Material 3

Reference Material

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I. Corporate Governance Reform Initiatives

I.1. Excerpts from JFSA's "Financial Services Policy" (published on Sept. 26, 2018): For Providing Better Financial Services in the Era of Transition

Changes surrounding finance

・Accelerating digitalization

・Declining population and aging

・Prolonged low-interest rate environment

The JFSA, as "Finance Nurturing Agency" aims at achieving <u>better financial services</u> through the following 7 initiatives:

The JFSA's mission

<u>**Enhancing people's welfare**</u> through:

・long-term personal asset building

・Sustainable growth of corporations and economy

1. Responding to the accelerating digitalization: Finance Digitalization Strategy

2. Promoting long-term personal asset building

3. Promoting active capital market and securing market integrity and transparency

4. Securing effective financial intermediation and financial stability: the roles and responsibilities of management and governance

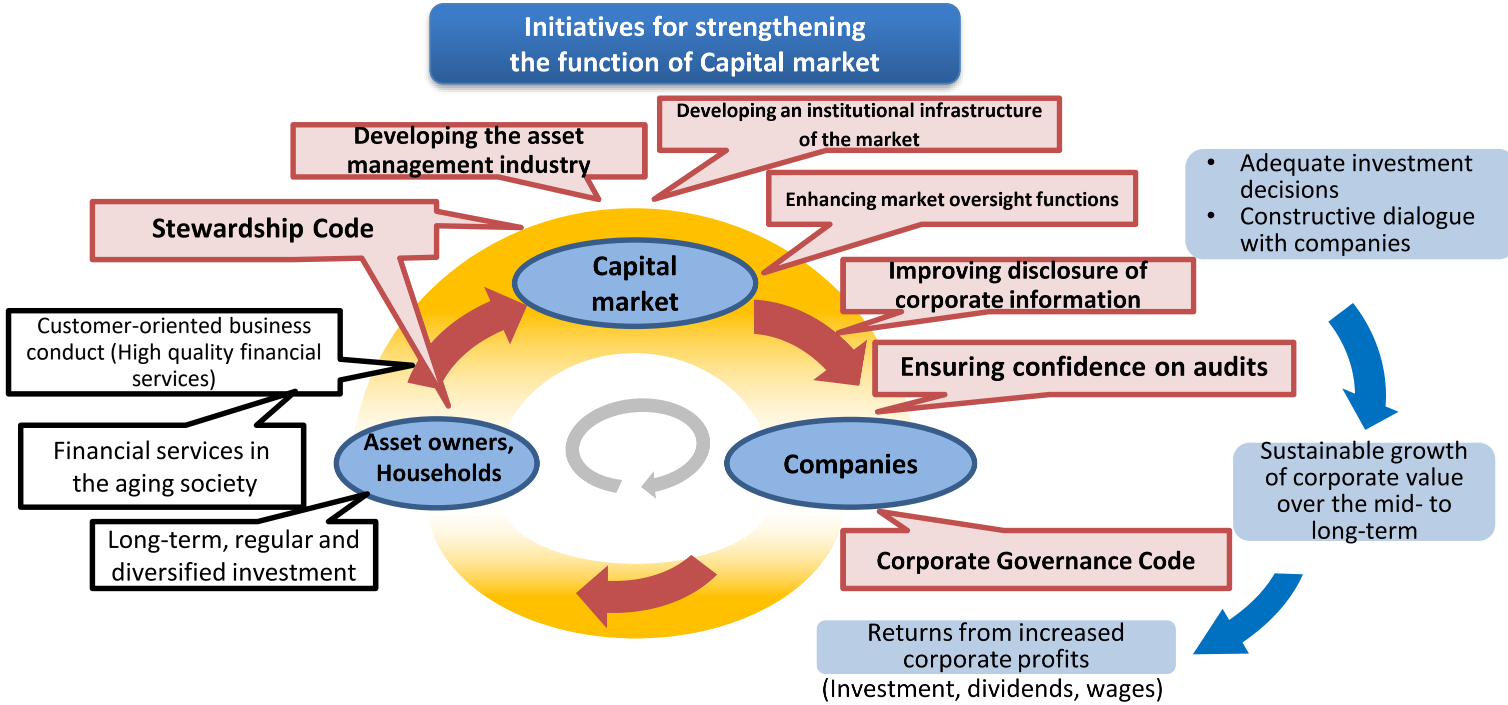
5. Ensuring customer confidence: challenges in conduct and compliance

6. Contributing to global policy discussion and building global network

7. Reforming the JFSA

In this program year, with the aim of making its PDCA cycle more coherent, the JFSA prepared the integrated report by combining its former reports, "Strategic Directions and Priorities" and "Progress and Assessment of the Strategic Directions and Priorities".

I.2. Excerpts from the FSA's "Financial Services Policy" (published on Sept. 26, 2018): Promoting active capital market and securing market integrity and transparency



Further promotion of Governance Reform and roles of institutional investors

The Stewardship Code
(Issued in Feb. 2014,
Revised in May 2017)

The Corporate Governance Code
(Issued in June 2015,
Revised in June 2018)

- Held meetings of the Follow-up Council, and examined **unwinding of cross-shareholdings, diversity of the boards, disclosure of voting records for each investee company on an individual agenda basis,** etc.
- Further promote Corporate Governance Reform through **announcing best practices of effective dialogues between companies and investors** as well as initiatives taken by companies.

I.3. Excerpts from the JFSA's "Financial Services Policy" (published on Sept. 26, 2018)

3. Promoting active capital market and securing market integrity and transparency

(1) Further promotion of the governance reform

[Policy for the current program year]

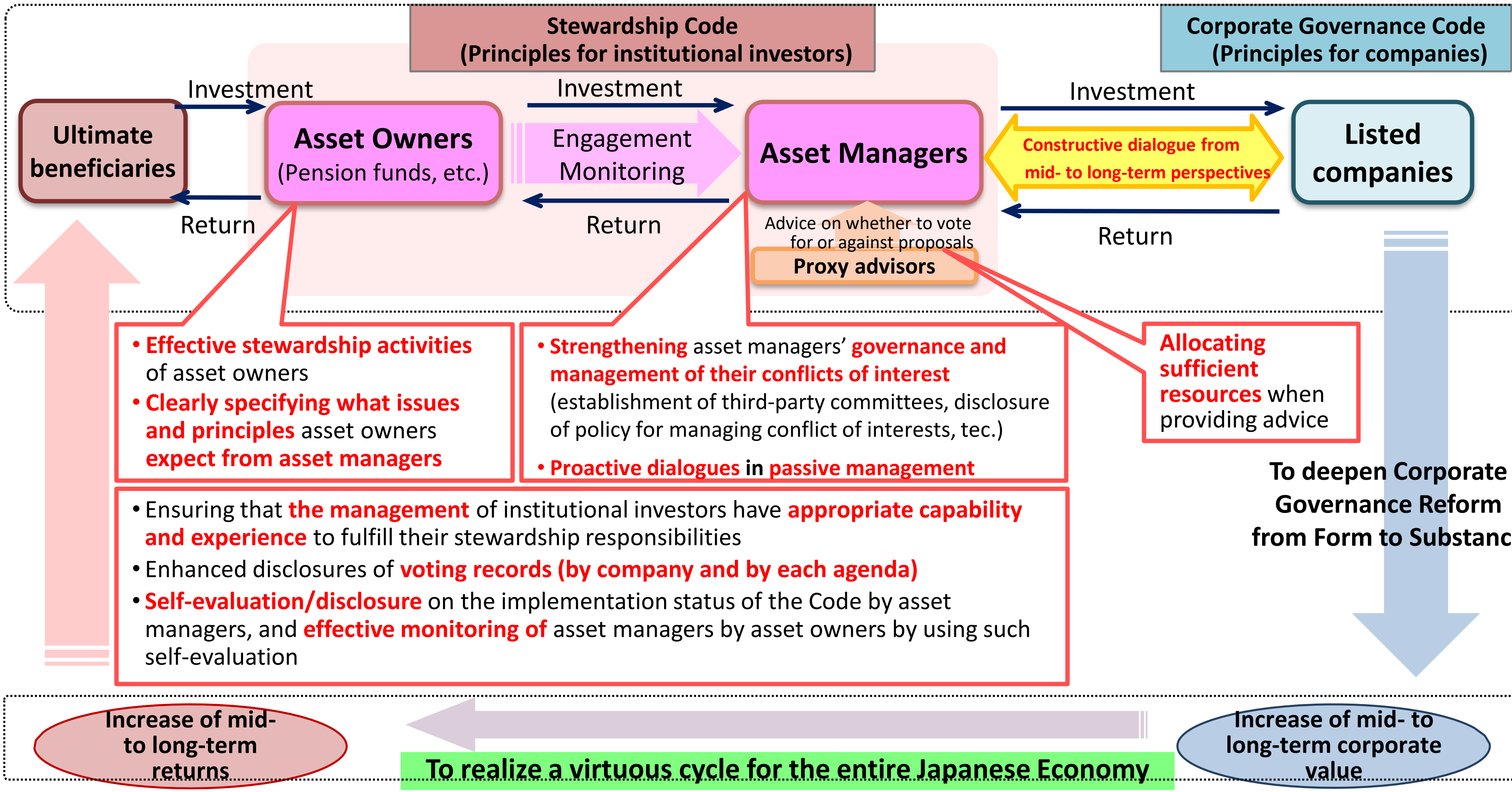
Based on the revised Codes and "Guidelines for Investor and Company Engagement", **we will hold meetings of the Follow-up Council** for the following initiative, **and publish results of its review on best practices of effective dialogue between investors and companies as well as initiatives taken by companies**, aiming at further promoting the corporate governance reform.

- Concerning corporate governance, the JFSA will review the current situation around business management in consideration of cost of capital, initiatives for reducing cross-shareholdings, progress in ensuring the diversity of the board in terms of gender and international experience, etc.
- Concerning asset managers, the JFSA will review the current status of disclosures of voting records for each investee company on an individual agenda basis, the use of proxy advisors, progress in effective dialogue with companies, from the perspective that voting rights should be exercised in a way to contribute to sustainable growth of investee companies.
- Concerning asset owners, the JFSA will review initiatives taken by corporate pension funds and their sponsoring companies for the purposes of supporting stewardship activities of corporate pension funds and encouraging them to effectively perform their functions.

I.4. Overview of the Revision of the Stewardship Code

(May 2017)

- In order to **deepen Corporate Governance Reform from "Form" to "Substance"**, it is important that **institutional investors** have **constructive dialogue with investee companies.**
- In this light, the Code was revised to encourage **asset managers to strengthen their governance and management of conflicts of interest,** and **clarify the roles of asset owners, including pension funds.**



I.5. The revision of the Corporate Governance Code and establishment of "Guidelines for Investor and Company Engagement"

(June 2018)

Issues around the corporate governance reform	Key points of the revised Corporate Governance Code and "Guidelines for Investor and Company Engagement" (※)
Decisive management decision	• Making decisive management decisions on **such matters as reviewing of the company's business portfolio**, and **clarifying the relevant policies** based on such decisions • **Accurately identifying** the company's **cost of capital**
Strategic and systematic investments in fixed assets, R&D, and human resources	• Implementing **strategic/systematic investments in property, plant and equipment, R&D, and human resources** • Developing/implementing **appropriate financial management policies** including those on the use of cash on hand
Objective, timely and transparent appointment/dismissal of CEO	• Establishing an objective, timely and transparent **process to appoint and dismiss CEO** (e.g. using the independent Nomination Committee)
Ensuring diversity in the board	• Ensuring that the board is equipped with sufficient knowledge, experience, and skills to appropriately fulfill its roles; and **ensuring the diversity of the board (gender, international experience, etc.)**
Reducing cross-shareholdings	• Reviewing objectives of **cross-shareholdings** and benefits/risks of such holdings, and **clarifying its policy** on cross-shareholdings
Improving expertise of corporate pension funds	• Sponsoring companies' efforts on **recruiting and assigning qualified persons** who contribute to increasing investment management expertise of **corporate pension funds**

(※) The Corporate Governance Code was revised to address these key points. Furthermore, "Guidelines for Investor and Company Engagement" were established to improve the effectiveness of dialogue (engagement) between institutional investors and companies.

I.6. Recent development of corporate governance in other countries

Corporate Governance Code

○UK: Revised in June 2018

＜Key changes＞

1)With respect to the principle which requires at least half the board to be independent directors, the special exemption for non-FTSE 350 companies (requirement of at least 2 independent directors) was removed.

2) Remuneration Committees should ensure that directors' remuneration reflects business results, and clarify the pay ratio compared to workforce remuneration, etc.

3) Board evaluations by third parties should be regularly conducted; and FTSE 350 companies should conduct such evaluations at least once in every 3 years.

4) When more than 20% of votes have been cast against a resolution, the Code specifies that the company should disclose what action it intends to take.

○Singapore: Revised in August 2018

1) The definition of independence of a director was clarified; and the independence is to be reinforced by reducing directors' shareholding ratios of the company.

2) At least one-third of the board should consist of independent directors (effective from 2022); in case the board chair is not an independent director, the majority of the board should be independent directors (before revision: half the board)

Stewardship Code

○Accelerated introduction of the Stewardship Code in Asia

・2014: Japan, Malaysia

・2016 : Singapore, Taiwan, Hong Kong, Korea

・2017 : Thailand

○UK : Working on the revision of the UK Stewardship Code, taking public comments into account

I.7. Summary of UK FRC's Annual Report on Corporate Governance

UK Financial Reporting Council (FRC) published its annual report 2017/2018 on corporate governance and stewardship in Oct. 2018.

Summary of the Report

[Implementation Status of the UK Corporate Governance Code]

- As for the requirement for the minimum number of **independent directors,** while **the compliance ratio (at least half the board) among FTSE 350 companies accounted for 97%**, **the compliance ratio (at least 2 directors) among SMEs accounted for 87%**, indicating the necessity for further improvement.
- At annual general shareholders meetings (AGMs) of FTSE 350 companies (held during the period from Oct. 2017 to Aug. 2018), there were 144 resolutions with 20% or more votes against proposals of the board, and 10 out of them did not pass. Resolutions with significant opposition are: 56 resolutions on the election of directors (1 did not pass), and 54 resolutions on directors' remuneration (6 did not pass). **Although such companies disclosed their explanations on the rejected proposals according to the relevant Principle of the Code, only few explained in detail.** Out of 134 resolutions passed at the AGMs, there were 28 resolutions, on which the companies did not announce how they intended to address shareholder concerns. According to the revised 2018 Code, effective from 2019, companies should **announce what actions they intend to take within 6 months from AGMs,** and disclose final results in their annual report or AGMs in the next year.

[Future development]

- **The UK Stewardship Code is expected to be revised** in late 2018 or early 2019, and **refer to stewardship responsibilities of key players,** including asset owners, asset managers, proxy advisors, and investment consultants.
- Stewardship is not limited to dialogue (engagement) between companies and investors, but involves the entire investment chain that includes asset owners, asset managers, and ultimate beneficiaries.

Source: Annual Review of Corporate Governance and Reporting 2017/2018, Financial Reporting Council

II. Initiatives under the Corporate Governance Code

1. Managing business in consideration of cost of capital

II.1. Managing business in consideration of cost of capital: Approach to cost of capital

＜General formula of cost of capital＞

Cost of Equity (using CAPM)	WACC：Weighted Average Cost of Capital
Calculated by adding risk premium to risk-free rate, where such risk premium is calculated by multiplying market risk premium by a stock's relative volatility (β) in the market $R_E = R_F + \beta(R_M - R_F)$ R_E : Cost of equity R_F : Risk-free rate R_M : Expected return from the market as a whole $R_M - R_F$: Market risk premium	Calculating weighted average of cost of debt (usually equals to contractual interest on interest-bearing debt) and cost of equity, by applying market value of each WACC＝cost of debt × (1-tax rate) × % debt ＋ cost of equity × % equity

Source: Prepared by JFSA based on Shinji Nakamura "Revision of Corporate Governance Code and Cost of Capital" *Shoji Homu* vol. 2174 (Aug 5/15, 2018)

[Reference: β by industry]

Food	Electricity/Gas	Retail	Wholesale	Pharmaceutical	Bank	Machinery	Transport equipment	Steel	Insurance	Real Estate	Securities
0.456	0.458	0.543	0.622	0.715	0.892	0.939	1.011	1.057	1.182	1.077	1.234

Source: Takeyuki Ishida "Underlying Idea Behind ISS Proxy Advisory Policy" Table 4, *Shoji Homu* vol. 2176 (Sept. 5, 2018)

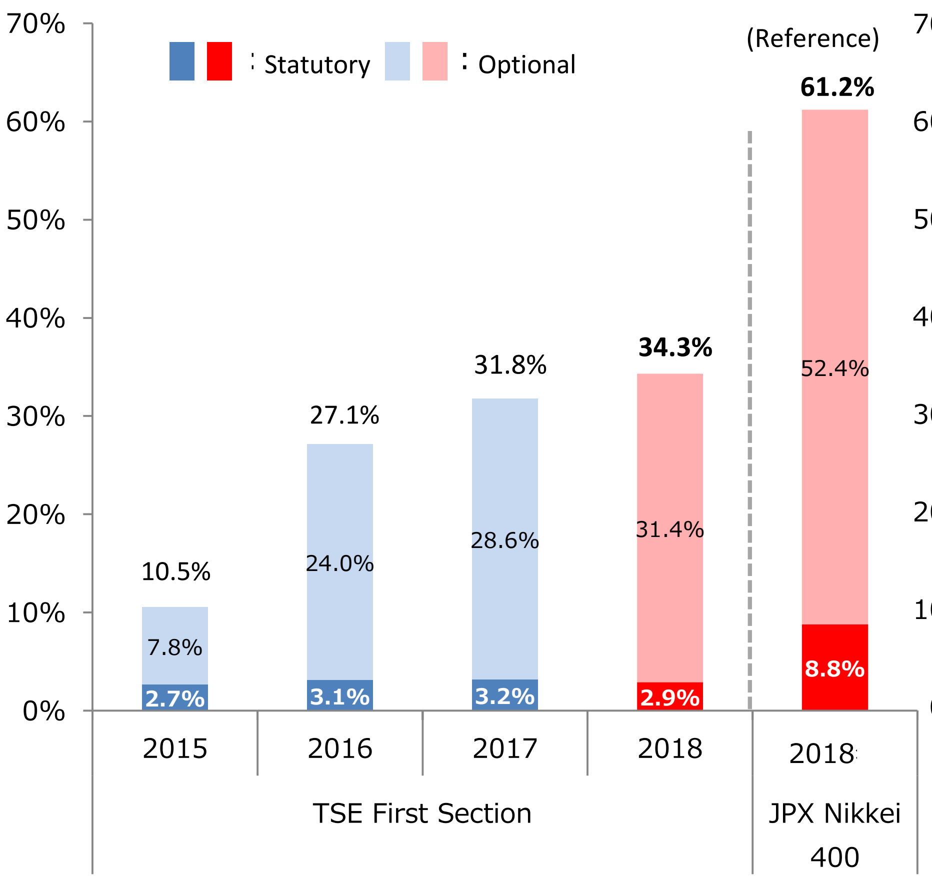
II. Initiatives under the Corporate Governance Code

2. Fulfilling the Board’s responsibilities

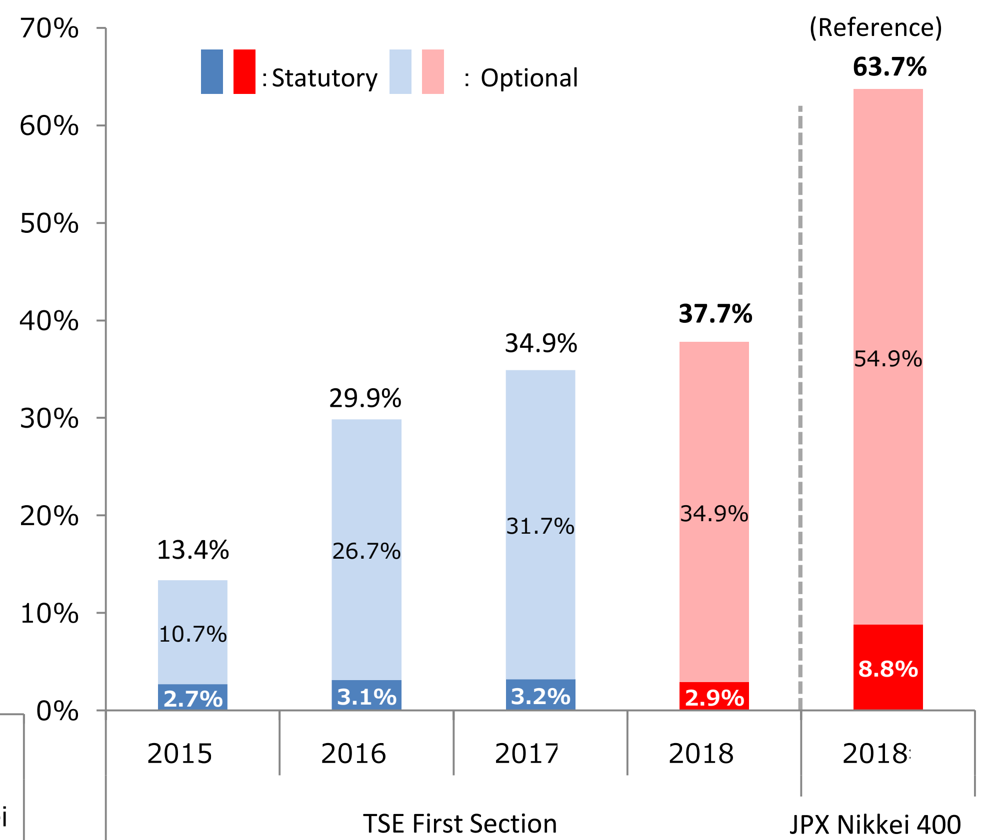
II.2. Fulfilling the Board's responsibilities: (1)Nomination & Remuneration Committees

- Despite a moderate increase in the number of companies with statutory or optional **Nomination Committee** and/or **Remuneration Committee,** such companies account for only around 30% of all listed companies listed on TSE First Section .

[% of Companies with Nomination Committee (TSE First Section)]



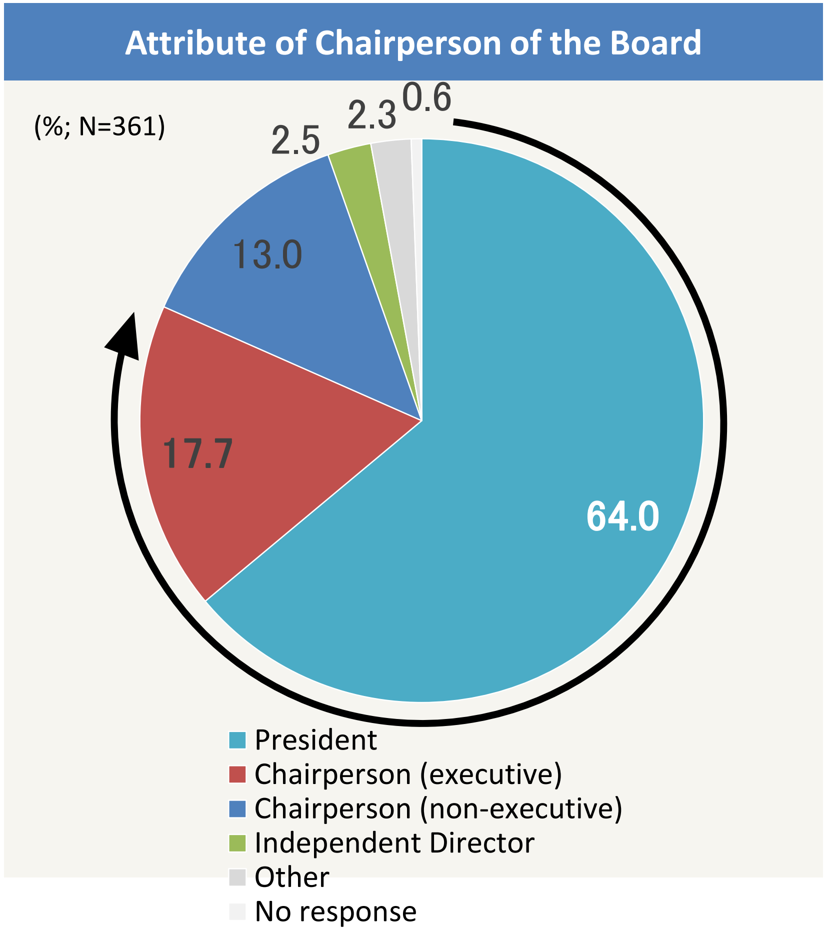
[% of Companies with Remuneration Committee (TSE First Section)]

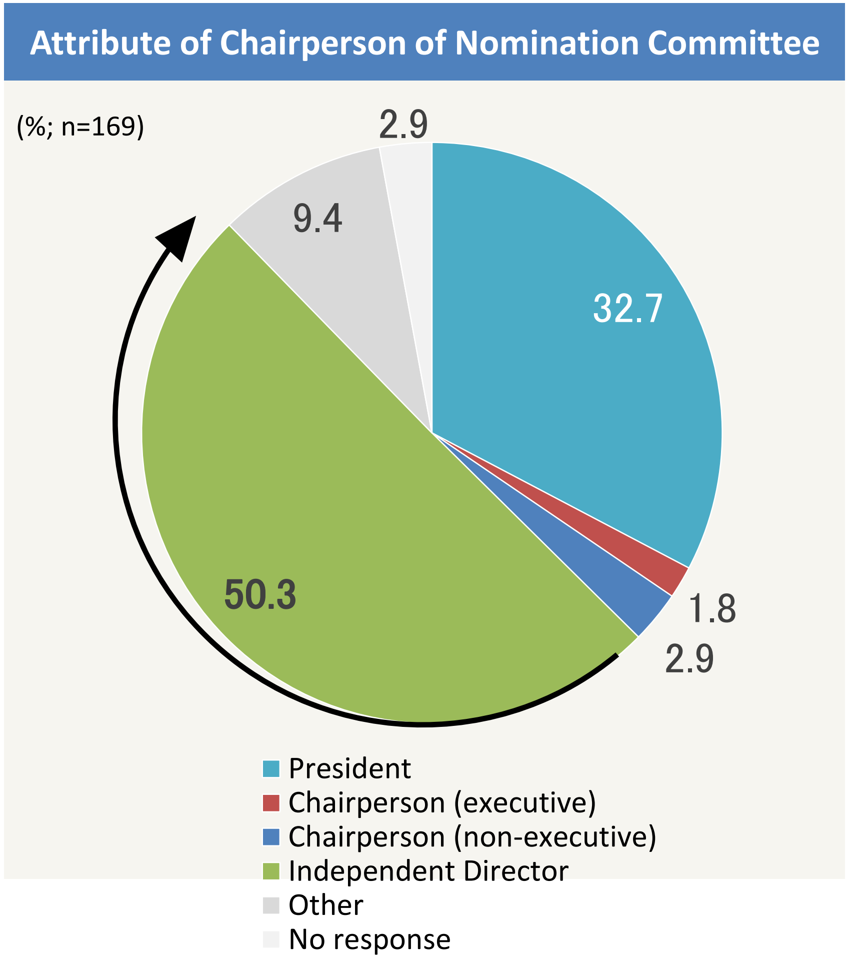


Source: Tokyo Stock Exchange

II.2. Fulfilling the Board's responsibilities: (2) Attributes of Chairpersons of the Board and Nomination committee

☐ In **more than 80%** of all companies, **either Executive Chairperson or President serves as Chairperson of the board.** Meanwhile, in **a half** of companies with Nomination Committee, **an independent director serves as Chairperson of the Committee.**





Source: Egon Zehnder Corporate Governance Survey Results 2018

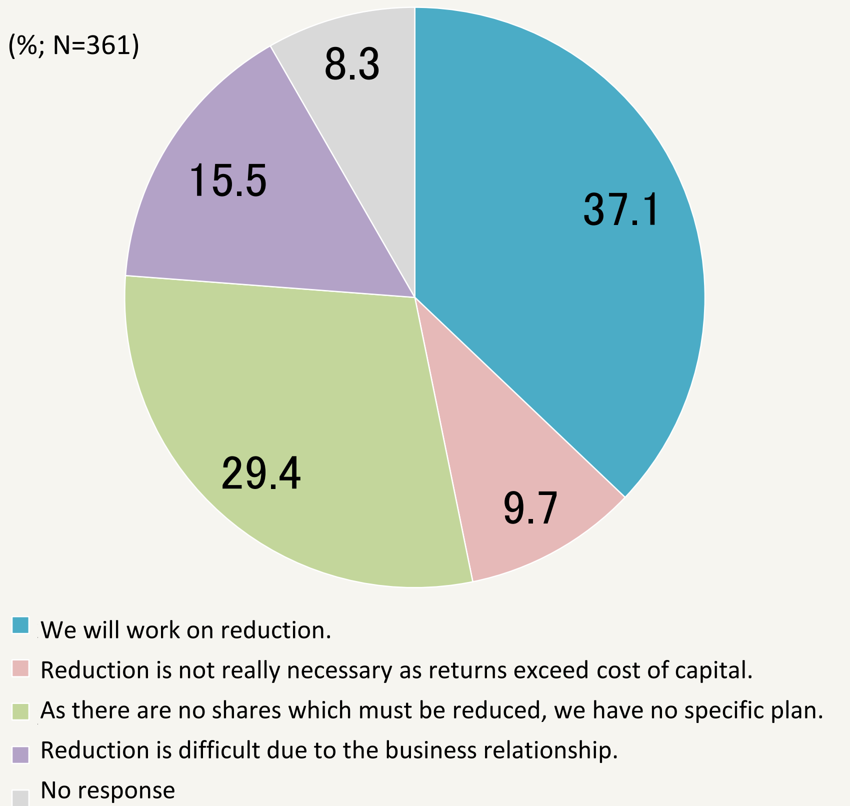
II. Initiatives under the Corporate Governance Code

3. Cross-shareholdings

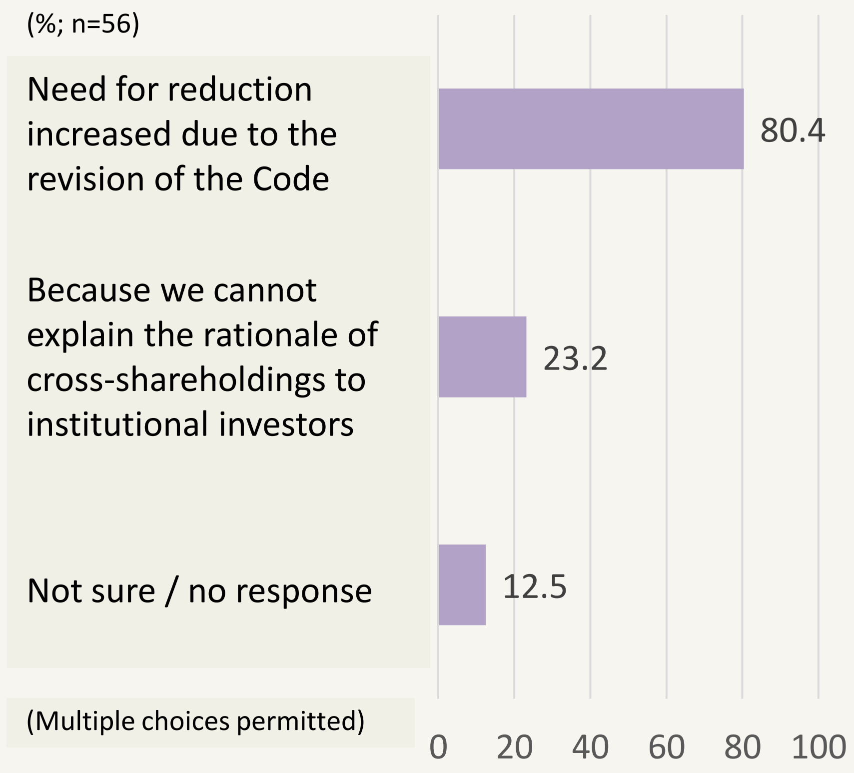
II.3. Cross-shareholdings: (1)-1. Recognition of the need for reduction

- Out of 56 companies which answered "Reduction is difficult due to the business relationship" with respect to their cross-shareholdings, **80.4% recognize the need for reduction,** in response to the revised Corporate Governance Code.

Policy on Cross-shareholdings



Reason for need for reduction
(companies which answered "reduction is difficult")

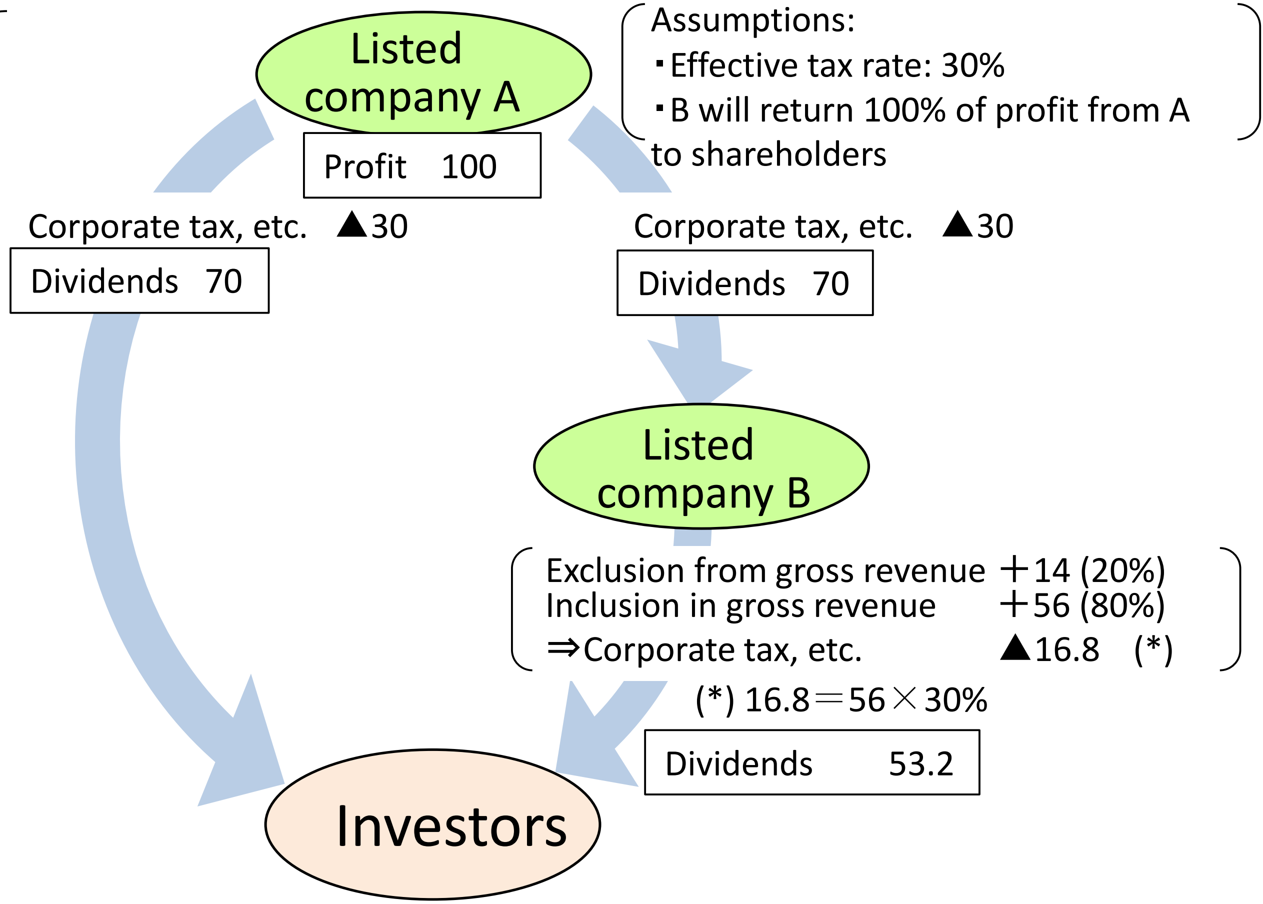


Source: Egon Zehnder Corporate Governance Survey Results 2018

II.3. Cross-shareholdings: (1)-2. Opinions focusing on finance of the companies

- **Impairment risk**
- **Liquidity-related cost**
- **Tax-related cost**

Exclusion of dividend received(Note) **from gross revenue**



(Note) Classification of shares subject to exclusion from gross revenue (after tax law change in 2015)

Shares of wholly owned subsidiary (ownership: **100%**)	**Full amount** of dividends
Shares of affiliated company (ownership: **more than 1/3 to 100%**)	**Full amount** of dividends －deduction of interest on borrowed funds
Other shares (ownership: **more than 5%, less than 1/3**)	Amount of dividends x **50%**
Shares not for controlling purpose (ownership: **5% or less**)	Amount of dividends x **20%**

II. Initiatives under the Corporate Governance Code

4. Ensuring confidence on audit

II.4. Ensuring confidence on audit: (1) Overview of Recommendations from the "Advisory Council on the Systems of Accounting and Auditing" (Published on March 8, 2016)

1.Reinforcing management of audit firms

- Audit Firm Governance Code
  (Development of principles for organizational operations of audit firms, disclosure of status of compliance with the Code)
- Improving environment for increasing the number of audit firms conducting audits of large listed companies
  (Improving the quality of audits by major audit firms and second-tier audit firms by implementing the Code)

2. Enhancing information on audit to shareholders, etc.

- Enhancing corporate disclosure regarding audits
  (Improving disclosure of audit in Securities Reports, etc.)
- Enhancing information provision regarding audit details
  (Enhancing information provision by audit firms and authorities; ensuring transparency of auditor's reports; enhancing disclosure of reasons for replacement of auditors, etc.)

3. Strengthening ability to detect corporate fraud

- Strengthening Individual CPAs' Ability and Exercising Professional skepticism as an organization
  (Improving on-the-Job training and education/training on how to deal with fraud, etc.)
- Conducting audits focusing on risks of fraud
  (Ensuring implementation of audit standards, and standards to address fraud, etc.)

4. Assessing audit quality from viewpoints of third parties

- Ensuring independence of audit firms
  (Conducting survey on auditor rotation system)
- Enhancing inspection/oversight by regulatory authorities
  (Improving timeliness & effectiveness of CPAAOB's inspection; reviewing the supervisory framework for audit firms, etc.)
- Enhancing self-regulatory function of Japanese Institute of Certified Public Accountants (JICPA)
  (Revisiting quality control review, etc.)

5. Improving environment for high-quality audit

- Strengthening corporate governance of companies regarding audit
  (Establishing criteria for selecting/evaluating auditors; securing the independence/effectiveness of the board of corporate auditors or *kansayaku* board; securing appropriate time for auditing)
- Ensuring effective internal control in companies
  (Implementing the internal control reporting system, and verifying the effectiveness)
- Utilizing IT in audit (JICPA continues study)
- Other (Conducting study on the examination system and professional accountancy education program)

Creating an environment where audit firms, which provide high-quality and transparent audit services under the effective management, are valued and selected

⇒ Reinforcing incentives for providing high-quality and transparent audit services; continuously improving the quality of audit in the entire market.

II.4. Ensuring confidence on audit: (2)-1. Sample of Auditor's Report

[Current]

Independent Auditor's Report

To. The board of directors of
XX Company

○○ Audit Firm

Designated Partner
Engagement Partner CPA ○○ Seal

Pursuant to Paragraph 1 of Article 193-2 of the Financial Instruments and Exchange Act, we have audited the consolidated financial statements for the period from MMDDYY to MMDDYY, consisting of …., provided in "Financial Information".

Management's Responsibility (omitted)

Auditor's Responsibility (omitted)

Auditor's Opinion

In our opinion, the financial statements present fairly, in all material respects, the financial position of XX Company and its subsidiaries as of MMDDYY, and its performance and cash flows for the fiscal year then ended, in accordance with accounting principles generally accepted in Japan.

Interests (omitted)

END

[After the Revision]

Independent Auditor's Report

To. The board of directors of
XX Company

○○ Audit Firm

Designated Partner
Engagement Partner CPA ○○ Seal

Auditor's Opinion (omitted)

Basis for the Opinion (omitted)

Key Audit Matters (See attached sheet)

[Example 1] Impairment of fixed asset

○ Matter: The Company reported an impairment loss for XX million yen with respect to ….

○ Reasons: Because it contains a subjective management judgment and material accounting estimates, we judged it should be treated as a Key Audit Matter.

○ Approach to the Matter: We examined …. Our procedures include …

[Example 2] Valuation of goodwill

Responsibility of Management and *Kansayaku*, etc. (omitted)

Auditor's Responsibility (omitted)

Interests (omitted)

END

II.4. Ensuring confidence on audit: (2)-1. Trial sample of description on Key Audit Matter

Key Audit Matter (KAM) and Reasons	Auditor's Approach to KAM
Impairment valuation of store assets ○ Description of Key Audit Matter The balance of fixed assets as of March 31, 2017 is xxx million yen. As described in the Note, the Company and its subsidiaries reported an impairment loss from buildings of the company-owned stores, etc. in the consolidated accounting period ended on March 31, 2017. ○ Reasons for judging it as a Key Audit Matter With respect to ●●business run by the Company and its subsidiaries, the business climate continued to be tough due to the deterioration of the supply-demand balance in the labor market and the slowdown of consumer spending. In such an environment, among stores with deteriorating operating results, when the Company judged that book values of store assets cannot be recovered, the Company recognized an impairment loss from such fixed assets. In judging the recoverability, future cash flows of the stores are used. The estimation of future cash flows of the stores involves such material accounting estimates as subjective management judgments on revenue growth, sales promotion programs, and the effect of cost saving programs, as well as the uncertainty which cannot be proved. Accordingly, we judged this matter as a Key Audit Matter.	○ Auditor's approach to the Key Audit Matter We obtained the future cash flows of stores with deteriorating operating results, and examined the method of estimation by the management and the base data. Our procedures concerning the method of estimation by the management and the base data include the following: ・Asked assumptions (on revenue growth, etc.) used by the management ・In order to measure the effect of sales promotion programs and cost savings programs, review the past programs and its results ・Compared the store budgets with the results of the current year, to examine the reasonableness of the assumptions for estimation by the management ・Set the amounts estimated by us or acceptable range in order to evaluate the amounts estimated by the management, and checked whether there were significant differences with the management's estimation We judged that the management's estimation related to the future cash flows of the stores was supported by available evidence.

Source: Prepared by JFSA based on the material submitted by the Japanese Institute of Certified Public Accountants to the 39the meeting of the Audit Standard Committee of the Business Accounting Council on Nov. 27, 2017

II. Initiatives under the Corporate Governance Code

5. Improving information disclosure

II.5. Improving information disclosure: (1)-1. Improving financial and narrative (non-financial) information (a)

Business Strategy/Business Model

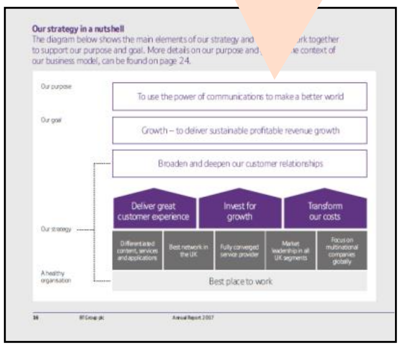
<Opinions from institutional investors>

- ○ To make mid- to long-term investment decisions, we [investors] need corporate disclosures of business strategies and long-term risk information which **help evaluate a company's future potential,** in addition to disclosures of financial information which is the information on past performances.
- ○ To evaluate a company's future potential, we [investors] would like to know **the essence of strategic thinking** and/or **mid-term goals.**
- ○ Narrative information should not be a mere list of information, but should be provided in a way that it is significantly **linked with** financial information.

BT Group (UK)'s disclosure on business strategy (Strategic Report)

Relationship between business objectives/goals and strategies

- Specific initiatives and priorities for each strategy
- Definition of key management indicators and actual results



Other:
- Explanations based on the business model
- Management resources (finance, human resources, assets, R&D, brand power, etc.)
- Information on risks relating to strategies and the business model

Example of disclosure by a Japanese company (fiscal year ended in March 2017)

Concerning the future economic climate, while a moderate recovery trend continues owing to strong corporate earnings, there will still be uncertainties, including possible impact of the political management in the US and political situations in Europe.

Furthermore, with a more-than-expected increase in sales volume and shortage in domestic labor supply in the context of the rapid growth of the market, the business environment surrounding our company has been rapidly changing. We expect that this trend will continue in the future and thus the business environments will remain tough.

Under such circumstances, in the fiscal year ending March 2018, with respect to XX business, we will implement a structural reform by improving the work environment, controlling total sales volume, reviewing logistics, and revising charges, and redesign our business model in a way to fit the future. Our company will internalize a commitment to promote the "reform of working practices" and "reform of business structure", and reinforce the foundation for sustainable growth.

As the targets of consolidated financial results, we aim at achieving operating revenue of X billion yen, operating income of X billion yen, and operating profit margin of X %.

Specific details of the mid-term growth strategy are under discussion, taking into account the above-mentioned structural reform.

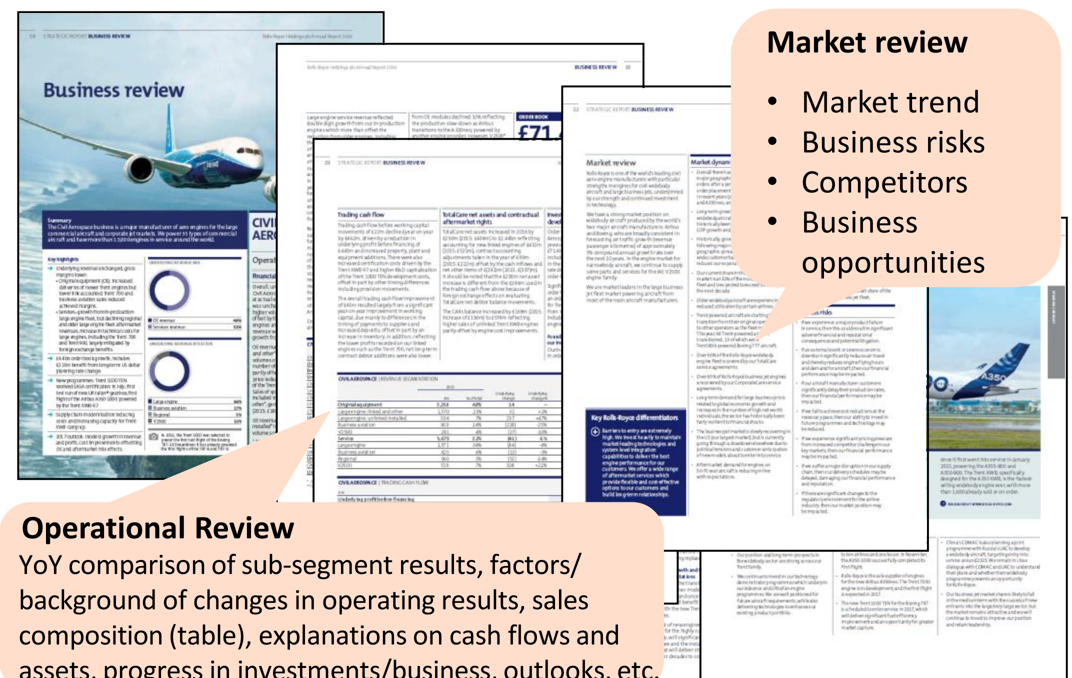
II.5. Improving information disclosure:
(1)-2. Improving financial and narrative (non-financial) information (b)

MD&A **(Management's Discussion and Analysis of Financial Conditions, Results of Operations and Cash Flows)**

<Opinions from institutional investors>

- ○ As for disclosures by some Japanese companies, we [investors] feel that the management's explanations on their business environment as well as **segment information** (by region/division) are not sufficient.
- ○ Without explanations by relating business results to business strategies, long-term plans, and business environment, we cannot evaluate the management's competencies or the appropriateness of risk-taking.
- ○ **Explanations from the management** (MD&A) linked to accurate financial information are essential for checking the appropriateness of business strategies of a company.
- ○ To understand a company's strategies and business environment, **CEO's view** is very informative.

Rolls-Royce's business review by segment (Civil aerospace segment)



Example of disclosure by a Japanese company (fiscal year ended in March 2017)

(1) Analysis on business results

(Sales)

Sales for the current consolidated fiscal year declined to XX yen (decreased by XX yen, down by X% YoY) due to the yen's appreciation. The breakdown by destination was as follows: domestic sales XX yen (decreased by XX yen, down by X% YoY) and overseas sales XX yen (decreased by XX yen, down by X% YoY). Looking at sales by product, sales of XX declined to XX yen (decreased by XX yen, down by X% YoY) due to a decrease in shipment volume as well as the yen's appreciation.

(Operating income)

Operating income was XX yen (decreased by XX yen, down by X% YoY). This is because the effect of cost savings was more than offset by the yen's appreciation and an increase in R&D expenses.

(Ordinary profit and profit attributable to owners of parent)

Ordinary profit was XX yen (decreased by XX yen, down by X% YoY), after recording share of profit of entities accounted for using equity method for XX yen and reducing interest expenses for XX yen, foreign exchange loss for XX, etc. Profit attributable to owners of parent declined to XX yen (decreased by XX yen, down by X% YoY) mainly due to posting extraordinary loss from business structure improvement costs and corporate tax for XX yen.

II.5. Improving information disclosure:
(1)-3. Improving financial and narrative (non-financial) information (c)

Risk information

<Opinions from institutional investors>

○ While Japanese companies have disclosed risk factors, only few companies have disclosed specific **impacts** of such risks and **countermeasures** for mitigating such risks. It is desirable to discuss risks on corporate activities by referring to the relationship with the future prospect of economic trends.

○ In making investment decisions, it is important for us to obtain information that helps identify risk factors, **uniqueness** of risks and **estimated changes** in risks.

○ The management should conduct strategic discussion and analysis of key risks, which the management identified, by **relating** them to risk management.

Rolls-Royce's disclosure of risk information


Risk management enables our strategy

1 Engineering excellence 2 Operational excellence 3 Capturing aftermarket value

PRIORITIES FOR 2017 ON PAGE 13

Change in risk level: Increased / Decreased / Static / New risk

Risk or uncertainty and potential impact	How we manage it	Key controls	Change in risk level	Strategic priorities
Disruptive technologies and business models Disruptive technologies, new entrants with alternative business models or disruptions to key markets or customers could reduce our ability to win sustainable future business, achieve operating results and realise future growth opportunities.	• Horizon and emerging technology scanning, and understanding our competitors, including patent searches. • Investing in innovation and new technologies (see page 9). • Focusing on enhancing our skills and capabilities to maintain our technology leadership (see page 41). • Forming strategic partnerships and conducting joint research programmes. • Establishing our digital business. This principal risk is subject to review by the Science & Technology Committee.	• Strategic planning process • Investment review committee • Digital board • Research & technology board	N	1 2 3
Product failure Product not meeting safety expectations, or causing significant impact to customers or the environment through failure...	• Ensuring a culture that puts safety first. • Applying our engineering design and validation process from initial design, through production and into service. • Reviewing the scope and effectiveness of the Group's product safety policies to ensure that they operate to the highest industry...	• Product safety review board • Quality compliance audit • Engineering technical audit	Static	1 2 3

Relationship with business strategy

Key risks/uncertainties, countermeasures, division in charge

Technological innovation, change in business model, product deficiency, etc.

Changes in risk level

Example of disclosure by a Japanese company (fiscal year ended in March 2017)

(1) Trend of global economy, social changes, and changes in laws and regulations and tax system

Development of global economy, social changes, and changes in laws and regulations and tax system may cause impacts on businesses of the entire Group.

(2) Exchange rates

Changes in exchange rates may, in particular, affect the Company's sales from export and purchases of imported materials in US dollars or Euro, as well as sales from export and purchases of imported materials at our production facilities located in Asia which are settled in currencies other than the one used in the country.

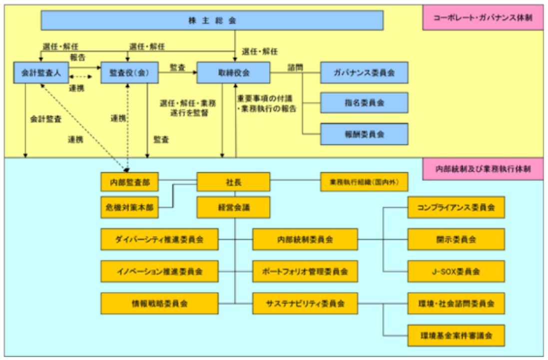
(3) Market price of stock

A drop of stock prices may lead to a loss on valuation of securities with respect to marketable stocks held by the Company, as well as an increase in retirement benefit expenses due to a decrease in a fair value of pension assets.

II.5. Improving information disclosure: (3)(4)-1 Easy-to-understand disclosures (the use of tables, graphs, photographs, etc.)

Examples of active use of tables, graphs, photographs, etc. for easier-to-understand disclosures

当社のコーポレート・ガバナンス及び内部統制の全体の仕組みを図示すると以下のとおりとなります。



③社外取締役・社外監査役との関係及び活動実績

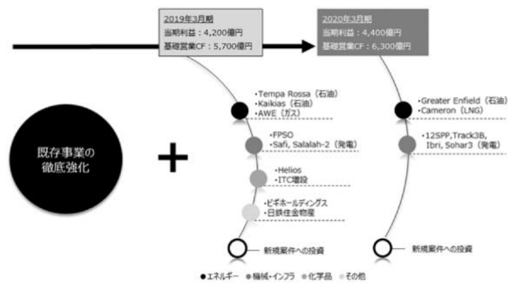
(a)社外取締役との関係と選任理由

- 社外取締役は、投融資案件を始めとする取締役会議案審議に必要な広汎な知識と経験を具備し、或いは経営の監督機能発揮に必要な出身分野における実績と見識を有することを選任基準としています。
- 当社は社外取締役候補者の選定に当り、経営の監督機能を遂行するため、当社からの独立性の確保を重視しています。また、多様なステークホルダーの視点を事業活動の監督に取り入れる観点から、その出身分野・性別等の多様性に留意しています。

当社が多岐にわたる業界・企業と商取引関係を有する総合商社であることから、個々の商取引において社外取締役との利益相反などの問題が生じる可能性もありますが、このような問題に対しては取締役会の運用・手続にて適切に対処しています。

②事業資産群とその利益貢献・キャッシュ創出開始時期

2019年3月期には、エネルギー、機械・インフラ、化学品の中核分野事業資産に加え、鉄鋼製品や生活産業などでも新規案件による利益貢献やキャッシュ創出の開始が見込まれます。案件の着実な立上げに万全を期すことで収益基盤の強化を進め、中期経営計画の定量目標の達成を目指します。



③キャッシュ・フロー配分の実績及び最新見通し（中期経営計画3年間累計）

2018年3月期の実績と2019年3月期の計画を踏まえて、昨年5月に公表した中期経営計画3年間累計のキャッシュ・フロー配分を今般以下のとおり見直しました。

基礎営業キャッシュ・フローの拡大及び株主還元の増加を反映する一方、投資規律の徹底を継続することで、3年間累計の投融資総額は1.7～1.9兆円、また、資産リサイクルは7,000億円を維持します。なお、株主還元の3年間累計の金額は、便宜的に、2020年3月期を昨年公表した下限配当1,000億円と置いて、算出したものです。

この結果、3年間累計での株主還元後のフリー・キャッシュ・フローは2,700～4,700億円まで増加することを見込んでおり、これを、その時々の経営状況に鑑みて、追加株主還元、有利子負債の返済、追加投資に配分します。

（単位：億円）

		2018年3月期 年間実績	3年間累計（今回修正）(2018年3月期～2020年3月期)	3年間累計（17年5月公表）(2018年3月期～2020年3月期)
キャッシュ・イン	基礎営業キャッシュ・フロー*1・・・①	6,700	18,700	17,000
	資産リサイクル・・・②	3,000	7,000	7,000
キャッシュ・アウト	投融資・・・③	▲5,600	▲17,000～▲19,000	▲17,000～▲19,000
	株主還元*2・・・④	▲1,725	▲4,000	▲3,000
株主還元*2後のフリー・キャッシュ・フロー*3 ・・・①+②+③+④		2,375	2,700～4,700	2,000～4,000

*1. 営業活動に係るキャッシュ・フロー－運転資本の増減に係るキャッシュ・フロー
*2. 3年間累計（今回修正）欄は、2020年3月期の配当を便宜的に下限配当1,000億円として算出
*3. 運転資本及び定期預金の増減の影響を除外したフリー・キャッシュ・フロー

④利益配分に関する考え方

株主還元策については第4 提出会社の状況 3「配当政策」を参照願います。

「メルカリ」が選ばれる理由

「メルカリ」は、使いやすく・楽しく、かつ安全・安心に取引できるマーケットプレイスとして、多くのユーザにご利用いただいております。

1．使いやすさ

手軽な出品プロセス

「メルカリ」では、簡単なプロセスで３分以内に出品できます。ホーム画面の右下にある「出品」ボタンを押して商品の写真を撮影し、簡単な商品説明を入力した後、価格と配送オプションを選択するだけで出品を完了することができます。出品されたアイテムはすぐに、すべてのユーザが閲覧できるようになります。

「メルカリ」では、過去の取引データを活用してより簡単に出品を完了することができる機能を提供しています。例えば、商品名に対応したカテゴリーやブランド名、商品の状態に応じた売れやすい価格帯が提案されることにより、簡単に出品を完了することができます。

Source: Mitsui & Co., Ltd. “Securities Report” (Fiscal year ending March 2019)

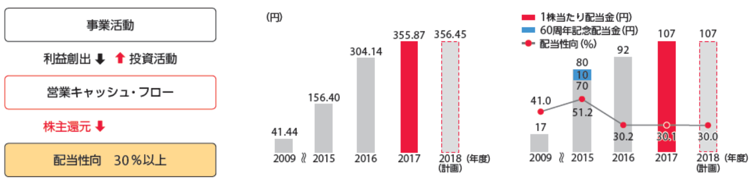
Source: Mercari, Inc. “ Securities Registration Statement”

II.5. Improving information disclosure: (3)(4)-2 Easy-to-understand disclosures on cost of capital

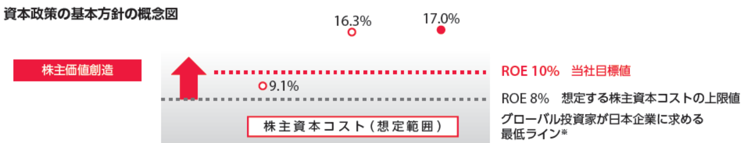
Example of easy-to-understand disclosure on the management's view on the ideal balance of growth investment, cash reserves and shareholder returns, as well as the view on cost of capital.

株主還元方針

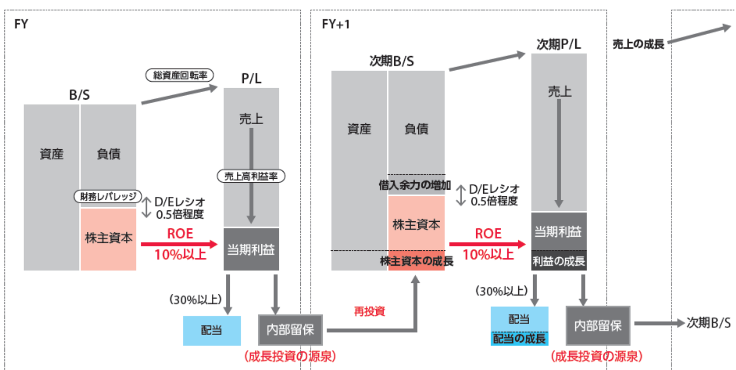
利益配分の考え方　　1株当たり当期純利益(EPS)　　1株当たり配当金・配当性向



資本政策の基本方針の概念図



※ 出所：伊藤レポート



FY

成長投資に必要な資金の源泉となる、営業キャッシュ・フローを確保し、一部を株主還元した上で、内部留保を積み増しし、適正水準の財務レバレッジを維持しながら成長分野へ資本を再投資しています。

安定的な営業キャッシュ・フローの確保

FY+1

再投資した資本を株主のみなさまの期待収益率(株主資本コスト)を上回る資本効率でリターンに結びつけることで、利益や配当の成長につなげるとともに、次なる成長投資に必要な資本を増加させていきます。

最適資本構成を踏まえたROEの維持・向上

Ⅱ.キャッシュ・フロー(CF)

基本的な考え方

キャッシュ・マネジメントの基本的な考え方としては、事業活動によるキャッシュ創出額を基準として投資を行うことです。優良な投資機会に対しては、積極的な投資を行う必要があり、外部から調達する資金を含めて投資枠の設定を行っています。そのため、D/Eレシオが一時的に0.5倍を超えることがありますが、中長期的には、0.5倍程度として有利子負債の水準をコントロールし、成長投資と財務健全性の維持の均衡を図っています。

キャッシュ・フローの状況　図2・3

2017年度における営業活動CFは、3,001億円となり、前期に比べ124億円増加しました。自己資本に対する営業活動CFは、前期の22%から2ポイント低下し20%となりましたが、高い水準で推移しています。

投資活動CFについては、第5次中期経営計画における投資計画に基づき、賃貸等不動産等の取得や、不動産開発事業への投資を2,206億円実行したことなどにより、△3,136億円となりました。その結果フリーキャッシュ・フロー(営業活動CF+投資活動CF)は△135億円となり、社債の発行や借入等による資金需要への対応によって財務活動CFは418億円となりました。

これらの結果、現金及び現金同等物の2017年度末残高(休日調整後)は前期末から305億円増加し、2,438億円となりました。

企業価値・キャッシュ創出力　図4・5

キャッシュ創出力を示す減価償却前の営業利益(EBITDA)※1は4,113億円となっており、キャッシュを生み出す力は着実に成長しています。今後についても、有利子負債の水準を一定程度に維持しつつ、優良な投資案件への積極的な投資を行うという方針を継続するとともに、新たな収益の柱を育てることによって、キャッシュ創出力をさらに高め、企業価値を向上させていきます。

2017年度末の企業価値(EV)※2は、時価総額2兆7,315億円にネット有利子負債4,497億円を合算し3兆1,813億円となっています。

企業価値とキャッシュ創出力の倍率を示すEV/EBITDA倍率は2017年度末で7.7倍となっています。

図2　キャッシュ・フロー

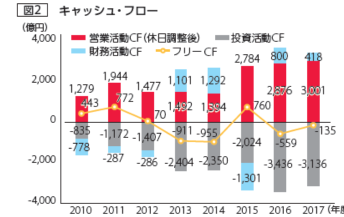


図3　自己資本に対する指数(自己資本を1とした場合の比率)

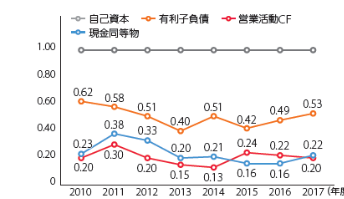
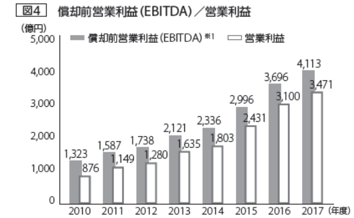
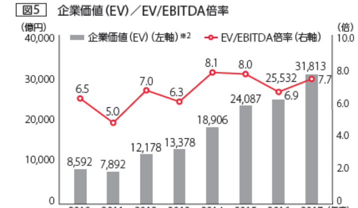


図4　償却前営業利益(EBITDA)／営業利益



※1　償却前営業利益(EBITDA)＝営業利益＋減価償却費

図5　企業価値(EV)／EV/EBITDA倍率



※2　企業価値(EV)＝時価総額＋ネット有利子負債

Source: Daiwa House Industry Co., Ltd. "Integrated Report" (2018)

III. Initiatives under the Stewardship Code

1. Investors’ initiatives

Disclosure of voting records for each investee company on an individual agenda basis

- **The number of asset managers, which disclosed their voting records by company and by agenda, has significantly increased** (104 asset managers as of end-Oct. 2018). Some of them also provided **reasons for casting "against" votes.**

Establishment of third-party committees by asset managers

- An increasing number of large Japanese asset managers **established third-party committees** which oversee the exercise of voting rights to manage conflicts of interest.

Asset owners' stewardship activities

- In June 2017, **Government Pension Investment Fund (GPIF)**, an asset owner, established **"Stewardship Principles"** and **"Proxy Voting Principles"** for asset managers which invest GPIF's funds. GPIF also requested the asset managers to disclose their voting records for each investee companies on an individual agenda basis.

(Note) These Principles require asset managers to develop mechanisms, including the establishment of a third-party committee, to manage conflicts of interest, and exercise their voting rights in accordance with the Corporate Governance Code.

- **Some corporate pension funds** signed up to the Stewardship Code.

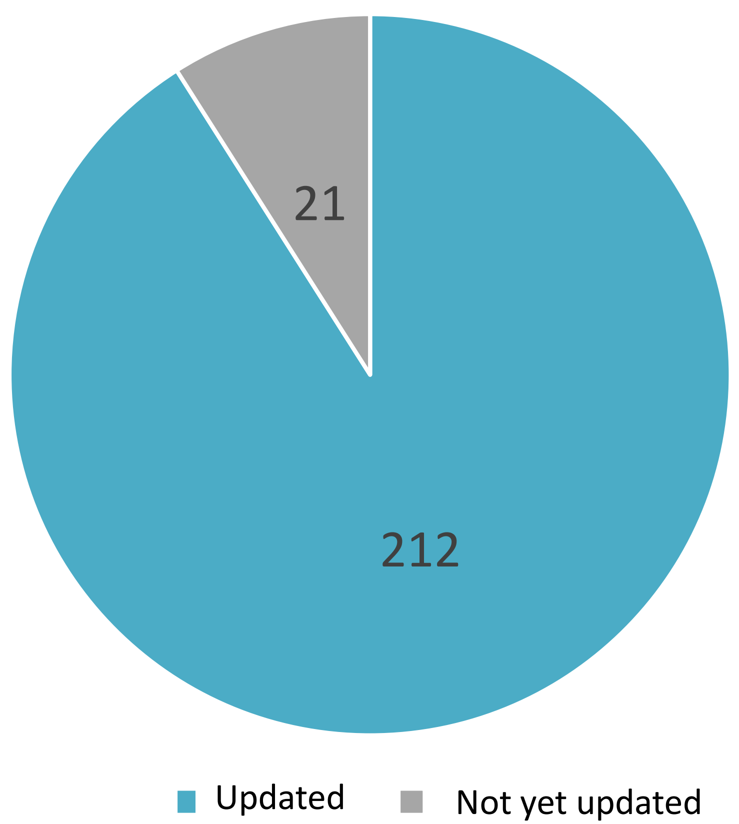
Disclosure of stewardship activities

- An increasing number of institutional investors have **disclosed reports on their stewardship activities including examples of dialogue (engagement)** as a part of self-evaluations of their stewardship activities.

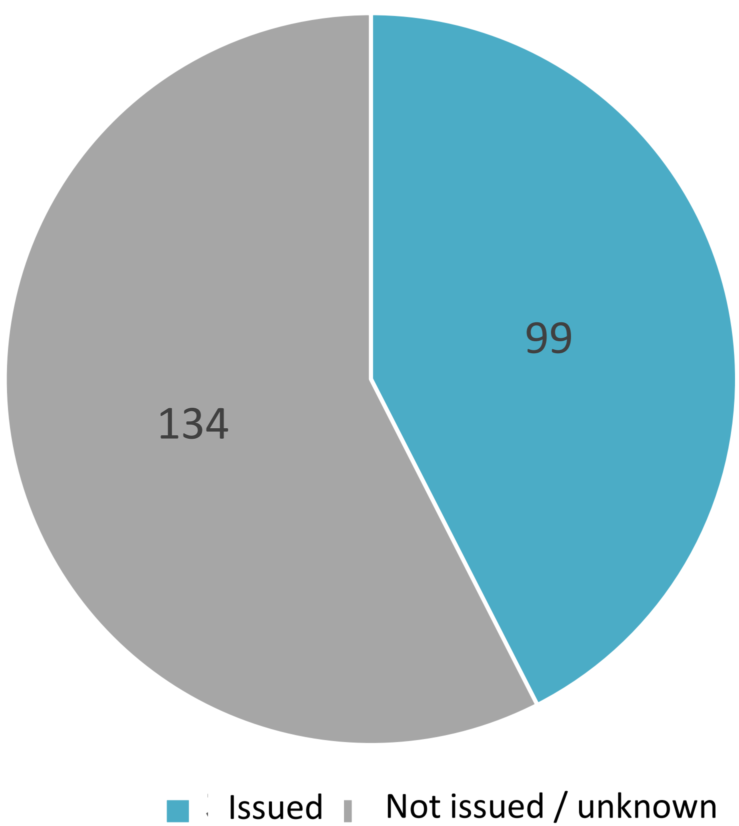
III.1. Investor's initiatives: (3) Disclosure of stewardship activities by institutional investors

- While most institutional investors updated their disclosure items corresponding to the revisions of the Code, only a limited number of institutional investors have disclosed reports on **their stewardship activities,** including their engagement with investee companies.

Update of disclosure items corresponding the revised Code



Reports on Stewardship activities



Source: Prepared by JFSA based on information (on websites, etc.) on 233 institutional investors which accepted the Stewardship Code by end-Aug. 2018 (aggregated data on Oct. 31, 2018)

III. Initiatives under the Stewardship Code

3. Other

III.3. Other: Examples of institutional investors' voting criteria or recommended criteria

	Mitsubishi UFJ Trust	J.P. Morgan Asset	ISS	Glass Lewis
Number of outside directors	In case a company did not nominate multiple outside director candidates, vote against all director candidates.	Unless at least one-third of the board comprises outside directors after AGM, vote against the proposal on election of representative director (President, etc.).	In case of Companies with *Kansayaku* Board, unless there are at least 2 outside directors after AGM, vote against a director candidate at the top management. (Effective from Feb. 2019, in case of Companies with Three Committees (i.e. audit, nomination and remuneration committees) and Companies with Supervisory Committee, unless at least one-third of the board comprises outside directors, vote against a director candidate at the top management.)	In case of Companies with *Kansayaku* Board, if the combined number of directors and *kansayaku* (corporate auditors) on the boards fails to meet the one-third independence threshold, vote against chairperson candidate (or President or equivalent)
Board size (number of directors)	In case the new total number of directors after an increase of directors is 21 or more, vote against all director candidates.	In case the total number of directors exceeds 15, vote against the proposal on election of directors.	N/A	In case a board has fewer than 5, or more than 20 directors, vote against a director candidate who is the company's Chairperson/ President or Nomination Committee chair (of a Company with Three Committees)
Capital policy	・If ROE has been lower than a 5% threshold for 5 consecutive years, and the improvement cannot be expected, and it is judged that leadership is responsible for mismanagement, vote against re-election of representative director. ・If a company has reported losses for 3 consecutive years, and the improvement cannot be expected, and it is judged that leadership is responsible for mismanagement, vote against re-election of directors.	If it is deemed that poor business results as a consequence of directors' mismanagement during their service caused a significant loss of shareholder value, vote against re-election of directors. ※Poor business results: Income from investments continues to be significantly low (constantly low ROE), etc.	In case of Companies with *Kansayaku* Board, if the average ROE for the past 5 years is lower than 5%, and a prospect for improvement is not observed, vote against a director candidate at the top management.	N/A
Cross-shareholdings	N/A	In case it is deemed that the rationale of cross-shareholdings has not been sufficiently explained, vote against re-election of directors.	(Effective from Feb. 2020, outside directors and outside *kansayaku* (corporate auditors) form cross-shareholders will be judged as not independent.)	N/A

Source: Prepared by JFSA based on each company's website. Data at the time of their AGMs in June 2018. Matters in the brackets refer to planned changes

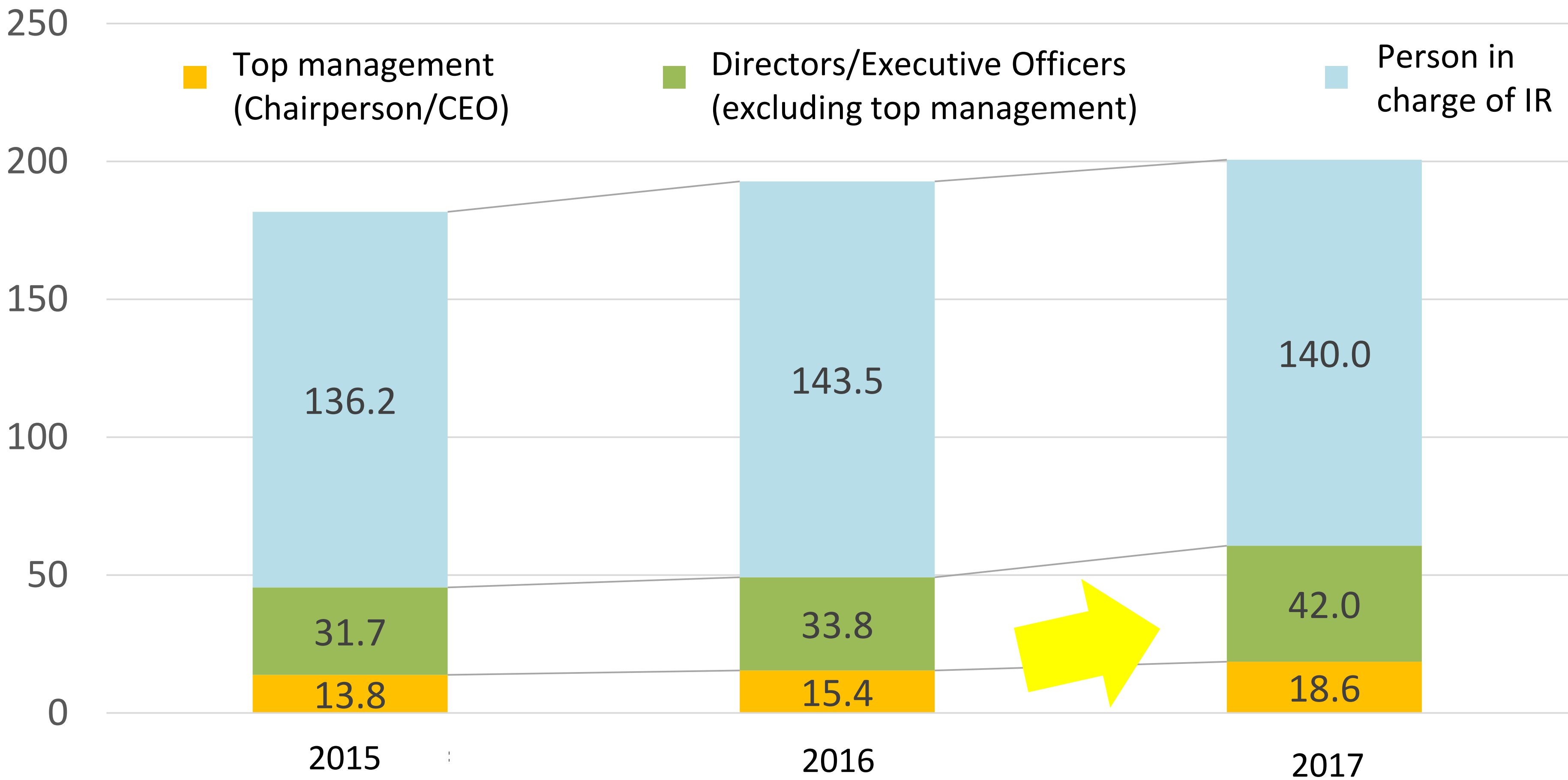
III.3 Other: Regulations on proxy advisors in other countries

	Legal Basis	Overview
US	Corporate Governance Reform and Transparency Act of 2017 (under Senate deliberation)	The following provisions are included: 1. Registration with SEC (organizational form, management of conflict of interest) 2. Requirement for assigning Compliance Officer 3. Requirement for providing companies with a prior opportunity to review and comment on proxy advice 4. Requirement for filing the annual report containing the number of agendas on which a proxy advisor provided advice, the number of staff members, etc.
	SEC's guidance for investment advisors (2014)	As a part of fiduciary duties, the following is required: 1. Ensuring an investment advisor has capabilities (human resources, structure, etc.) for sufficiently analyzing agendas 2. Oversight of proxy advisors
EU	Shareholders' Rights Directive (Entry into force June 10, 2017; member states must have the requirements implemented in national laws by June 10, 2019)	Member states must implement regulations, including requirements for Proxy Advisors to make annual disclosures on the following information related to their proxy advice: 1. Essential features of the approaches (methodologies, models) they apply 2. Procedures to ensure the quality of proxy advice (including qualification of staff involved) 3. Whether they take regulatory and company-specific circumstances into account 4. Essential features of voting policies they apply for each market 5. The extent of dialogue with companies 6. Policy on the management of conflicts of interest, etc. (Reference) In response to the request from the European Securities and Markets Authority (ESMA), BBP Group, a body consisting of proxy advisors, developed principles concerning proxy advisors' advisory services (Best Practice Principle) in 2014.
UK	Stewardship Code (Latest revision in 2012)	Principle 6 stipulates that institutional investors should disclose the use of proxy advisors services, if any. ※The FRC Monitoring report 2016 expressed concerns about merely formal approaches (e.g. box-ticking approach) taken by proxy advisors, and recommended that institutional investors should take into account broad-ranged circumstances which can be confirmed.

III.3 Other: The management's participation in engagement activities (dialogue)

☐ Despite an increasing trend in the number of companies, whose **management and executives participate in dialogue with institutional investors,** it is pointed out that the absolute number of such companies is **still small.**

<Average number of dialogues per year (companies)>

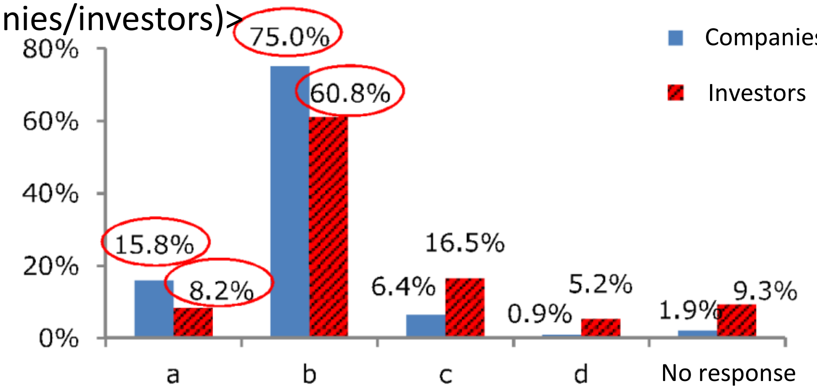


Source: Prepared by JFSA, based on FY 2015, 2016 & 2017 The Life Insurance Association of Japan Survey "Approaches toward Enhancing Equity Values"

III.3 Other: Perceptions of Companies and Investors (a)

☐ While both companies and investors perceive that they had constructive dialogue to a certain extent, a few of them perceive **such benefits as awareness or changes as a result of dialogue.**

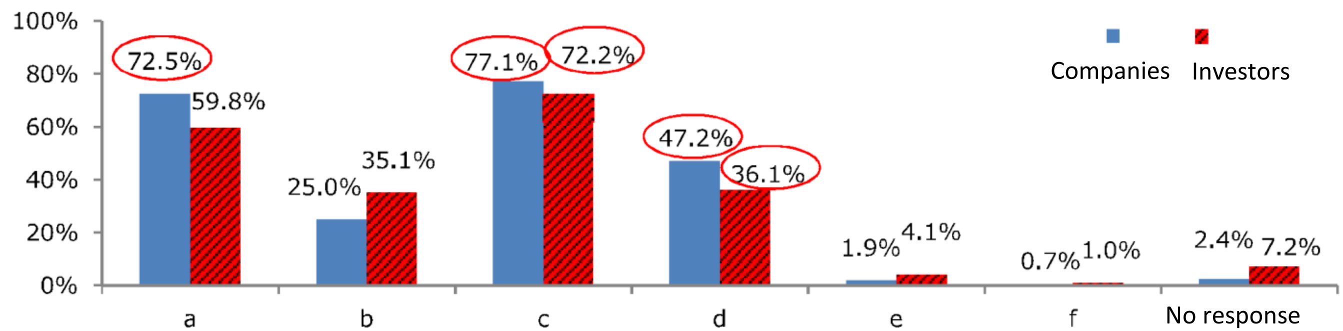
<Perception on whether they had meaningful dialogue which contributes to increasing mid- to long-term equity value (companies/investors)>



a. Sufficiently had such dialogue
b. Had such dialogue to a certain extent
c. Did not really have such dialogue
d. Rarely had such dialogue

<Perceived benefits from dialogue (companies/investors)>

a. Enhancement of discussion from the mid- to long-term perspective (business strategies, etc.)
b. Enhancement of discussion on non-financial information (ESG, etc.)
c. Deep understanding of the other's ways of thinking; mutual understanding
d. (companies only) Awareness that can be applied to business management
d. (investors) Change/improvement of companies as a result of dialogue
e. Nothing in particular
f. Other

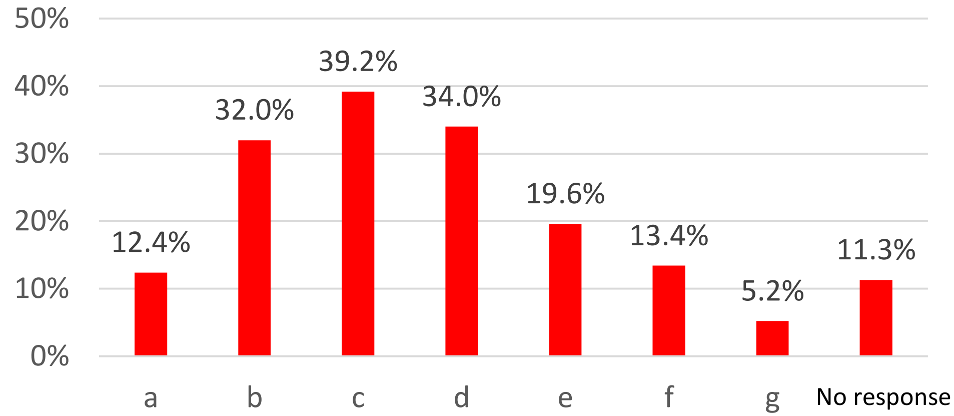


Source: FY2017 The Life Insurance Association of Japan Survey "Approaches toward Enhancing Equity Values"
* Survey period: from Oct. 4, 2017 to Nov. 6, 2017, Respondents: 581 listed companies and 116 institutional investors

III.3 Other: Perceptions of Companies and Investors (b)

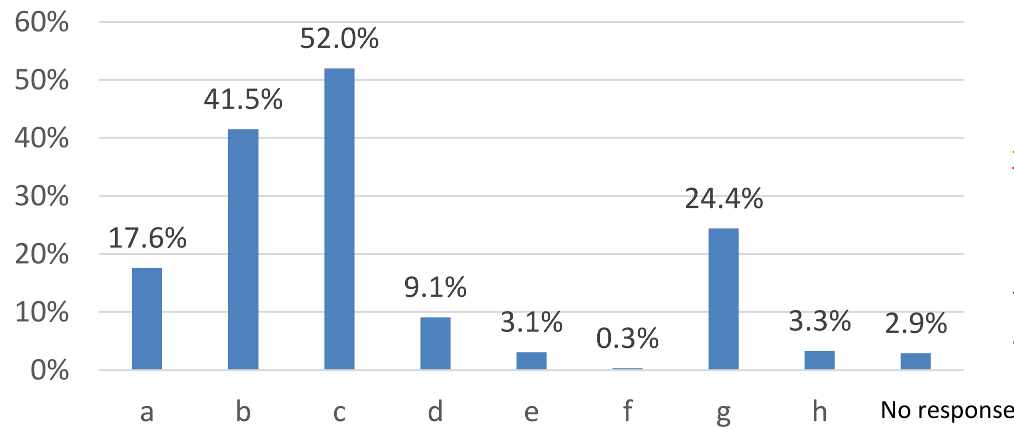
☐ While investors place emphasis on the **involvement of the company's management in dialogue,** companies are concerned about investors' **"short-termism".**

<Companies' issues in conducting dialogue (investors)>



a. What was announced to investors is different from the company's real intent (double standard)
b. Top management is not involved in dialogue
c. What was discussed during dialogue is not reported to the management
d. Disclosure is insufficient
e. There is no dedicated personnel for dialogue
f. Nothing in particular
g. Other

<Companies' issues in conducting dialogue (companies)>



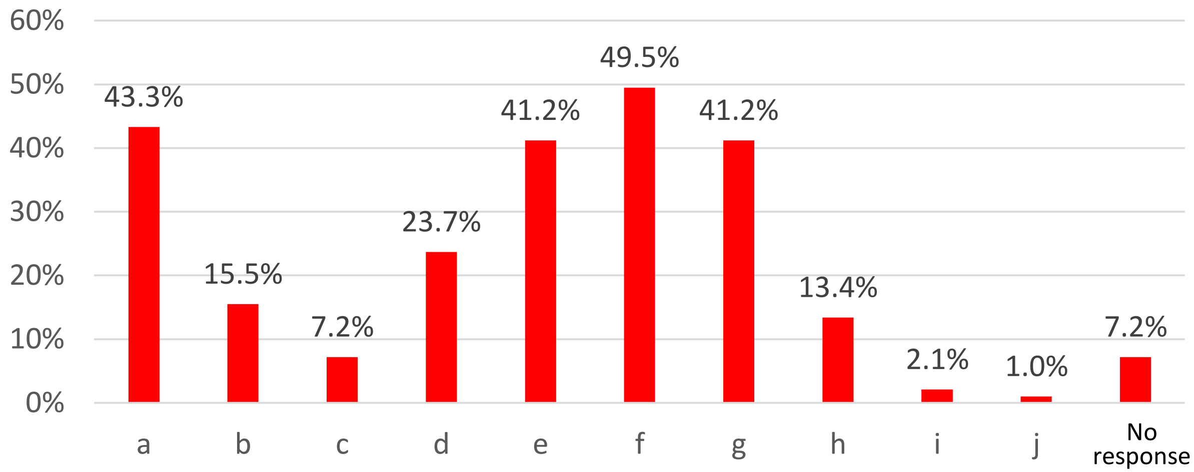
a. One-sided proposals and requests to companies
b. Analysis and understanding of the company are shallow
c. Implementation of dialogues based only on short-term themes
d. Too many superficial dialogues to generate performance results
e. Proposals that seem to neglect other stakeholders
f. Do not respond to dialogues
g. None in particular
h. Other

Source: Prepared by JFSA, based on FY2017 The Life Insurance Association of Japan Survey "Approaches toward Enhancing Equity Values"
* Survey period: from Oct. 4, 2017 to Nov. 6, 2017, Respondents: 581 listed companies and 116 institutional investors

III.3 Other: Perceptions of Companies and Investors (C)

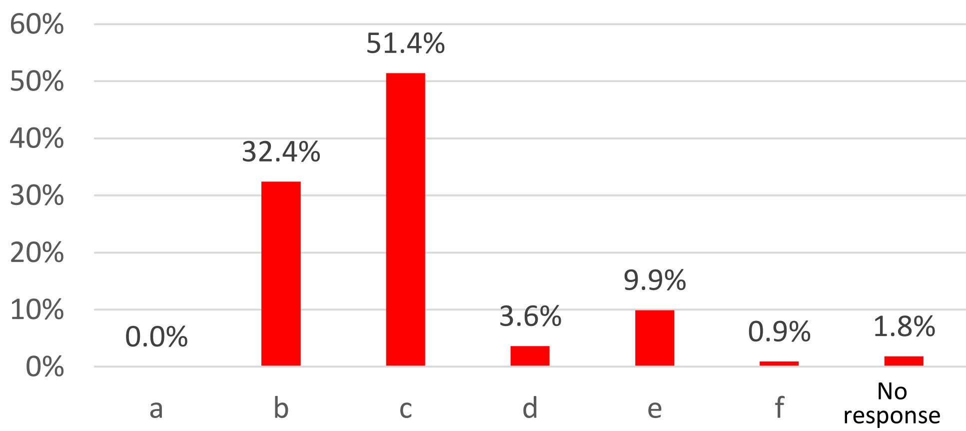
☐ Investors expect enhanced disclosure items and outside directors' fulfillment of their roles.

<Disclosure items which need to be enhanced (investors)>



a. Evaluation of effectiveness of the board
b. Policy for compensation for board members
c. Policy for designating board members
d. Training plan for successors, such as for CEO
e. Analysis of business performance/outlook of management
f. Reasons for selecting and state of activities of outside board members
g. Non-financial information such as environment (E), society (S), etc.
h. Supplementary/detailed data related to account settlement
i. Nothing in particular
j. Other

<Evaluation on whether outside directors are fulfilling expected roles (investors)>



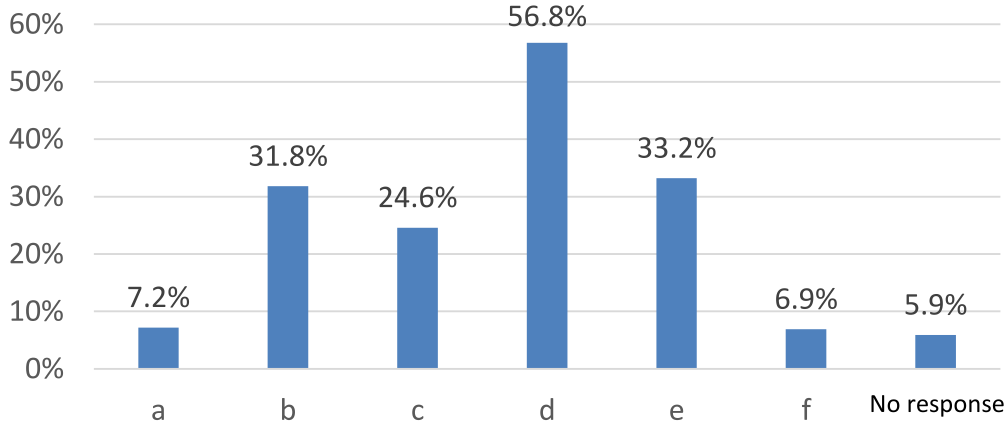
a. Sufficiently fulfilling expected roles
b. Fulfilling expected roles to a certain extent
c. Insufficient; have room for improvement
d. Not fulfilling expected roles at all
e. Investors cannot make an evaluation
f. Other

Source: FY2017 The Life Insurance Association of Japan Survey "Approaches toward Enhancing Equity Values"
* Survey period: from Oct. 4, 2017 to Nov. 6, 2017, Respondents: 581 listed companies and 116 institutional investors

III.3 Other: Perceptions of Companies and Investors (d)

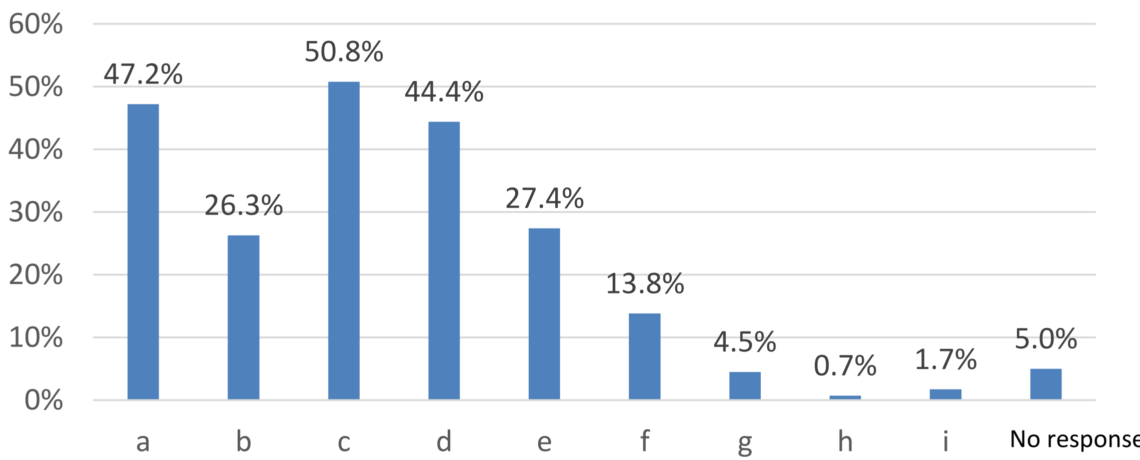
- Companies are concerned that investors are **easily influenced by judgments of proxy advisors**, and expect investors to disclose their voting criteria and reasons for voting decisions, and to identify company-specific circumstances.

<Issues on investors' exercise of voting rights (companies)>



a. There are many investors who do not exercise their voting rights
b. Do not know who substantial shareholders are
c. Insufficient dialogues with investors regarding proposal contents, etc.
d. Easily influenced by judgments of proxy advisors
e. Do not know reasons for decisions of approval or disapproval of shareholders regarding proposals
f. Other

<Expectations for investors concerning their exercise of voting rights (companies)>



a. Improved disclosure on voting criteria
b. Enhancement of dialogue on the exercise of voting rights
c. Exercise of voting rights, taking into account company-specific circumstances identified through dialogue, etc.
d. Explanation on voting for/against our proposals
e. Improved disclosure on voting records
f. Appropriate use of proxy advisors
g. Electronic exercise of voting rights
h. Strengthened management of conflicts of interest
i. Other

Source: FY2017 The Life Insurance Association of Japan Survey "Approaches toward Enhancing Equity Values"
* Survey period: from Oct. 4, 2017 to Nov. 6, 2017, Respondents: 581 listed companies and 116 institutional investors

III.3 Other: Investors' views on stewardship activities

<Opinions from companies>

- ✓ Compared to sell-side analysts, their understanding of our business, including the business environment is shallower, and sometimes there is a gap in discussion.
- ✓ While investors mention "dialogue from the mid- to long-term perspective", in many cases, it actually is discussion about the next 2-3 years. We got an impression that many investors still exhibit **"short-termism".** (On the contrary, some other companies pointed out that an increasing number of investors begin to ask questions about long-term – say 10 years – business strategies, etc.)
- ✓ To ensure that votes against our proposals lead to the improvement of our business management, investors should clarify whether they disclose their proxy voting standards and they **use proxy advisors.**
- ✓ **As for collective engagement,** we are expecting that multiple investors work on thorough preparation.

Source: FY2017 The Life Insurance Association of Japan Survey "Approaches toward Enhancing Equity Values"
* Survey period: from Oct. 4, 2017 to Nov. 6, 2017, Respondents: 581 listed companies and 116 institutional investors