Material 3

Provisional translation

JPX
TOKYO STOCK EXCHANGE

TSE's Recent Initiatives on Corporate Governance

Exchange & beyond

Tokyo Stock Exchange, Inc.

19 April 2023

Contents

1. Background (Action to Implement Management that is Conscious of Cost of Capital and Stock Price)

Excerpt from March 31 publication

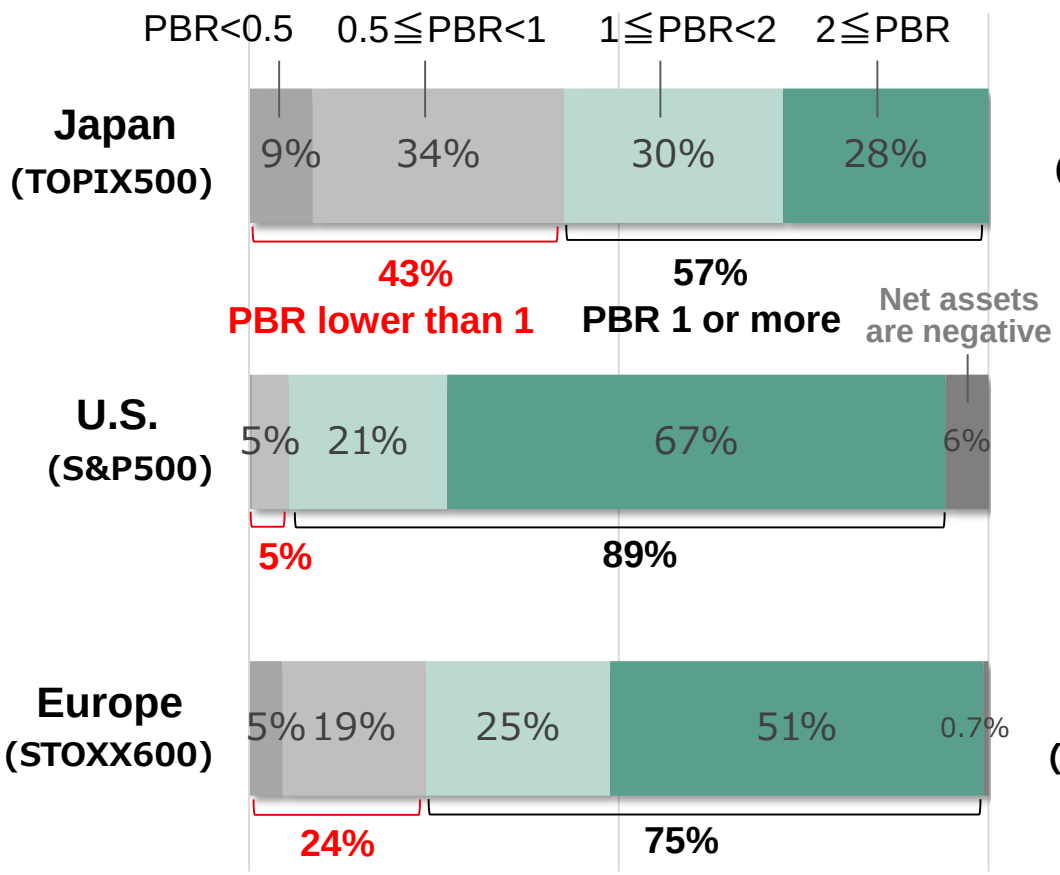
Background

- In Japan's Corporate Governance Code (Principle 5.2), management with consciousness of cost of capital is mentioned from the perspective that the allocation of resources with sufficient consideration of cost of capital and profitability is important for companies to meet the expectations of investors and other stakeholders and to achieve sustainable growth and enhancement of corporate value over the mid- to long-term.
- However, approximately half of the listed companies on the Prime Market and 60% in the Standard Market have ROE below 8% and P/B ratios below 1, indicating that there are issues in terms of profitability and growth potential. In response to this, the Council of Experts Concerning the Follow-up of Market Restructuring pointed out the need for reform in the thought processes of management to be more conscious of cost of capital and stock prices in order to improve the corporate value of each company in the future.
- In light of these circumstances and discussions, this document summarizes actions that can be considered important for achieving management that is conscious of cost of capital and stock price, and requests that listed companies actively implement them.

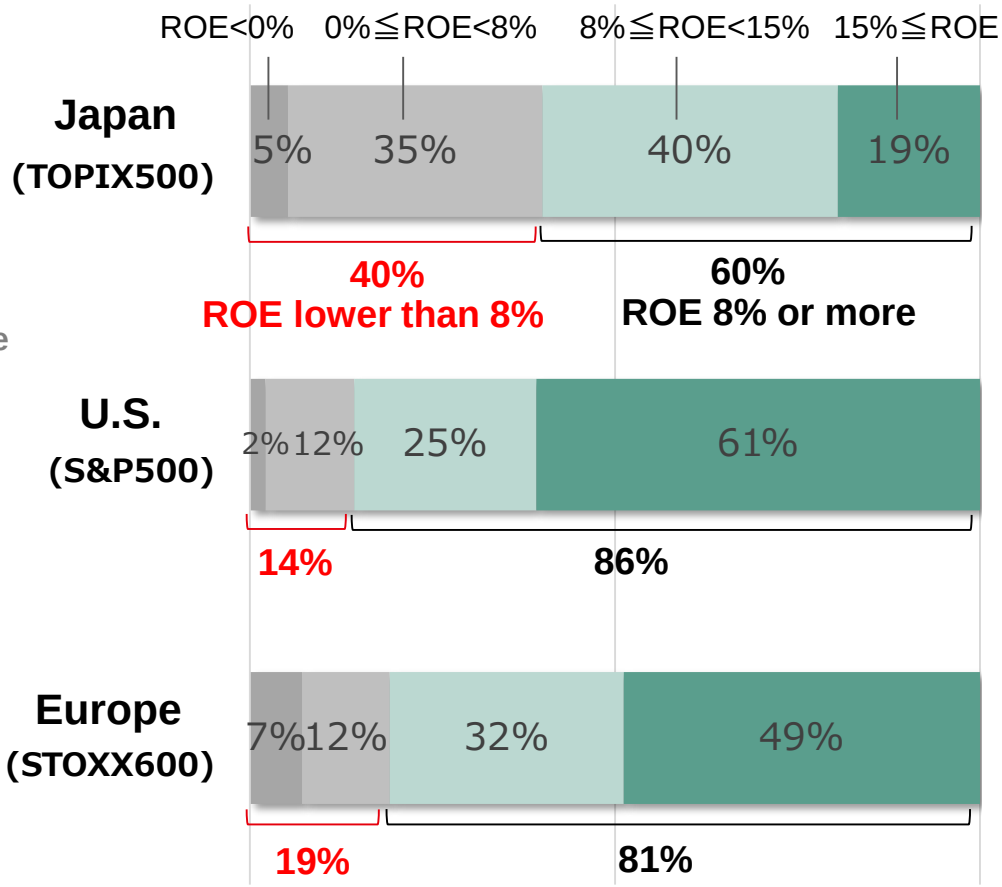
(Reference) International comparison of PBR and ROE

- **43% of Japan's major companies (TOPIX 500 constituents) have P/B ratios below 1 and 40% have ROE below 8%.**

Global Comparison of PBR (major companies)



Global Comparison of ROE (major companies)



Note: Compiled by TSE based on Bloomberg data as of July 1, 2022.

1. Purpose （Action to Implement Management that is Conscious of Cost of Capital and Stock Price）

Excerpt from March 31 publication

Purpose

- The purpose of these actions is to have the management of the company carry out their management duties with more consideration of cost of capital and profitability based on the balance sheet, rather than just sales and profit levels on the income statement, in order to achieve sustainable growth and increase corporate value over the mid- to long-term.
- Specifically, based on the basic management policy established by the Board of Directors, the management team is expected to take the lead in appropriately allocating resources with sufficient consideration of cost of capital and profitability by pushing forward initiatives such as investment in R&D and human capital that leads to the creation of intellectual property and intangible assets that contribute to sustainable growth, investment in equipment and facilities, and business portfolio restructuring.

Note: While share buybacks and dividend increases are considered effective means of improving profitability, if shown as such by the company's analysis of whether the balance sheet effectively contributes to value creation, TSE is not necessarily expecting companies to use only these or solve issues with a one-off response. Efforts are expected on a fundamental level to attain profitability in excess of cost of capital on a sustained basis and achieve sustainable growth.

- In taking these initiatives forward, companies are expected to enable investors to assess their progress by presenting clear information on related policies, targets, and specific details in whatever way they see fit, and to gradually improve their initiatives through proactive dialogue with investors based on this disclosure.

1. Details of Request

（Action to Implement Management that is Conscious of Cost of Capital and Stock Price）

Excerpt from March 31 publication

JPX

Companies Subject to Request

- All companies listed on the Prime and Standard Markets.

Requested Action

- In order to implement management that is conscious of cost of capital and stock price, please implement the following series of actions on an ongoing basis.

Analysis of Current Situation	• Gain a proper understanding of the company's cost of capital and profitability • Analyze and evaluate the current situation around these and the market valuation at board of directors meetings
Planning & Disclosure	• Have board of directors discuss and develop policies, targets, planning periods, and specific initiatives for improvement • Disclose clear information on these, along with assessment of the current situation, to investors
Implementation of Initiatives	• Push forward with management that is conscious of cost of capital and stock price, based on the disclosed plans • Engage in proactive dialogue with investors based on this disclosure

Conduct a progress analysis and update disclosures at least once a year

Start Date

- Since analysis and discussion of the current situation must be carried out sufficiently before planning and disclosure can begin, TSE is not specifying a timeframe for the start date of disclosure, but requests as prompt a response as possible.

Note: If it takes some time to analyze and discuss the current situation, disclosure could be expanded in stages, for example by first indicating the level of progress of plan development and preparation for disclosure and the expected timing of disclosure, and then disclosing specific details once the plan is developed.

Overview of 2. – 4.

Items	Overview
2. Better Dialogue with Shareholders and Related Disclosure	From the perspective of developing measures and organizational structures aimed at promoting constructive dialogue with shareholders, TSE requests that companies who have engaged with shareholders disclose on this fact and other relevant information
3. Using "Explain" to Contribute to Constructive Dialogue	From the perspective of fully describing their approach and initiatives in a way that gains the understanding of investors, TSE provides material for listed companies to carry out a self-review by presenting of their use of “explain.”
4. Consider the disclosure and corporate governance issues with regard to quasi-controlled listed companies	Based on discussion at the “Study Group to review Minority Shareholder Protection and other Framework of Quasi-Controlled Listed Companies,” TSE envisions organizing the key points in the disclosure of information on listed companies with parent-subsidiary relationships and expanding disclosure to a wider range of companies. In addition, TSE continues to consider governance-related issues.

2. Background and Purpose (Better Dialogue with Shareholders and Related Disclosure)

Excerpt from March 31 publication

Background

- Japan's Corporate Governance Code states that companies should engage in constructive dialogue with shareholders in order to contribute to sustainable growth and the increase of corporate value over the mid- to long-term (General Principle 5). Specifically, the Code states that "taking the requests and interests of shareholders into consideration, to the extent reasonable, the senior management, directors, including outside directors, and kansayaku, should have a basic position to engage in dialogue with shareholders," and that "the board should establish, approve and disclose policies concerning the measures and organizational structures aimed at promoting constructive dialogue with shareholders" (Principle 5-1).
- The importance of dialogue with investors has also been reiterated at the "Council of Experts Concerning the Follow-up of Market Restructuring," in the sense that it is important for enabling companies to gain insight into how to improve their management capabilities.
- On the other hand, at the Follow-up Council, it was noted that some companies remain reluctant to engage in such dialogue, and that in order to promote this, TSE should require companies listed on the Prime Market, which are expected to put constructive dialogue at the center of efforts to improve their corporate value, to disclose on how much dialogue has taken place between management and investors and the content of this dialogue.

Purpose

- Based on the above, it is important for companies listed on the Prime Market to develop measures and organizational structures aimed at promoting constructive dialogue with shareholders, and to respond sincerely to requests for dialogue from shareholders.
- In addition, this document requests that companies who have engaged with shareholders disclose on this fact and other relevant information.

2. Disclosure on Dialogue with Shareholders (1/2)

Excerpt from March 31 publication

Companies Subject to Request

- **All companies listed on the Prime Market**

Outline of Disclosure

- **Please disclose information about dialogue with shareholders during the most recent business year.**

Suggested disclosure items:

- ✓ Main personnel carrying out dialogue with shareholders
- ✓ Overview of shareholders with whom dialogue was held (e.g. domestic/foreign, active/passive, investment style such as growth/value/dividend oriented, areas of responsibility of counterparties (fund manager, analyst, ESG, voting, etc.))
- ✓ Main topics of dialogue and items of interest to shareholders
  - ➢ Especially, cases of dialogue that was insightful for the company or dialogue where shareholder understanding was gained through explanation from the company management
- ✓ Whether feedback was given to management or the board on shareholders' views and concerns learned through dialogue
- ✓ Actions taken based on the dialogue and later feedback, if any etc.

Note 1: The items listed above are examples of items that could be appropriate for disclosure as part of measures to improve the effectiveness of dialogue with shareholders, based on the contents of Japan's Corporate Governance Code. Regardless of the above, companies are not necessarily required to disclose all of the above items, and should disclose other information where this is considered necessary.

Note 2: Companies that have not carried out dialogue with shareholders during the most recent business year may disclose on the progress of measures and organizational structures aimed at promoting constructive dialogue with shareholders.

Note 3: If a company engages in dialogue with investors regarding its efforts to improve profitability based on the balance sheet and stock price, based on Document 1, "Action to Implement Management that is Conscious of Cost of Capital and Stock Price," it is expected to also disclose about this dialogue.

2. Disclosure on Dialogue with Shareholders (2/2)

Excerpt from March 31 publication

Form of Disclosure

- Although TSE is not specifying any type of document or format for disclosing information about dialogue between management and shareholders, companies could disclose such information in, for example, annual reports, or the company's website.
- No matter how the information is disclosed, to make it easier for investors to find, please state that the company is disclosing the information and how to access it (e.g. a website URL) in the "Disclosure Based on each Principle of the Corporate Governance Code" section of the Corporate Governance Report.

Start Date

- TSE requests as prompt a response as possible.

Note 1: For example, a company listed in the Prime Market could disclose promptly about its dialogue in the fiscal year ending after the release of this document, and then state that disclosure has been made in the corporate governance report that is updated after the annual shareholders' meeting.

Note 2: TSE expects disclosure contents as well as corporate governance reports to be updated after the end of each fiscal year.

3. Purpose （Using "Explain" to Contribute to Constructive Dialogue）

Excerpt from March 31 publication

- Specific measures mentioned in the Principles of the Corporate Governance Code are common methods (best practices) that may be used to realize the goals and ideas of the Principles. If there are Principles for which a listed company considers it would be inappropriate to comply in light of its individual circumstances, TSE allows instead a full explanation of the reasons for non-compliance (the "comply-or-explain" approach).

  Note: It has been suggested that in many cases, a proactive explanation is preferable to superficial compliance. (See "Responses to the Corporate Governance Code and Next Steps of the “Council of Experts Concerning the Follow-Up of Japan’s Stewardship Code and Japan’s Corporate Governance Code" (Oct. 10, 2015)")

- From this perspective, it is important for companies using "explain" to fully describe their approach and initiatives in a way that gains the understanding of investors, but recently there have been instances of companies leaving their explanation as "under consideration" for several years, along with other similar examples, leading to suggestions that the comply-or-explain approach has lost some of its substance.

- In response to the above, in this document, TSE has compiled points to note when writing explanations that can be thought to contribute to constructive dialogue with investors. Listed companies can use these as a reference to carry out a self-review of their use of "explain."

3. Key Points for Using "Explain"

Excerpt from March 31 publication

- In order to use the "explain" option in a way that contributes to constructive dialogue, it may be useful to consider the following points.

- Clearly indicate what parts of the relevant Principle are not being implemented.
  - In particular, if there are some parts which are implemented and some which are not within one Principle, indicate these clearly
- For parts which are not implemented, explain the company's reasons for not complying at this time (reasons why it is appropriate not to comply) from the following perspectives:
  - Individual circumstances (e.g., industry, size, business characteristics, organizational structure, environment surrounding the company)
  - If alternative measures have been adopted, details of these and the reasons why they are appropriate for the company
- If the company plans to comply with the relevant Principle in the future, give specific details of the discussions and work toward compliance from the following perspectives:
  - Structure, methods and processes of discussions/work, and factors being considered
  - Progress of discussions/work, specific schedule for compliance
  - Details of transitional measures being implemented prior to compliance, if any

3. Typical Types of Explanations Considered Insufficient

Excerpt from March 31 publication

- TSE carried out a survey on the current usage of "explain." The following were the main characteristics observed in cases where the explanations could be considered insufficient for investors.

Type of Explanation	Main Characteristics
a) Compliance Status Unclear	• It is difficult to understand why the company chose to "explain" because the description of what part of the Principle is not complied with is unclear.
b) No Statement of Reasons for Non-compliance	• The company states "under consideration" without giving the reasons for non-compliance or specific details of discussions/work toward compliance.
c) Abstract Explanation	• The company gives an entirely abstract explanation, such as patching the wording of the Code together. • It is not based on specific individual circumstances.

4. Outline of interim report (Study Group to review Minority Shareholder Protection and other Framework of Quasi-Controlled Listed Companies)

Excerpt from January 8 Study Group

Background

- In certain cases, mainly among companies that came to have controlling shareholders after listing, minority shareholders may not have been afforded sufficient protection.
  - ✓ Information on agreements with controlling shareholders regarding the appointment of directors, etc. not sufficiently disclosed
  - ✓ How business opportunities and business fields are coordinated and allocated among controlling shareholders' group companies unclear
  - ✓ Company did not obtain an opinion that actively expresses "the interests of minority shareholders will not be undermined" regarding tender offer by controlling shareholder
  - ✓ Company ends up with no independent director to represent general shareholder interests
- Similar cases are seen at companies with "quasi-controlling shareholders," who do not fall under the definition of "controlling shareholder" but have strong influence.

Issues considered

(1) Information Disclosure

After researching and examining the actual situation, TSE reviews ways to enhance information disclosure on (i) agreements on governance at listed companies and (ii) approaches to and policies on conflicts of interest and supervision/control of those conflicts (including how business opportunities and business fields are coordinated and allocated).

(2) Corporate Governance

The Study Group continues to discuss corporate governance including election of independent directors.

(3) Procedures

The Study Group continues to discuss frameworks for minority shareholder protection when a controlling shareholder makes a tender offer with the aim of taking a listed subsidiary private, taking into account the role expected of special committees.

(4) Scope of Application

With respect to widening the application of frameworks for controlling shareholders to quasi-controlling shareholders, TSE reviews (i) the definition of "quasi-controlling shareholder" in practice and (ii) what listing rules related to minority shareholder protection should be applied to listed companies with quasi-controlling shareholders.

4. Developments on Minority Shareholder Protection since Interim Report

Excerpt from January 8 Study Group

2021	**March**	**Amendment to the Companies Act** ➢ Subsidiary companies must disclose, in their business reports, summaries of the contents of “agreements regarding important financial and business policies” made with their parent companies.
	June	**Revision of the Corporate Governance Code** ➢ Stated clearly in the notes to the Code that controlling shareholders should respect the common interests of the company and its shareholders and should not treat minority shareholders unfairly ➢ Established new Supplementary Principle 4.8.3 for companies with controlling shareholders ✓ Appointing at least one-third of their directors (the majority of directors if listed on the Prime Market) as independent directors who are independent of the controlling shareholder; or ✓ Establishing a special committee composed of independent persons including independent director(s) to deliberate and review material transactions or actions that conflict with the interests of the controlling shareholder and minority shareholders ➢ Established new Supplementary Principle 5.2.1 on information disclosure regarding business portfolio ✓ In formulating and announcing business strategies, etc., companies should clearly present the basic policy regarding the business portfolio decided by the board and the status of the review of such portfolio.
	December	➢ Corporate Governance Reports submitted (in response to the revised Code, including Supplementary Principle 4.8.3)
2022	**From January**	**Survey on Governance-related Agreements** ➢ In order to understand the actual volume of agreements that are not disclosed.
	June	**Report by the Working Group on Corporate Disclosure of the Financial System Council** ➢ Proposed how "material contracts" (agreements between companies and shareholders on (i) corporate governance and (ii) sale/additional purchase of shares held by shareholders) should be disclosed in Annual Securities Reports

4. Current Status of Disclosure and Direction of Measures

Excerpt from March 22 Study Group

	Listed parent company/listed subsidiary	Listed company that holds a certain proportion of voting rights/has a certain proportion held by another company
Current disclosure framework	■ Disclosure of matters that are material for shareholders to make investment decisions, mainly in the CG report Listed parent company⇒Own shareholders Listed subsidiary⇒Own minority shareholders	■ Not subject to disclosure in the CG report
Current status of disclosure	■ Adequate disclosure from some companies ■ Inadequate disclosure from the majority of listed companies	
Direction of measures	■ First, to ensure adequate disclosure in the CG Report, its effectiveness could be improved through the below measures: ➢ Setting out points to be included in each disclosure item (to spread awareness of what contents are expected) ➢ Requesting listed parent companies to cooperate with disclosure efforts at their listed subsidiaries	■ First, on a request basis, the scope of disclosure could be extended to those with other associated/affiliated company relationships (20% ownership or 15% ownership + substantial influence)

■ After today's study group, TSE will promptly **publish a revised version of the Preparation Guidelines for CG Reports**, along with **example disclosures**, that reflect today's discussion

⇒ Thereafter, **TSE will continue to follow up on the status of disclosure and update the example disclosures in order to promote and deepen disclosure**

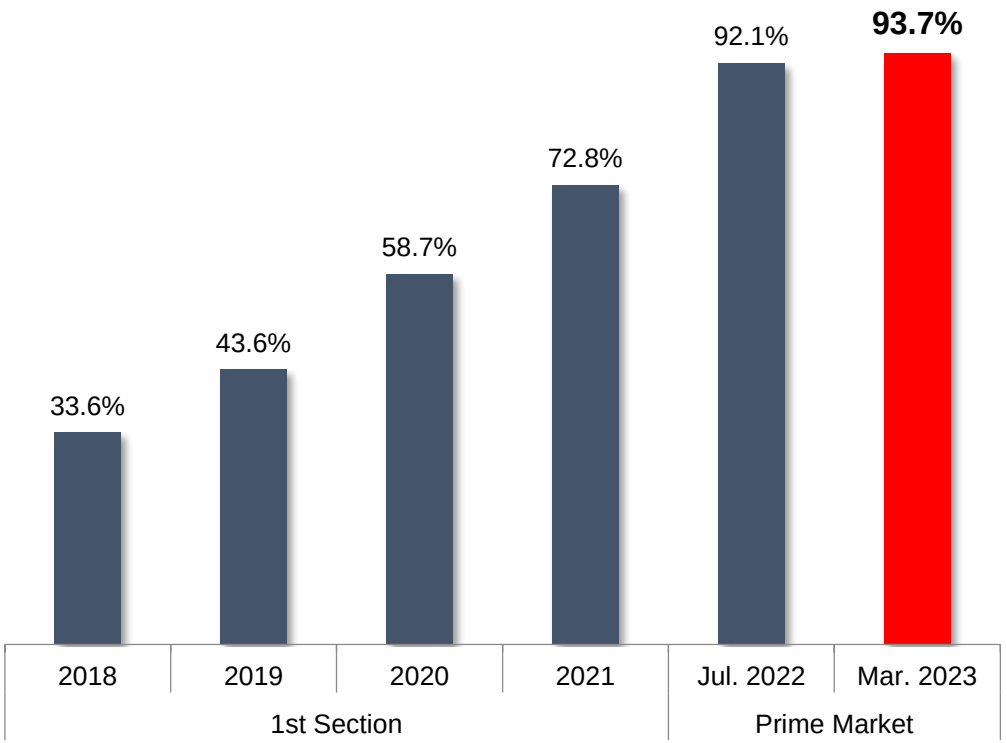
- We will continue to consider how listed companies should be responsible for protecting minority shareholders, including the responsibility for listed parent companies to cooperate with disclosure efforts at listed subsidiaries.
- With respect to the disclosure of governance-related agreements, amendments to the Cabinet Office Ordinance on Disclosure of Corporate Information, etc. regarding material agreements in Securities Reports are currently being considered. TSE will consider this matter in accordance with this amendment.

Reference Material

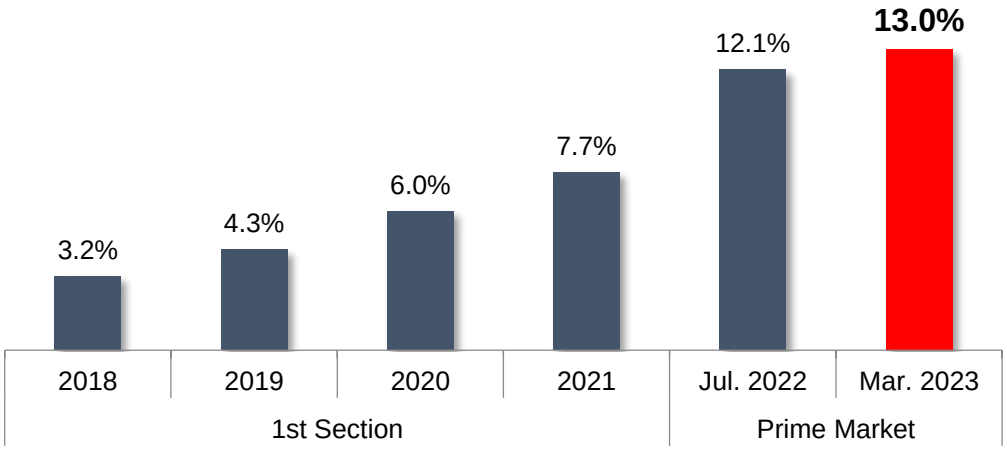
(Appointment of Independent Directors and
Establishment of Nomination and Remuneration Committees)

Appointment of independent directors (Prime Market)

Proportion of Prime Market companies with 1/3 or more independent directors



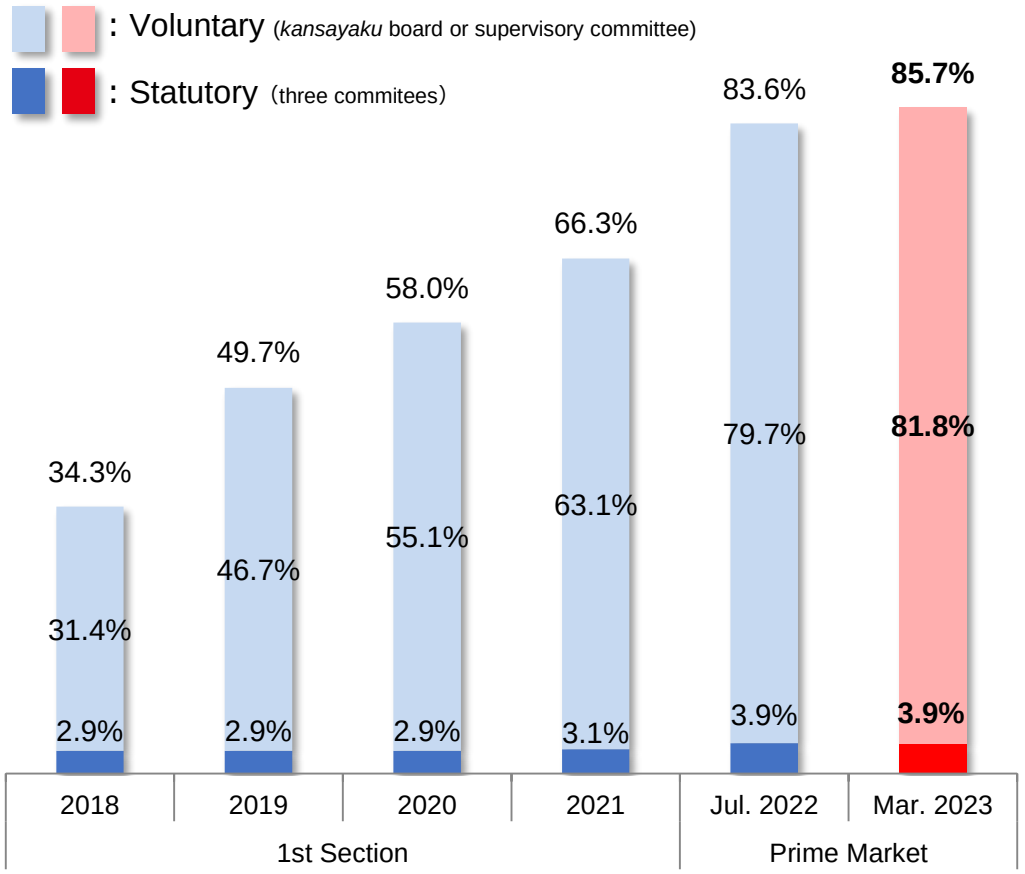
Proportion of Prime Market companies with majority independent directors



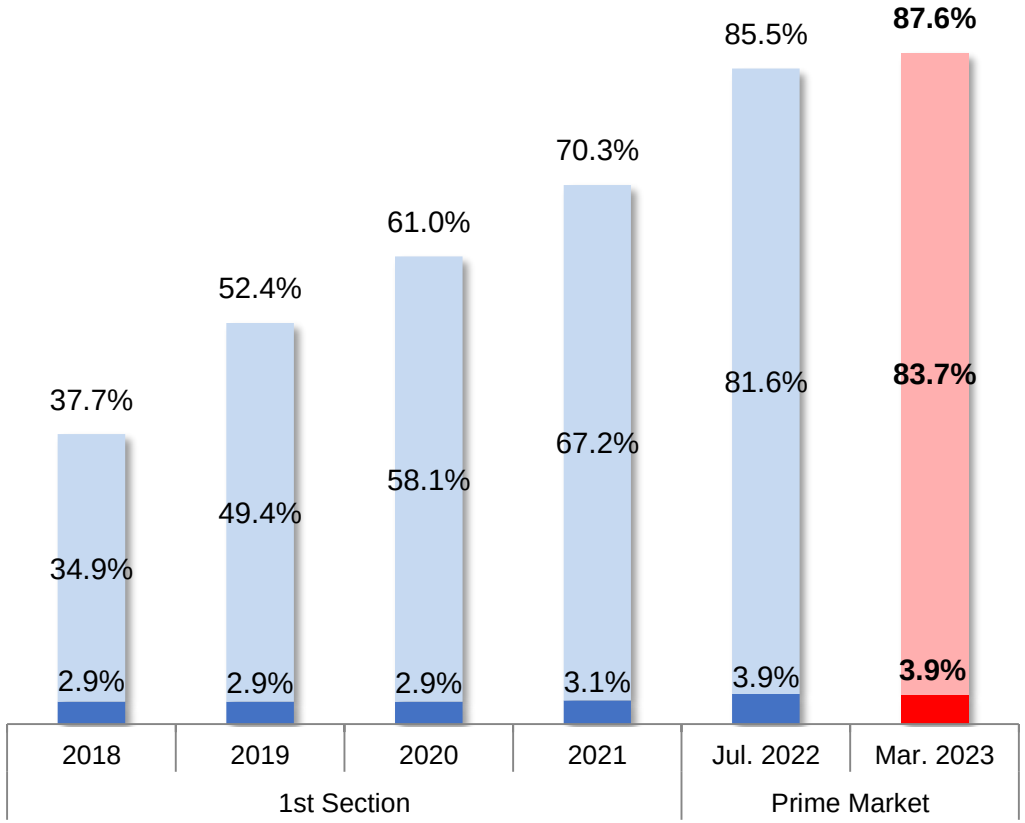
Principle 4.8	Companies listed on Prime Market should appoint at least one-third independent directors, or majority where necessary (at least two independent directors, or at least one-third where necessary if listed on other markets).

Establishment of nomination and remuneration committee（Prime Market）

Proportion of Prime Market companies with nomination committee



Proportion of Prime Market companies with remuneration committee



Supplementary Principle 4.10.1	Companies should establish an independent nomination committee and remuneration committee. (Companies listed on the Prime Market should basically have the majority of the members of each committee be independent directors, and should disclose policies/mandates/roles of the committees.)