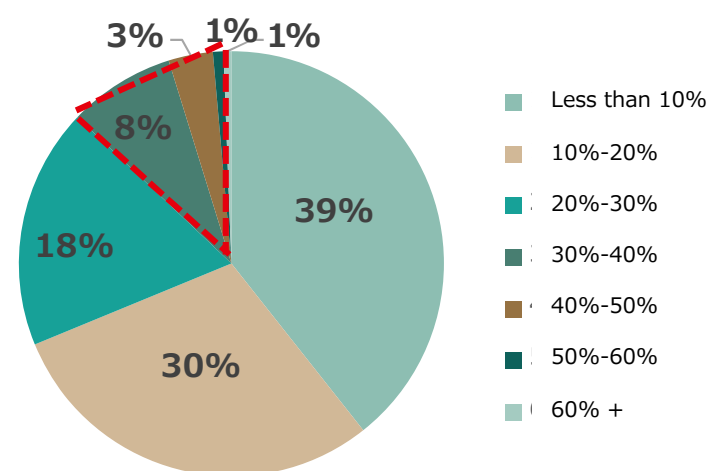
Companies that disclosure information in English ※ 2



English Disclosure (by Foreign investor shareholder ratio) ※2

|                                       | 30% + | 20%-30% | 10%-20% | Less than 10% |
|---------------------------------------|-------|---------|---------|---------------|
| Financial Result                      | 72.0% | 60.9%   | 45.6%   | 23.7%         |
| Important Event (Insider information) | 59.1% | 37.2%   | 22.1%   | 7.5%          |
| Notice of AGM (Proxy materials)       | 74.5% | 65.0%   | 45.0%   | 13.8%         |
| Notice of AGM (full)                  | 43.7% | 24.5%   | 9.8%    | 2.1%          |
| CG Report                             | 44.1% | 22.4%   | 10.8%   | 2.2%          |
| Annual Report                         | 8.4%  | 4.6%    | 2.8%    | 0.7%          |
| IR Material                           | 69.6% | 54.4%   | 37.9%   | 14.2%         |

(Ref) Foreign Investors Shareholder Ratio ※ 3



All 1<sup>st</sup> Section Listed Companies

※ 1 : 2017 Survey to foreign institutional investors, ※ 2 : End of August 2020 From TSE website, ※ 3 FY 2019 TSE statistics

# Regulations on the Prime Market

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## “Final Report by the Expert Study Group on the Structure of Capital Markets in Japan”(excerpts)

There were some comments that **the minimum requirements for corporate governance appropriate to the Prime Market should be stipulated in the listing standards so as to clarify the differences between the Prime Market and the Standard Market.** By contrast, other comments indicated that **issues regarding corporate governance had been addressed on a principle basis for the past years and that much caution would be required in considering whether to introduce listing standards that compel or force compliance.**

## “Discussions at the Expert Study Group on Capital Markets in Japan” (excerpts)

- **The level of governance is a matter of the level of “comply-or-explain”, and therefore, a matter of choice for each company through dialogue with institutional investors, etc., is not something to be forced by market segment**
- **The Governance Code is “comply-or-explain” by nature, and making the governance element a de facto mandatory by making it a criterion for listing should be avoided for the purpose of the Governance Code**
- **Corporate Governance is “comply-or-explain.” If we are talking about compliance, such standards need to be written not in the Corporate Governance Code, but in other standards such as listing standards**

### Voting

#### Securities Listing Regulations Section 4 Code of Corporate Conduct Sub-section 1 Matters to be Observed

**Rule 435.** Exercise of Voting Rights in Writing, etc.

An issuer of a listed domestic stock **shall determine matters referred to in Article 298, Paragraph 1, Item (3) of the Companies Act, where it convenes a general shareholders meeting; ...**

#### Corporate Governance Code

**Principle 1.2 Exercise of Shareholder Rights at General Shareholder Meetings** Companies should recognize that general shareholder meetings are an opportunity for constructive dialogue with shareholders, and should therefore take appropriate measures to ensure the exercise of shareholder rights at such meetings.

**Supplementary Principles 1 – 2** ④ Bearing in mind the number of institutional and foreign shareholders, companies **should take steps for the creation of an infrastructure allowing electronic voting**, including the use of the Electronic Voting Platform, and the provision of English translations of the convening notices of general shareholder meeting

### Electing Independent Directors

#### Securities Listing Regulations Section 4 Code of Corporate Conduct Sub-section 1 Matters to be Observed

**Rule 436-2.** Securing Independent Director(s)/Auditor(s)

For the protection of general investors, an issuer of listed domestic stocks **must secure at least one independent director/auditor ...or outside auditor ...who is unlikely to have conflicts of interest with general investors;...**

#### Corporate Governance Code

##### Principle 4.8 Effective Use of Independent Directors

Independent directors should fulfill their roles and responsibilities with the aim of contributing to sustainable growth of companies and increasing corporate value over the mid- to long-term. Companies should therefore appoint **at least two independent directors** that sufficiently have such qualities. Irrespective of the above, if a **company believes it needs to appoint at least one-third of directors as independent directors** based on a broad consideration of factors such as the industry, company size, business characteristics, organizational structure and circumstances surrounding the company, it should **appoint a sufficient number of independent directors**

## Section 4 Code of Corporate Conduct

### Sub-section 1 Matters to be Observed

#### Rule 436-3. Explanation of Reason for Compliance or Non-Compliance with Corporate Governance Code

When the issuer of a listed domestic stock **complies or does not comply with each principle** of the attached "Corporate Governance Code," it shall **explain reasons** for such compliance or non-compliance in the report prescribed in Rule 419. In this case, the category of listed companies and the scope of the applicable principles subject to explanation of such reasons shall be as referred to in the following items.

(1) Companies listed on the 1st or 2nd Section:

General Principles, Principles, and Supplementary Principles

(2) Companies listed on Mothers or JASDAQ:

General Principles

### Sub-section 2 Matters Desired to be Observed

#### Rule 445-3. Respect for the Corporate Governance Code

Listed companies shall respect the intent and spirit of the attached "Corporate Governance Code" and make efforts to enhance their corporate governance.

# (Ref) Corporate Governance Code in Europe

|                              | UK   | Germany   | France  |
|------------------------------|--|---|---|
| Name                         | Corporate Governance Code  | Corporate Governance Code (KODEX)   | Corporate Governance Code<br>※ For SME companies, “MiddleNext Code” (companies can choose)              |
| Published/ Revised           | Published in 1998<br>(Name change in 2010)<br>Latest Revision in 2018  | Published in 2002<br>Latest Revision in 2019  | Published in 2008<br>Latest Revision in Jan 2020  |
| Formulated by                | The Financial Reporting Council  | Government Commission/<br>Regierungskommission<br>Deutscher Corporate<br>Governance Kodex | Mouvement des entreprises de<br>France etc.   |
| “Comply or Explain” approach | Comply or Explain (Note)   | Comply or Explain   | Comply or Explain   |
| Applicable to                | Basically for Premium Segment listed companies: Different wording for FTSE350 companies and others (Standard listed companies can refer to it as well) | Listed Companies on EU regulated market   | Listed Companies on EU regulated market (listed companies can choose MiddleNext Code as reference code) |
| Revision Cycle               | -  | Every Year  | Afep and Medef initiates revision   |

(Note) UK Code states “Principle” is “Apply and Explain” and “Provision” is “Comply or Explain”

- In the UK Corporate Governance Code, some of the provisions vary by company size. As a result of the 2018 revision, there is no longer any difference in the independent directors ratio by company size.

## 2014-2016 Code

- **Except for smaller companies**, at least half the board, excluding the chairman, should comprise non-executive directors determined by the board to be independent. **A smaller company should have at least two independent non-executive directors.**
- The board should **establish an audit committee of at least three, or in the case of smaller companies two**, independent non-executive directors. **In smaller companies** the company chairman may be a member of, but not chair, the committee in addition to the independent non-executive directors, provided he or she was considered independent on appointment as chairman.
- The board should **establish a remuneration committee of at least three, or in the case of smaller companies two**, independent non-executive directors. In addition the company chairman may also be a member of, but not chair, the committee if he or she was considered independent on appointment as chairman.

## 2018 Code

- At least half the board, excluding the chair, should be non-executive directors whom the board considers to be independent.
- The board should establish an audit committee of independent non-executive directors, with a minimum membership of three, or in the case of smaller companies, two. The chair of the board should not be a member. ...
- The board should establish a remuneration committee of independent non-executive directors, with a minimum membership of three, or in the case of smaller companies, two. In addition, the chair of the board can only be a member. ...

(Note) Smaller companies mean companies that were never part of FTSE 350 in the previous accounting year