

Material 2

Provisional
translation

Other issues

March 9, 2021
Japan Financial Services Agency

(1) Governance according to the new market segments

Governance according to the new market segments

Securities Listing Regulations (Tokyo Stock Exchange, Inc.) Excerpts

Chapter 4. Listing Supervision

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

The issuer of a listed domestic stock shall: (x) comply with each principle of the attached "Corporate Governance Code;" or (y) explain reasons for 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

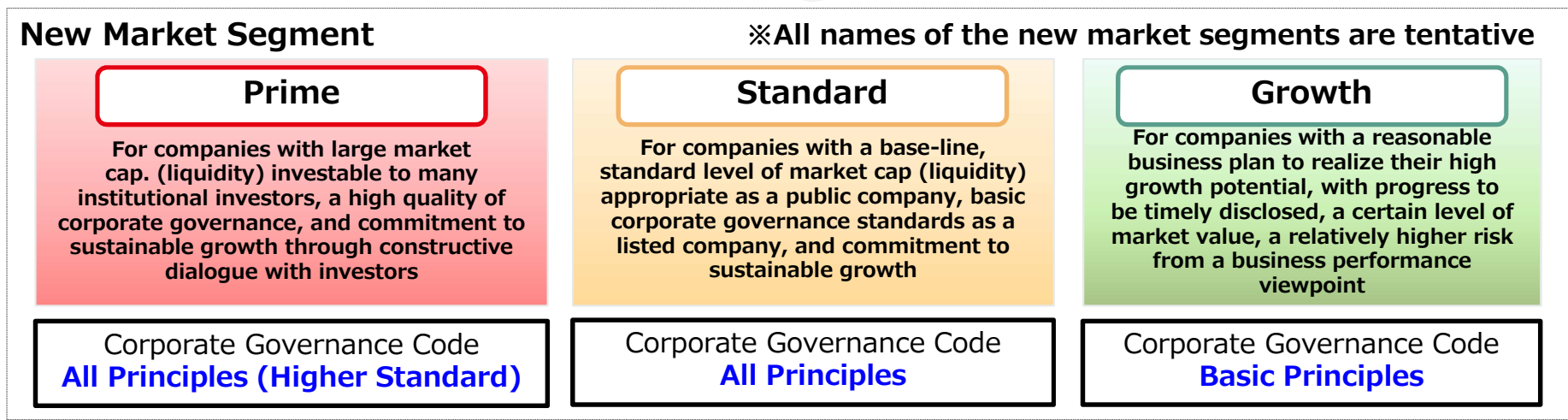
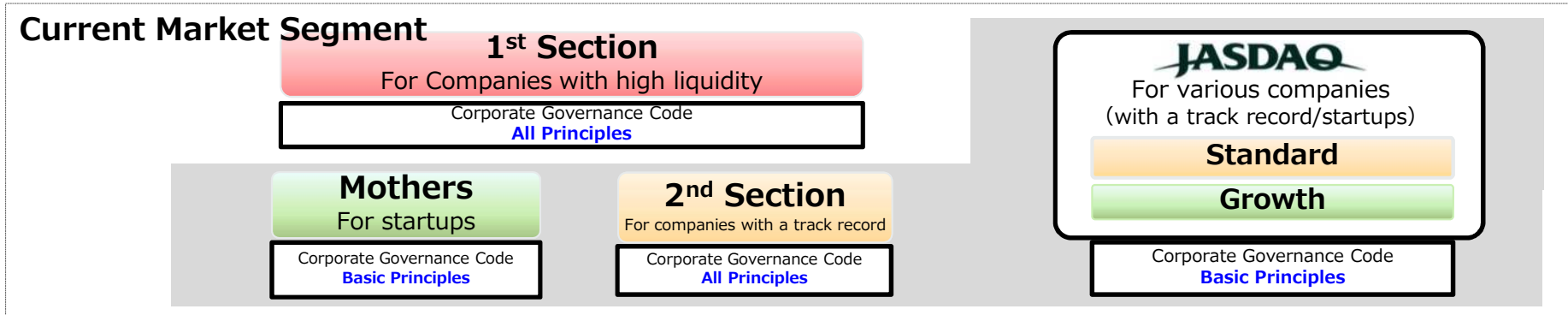
Listed companies shall respect the intent and spirit of the attached "Corporate Governance Code" and make efforts to enhance their corporate governance.

Summary of the New Market Segment

Material of The 21st Follow-up Council



- 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 attract **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



“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.

Governance required for companies listed on the “Prime Market”

Material of The 21st Follow-up Council

Based on the “Prime Market” concept of "commitment to sustained growth and medium- to long-term improvement of corporate value with a focus on constructive dialogue with investors," it is necessary to examine the governance required for companies listed on the “Prime Market”.

- In requiring an even higher level of corporate governance for companies listed on the “Prime Market,”
 - It is necessary to consider whether to adopt a “comply or explain” approach, compliance requirement, or a combination thereof according to the items.
 - When defining the content of the code, it is necessary to consider whether to write two sets of rules in one code or to create multiple codes.
 - It is necessary to examine what specific items should be required from what perspectives as the content of an even higher level of corporate governance.

<Possible perspectives (Examples)>

- Perspective of governance in response to the possible changes on business brought by the rapid progress of digitalization
- Perspective of governance expected by domestic and foreign investors
- Perspective of promoting constructive dialogue with investors

<Major items pointed out by the Expert Study Group on Capital Markets (Example)>

- ✓ Number of independent directors on the Board and independence of advisory committees on the Board, based on the concept of a market that is an investable market from the perspective of international institutional investors
 - At least one-third of the directors are independent as required by many institutional investors in the Proxy Voting Policy / Guidelines
 - The majority of directors are independent, which is the standard outside of Japan
- ✓ Establishment of a nomination committee and remuneration committee (standard outside of Japan)
- ✓ Disclosure in English to deepen communication with domestic and foreign investors
etc.

Board Effectiveness and Ensuring Diversity in the Core Human Resources in Companies for Post-COVID Transformation of Companies

The Council of Experts Concerning the Follow-up of Japan's Stewardship Code and Japan's Corporate Governance Code
Opinion Statement No. 5 (Published on 18 December, 2020)

- Opinion Statement published in December 2020 mentions the following.

The Council Opinion Statement No. 5 (Excerpts)

I. Introduction

(Omission)

This opinion statement provides recommendations on these issues for inclusion in the next revision of the Corporate Governance Code, with the aim of demonstrating a higher level of governance under a “comply or explain” framework.

II. The policies of board effectiveness and ensuring diversity in the company's core human resources

Looking at the codes and listing rules of other countries, the majority of countries require the appointment of enough independent directors to account for at least one third or the majority of the board.

In Japan, especially in the "Prime Market (tentative name)" after the transition to the new market segments in 2022, a high standard of governance will be required for the market for companies representing Japan. In light of those points, companies listed on the said market should be required to appoint enough independent directors to account for at least one-third of the board. Furthermore, companies should be encouraged to appoint enough independent directors to form the majority of the board if they consider it necessary in light of their business environment and business characteristics, etc.

*

* They may include industry, size (market capitalization, etc.), business characteristics, organizational structure, and the environment surrounding the company.

Opinions on governance according to the new market segments (1)

- Opinions on market segmentation related to the remaining issues regarding the Board effectiveness are as follows.

Main comments

【Composition of committees】

- Companies listed on the Prime Market should have a committee composition in which the majority of members are independent.
- For companies listed on the Prime Market, on the assumption that the Nomination Committee and Remuneration Committee should be established, why not make the composition of the committees more independent by appointing enough independent directors to account for the majority of directors or by having the committee chairman be an outside person.
- Considering the revision of the Corporate Governance Code as a hurdle for listing on the Prime Market of TSE, the establishment of independent committees equivalent to the Nomination Committee and the Remuneration Committee will become more important. It is important to verify the effectiveness of such committees.
- From the perspective of the global competitiveness of companies listed on the Prime Market, one idea is to require the establishment of something like a Nomination and Remuneration committee. It is also necessary to consider the composition of independent directors and their qualifications.

【Role of committees】

- With respect to companies listed on the Prime Market, it is conceivable that a little more specific stipulation in supplementary principles should be made on how the compensation committee including voluntary ones should be, which should be independent and neutral in order to have sufficient understanding of the design policy of the compensation plan for executives and be able to evaluate the performance, etc.

【Role of the Chairman of the board】

- Taking into account the recognition of the effectiveness of the independence of the chairperson of the board overseas, and the low percentage of outside directors serving as chairpersons in Japan, why don't we consider referring to the independence of the chairperson of the board in the Prime Market by requiring an independent director to chair the board or, if not, a majority of independent directors?

Opinions on governance according to the new market segments (2)

□ Other opinions on market segmentation are as follows.

Main comments

【Electronic voting platform】

- Considering that the Prime Market is to be an international market, I think it can be incorporated into the market infrastructure to a certain extent.(Ueda, 22nd)
- There is a discussion on the use of electronic voting platforms to ensure sufficient lead time before AGM. For example, the use of an electronic voting platform and a change in the record date may be an option for companies listed on the Prime Market. (Sampei, 22nd)
- As for the use of the electronic voting platform, it should be included in the prerequisites of listing on the Prime Market. (Iwama, 22nd)

【Disclosure in English】

- Considering that the Tokyo market, especially the new Prime Market, is positioned as a globally-competitive market, the provision of English translations is indispensable. Since it is also related to the credibility of the market, it is necessary to reconsider whether it is appropriate to address this disclosure issue through codes, which are a soft form of law, or to consider a hard form of law. (Ueda, 22nd)
- Considering the Prime Market where professional investors, including overseas investors, play an active role, disclosure in English is naturally required. Although there may be an issue of cost, there are advantages of being listed on the Prime Market. Taking that into account, I would say they should naturally bear the cost of disclosure.(Kawakita, 22nd)
- Companies listed on the Prime Market should prepare securities reports and notices of convocation of AGMs that are translated into English. (Waring, 20th)

【Integrated disclosure, early disclosure of securities reports, and schedule of AGMs】

- At least for companies listed on the Prime Market, it would be desirable to prepare both an Annual Business Report and Securities Report, instead of imposing dual requirements. Otherwise, early disclosure will merely increase the burden on companies. Otherwise, early disclosure will only increase the burden on companies. In particular, companies listed on the Prime Market are not allowed to take the stance of disclosing their information in the securities report after the shareholders' meeting, just because this is not required by the Companies Act. (Okada, 22nd)
- Companies listed on the Prime Market should move the record dates to April and hold AGM in July.(Waring, 20th)

【Group governance, shareholding structure, etc.】

- Even for the Standard Market, a possible approach may be to reduce the number of independent directors to one-third for a subsidiary with a controlling shareholder. (Takei, 23rd)
- In the case of subsidiary listings, etc., the majority of directors are required to be independent outside directors.(Ueda, 21st)
- From the perspective that companies are listed on the TSE, which global investors participate in, it could be said that the cases of parent-subsidary listings and cross-shareholdings are abusing the market mechanism in a certain sense. (Ueda, 20th)

【Audit】

- it is very difficult for overseas investors to understand the *kansayaku* system. Therefore, in order to gain their understanding, we should look at a Company with Kansayaku Board as a dual-monitoring model, consisting of governance in terms of the efficiency by outside directors, which is globally easy to understand, and legal governance by kansayaku, which is unique to Japan. And the Prime Market should accept such companies.(Okada, 22th)

Subjects to be discussed at the 25th Council

- Based on the discussions so far, what do you think about the governance requirements for companies listed on the Prime Market, Standard Market, and Growth Market, especially from the following perspectives?
 - While companies listed on the Prime Market will be required to have a higher level of governance than companies listed on other markets, what do you think about the governance requirements for companies listed on the Prime Market compared to those for companies listed on the Standard Market?
 - What do you think about the governance requirements for companies listed on the Prime and Standard Markets as well as for companies listed on the Growth Market?

(2) Other issues

(Reference) Agenda Items at the Council

Material of the 21st Follow-up Council

- At future Council meetings, we will discuss the following items as corporate governance issues for the post-COVID transformation.

Agenda Items	Detail
Board effectiveness	<ul style="list-style-type: none"> • Improving the quality and quantity of independent directors • Diversity of directors and their candidates • Establishment and use of nomination committees and remuneration committees (e.g. independence) and enhancement of succession plans • Use of Board Evaluation
Management in light of the cost of capital	<ul style="list-style-type: none"> • Implementation of business portfolio strategy • Cash holdings and cross-shareholdings • The concept of corporate value
Ensuring confidence in audits	<ul style="list-style-type: none"> • Strengthening of <i>Kansayaku</i>, internal audit departments, etc. (e.g., dual reporting lines, triple auditing, etc.) • Effective use of the whistleblower system • Risk-taking and internal control system, including company-wide proactive risk management
Group governance	<ul style="list-style-type: none"> • Optimal allocation of management resources and risk management in group management • Protection of minority shareholders from controlling shareholders
General shareholder meeting	<ul style="list-style-type: none"> • Early provision of general meeting materials, dispersion of the general meeting schedule, disclosure in English, electronic voting/virtual shareholder meetings
Medium- to long-term sustainability	<ul style="list-style-type: none"> • Medium- to long-term sustainability including ESG factors • Diversity in management, etc.
Especially, challenges for Post-COVID Transformation of Companies	<ul style="list-style-type: none"> • Transformation of companies in the context of digital transformation • Developing and investing in human resources and improving the internal environment for sustainable growth • Risk management in response to increased uncertainty (e.g., infectious diseases, climate issues, human rights, data security)

* In addition, there are other issues, such as the management of conflicts of interest between sponsor companies and corporate pension plans (“Second Revision of the Stewardship Code” (The Council of Experts on the Stewardship Code (FY2019), published March 24, 2020)).

Subjects to be discussed at the 25th Council

- Are there any other points that need to be further discussed in relation to the overall issues for the revision of the Corporate Governance Code?