

Minutes of the 1st Council of Experts
Concerning the Corporate Governance Code

1. Time and date: 9:30–11:00 am, August 7 (Thursday), 2014
2. Place: Financial Services Agency

[Yufu, Director of the Corporate Accounting and Disclosure Division] I'd like to announce that camera crews are here only for the opening part of the council today. I'd like to request the camera crews to leave after the opening remarks.

Now I turn it over to Chairman Ikeo.

[Ikeo, chairman] It is already past the scheduled opening time, so I'd like to open the first Council of Experts Concerning the Corporate Governance Code. I really appreciate your taking time from busy schedule for the Council.

I'm Ikeo from Keio University, and the Chairman of this Council of Experts.

Now I'd like to turn to Mr. Ikeda, Director-General of the Planning and Coordination Bureau, representing the secretariat of this Council for an opening remark.

[Ikeda] Good morning, everyone. I'm Ikeda, Director-General of the Planning and Coordination Bureau, the Financial Services Agency.

I'd like to thank all the members for coming to this Council despite their busy schedules. It is my pleasure to make an opening remark at the first Council of Experts.

As you note, in "Japan Revitalization Strategy: Revised in 2014" which was approved by the Cabinet this June, it is explicitly stated that the Corporate Governance Code is to be drafted to provide corporate governance principles for listed companies.

The Government and the Financial Services Agency have already taken various measures to enhance corporate governance of listed companies; nonetheless, I believe that compiling basic concepts on corporate governance in the form of the Code would contribute to sustainable growth of corporations, investors and the overall economy through encouraging corporations to take autonomous actions in order to enhance sustainable growth of corporate values.

Regarding corporate governance, we released the Japan's Stewardship Code in February this year, and by the end of this May, 127 institutional investors have declared that they would accept the Code. We do hope that the Corporate Governance Code and the Stewardship Code would work together effectively, like two wheels of a cart, to create a virtuous cycle in the future – meaning enhanced corporate value, sustainable corporate growth, and increased return on investment for investors and beneficiaries.

I am aware that all members of this Council are very busy, but I would appreciate a vigorous discussion. I'd like to close my remark by expressing our sincere appreciation for your participation.

[Ikeo, chairman] Thank you very much.

Next, I would request Mr. Shizuka, Managing Director of the Tokyo Stock Exchange, representing the secretariat of the Council. Mr. Shizuka, please.

[Shizuka, Managing Director] I'm Shizuka from the Tokyo Stock Exchange. As the joint secretariat, we will do our best to support your discussion.

It was already 15 years ago when OECD - an international organization, of which Japan is a member - established 5 principles regarding corporate governance and announced them to the world, as we discuss further later. While objectives to be achieved through corporate governance was compiled as 5 principles, they also state that these 5 principles are the global common goals, but that measures to implement these 5 principles may vary from country to country, or from market to market.

We, the Tokyo Stock Exchange, established "Principles of Corporate Governance for Listed Companies" in conformity with OECD's Principles, and presented objectives for listed companies to be achieved through corporate governance. Furthermore, by establishing the Code of Corporate Conduct as our independent initiative, we have gradually reinforced measures to implement our principles over those years. One example of such measures is an obligation to make efforts to appoint independent directors. It was introduced this February. Including this, the Code of Corporate Conduct provides nearly 30 rules. Many of them have become norms or codes through a spontaneous process: reflecting investors' voices, we requested listed companies for improvement; listed companies have gradually responded to our request; and as a result, such a response has become a mainstream.

In the future, in accordance with basic policies to be decided at the Council, we will work on drafting specific codes in the end. Taking our said experiences into account, at present, we have three expectations for the Code.

First of all, we hope to see that the said process of spontaneous emergence of norms would evolve to be a more systematic process, for example, with regular reviews. By achieving such an evolution, we wish to make use of the process as a base to continue generating more convincing norms more smoothly in the future.

Secondly, we hope to see clearly corresponding relationship between basic concepts of principles as goals and codes as measures to achieve such goals, rather than a mere list of many norms. In the UK, which is the motherland of Codes, such an approach enables people to understand whether or not companies deviating from norms really intend to respect principles, through their explanation.

Thirdly, as introduced earlier, as clearly stated in the Government's Growth Strategy, although it is important that the Code is geared to the reality of listed companies, we also expect it to be highly appreciated by the international community. Beyond the norms accumulated in the past, we would appreciate it if you could help us incorporate as many new norms as possible, which may earn high recognition in the international community.

We have to ask you to conduct an extensive discussion in a short period. Thank you in advance for your cooperation.

[Ikeo, chairman] Thank you very much.

Now the secretariat will explain how to proceed with the Council of Experts, and so on.

[Yufu] I'm Yufu, Director, Corporate Accounting and Disclosure Division of the Financial Services Agency, and serve as the co-secretariat of the Council. Now may I ask the camera crews to leave the room?

We will be using so many reference materials today. Please take a look at Material 1, consisting of 2 sheets. The title is "The Council of Experts Concerning the Corporate Governance Code." I think I don't have to give you a detailed explanation on this. In response to the Cabinet decision, the Council is convened to obtain recommendations on basic concepts of the Corporate Governance Code, making the best use of insights from experts in the private sector.

On page 2, you will find the list of the members of this Council. Let me introduce the members. I'm going to read out the names of the attending members, from the left to the right. Please stand up when your name is read out.

Mr. Junji Ota.

[Ota, member] It is my pleasure to work with you.

[Yufu] Mr. Akiyoshi Oba.

[Oba, member] Good Morning.

[Yufu] Mr. Toshiaki Oguchi.

[Oguchi, member] Good Morning.

[Yufu] Mr. Hideki Kanda.

[Kanda, member] Good Morning.

[Yufu] Mr. Kazuhiro Takei.

[Takei, member] It is my pleasure to work with you.

[Yufu] Mr. Kazuhiko Toyama.

[Toyama, member] Good Morning.

[Yufu] Ms. Mika Nakamura.

[Nakamura, member] It is my pleasure to work with you.

[Yufu] Mr. Sadayuki Horie.

[Horie, member] It is my pleasure to work with you.

[Yufu] Mr. Kimitaka Mori.

[Mori, member] Good Morning.

[Yufu] Although not here today, Mr. Akira Uchida, Mr. Scott Callon, and Mr. Tadimitsu Matsui also participate in the Council, as shown on the list of the members.

Similarly, although not here today, Mr. Mats Isaksson from OECD (the Organisation for Economic Co-operation and Development) will also participate, where necessary, as Advisor of the Council of Experts.

Now, let me introduce an observer, on my left. Mr. Nakahara, Director, Corporate System Division of the Ministry of Economy, Trade and Industry.

[Nakahara, Director, Corporate System Division, Ministry of Economy, Trade and Industry (METI)] Good Morning. I'm Nakahara.

[Yufu] Furthermore, as another observer, we asked Mr. Sakamoto, Counsellor, Minister's Secretariat of the Ministry of Justice. He is absent today.

The Financial Services Agency and the Tokyo Stock Exchange assume the joint secretariat of the Council. Due to the limitation of time, I will not introduce the secretariat members. Instead, please refer to the seating map at your hand.

That's it.

[Ikeo, chairman] Thank you very much.

Now I'd like to ask the secretariat to explain the draft Procedures to Run the Council of Experts.

[Yufu] Please take a look at Material 2. It is a piece of paper about mutual agreement on how to run the Council. We prepared the draft, representing typical procedures. Article 2 provides that the council shall be convened by the chairman; and that as soon as a date to be convened is fixed, such a date of the council shall be announced without delay. Article 5 provides that the Council of Experts shall be open to public, as is so with today's council. Article 6 provides that the minutes shall be prepared and published after each council. Article 7 provides that materials of the Council of Experts shall also be open to public. These are rough procedures to run the Council.

[Ikeo, chairman] Thank you very much. I would like your opinions about whether we may follow the procedures just explained. Do you agree that the Council is, in principle, open to public?

Well, I believe everyone agrees. We confirm what is written in Material 2 is the mutual agreement of the Council of Experts.

Next, in accordance with Material 3, the secretariat will explain the background for the Council of Experts, OECD Principles of Corporate Governance, and Corporate Governance Codes of major countries and so on. After the presentation, we will have free discussion.

Could you start from the explanation of Material 3?

[Yufu] I assume you have PowerPoint handouts with an indication of “Material 3” at the upper right corner. I’ll explain according to this material.

Please turn the front page. You can see the table of contents: background of the establishment of this Council, Outline of the OECD Principles of Corporate Governance, Codes of other countries, and finally the reference materials including the TSE’s Governance Principles and Stewardship Code.

On the next page, you can find the background of establishing the Council of Experts. This is an excerpt from the revised Japan Revitalization Strategy (Growth Strategy), approved by the Cabinet on June 24. It consists of 4 pages. The related subject is discussed in both the general and particular of the Growth Strategy. As we quoted all related descriptions, the volume is as long as 4 pages. The first page is an excerpt from the general of the Strategy, and I will skip this page. Please take a look at the bottom half of the second page. Under the section titled “Enhancing corporate governance,” it reads “Drafting the Corporate Governance Code: the Tokyo Stock Exchange will draft the Corporate Governance Code to encourage companies’ initiatives to attain sustainable growth. Publicly listed companies are asked either to comply with the principles or explain why they are not complied with. Drafting in time for the season of general shareholders’ meetings next year”.

Please take a look at page 3. This is an excerpt from the particular of the Growth Strategy. Let me introduce what is written from the middle of page 3. Under the title “Enhancing Corporate governance, Promoting Supply of Risk Money...” , it reads “In order to increase corporate profits through improvement of productivity and ensure that the increased profits

lead to increase of wages, reinvestment and the return of profits to shareholders, it is important – primarily for global companies – to achieve sustainable increases in corporate value by cost of capital and enhancing corporate governance. It is important to strengthen the favorable economic cycle by returning the benefits of economic growth achieved through these initiatives throughout the economy via the expansion of employment opportunities, wage increases, and increases in capital expenditures and distribution of dividends. To that end, the following measures will be implemented.” Please turn to the next page, and you will read” – Drafting the Corporate Governance Code, etc. There is a short explanation about the corporate governance, which reads “Corporate governance is the system which supports companies making timely entrepreneurial decisions with transparency and integrity and with due regards to the views of shareholders as well as customers, employees, local communities and other stakeholders.” Skipping a few words, it describes that compiling it in the form of the Code “should help companies’ initiatives towards sustainable growth of their corporate values and would thereby contribute to the prosperity of the companies themselves, investors and, ultimately, the whole economy.” Then it reads that the Corporate Governance Code is to be formulated “by referring to, among other rules, the Tokyo Stock Exchange’s existing rules and guidelines regarding corporate governance, and the OECD Principles of Corporate Governance.” Also, it states “[t]he Code will, while reflecting the circumstances of Japanese companies, aim to attain international reputation.” The remaining part was already addressed during the opening remarks.

Please look at page 5. The Cabinet approval, which I just explained, provided the basis for establishment of the Council: it was a government decision. Prior to that, Liberal Democratic Party, the governing party, made recommendations on economic policies named Japan Revival Vision in this May. Let me introduce these recommendations. Please look at the second paragraph in the middle of the page, starting from “We propose that in a similar manner.” It reads, “...set forth concrete methods of sound corporate governance for listed Japanese companies, including introduction of independent directors, securing transparency in setting compensation and methods for nominating directors and appointing other top personnel, separation of execution and oversight functions, and practices for top management development and training.” Furthermore, the underlined part describes almost the same effect as the Cabinet decisions as well as procedures. The following last paragraph is also a recommendation: “The effectiveness of corporate governance will be enhanced by clarification of the status of executive officers, and the duties of loyalty that they owe, none of which are prescribed by law; requiring balance among directors from various viewpoints, such as experience, independence, and knowledge; and disclosure of methods of corporate governance and explanation thereof by management. In addition, there is a need to build systems to enhance information flow within firms, such as an internal whistleblower system

that feeds into both outside directors and statutory auditors.”

Please turn to page 6. It says that the above-mentioned Corporate Governance Code, for example, could incorporate the following items, and it gives some illustrative examples as shown in the Material: (1) independent outside directors, (2) shareholders’ voices – let’s turn to the next page 7 – (3) stock crossholding. The LDP’s policy recommendations include such descriptions. That’s why we presented them.

Please turn to page 8. It is about the OECD Principles of Corporate Governance. We distributed color brochures to the members of this Council, and monochrome copies to non-members. You have Japanese and English versions of OECD Principles at your hand. The translation was done by OECD and the Ministry of Foreign Affairs. In addition to English and Japanese versions, OECD translated the Principles into French, German, Russian, Italian, and other languages for distribution. Concerning specific contents of the Principles, Mr. Mats Isaksson from OECD will give us a presentation in the next Council. So we quoted only the outline here. The OECD Principles consist of Preamble and 6 chapters, although Preamble and Chapter 1 is not included in this material. Chapter 1 is titled “Ensuring the Basis of an Effective Corporate Governance Framework”, and discusses such matters as the division of responsibilities among different authorities, or securing resources of authorities. This chapter is intended for governments, and not relevant to the discussion concerning the Code. So we listed the remaining 5 chapters, excluding Chapter 1.

Please turn to the next page. Page 9. Starting from this page, I will give you a brief explanation about each country’s corporate governance code. Page 9 shows the prescriptive frameworks of corporate governance of major countries.

Shown in the right side of the chart, the United States basically takes rule-based approach for corporate governance. Its stance is directly to impose obligations on companies through the Sarbanes-Oxley Act, SEC Regulations, and stock exchange rules.

In contrast, the UK, Germany, and France have so-called ‘principles-based’ and ‘comply or explain’ type corporate governance codes. So, what secures ‘comply or explain’ approach? In case of the UK, it is Listing Rules. In Germany, although it is written as the Stock Act (Aktengesetz), it is, in effect, the stock corporation act. In France, the Commercial Code (Code de Commerce) provides the basis to secure ‘comply or explain.’

In the next row, countries which have a Stewardship Code are specified. In the right side of the row, you can see examples of the countries which have principles-based, ‘comply or

explain' type corporate governance codes, in addition to the above-mentioned major countries. Beyond these countries, I am aware some other countries such as Turkey also have this kind of code.

Please turn to the next page, which is page 10. The chart outlines governance codes in the UK, Germany and France, each with the year of establishment and the establishing body. As for the UK code, the governing authority has changed several times in the past, but currently the FRC (the Financial Reporting Council) is in charge. FRC can be described as a semi-private agency. It's an independent self-regulation body. The root of the current code was recommendations by the Hampel Committee. In Germany, the Ministry of Justice is the parent organization body, and the Cromme Commission drafted the code. In France, while two associations of private corporations established a working party and drafted the code, the French Commercial Code provides the 'comply or explain' framework in this regard.

From page 11, I will briefly introduce the background of the establishment of each country's code.

First of all, in the UK, the best-known Cadbury Report was released in 1992. In 1991, a committee named "the Committee on the Financial Aspect of Corporate Governance" was established by FRC, which I referred to earlier, the London Stock Exchange, and the accountancy profession to facilitate discussion over corporate accounting reports and accountabilities. The Committee was chaired by Sir Adrian Cadbury, and compiled the report (the Cadbury Report) in 1992. After the establishment of the Committee, the UK saw several incidents which questioned governance practices of large corporations, such as BCCI scandal, and Robert Maxwell scandal, a misconduct and business failure of a media conglomerate. In response, the final report contained many pages about the effectiveness of the board of directors, and things like that.

Then, in 1995, the Greenbury Report was released. In response to the growing criticism against the high level of director remunerations in some privatized public corporations, the Confederation of British Industry (CBI) established a study group on director remunerations, chaired by Sir Richard Greenbury. In 1995, they recommended the establishment of remuneration committee, and disclosure of remunerations.

The information on the UK is as long as 2 pages. Please look at page 12. Then, in the UK, the Hampel Report was released in 1998. It was the Cadbury Committee which initially called for a succeeding committee. The report, which was published in 1998, provided a wide range of principles on overall corporate governance, including the board of directors, external

accounting auditors, and institutional investors.

Immediately after that, the Combined Code was established. Reflecting a recommendation of the Hampel Committee, the London Stock Exchange integrated codes and principles suggested by 3 reports, namely the Cadbury Report, Greenbury Report, and Hampel Report, into the Combined Code - the name may be self-explanatory. The best practice code on corporate governance was established in this way, and attached to the Listing Rules of the London Stock Exchange. Then, in 2010, the Combined Code was separated and re-organized into two codes: the part addressed to institutional investors became the Stewardship Code, and the norms for companies became the Corporate Governance Code.

Page 13 shows the history in Germany. In 2001, a little later than the UK, the Baums Report was released in Germany. In 2000, then prime-minister Schröder signed an order to establish a government committee concerning corporate governance and modernization of the companies act. The committee chaired by Professor Baums prepared the report, in which they recommended to draft the Corporate Governance Code. In response, the Corporate Governance Code was developed in 2002. Specifically speaking, in 2001, the Ministry of Justice established a government committee for drafting the Corporate Governance Code. As the committee was chaired by Dr. Cromme, it was called the Cromme Commission. The outcome is called KODEX, which should mean a code in the German language, and a wide-ranged, comprehensive code, reflecting the OECD Principles.

Next is France, on page 14. France took the first action relatively early. In 1995, the first version of the Viénot Report (Viénot I) was released. Focusing on the board of directors, the report provided recommendations concerning functions and administrative procedures of the board of directors. Then, in 1999, the second version of the Viénot Report (Viénot II) was released, providing several additional recommendations such as disclosure of executive remuneration. Then, as written below, the Bouton Report was released in 2002. The report provided stricter recommendations on the board of directors than those in the Viénot Reports, and added new recommendations concerning the independence of accounting auditors, disclosure of financial information, among others. In response, these recommendations were integrated into the form of the code in 2008. Two private organizations involved in the preparation of these reports compiled recommendations in three reports and developed the code in 2008.

Please turn to page 15. The chart shows the key headings of each country's code for the comparison purpose. Although we will not further discuss these UK, German, and French codes today, there are English and Japanese versions of the codes at your hand for your

reference. Please note that the Japanese versions are provisionally translated by us. As Germany and France published the English versions of their codes, we translated the codes from English to Japanese. We are not very confident whether this approach was appropriate, but we will improve our translation as needed. Please consider these to be provisional translations at this point. I'm not going to give a detailed explanation, but the key headings of each code are shown in this chart.

First, the OECD Principles consists of Preamble, as I mentioned earlier, and chapters 1, 2, 3, 4, 5, and 6. You can see that different font colors are used: Chapters 2 and 3 are basically pertaining to shareholders' rights; the green-colored part is related to stakeholders; the red-colored part is related to disclosure; and blue-colored part is descriptions about the Board of Directors. If you look at the UK and Germany, despite some differences, you can see both codes cover a wide range of focus areas. I got an impression that the French code is a little different. First of all, it consists of 25 chapters. And it is not divided into categories, and looks like a long list. As I explained earlier, this code traces its roots to the Viénot I Report released in 1995, earlier than the establishment of the OECD Principles. The code was formulated in a way to make changes and additions to it. Originally, the formal name of the Viénot I Report in 1995 was "the Board of Directors in France." So the origin of the code was sort of Boardroom Guide or Directors' Guidebook, focusing only on directors. Probably because of such a history, I assume the content of the code is dominated by chapters in blue color. Nonetheless, the current code has provisions related with disclosure and stakeholders, which were added later.

In the right end, there is a description about the TSE' Corporate Governance Principles, which I will introduce later. It was developed by the TSE in 2004. It follows the framework of the OECD Principles for Corporate Governance, thus being similar and corresponding to it.

Concerning the volume of each code, in terms of the main text of its English version except for appendix, the UK code consists of 25 pages in total; the German code is a little shorter – 15 pages; and the French code is as long as 33 pages.

Now please take a look at page 16. I will just touch upon it without a detailed explanation. This is just an outline of the TSE's Principles of Corporate Governance for Listed Companies, established in 2004 and revised once in 2009. Corresponding to the framework of OECD Principles, the TSE's Principles have chapters from 1 to 5. These Principles, however, do not take 'comply or explain' approach.

Please turn to the last page – page 17. Again, I will just touch upon it. It is about the Stewardship Code. As written in the background, it was decided by the initial Growth

Strategy a year ago to establish the Code. After a great deal of consideration by the Council of Experts concerned, the Code was established. As written under the heading of the framework, the Code provides the framework where each institutional investor can take actions depending on their own situation. The initial list of institutional investors who have signed up to the Code was published in June, and 127 investors declared their acceptance of the Code. Below that, you can see some underlined keywords, which have the similar characteristics to the Corporate Governance Codes: rather than specifying actions to be taken by institutional investors in detail, it takes ‘principles-based’ approach where basic principles are presented. Furthermore, it takes ‘comply or explain’ approach, rather than unified obligations as in laws and regulations. The Code has 7 specific principles as shown in the yellow box. Although I’m not going to explain, you have brochures of the TSE’s Principles of Corporate Governance for Listed Companies and the Stewardship Code at your hand.

That’s it for my explanation.

[Ikeo, chairman] Thank you very much.

Well, we are now open to free discussion. I’d like to hear your questions and comments. As today is the first Council, we won’t discuss any specific topic. Rather, I’d like to hear your thoughts about corporate governance in general, and your opinions about how to proceed with the Council of Experts. Or if you have any questions related to Materials just presented by the secretariat, please do ask.

Is there anybody who wants to start? Mr. Horie, please.

[Horie, member] Considering an impressive lineup of members, before the time runs out, let me speak first.

Together with Mr. Oguchi and Mr. Oba present here, I participated in the development of the Stewardship Code. I do not necessarily mean to represent institutional investors, but I tell you that, after the implementation of the Stewardship Code, I feel there is confusion among investment managers and asset owners, including GPIF with which I’m involved, concerning how to address the code. To clear up the confusion, I have two very basic requests for industrial companies. The first one is related to the disclosure. My request regarding the disclosure is very simple. Considering that the intent of the Council is to increase mid to long-term corporate value, when we engage with corporations, I think the disclosure is not sufficient. For example, I’m often told by institutional investors that the disclosure is poor in terms of the lack of capital productivity targets, or lack of information regarding how to take

measures to increase the capital productivity. What should be done through an engagement? I believe it should be discussion to increase corporate value. To enable smooth discussion in such an area, I'd like to see an improvement in disclosure of information, especially on the capital productivity, which is related to corporate value, under this guideline. This is my first point.

The second request is to address the lack of the right condition to exercise voting rights. I pointed it out at the Council for the Stewardship Code as well. As Professor Tanaka pointed out in the column "*Keizai Kyoshitsu (Economics Classroom)*" of today's Nikkei newspaper, even though institutional investors want to exercise their voting rights, it is virtually impossible to deliberate on many points on the agenda within the limited timeframe, because many companies hold their shareholders meetings on the same day since they have the same record date and account closing date, for example. This is one problem. Another thing is about the timing of disclosure of agenda in different categories: I'd like the separation of timing to disclose the appointment of directors, and the dividend policy, etc. which cannot be determined until the financial results are finalized. As for the appointment of directors, the proposal should be ready even though the financial results are not finalized. Therefore, please take a measure to bring forward the timing to disclose to institutional investors a proposal for the appointment of directors. I'd like industrial companies to set the right condition to facilitate shareholder engagement by institutional investors. Please take these 2 basic requests into your consideration.

[Ikeo, chairman] Thank you very much.

Mr. Toyama, please.

[Toyama, member] As a discussion of corporate governance in general, from my experience of involvement in the Kanebo scandal in many ways, I first want to argue the reality [of listed companies], which Mr. Shizuka mentioned earlier. There are many different views on the reality. Currently, the Ministry of Economy, Trade and Industry (METI) is hosting the Study Group for Creating Japan's Earning Power. And a while ago, the METI released the Ito Report. The reality of Japanese corporations in the past 20-30 years is, quite frankly, the reality of defeat. In essence, they lost their share of sales. In 1995, 141 companies were included in Fortune 500, but currently the number decreased to 62 companies. They lost sales. As for the profit level, although the Ito Report points out low ROE, the actual problem is low profit margin on sales, rather than low ROE. It means [Japanese corporations are] losing in competitions. Actually, leverage does not matter so much to low ROE in Japan. Therefore, companies were defeated not because they curried favor with shareholders through

their capital policy, but they were defeated in their core business. Therefore, they lost profits, and lost sales. Moreover, as you know, according to the employment statistics, the share of large corporations in employment has been decreasing. Top executives often make excuses, saying “we focus on sales, long-term growth and employment. That’s why our profit ratio is low.” I myself manage a company, so this is like criticizing myself: frankly speaking, these excuses are almost wrong, because it has been like this for the past 30 years. I can see it from the collected data. It has been so for 30 years – frankly speaking, it means most of top executives of Japanese corporations are incapable. To tell the conclusion first. Of course, there are excellent companies such as Seven [7-i Holdings] and Komatsu. There are excellent companies, but always the same companies are named as excellent companies. Most companies are not mentioned. Unfortunately, that is the circumstance we face.

On the other hand, Japanese corporations are great in terms of *Gemba* power and technical strength. As the Ito Report also states, they are highly praised in the world. I believe there is no doubt about it. So while the bottom structure or base structure is this much solid, why do we see the current situation? That is, unfortunately, because the upper structure is weak. That’s one reality.

Therefore, we must be humble. I am Vice Chairman of Japan Association of Corporate Executives, and belong to the business world...it’s time for the business community to humbly face the fact, and consider what should be done. I believe that is probably the foundation of discussion on the Corporate Governance Code.

By its nature, it’s not the Government’s business to say “restore earning power.” Actually, a little more than a year ago, I published a book titled “Restore Earning Power!” I wrote the book not because I wanted the Government to say so. I thought it is the responsibilities of corporations to make earnings, create employment opportunities, and pay taxes. That’s why I wrote the book. I think this is one reality to accept as premises for the Code.

Another reality is associated with the global competitions. Frankly speaking, companies not ranked among top 3 in the world will perish. Unfortunately, that’s the current global competitions. Then what should companies aim at? The world of business competition is the place where the world cup games are always going on. So companies must win a medal there. To win a medal, one should always impose high discipline on or set high goals for oneself. In that sense, as our shot concerning corporate governance this time, the stricter with the management the better, I believe. So, you don’t have to gear [the Code] to the reality. Just because the reality is like this, we don’t have to adapt to the poor reality, saying “because this is the current situation.” The basic concept is ‘comply or explain,’ isn’t it? Then, if companies

do not want to follow any part of the Code, they could openly and squarely explain reasons why they do not comply. For example, if a management team is reluctant to have independent directors in their company, they should squarely explain why their corporate value can be higher without independent directors. Or companies could squarely explain why they do not use leverage and go for “full equity” approach. I serve as Director of Omron. Omron is a company with no debt, but its ROIC exceeds 10% and ROE also exceeds 10%. I believe the company’s ROIC is fully disclosed on an item by item basis. In terms of the capital productivity, the company is disclosing information by segment. Nevertheless, [its ROIC and ROE] exceed 10%. Omron is not a so-called “black company”. It’s a very white company. Omron is one of the companies most famous for treating people with respect, and one of the companies most famous for CSR. So it can never be a trade-off.

In that sense, when we consider the basics...I think we will look at various comparisons among various countries ...Our goal here is that we should aim at introducing corporate governance which is stricter to the management than any other countries: probably that should be our basic stance. I must repeat that the Code does not have to be adapted to the poor reality, at least as long as we discuss it under the framework of ‘comply or explain.’ Japanese corporations have real strength. So in essence, if we impose stricter discipline, Japanese corporations will, without doubt, grow again and enhance earning power in the future. Based on my experience of participating in the management of a large number of companies, it seems real to me. Probably I must be the most experienced in Japan in terms of the number of companies managed, including Japan Airlines. So I am quite sure about it. I’d be grateful if the Council of Experts takes such a basic stance and have such basic principles.

That’s it.

[Ikeo, chairman] Thank you very much.

Mr. Oguchi, please.

[Oguchi, member] Thank you. As the Secretariat explained earlier, I think the usual flow is that first you have the corporate governance code and then from there you derive the stewardship code. But in the case of Japan it is the other way round. This doesn’t mean that we don’t need a corporate governance code. I think it’s because in reality we couldn’t agree on the best practice for a corporate governance code. There are various opinions and we couldn’t come to an agreement on that. Now that we have a chance to reach an agreement on the best practice as part of the government’s policy, I think we should make good use of this opportunity. As I’ve just said, if you go into the details there are various models and various

concepts about corporate governance. Out of all that, I think there is one way of thinking that may be used as a starting point. The Stewardship Code was mentioned earlier and I also participated in the council of experts on that. In the introduction to the Stewardship Code, under item 5 of “Aims of the Code”, the responsibilities of companies and institutional investors are positioned as the two wheels of a car, and there is this concept that, in a company, which is one of the two wheels, “the board of directors has the responsibility to enhance the corporate value by exerting adequate governance and proper oversight on the management, taking decisions on key policy and business matters.” Of course it is not my intention to conclude that this concept is right simply because it is written here, but I think this is a concept that includes various elements, so for example, using this as a starting point, we can fill out the details in such areas as what is proper oversight in concrete terms, what is adequate governance. And by doing so, I believe we can arrive at a coherent concept of governance without being overly-concerned about unimportant details.

Moving on to my second point, the Ito Report, which Mr. Toyama mentioned earlier, was released yesterday. In one of the sections—these are the words of a famous businessman, so I think many of you already know this—it is written that “products usually come with some kind of guarantee, and if a product has a flaw or defect, it can usually be repaired at no cost within a certain warranty period or exchanged for a new one. However, stocks do not have any of this kind of guarantee.” And he goes on to say that “products like that are being sold to investors. And in a sense, these are really terrible products that are being sold.” But why do we still buy stocks? I think it’s because even if there is a risk, we buy stocks in expectation of the future. When we think about corporate governance code from that perspective, considering the nature of stocks, I won’t say that we are providing some kind of quality assurance, but if we can say that we have such and such kind of code which provides protection for such and such kind of events, I think it would have a great significance in terms of selling something like a made-in-Japan brand of listed stocks in the Japanese market to overseas investors. I think there will be different views about how stringent the code should be. But considering that 30% of investors are foreigners—in terms of the flow (of funds invested), the figure is even higher and if we think in terms of business companies it will mean 30% in exports—I think there might be a need to keep in mind that we want the people in export destinations to buy this product called Japanese stocks which has no guarantee by establishing a code and sending a message overseas to give them assurance and anticipation of (profit). In this connection, this is a request that I also made during the Stewardship Code review. Just now a mutual understanding on disclosure was mentioned at the beginning. I am fully aware of the Secretariat’s workload, but in line with the sense of disclosure, you could perhaps produce an English version of the minutes as far as possible, and try to communicate with overseas investors along the way. We may have a solicitation for public comments

eventually, but before that, something even better might be produced if we could have something like an on-going dialogue that includes overseas investors.

And finally, I think the roles and functions of the board of directors will become the center of discussion, but as shown in the case studies from various countries earlier on, I would certainly like the perspective of protection of minority shareholders to be included in the discussion. Speaking in concrete terms, (I am referring to) for example the problem of takeover defense measures or the problem of cross-shareholdings. In a sense the system in Japan is now based on a principle of shareholder supremacy for better or worse, and things are fine as long as the agreement of the majority of shareholders can be obtained....I think that's the kind of system we have right now. The role of the board of directors is to oversee management on behalf of the shareholders, so when the directors do their job properly, minority shareholders will be protected. I think protecting minority shareholders by incorporating the elements mentioned earlier, such as equality, transparency and also perhaps disclosure, has great importance to the management in reality, and I would certainly like such elements to be included in the review.

That's all I have to say.

[Ikeo, chairman] Please go ahead.

[Mori, member] Thank you. With regard to corporate governance, I had been in a position to see many things on the field. I think to some extent many Japanese companies have a strong sense of ethics, strong technical capabilities and can be called good companies. But from the perspective of responsibility for explaining to investors, or what is called accountability, I have the impression that Japanese companies are slightly weak compared to other functions.

I interpret the comments of the other members just now as meaning, that institutional investors are not sure how to respond to the Stewardship Code. I think if corporate governance, discipline of companies' side, is not properly established, then stewardship might not be able to exert any impact. Specifically, it means that companies need to enhance their accountability and information disclosure. The information must have reliability and comparability, so I think such areas should be included in the corporate governance code as part of best practice.

Japanese food products enjoy good sales all over the world. I hear that agricultural products from Hokkaido for instance sell out in no time at all when department stores in

Singapore hold special product promotional events. Why is this so? I think it is because the made-in-Japan brand already has such qualities as safety, security and reliability. So I believe we need to establish the corporate governance code that will enable Japan's market to become number one in the global capital market, in respect of safety, security and reliability. Thank you.

[Ikeo, chairman] Thank you.

Next will be Mr. Oba.

[Oba, member] I have one question and one comment.

The Tokyo Stock Exchange formulated a set of Corporate Governance Principles in 2004, and revised them in 2009. Such is the situation, and I believe various efforts are being made. My question is exactly what is lacking in your understanding of the current situation. Mr. Yufu has explained that framework of Comply or Explain is not included in the Principles, so is this the most pressing issue? As Mr. Toyama indicated in his comment... first it was 2004, then 2009 and now 2014... during this period, looking at the overall corporate value creation of individual companies—no doubt there are also many splendid companies—I think it is difficult to say that many companies have achieved great success in value creation. The motivation of managers to maximize the value of the company has already been indicated in chapter 5 of the Principles. Nevertheless, things like that have not been realized. So my question is exactly what is lacking in your understanding?

In my opinion, as indicated in everybody's comments earlier on, I think there are two aspects that can be called the fundamental spirit in the formulation of corporate governance. The first aspect is, as everybody pointed out earlier, ensuring transparency. The extent to which transparency should be maintained when making disclosures must be included in the fundamental spirit. This is connected to the introduction of outside directors, which is now a hot topic of discussion, and it is said that to get outside directors to play an active role, the first point is transparency, the second point is also transparency and even if you don't have a third or fourth point, the fifth point is still transparency. Since it is said that it is important to be able to show whether transparency is secured, I think ensuring transparency should be the first principle of the fundamental spirit.

The second aspect is what is called fiduciary responsibilities or the extent to which both the management of companies and investors are aware of their responsibilities as professionals in their work. This is an example from the U.S....I want to introduce the words

spoken by President Roosevelt when he asked Congress to pass the disclosure law or in other words, the Securities Act in the middle of the Great Depression in 1933. There is a famous episode in which he asked Congress to deliberate on the enactment of the securities act by returning to the starting point, to the ancient truth that those in the position of handling and making use of other people's money, the public's money need to understand that basically they are trustees acting for other people. In other words, when you think about corporate governance, I think it is a question of the extent to which corporate executives, as professionals in their work, strive for the creation of corporate value using the public's money. It is also a question of the extent to which (institutional) investors, as professionals in their work, can follow the wishes of their customers and provide them with returns in a way that meets their expectations. In that sense, I think the second aspect of the fundamental spirit is fiduciary responsibilities. And I would be glad if these two aspects could be incorporated as the fundamental spirit.

That's all I have to say.

[Ikeo, chairman] Thank you.

As for your question at the beginning, rather than asking for somebody to provide an answer, I think you are saying that we should confirm and be more aware of the situation we are in. In any case, if there is some awareness of the issues on the part of the Secretariat, please go ahead and bring it up.

[Ikeda] I think Chairman Ikeo is right. In any case, let me at least say what I think as the representative of the Secretariat in response to the question. As I have already said in my opening remarks, the government or the stock exchange has made various efforts to strengthen corporate governance, but as you pointed out, we have received comments from many experts that the efforts did not produce adequate results. In like what Mr. Oba has just said, I've always thought that the way to achieving the objective with regard to the problem of corporate governance lies in getting companies to think in terms of the fiduciary responsibilities and also investors to think in terms of the fiduciary responsibilities, and then both parties will talk with each other directly in a constructive manner and find solutions in the process. However, currently this kind of dialogue between the two parties has not necessarily work smoothly. The (institutional) investors say that they don't get any explanation no matter what they say to the companies. The companies say that the (institutional) investors do not try to understand no matter how they explain. Both the Financial Services Agency and the Stock Exchange have received such comments. In the first place, this kind of dialogue should not have been conducted through a government office or

the Stock Exchange, and I think the most constructive way is to get both parties to have direct dialogue.

In that sense, when we continue to think about corporate governance code or when we look at the current principles of Tokyo Stock Exchange, the question is whether the main points are made in a way that promotes that kind of dialogue. For instance, when you look at the current Tokyo Stock Exchange principles, I think the main points in principle are firmly established, but only the things that really matter in principle are written. For example, one of the items involves improving the environment to enable shareholders to exercise their voting right appropriately. But can further dialogue be carried out based on that? What will be the points in that kind of situation? How should it be like? Such questions probably belong to the world of ‘Comply or Explain’, and I don’t think they are really a rule-based problem. But I think we need to clarify to a certain extent what kind of areas will be the points of that dialogue so that progress can be made in the dialogue between the two parties. As to how it can be done in concrete terms, we would like to hear your views and think about this question together with everybody. Thank you in advance for your cooperation.

[Shizuka] Speaking in my capacity as the person who created the “Principles” mentioned earlier, actually we wanted to create something slightly deeper than the Corporate Governance Principles, the very thing that will serve as the material for dialogue that the Director-General has just discussed. But things do not always go the way you want and everything went no further than that level of current expression. As pointed out several times earlier on, originally investors and companies share the fate of riding in the same boat, but there was a complete lack of such awareness. At any rate, in the past, discussions on who is the owner of a company always got stuck and no progress could be made in the dialogue. So I wanted to create something like a common language that will at least allow both parties to talk to each other, and what was produced eventually is the current Corporate Governance Principles. Speaking in that sense, the reality is that only the foundation for people with different religious beliefs to talk to each other has been created, but there has been no progress beyond that as you have pointed out. As for the question of what should be done, I think dialogue is important of course, but first we need to promote dialogue so that people will realize that they are moving in the same direction as fellow mates riding in the same boat. As to what actually needs to be done in order to achieve that, I would like to continue thinking about this together with everybody.

[Ikeo, chairman] Thank you.

And now, yes, please go ahead.

[Ota, member] My understanding is that this Council of Experts is essentially a platform to sort out the basic policy. If this basic policy can be established, then in response to that, work can start on the formulation of effective measures. The schedule will be something like that based on my understanding.

In Material 1, it is stated that the chairperson may request related parties to attend meetings if necessary. And earlier on there was some information on who will be providing explanations at the next meeting. But for the discussion in this kind of platform to be proceeded effectively, what kind of related parties have you lined up or is it the case that nothing has been planned at all as it depends on the progress of the discussion? I am concerned about how the meetings will proceed.

As to why I am concerned, I am attending this meeting in my capacity as the chairperson of the Japan Audit & Supervisory Board Members Association. I have numerous opportunities to hear from many *kansayaku* (Audit & Supervisory Board Member) and audit committee members who are members of the association about current issues and circumstances, such as the worries that *kansayaku* (Audit & Supervisory Board Member) and audit committee members have concerning corporate management, problems in communicating with management or problems concerning management efficiency. The association has also had many opportunities to invite several of the members who are present today to give lectures and conduct training and so on. With regard to daily corporate management, I think *kansayaku* (Audit & Supervisory Board Member) and audit committee members maintain a certain degree of tension in their confrontational relationship with the management. And so, as Mr. Toyama pointed out just now, if the top management is hopeless—I think he was just citing an example—or rather when the actual state of affairs are no good, there is no need to follow. I think he is right basically. If we are going to decide on a basic policy leading to actual implementation through this platform, no matter what kind of code is established, if we don't have a foundation in which the managers and related parties of corporate organizations—the people who will apply the code and turn it into reality—fully understand and accept the purpose of the code, I'm afraid that it will simply turn into an exercise in superficiality. I am not saying that we should just follow the current situation. Instead I think it might be better to invite related parties to discuss the actual state of affairs in corporate management. Of course, in that case, people will start thinking, so do we invite business organizations? As shown in the case brought up earlier, I think we should hear from good managers or bad managers— it might be difficult—, but if there are brave people like that, if there are people who will share their thoughts in self-reflection, I think we need to listen carefully to their views on the actual state of affairs and try to link such actual facts to a

meaningful conclusion. I think it will be great to create this kind of opportunity if you are going to invite related parties to come here and give their opinions.

That's all I have to say.

[Ikeo, chairman] I think a lot depends on how the discussion here proceeds. It's just that we have a deadline and we cannot go on discussing forever. I think we will know to a certain extent the pace at which the discussion should proceed by counting backward from the end. As for how many hearings can be conducted within the given period of time, I think the schedule will be tight.

Do you have anything to add regarding the schedule that has been decided at present?

[Ikeda] At present, we don't have any firm ideas or schedules about whether we will create opportunities for hearings. I will take today's comments into consideration and discuss how we should proceed with the chairperson. The Revitalization Strategy clearly states that a basic policy will be settled by around autumn. Well, I expect a slight margin around autumn, but I think we have to do what needs to be done within that schedule, which is quite tight to the Secretariat.

Previously, we had also conducted corporate governance discussions in this room with Mr. Ikeo as the chairperson. Based on our experience at that time, many business persons rejected our invitation when we asked them to give explanations and presentations here. When we visited their office and asked them to provide examples of good management, they gladly did so. But when we asked them to give a presentation here, they politely refused. I will take Mr. Ota's comment into consideration together with our past experience when working out the schedule.

[Ikeo, chairman] Next, Ms. Nakamura, please go ahead.

[Nakamura, member] This is related to what has just been discussed. I am attending this meeting in my capacity as a member of Nippon Keidanren. I would like to contribute to discussion from the view point of listed companies.

Overall, the listed companies are in a position that become subject to the code. I am really pleased that the principles will be established on "Comply or Explain approach", in which one can explain why it does not follow the code rather than rule-based approach.

There are outside directors appointed in our company, and I think it is meaningful in its own way. At the same time, I believe the *kansayaku* system (Audit & Supervisory Board) is very effective. I think we should encourage foreign investors to learn that we have such systems. It would be great if the discussion here could produce a means for conveying to investors both foreign and domestic the fact that companies here are doing things that they think are beneficial through various choices from among several forms that are allowed in our legal systems. Thank you.

[Ikeo, chairman] Mr. Kanda.

[Kanda, member] I would like to make one point concerning a small detail and another point which is slightly abstract.

My first point might be too trivial. Somewhere on page 9 there is a chart of various countries. The Sarbanes-Oxley Act is cited in an example about the U.S., I think. If you list this as an example, please include the Dodd-Frank Act as well. After the financial crisis, there was a lot of debate for a more general corporate governance code. The Dodd-Frank Act introduced something called "say on pay," for example. I think such matter should belong to the field of corporate governance, so I would be grateful if you could include it as well. Also, other countries had debates about corporate governance after the financial crisis, so I think it would be useful to include such information somewhere along the way. Such information may have already been well covered in Japan, but I think it will be useful when making comparisons among various countries.

A more general point I want to make is the following. In this field, there already exist various high-level discussions, compilations and codes in different places. At the same time, things change very quickly on a daily basis. Earlier, there was a comment that unlike manufacturing, we sell a product called stocks, and I thought it was indeed an excellent comment. I think, unlike manufacturing, Japanese are not good at dealing with this kind of world. We sell a mechanism called stock company, so to speak, but this mechanism called stock company is filled with defects. As for the question of how we should handle the defects, some parts have been dealt with under the Financial Instruments and Exchange Act and the Companies Act, but there are parts that we have to entrust to best practice that extends beyond the law on a voluntary basis. This is how we are competing in the world. Therefore, we have to make a commitment—the term engagement was brought up earlier—that we will deal with such defects. I think, unlike manufacturing, Japanese find this field very difficult to handle.

The important thing here is—though I cannot think of good words—appearance or

presentation, or appealingness. I mean it in a positive sense. And so, if our aim is to create a code, we should create something that goes one step further than just compiling various norms that are currently found. In this regard, we may not have a lot of time, but I would like to ask everybody to give adequate consideration to global trends that change drastically. At the beginning, we were told that we will hear more about the state of the OECD that was introduced briefly today and will be explained more in the next meeting. I heard that the OECD principles are currently being revised. I think it would be great if we could exchange ideas on why and what kind of areas are considered at the OECD, and based on that, formulate our own code.

That's all I have to say.

[Ikeo, chairman] Thank you.

Mr. Takei, do you have something to add?

[Takei, member] Thank you, I have no comments today.

[Ikeo, chairman] Since we have some time left, please feel free to make comments a second time. Does anybody wish to do so?

Is it okay with everybody? Alright then, since we have heard a round of comments from everybody, I would like to bring today's free discussion to a close.

As for the next meeting onwards, as mentioned earlier, it is clearly indicated even in the revised version of the Japan Revitalization Strategy approved by the Cabinet that it should be based on the OECD's corporate governance principles, so Mr. Mats Isaksson from OECD will talk about the OECD's corporate governance principles at the next meeting. I would like to get started on more detailed discussion together with that.

Finally, if the Secretariat has anything to inform everybody, please go ahead.

[Yufu] As for the schedule of the next meeting, the Secretariat has sounded out (everybody about) various potential dates. I will take everybody's schedule into consideration and let you know at a later date. All the members have extremely busy schedules, and some simply cannot come today, because today's a meeting happens to coincide with the announcement of financial results for example. So I think it will be quite difficult for all the members to be present. In that sense, we may have some members who cannot fit a meeting into their

schedule, but if you make a request, I will explain what is discussed during your absence at a later date. Thank you in advance for your cooperation.

That's all I have to say from the Secretariat.

[Ikeo, chairman] Thank you.

And now I declare this meeting closed. Thank you very much.

End