ICGN
International Corporate Governance Network

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25 January 2019

To the Disclosure Working Group of the Financial Services:

ICGN Response to the Consultation Paper "Review of the TSE Cash Equity Market Structure"

The International Corporate Governance Network (ICGN) is pleased to respond to the Tokyo Stock Exchange (TSE) consultation on its consultation Paper "Review of the TSE Cash Equity Market Structure, released on 21 December 2018"

Led by investors responsible for assets under management in excess of US$34 trillion, ICGN is a leading authority on global standards of corporate governance and investor stewardship. Our membership is based in more than 45 countries and includes companies, advisors and other stakeholders. ICGN's mission is to promote high standards of professionalism in governance for investors and companies alike in their mutual pursuit of long-term value creation contributing to sustainable economies world-wide. Our policy positions are guided by the ICGN Global Governance Principles[1] and the ICGN Global Stewardship Principles[2], both of which have been developed in consultation with ICGN Members and as part of a wider peer review. For more information on ICGN please see: www.icgn.org.

As one of the world's leading equity markets, with over 30% of TSE owned by overseas investors, Japan is important to ICGN members. Accordingly, ICGN is actively involved in the dialogue regarding corporate governance and investor stewardship in Japan, and we respond regularly to consultations relating to stewardship and governance by the TSE, the Financial Services Authority (FSA) and the Ministry of Justice. Most recently, in late 2018, ICGN issued a Statement to the Council of Experts for the Follow-up of Japan's Stewardship Code and Japan's Corporate Governance Code.[3]

[1] See: Japanese language version of Global Governance Principles: http://icgn.flpbks.com/icgn_global_governance_principles_jpn/
[2] See: Japanese language version of Global Stewardship Principles https://www.icgn.org/sites/default/files/ICGN_Global_Stewardship_Principles_JPN_1.pdf
[3] See ICGN consultation submission to the Council of Experts for the Follow-up of Japan's Stewardship Code and Japan's Corporate Governance Code in November 2018: https://www.icgn.org/sites/default/files/25.%20ICGN%20Letter%20to%20FSA%20Council%20of%20Experts.pdf

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ICGN's Japanese investor base includes, leading asset owners and asset managers, corporates, regulators, auditors, academics and other members of the Japanese corporate governance community. Our members, both in Japan and globally, recognise the significant progress that has been made with regard to both corporate governance and stewardship in Japan, and we look forward to engaging further with you to develop mutual understanding and to contribute to ongoing improvements in Japanese corporate governance.

In this context we are pleased to continue this dialogue with regard to the current TSE consultation on the equity market structures in Japan. The consultation itself raises specific issues relating to listing and delisting criteria for companies in the various market segments in Japan. Our approach to this response is not to wade into the details of the individual segments, but rather to provide some overarching views based on our global experience and perspective.

In this context we would like to stress the following points to consider as you resolve the questions on the consultation:

- **Governance and the life cycle of the company**. We believe there is merit in maintaining different market structures for companies in different stages of development. This is a common practice in markets around the world and reflects the recognition that a company's governance structures and needs evolve over time, along with the stage of development in its lifecycle. Governance and listing requirements should reflect the company's size, complexity and ownership structure as it matures. But for small companies the emphasis should be on proportionate governance standards that do not unduly inhibit entrepreneurial flexibility. Ultimately, however, most investors want to see companies grow and mature, and be prepared to adopt governance structures for more established companies, as reflected in Japan's Corporate Governance Code.

- **Principles versus rules.** While investors generally accept the legitimacy of more flexible governance structures for smaller companies, they still want companies to have good corporate governance and to contribute to long-term success and sustainable value creation. This is a question of culture and values as much as structure and should be guided in the first instance by overarching principles that have relevance in all markets for all kinds of companies—for example the OECD guiding principles of fairness, responsibility, accountability and transparency.

- **Good governance is important for small companies too, even if it might look different.** Even for startup and smaller issuers, investors would like to see companies that embrace the spirit of corporate governance and are prepared to adapt their governance practices to more developed standards as they mature. Regardless of individual regulatory or listing requirements, investors are looking for companies to demonstrate respect for minority shareholder rights, to provide robust disclosure of financial and non-financial performance, as well as the willingness to engage with investors, at both the executive and board levels.

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- **Good idea to harmonise on basic principles between market divisions.** While the governance standards and listing requirements will differ in Japan depending on company size and listing category, we believe there should be a fundamental harmony and consistency in core principles between listing standards in the differing market divisions to facilitate a company adopting more demanding governance requirements as it evolves.

- **Market category for good corporate governance?** If the TSE is reviewing market structures and listing rules, there may be scope for considering a listing segment for companies with "good" corporate governance. This has been done in other markets as a way to promote good corporate governance and provide visibility to companies with the highest governance standards. The Japanese Corporate Governance Code would provide the foundation for such a listing segment and determining factors could be drawn from those criteria articulated in our letter to the FSA this past November 2018, which reflect concerns of international investors investing in Japan. These might include:

    - Boards in excess of one-third independence
    - Board responsibility for corporate governance disclosures
    - Role of independent board committees with clear disclosures and terms of reference
    - Disclosed rationale for cross-shareholdings (where they exist)
    - Corporate disclosure: capital allocation and cost of capital
    - Actions to improve board quality: gender, diversity, tenure/refreshment, board evaluations.

We hope these comments are useful in your deliberations. If you would like to follow up with us with questions or comments, please contact our Policy Director George Dallas: george.dallas@icgn.org .

Yours sincerely,

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