

17 March 2020 (No. of pages: 8)

Japanese report: 26 Feb 2020

# Essence of the Tokyo Stock Exchange Restructuring: Tougher on Corporations than Expected

*Hurdles get higher for new listings, market transition, and maintaining listings*

Policy Research Dept.  
**Atsushi Kamio**

## Summary

- The Tokyo Stock Exchange has announced its "Overview of the Market Structure Review: Outline of the New Market Segments." There are no significant changes in market classifications or concepts from the *Financial System Council Capital Market Working Group Final Report by the Expert Study Group on the Structure of Capital Markets in Japan* published by the Financial Services Agency (FSA) at the end of last year. The three markets are the Prime Market, the Standard Market, and the Growth Market (all provisional names). Transition to the new market is scheduled for April 1, 2022.
- New listing and maintenance standards are indicated for each market, along with concrete categories including liquidity, governance, operating results and financial position. Currently listed companies are required to choose their markets independently in accordance with the listing maintenance criteria. In addition, changes in the definition of shares in circulation are under consideration. Cross-shareholdings may be excluded from shares in circulation.
- Companies listed on the 1st Section of the stock market that aim to be listed on the Prime Market but fail to meet the listing maintenance criteria can utilize transitional measures, but the conditions which must be met are the announcement of plans and the disclosure of progress toward achieving the listing maintenance criteria. Markets judge whether a listing is good or bad, and companies need to take actions to improve their corporate value more than ever before.
- Revision of the current system is also anticipated prior to the transition to the new market. Relaxed standards have been applied for promotion from Mothers and others to the 1st Section of the market, which may be revised in July this year. On the other hand, it is anticipated that companies making losses will be able to list on the 1st Section of the market.

## Main Points of the Market Structure Review

On February 21, the Tokyo Stock Exchange announced its "Overview of the Market Structure Review: Outline of the New Market Segments" (referred to as Market Structure Review in the below.) There are no significant changes in market classifications or concepts from the *Financial System Council Capital Market Working Group Final Report by the Expert Study Group on the Structure of Capital Markets in Japan* published by the Financial Services Agency (FSA) on December 27 last year. The TSE Market Structure Review contains details on standards for listing and paperwork required when selecting a market. The main points of the Market Structure Review are presented below.

### Three market classifications

As was pointed out in the FSA report, the new market segments are the Prime Market, the Standard Market, and the Growth Market (Chart 1, market names are all provisional). There are no changes in the concepts of the new markets since the publication of the FSA report. Descriptions of the new markets are provided below.

#### Prime Market

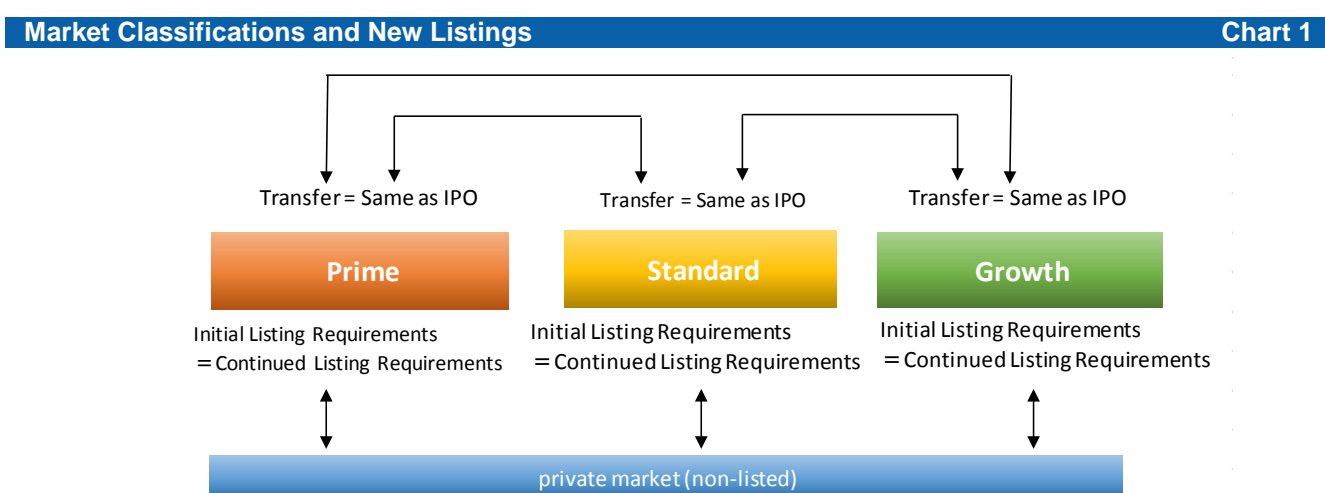
This market is oriented toward corporations committed to continuous growth and improvement in corporate value in the mid to long-term, with a willingness to carry on constructive dialogue with shareholders. These companies have market capitalization (liquidity) of a scale that makes them appropriate investments for institutional investors, as well as high standards in the area of corporate governance.

#### Standard Market

Open market investment opportunities having a certain level of market capitalization (liquidity), and listed companies maintaining basic standards of corporate governance, this market is oriented toward corporations committed to continuous growth and improvement in corporate value in the mid to long-term.

#### Growth Market

This market is oriented toward corporations having a relatively high risk from the viewpoint of business results. On the other hand, listed companies have business plans with high growth potential, and carry out disclosure appropriately as advances occur, and are able to attain a certain level of market evaluation.



Source: Tokyo Stock Exchange, "Overview of the Market Structure Review: Outline of the New Market Segments" (February 21, 2020); compiled by DIR.

---

### *New listing and maintenance standards of new markets, and changes in definition of shares in circulation*

New listing and maintenance standards are indicated for each market, along with concrete categories including liquidity, governance, operating results and financial position (Chart 2). According to the current standard, criteria for new listings and maintenance of listing are different, but in principle they have much in common. Listed companies will be required to continue to comply with the listing maintenance standards of each market segment even after achieving listing. If a company comes into conflict with the listing maintenance standards, a grace period is provided during which the company can make the required improvements.

Meanwhile, if a listed company wants to be listed on a different market, they must apply separately to that market and undergo an inspection based on the standards for new listings of that market. There is no alternative route to new listing provided such as the relaxed criteria for promotion to the 1st Section of the TSE. In other words, it will no longer be possible to make use of the alternative route to listing on the 1st Section now available to companies listed on Mother's and the 2nd Section of the TSE. Currently, in order to gain listing on the 1st Section of the TSE, unlisted companies and companies listed on JASDAQ must fulfill the requirement of 25 billion yen in market capitalization. But companies listed on Mother's or the 2nd Section of the TSE are only required to have 4 billion yen. Meanwhile, if a company listed on the 1st Section of the TSE is overrun with debt, rather than being demoted to the 2nd Section of the market as is now the rule, they will simply be delisted.

## Standards for New Listing and Maintenance of Listing for Each Market

Chart 2

Item	Prime Market		Standard Market		Growth Market	
	New Listing	Listing Maintenance	New Listing	Listing Maintenance	New Listing	Listing Maintenance
Number of Shareholders	800 or more	800 or more	400 or more	400 or more	150 or more	150 or more
Number of Shares Outstanding	20,000 units or more	20,000 units or more	2,000 units or more	2,000 units or more	1,000 units or more	1,000 units or more
Market Capitalization of Tradable Shares	10 bil yen or more	10 bil yen or more	1 bil yen or more	1 bil yen or more	500 mil yen or more	500 mil yen or more
Trading Value	25 bil yen or more of market capitalization	Average trading value per day of 20 mil yen or more	—	Up to 10 units per month / trading failure for 3-months	—	Up to 10 units per month / trading failure for 3-months
Trading Volume			—		—	
Market Capitalization	—	—	—	—	—	40 bil yen or more (nothing for 10 yrs after listing)
Share Ratio	35% or more	35% or more	25% or more	25% or more	25% or more	25% or more
Earnings Base	2.5 bil yen or more in total profits for past 2-yrs	—	100 mil yen or more in profits over past year	—	—	—
	Sales of 10 bil yen or more, market capitalization of 100 bil yen or more		—			
Financial Condition	5 bil yen or more	(Note 2)	Must be positive	(Note 2)	—	(Note 2)
Net Assets						

Source: Tokyo Stock Exchange, "Overview of the Market Structure Review: Outline of the New Market Segments" (February 21, 2020); compiled by DIR.

Notes: 1) As for other requirements, public offering for initial listing on the Growth Market is over 500 units.

2) The delisting standard for all markets will be excessive debt (exception will be made if a certain amount in market capitalization can be expected). In the case of the Growth Market, this will be applied once 3-years have passed since listing.

3) Corporate governance code (CG code) to be fully applied to Prime Market after review (higher standard expected). Same with Standard Market. Basic CG code to be applied in case of Growth Market.

Definition of shares in circulation are expected to be reviewed, though this has to do partly with market capitalization of tradable shares and share ratio. At this time, shares in circulation are defined as total listed shares after deducting number of shares held by officers, treasury stock, shares held by shareholders who own 10% or more of total listed shares, and shares held by special stakeholders other than officers (at time of listing and certain specified times only). This definition is to be reviewed, with the new definition now leaning in the direction of excluding shares held by shareholders which are considered to be not in circulation, regardless of the ratio of holdings. To be more precise, the new definition will likely be applicable to cross-shareholdings. It has not yet been decided when this review will take place, but a decision is expected sometime in 2020.

### ***Corporations to choose their market and maintenance criteria***

Currently listed companies will be required to choose their markets independently in accordance with the listing maintenance criteria. When doing so, as a decision-making reference, there are the listing maintenance standards for new market segment (see Chart 2) whose date for transition is end June 2021. Decisions as to whether or not companies are in compliance with the market of their choice will be made by end July 2021 with notices to be sent out to listed companies at that time by the TSE.

For example, a notice will be sent out to companies with listings on the 1st Section of the TSE regarding whether or not they are in compliance with the listing maintenance standards of the Prime Market, the Standard Market, or the Growth Market. If a company wishes to be listed on the Prime Market, but they are not in compliance with those standards, it will then be necessary to submit a plan toward the fulfilling of listing maintenance standards for the new market segment<sup>1</sup>. These documents will be made available to the public. Therefore, listed companies should produce a practical plan, and also must take the appropriate procedures such as a resolution of the board of directors. The plan must be written up so as to fulfill the requirements of the listing maintenance standards as shown in Chart 2. Companies must submit a realistic plan that covers not only improvements in the share ratio, but market capitalization of tradable shares as well, including efforts to improve corporate governance. It is also required to make a report on an annual basis of progress made toward fulfilling said plan.

After submission/disclosure of the plan, transitional measures, which are fairly loose in comparison to the Prime Market listing maintenance standards, will be applied. The transitional measures will be applied in place of the new market segment listing maintenance standards for the time being. The standards will be at about the same level as the current alternative listing criteria (market capitalization of traded shares 1 bil yen or more, and share ratio of 5% or more)<sup>2</sup>. There are no plans for reviewing the transitional measures for the time being, but a review of the measures could occur at some point in the future.

### ***Revision of current system before market restructuring***

With the advent of new market classifications in mind, many aspects of the current system are expected to be reviewed even before market restructuring goes into effect. Amongst these, the issues receiving the most attention are standardization of new listings on the 1st Section of the TSE, 1st Section listings and change of markets, as well as clarification of listing examination and judgment standards for companies that are running a deficit. The system outline was announced in March 2020, and comments from the public are now being fielded. After that, possibilities are that revisions to the current system may occur in July. The current system can be made use of until the July revisions. There is no grace period expected.

### ***Standardization of new listings on the 1st Section of the TSE, 1st Section listings and change of markets***

Regarding the standards shown in Chart 2, such as market capitalization of tradable shares of 10 billion yen or more and 25 billion yen or more, these are expected to be applied before the official market restructuring takes place. This may be the case for new listing standards on the 1st Section of the TSE, designation of listings to be moved from the 2nd Section to the 1st Section, and change of markets from Mother's and JASDAQ to the 1st Section. Before this review, associated with the

---

<sup>1</sup> Regardless of which market a company wishes to be listed on, a market selection application and a document certifying the board of directors' resolution on market selection must be submitted and disclosed.

<sup>2</sup> For the time being, in the case of the Standard Market and the Growth Market, standards at the same level as the current delisting standards will be applied in place of the new market segment listing maintenance standards (market capitalization of traded shares 250 mil yen or more, and share ratio of 5% or more).

revision of the current system before market restructuring takes place, a last minute rush in promotions from the Mother's market and the 2nd Section to the 1st Section is expected.

### ***Clarification of listing examination standards for companies running a deficit***

Listing on the 1st Section of the stock exchange requires a reasonable prospect for stable profits for a certain designated period after listing. Practically speaking, it will be extremely difficult for companies running a deficit to gain listing. However, once a company has been listed, it can retain its listing even if it reports a deficit, as long as it can retain a stable earnings base. It is expected that this will be especially applicable to industries which are required to invest large amounts in the future of their business, such as internet services and the biomedical field.

### ***Review of TOPIX market and schedule***

Discussion based on the Financial Services Agency report has not progressed. Therefore, in order to encourage discussion, an Index Consultation function for the purpose of hearing the opinions of index users has been introduced. An Index Advisory Panel made up of index users has also been put into place to promote constant improvement of the index.

In regard to issues making up the TOPIX market, a new rule is being considered which makes use of free-floating market capitalization, with a target of 10 billion yen in market capitalization as its standard. Meanwhile, establishment of an upper limit of applicable number of issues which is periodically reshuffled may also be considered, as well as a rule for selection of issues making up the index based on qualitative factors.

Decisions and announcements regarding new calculation rules for TOPIX and other indices are to be made between April 2020 and end March 2022. Changes to new calculation rules for TOPIX and other indices will then be made in stages starting in April 2022.

### ***Future schedule***

As is shown in Chart 3, transition to the new market will take place on April 1, 2022. Announcement of a concrete outline of the new system will take place within the year (2020). Listed companies will receive notification from the TSE in July 2021 as to whether or not they comply with listing maintenance standards. Then market selection procedures must be carried out between September and December 2021 based on said decision-making reference material. Selection of a market will then be required based on the CG code which is expected to be revised based on discussions taking place beginning this summer and the new listing criteria.

Period	Item Up for Review	Comments
March 2020	Announcement of system overview (current system partially revised, call for comments from public)	Revision of standards for new listings and change of markets
July 2020	Revision of current system	Companies applying for new listing after these revisions will be listed according to a framework close to standards for the new market classifications.
Within the Year (2020)	Announcement of system overview (new market classification system, call for comments from public)	Details of listing standards for new market segments, details of transition process for listed companies.
Starting in Spring 2021	Revision of CG code	Higher standards are expected to be indicated, in consideration of companies with plans on listing on the Prime Market.
End June 2021	Base date of transition	Confirmation of whether or not companies are in compliance with listing maintenance standards of new market segments (notification by end July)
Sept.-Dec. 2021	Market selection procedures to be taken by listed companies	Selection based on listing standards and revised CG code of new market segments. Disclosure of contents of plan toward compliance with listing maintenance standards of new market segments.
April 1, 2022	Market transition date	Completion of transition to new market segments.
Starting in April 2022	Change to new calculation rules starts for TOPIX and other indices.	Changes to occur in stages in consideration of effect on market.

Source: Tokyo Stock Exchange, "Overview of the Market Structure Review: Outline of the New Market Segments" (February 21, 2020), "Planned Measures for Review of Tokyo Stock Price Index (TOPIX), etc." (February 21, 2020); compiled by DIR.

## In conclusion

The Tokyo market restructuring was designed with the intension of making improvements in the continuous growth of listed companies in the mid to long-term, as well as the improvement of corporate value. For corporations, the number of issues they will have to think about, from a variety of perspectives, will increase. First of all, the hurdles will get harder for new listings, transition to different markets, and maintenance of listing. Certain things will be more difficult than they currently are, especially gaining listing on the Prime Market by a company that is originally unlisted, and also transitioning to the Prime Market from the Standard or Growth Market<sup>3</sup>. Meanwhile, efforts towards improving corporate governance and dealing with revisions to the CG code will be required. The change in definition of shares in circulation may lead to the exclusion of cross-shareholdings, forcing companies with a small share ratio to rethink the form in which these shares are held.

Furthermore, in order for companies which are not in compliance with the standards for maintenance of listing to be eligible for application of measures making use of more relaxed standards (such as a company listed on the 1st Section of the stock market which does not comply with standards for listing

<sup>3</sup> The current system is also expected to be revised as was explained earlier in this report. In regard to new listings, designation for 1st Section, and changes in market listing, standards will be applied such as market capitalization of traded shares of 10 bil yen or more, and 25 bil yen or more).



on the Prime Market), submission and public announcement of plans, as well as disclosure of progress toward achieving compliance with the listing maintenance criteria. At the stage when the FSA issued its report at the end of last year, market participants had the impression that corporations with listings on the 1st Section of the Tokyo Stock Exchange hoping to gain listing on the Prime Market would be able to do so with fairly relaxed conditions, but this more recently published TSE framework may have overshadowed that original impression. The obligation to submit and publicly announce plans as well as disclosure of progress toward achieving the listing maintenance criteria of the new market segment means that the market itself will be the judge of whether or not the corporation applying fits the criteria. First, a reasonable plan must be shown, but even if the TSE administration accepts it, the question of how the market evaluates the plan will still carry great importance. Progress toward fulfilling the plan will also be evaluated by the market, and the question of how the stock price is doing will likely be included in the evaluation process. Companies need to take action to improve their corporate value more than ever before.

On the other hand, there are some conditions that are easier on corporations than before. One of these is the fact that considerations are being made to make it possible for a corporation to gain listing on the 1st Section or the Prime Market even in cases where the corporation carries a deficit. Many corporations in the internet services industry are required to make a huge investment in the future of their business both in order to acquire market share and to find talented personnel and to advertise. Furthermore, profit level is emphasized when it comes to listing on the 1st Section of the stock market, and in order to gain short-term profits, corporations of this type would be forced to hold down investment. Considerations being made in this round of revisions are expected to encourage this type of corporation to invest.

The situation differs between individual corporations, but it is necessary to continue to faithfully implement what is required while taking into consideration strategies for business expansion.