Provisional translation

Material 2

The Twelfth Council of Experts Concerning the Follow-up of Japan's Stewardship Code and Japan's Corporate Governance Code

<Points at issue for deepening the Corporate Governance Reform>

Based on the preceding discussions at the Follow-up Council (on October 18), the following issues need to be addressed to deepen the Corporate Governance Reform.

ー Are there any additional issues to be addressed?

ー Taking the following issues into account, what should investors and companies focus on in their dialogue?

（1） Management decisions in response to changes in the management environment

○ The objective of the Corporate Governance Reform is to increase mid- to long-term corporate value through decisive management decision by the senior management. However, Japanese companies have issues including low awareness of capital efficiency and earnings power, and therefore, the objective of the Reform has not been fully achieved yet.

○ Global investors want to have dialogue with boards of directors to increase profitability of the companies. It is beneficial to enhance disclosures about their capital policies.

○ It is not appropriate to measure operational efficiency solely by ROE. In the meantime, the low levels of ROA and ROS are Japanese companies' challenges.

○ Providing incentives to the senior management is important for their decisive management decision.

（2） Investments and reserves of cash and deposits

○ When the Corporate Governance Code was being established, it was considered important to increase profits and invest in equipment and human resources, and corporate governance was meant to be a structure to support it. Japanese companies should make use of cash on hand to accelerate investments in their equipment, human resources, R & D, etc., thus increasing their competitiveness in the global market.

○ Each company has their own reasons for using internal reserves for corporate growth. We should not discuss this topic by generalizing the whole range of companies. Instead, this issue should be addressed through specific dialogue with investors and/or oversight by outside directors.

（3） CEO/the Board

- ○ Boards of directors, especially outside directors, should proactively and voluntarily take part in dismissal of the current CEO or equivalent who has become dysfunctional, appointment of a successor, and selection and development of successor candidates to secure the objectivity, transparency and adequacy of such procedures.

- ○ Active use of the nomination committee is recommended for appointing a successor to CEO, in which the majority of the members are independent directors.

- ○ It is important to have sufficient discussions on qualifications of outside directors and diversity of board members, and to select outside director candidates with deep expertise relevant to the strategies of the company. Outside directors are required to have capabilities to effectively oversee management in terms of capital efficiency, cross-shareholdings, etc.

- ○ Some outside directors do not seem to be fully aware of their roles. It is important to take initiatives to ensure that outside directors develop a clear understanding of their roles.

- ○ From the perspective of the separation of oversight and execution, it is not necessarily desirable that the current or retired CEO chair the board. However, in Japan, there are many cases where such retired CEO work on external affairs for the succession of brands, although they do not intervene in day-to-day business execution. Accordingly, it is difficult to discuss cases of different companies in a single uniform manner.

- ○ Negative effects of governance by former top management should be eliminated.

- ○ Governance function should be enhanced to effectively prevent corporate scandals, etc.

- ○ Internal/full-time *kansayaku* or audit committee members should be appointed from those who have appropriate expertise in terms of both knowledge and experience.

（4） Cross-shareholdings

- ○ Cross-shareholdings may lead to obstruction to fair competition, unreasonable restraint of trade, unequal treatment of shareholders, inappropriate use of an anti-takeover measure, inefficient capital management, deterioration of management discipline, and so forth. Therefore, companies concerned should continue to reduce their cross-shareholdings.

- ○ Since there are strong incentives for “held companies” to make certain companies hold their shares as cross-shareholdings, there are limitations to reduce cross-shareholdings through sole efforts by the holding companies.

○ Companies concerned have not sufficiently explained/disclosed rationales of such shareholdings. For the purposes of improving transparency and serving for dialogue with investors, the companies should enhance disclosures about cross-shareholdings by including changes in shareholdings, specifically how important importance of cross-shareholdings for the specific business of the held companies, and voting records for each company on an individual agenda item basis, and by making disclosures in English as well. Furthermore, the fact that distinction between cross-shareholdings and pure investments is vague poses a problem in identifying the real situation.

○ There are some cases where the nature of cross-shareholdings has changed from securing shareholders expected to support the companies to strategic alliance. Accordingly, companies should check purposes of cross-shareholdings for each company.

（5）Asset owners

○ Corporate pension funds are asset owners that fit most in the concept of the Stewardship Code in terms of increasing mid- to long-term corporate value for ultimate beneficiaries. Although circumstances may vary by corporate pension funds, unless there are any special reasons for not doing so, they should, in principle, conduct stewardship activities.

When corporate pension funds conduct stewardship activities, what challenges will they face?

（6）Other (dialogue with investors)

○ The quality of dialogue varies by investors, and there are many cases where the content is not substantial. Nonetheless, in order to advance the Corporate Governance Reform, dialogue with investors plays an important role in addition to companies’ own efforts. Ingenuity is necessary for investors to have effective dialogue, taking into account the specific circumstances of each company.

○ It is important to once again communicate the intention of each principle of the Corporate Governance Code, and fill possible perception gaps in dialogue between long-term investors and companies, thus securing the effectiveness of the Code.

○ Advancing the Corporate Governance Reform is essential for the stable asset growth of households, who are shareholders of companies through pension funds, etc.