

Material 1

Provisional
Translation

Group governance/Shareholding structure

January 26, 2021
Japan Financial Services Agency

(1) Current status of listed subsidiaries, etc.

(1) Current status of listed subsidiaries, etc. (i)

- ❑ In Opinion Statement No.4 of the Council published in April 2019, it was stated that **the future task is to consider the Group Governance from the perspective of protecting general shareholders such as listed subsidiaries, etc.**(*)

(*) A listed company that has a controlling shareholder or similar major shareholder (the same applies to the following materials).

Opinion Statement No. 4 (Excerpt)

2. Group Governance

With respect to Japanese corporate group management, **it has been pointed out that the appropriate allocation of management resources and the risk management of subsidiaries may not be being carried out sufficiently**, and that **the independence of the Board of Directors may need to be strengthened**, because listed subsidiaries with a controlling shareholder (so-called “listed subsidiaries”) **have the risk of conflict of interest between the controlling shareholder and general shareholders**.

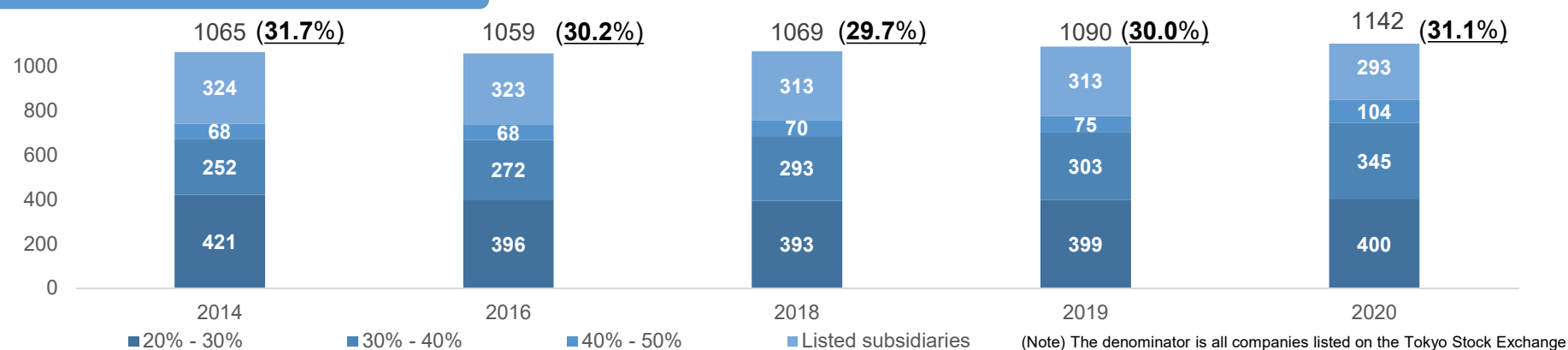
Discussions with respect to group governance, including discussions on governance of listed subsidiaries, **should include better explanations by parent companies as to why they have listed subsidiaries**. They should also involve **establishing stricter governance of these listed subsidiaries, such as increasing the proportion of directors independent from a controlling shareholder, keeping in mind the review of the Tokyo Stock Exchange’s independent director criteria**.

Based on these discussions, **the Council will continue to review further group governance from the standpoint of protecting general shareholders**.

(1) Current status of listed subsidiaries, etc. (ii)

- Since 2014, the number of listed subsidiaries, etc. has increased by 77 (a 0.6% decrease).
- Looking at the number of listed companies with controlling shareholders (limited to listed companies), the ratio of listed companies with controlling shareholders holding 30% or more of the shares is less than 1% in the US and the UK, about 4% in France and Germany, and 10.7% in Japan.

Changes in listed subsidiaries, etc.



Source: Prepared by Tokyo Stock Exchange based on the largest shareholder data from QUICK

| Country | The number of listed companies | The number of listed companies that have controlling shareholders (*) (limited to listed companies) (the ratio to the total number of listed companies) | |
|--------------|--------------------------------|--|--|
| | | 50% or more held by controlling shareholders | 30% or more held by controlling shareholders |
| U.S. | 5,348 | 28 (0.52%) | 48 (0.89%) |
| U.K. | 1,920 | 0 (0.00%) | 4 (0.20%) |
| France | 806 | 18 (2.23%) | 30 (3.72%) |
| Germany | 794 | 17 (2.14%) | 28 (3.52%) |
| Japan | 3,892 | 238 (6.11%) | 418 (10.73%) |

(Note) "Controlling shareholder" in this survey refers to a person who directly owns 30% or more of the outstanding shares of the target listed company.

Source: Prepared by the FSA based on the FY2018 Industrial Economics Research Contracted Projects (Research Project Expenses Related to Economic and Industrial Policy and the Fourth Industrial Revolution) (Research on M&A) Research Report

**(2) Protecting minority shareholders of
listed subsidiaries, etc.**

(2) Protecting minority shareholders of listed subsidiaries, etc. (opinions regarding conflict of interest)

- Regarding listed subsidiaries, mainly investors **have concerns about the possibility of conflict of interest between parent companies and minority shareholders**(*).

(*) Maximization of the value of the "corporate group" by the parent company does not necessarily coincide with the maximization of the value of the subsidiaries.

- 78% of listed parent companies answered that they "do not entail much" risk of conflict of interest with minority shareholders.**

Opinions about challenges of listed subsidiaries, etc.

- Although the overall optimization of the corporate group and the partial optimization of the quasi-controlled listed companies are not always in tension, it is necessary to establish a system in advance to prepare for contingency situations where the two diverge. (Investors)
- When discussing parent-subsidary listings, the company's perspectives are business (execution) synergies or options, while the investor's perspective are supervising conflicts of interest with minority shareholders. The current situation is that the perspectives of the companies and the investors are not aligned. (Investors)
- Given the current status of conglomerate discount, the information (including track record) required to generate premiums must be at a high level, both in terms of quality and quantity. (Investors)

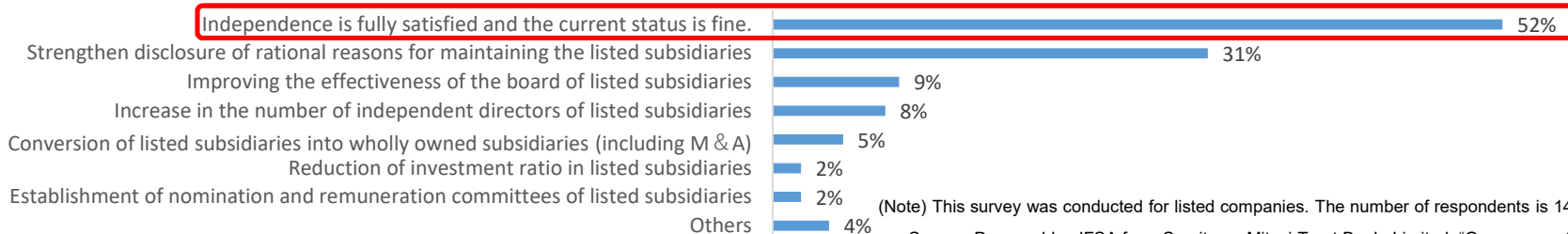
Do you feel there is the risk of conflict of interest with general shareholders of the listed subsidiaries?



(Note) This survey was conducted for listed companies. The number of respondents is 141 companies.

Source: Prepared by JFSA from Sumitomo Mitsui Trust Bank, Limited, "Governance Survey 2019"

What are the high-priority issues to be considered from the perspective of ensuring the independence of listed subsidiaries?



(Note) This survey was conducted for listed companies. The number of respondents is 141 companies.

Source: Prepared by JFSA from Sumitomo Mitsui Trust Bank, Limited, "Governance Survey 2019"

(2) Protecting minority shareholders of listed subsidiaries, etc. (current status of governance (i))

- The ratio of listed subsidiaries at which at least one-third of the directors are independent is 15%, while that of companies listed on TSE1 is about 43.6%. (2019)
- In addition, in the case of listed companies without controlling shareholders, the ratio of having a remuneration committee is 38.1%, while in the case of unlisted companies or listed companies with individual controlling shareholders, the ratio is just over 10%.

| Target of aggregation | The number of companies | Directors | | Independent director | | | | |
|---------------------------|-------------------------|----------------|----------------|------------------------|------------------------|-------------------------|------------------------|-----------------------|
| | | Average number | Average number | 0 person | 1 person | 2 people or more | 1/3 or more | More than half |
| Listed subsidiaries | 313 | 8.52 | 2.0 | 16 companies | 57 companies | 240 companies | 47 companies | 5 companies |
| | | | | 5.1% | 18.2% | 76.7% | 15.0% | 1.6% |
| Companies listed on TSE 1 | 2,148 | 9.1 | 2.7 | 7 companies | 134 companies | 2,007 companies | 937 companies | 93 companies |
| | | | | 0.3% | 6.2% | 93.4% | 43.6% | 4.3% |
| All listed companies | 3,639 | 8.3 | 2.2 | 191 companies | 684 companies | 2,764 companies | 1,298 companies | 128 companies |
| | | | | 5.2% | 18.8% | 76.0% | 35.7% | 3.5% |

| | With controlling shareholders (*) | | | | | | Without controlling shareholders | |
|------------------------------|-----------------------------------|--------------|-------------------------------|--------------|-------------------------|--------------|----------------------------------|--------------|
| | Parent companies (listed) | | Parent companies (non-listed) | | Individuals | | Number | Ratio |
| | Number | Ratio | Number | Ratio | Number | Ratio | | |
| With Remuneration committees | 117/ 313 companies | 37.4% | 8/ 64 companies | 12.5% | 29/ 261 companies | 11.1% | 1,143/ 3,001 companies | 38.1% |

(Note) A controlling shareholder means a parent company or an entity which directly or indirectly hold a majority of the voting rights (Securities Listing regulations, Rule 2. (42)-2)

Source: Prepared by JFSA from each company's corporate governance report as of July 12, 2019.

(2) Protecting minority shareholders of listed subsidiaries, etc. (current status of governance (ii))

- ❑ Under the Listing Rules, when listed companies with controlling shareholders engage in significant transactions with the controlling shareholders, it is required to **obtain an opinion that the transaction is disadvantageous to minority shareholders from a disinterested person, and to disclose the details of the opinion as necessary and sufficient from time to time.**
- ❑ **64.1% of companies obtain opinions regarding the above rule from their independent directors or independent *kansayaku*.**

| Sources of opinions | Cases | ratio |
|--|------------|--------------|
| <u>Independent directors</u> | <u>174</u> | <u>34.3%</u> |
| <u>Independent <i>kansayaku</i></u> | <u>151</u> | <u>29.8%</u> |
| Independent committees | 115 | 22.7% |
| Attorneys or Certified accountants | 21 | 4.1% |
| External agencies | 15 | 3.0% |
| Others (Non-interested directors, etc.) | 31 | 6.1% |

Source: Prepared by the Tokyo Stock Exchange

Securities Listing Regulations Rule 441-2. Matters to be Observed Pertaining to Significant Transactions, etc. with Controlling Shareholder

A listed company that has a controlling shareholder shall, in the cases referred to in the following items, **obtain an opinion from an entity that has no interest in such controlling shareholder, to the effect that any decision on the matters prescribed in such items will not undermine the interests of the minority shareholders of such listed company.** (skip)

2 A listed company shall, in the cases referred to in each item of the preceding paragraph, **perform necessary and sufficient timely disclosure.**

(2) Protecting minority shareholders of listed subsidiaries, etc. (Overview of overseas systems)

- In the U.S., there is a well-established discipline for protecting minority shareholders based mainly on precedents, and in the U.K., there is a well-developed discipline mainly under the Listing Rules.

| | Japan | U.S. | U.K. |
|--|---|--|--|
| Characteristic | Obtaining prior opinions from third parties and disclosing information | Mainly discipline through judicial decisions based on the controlling shareholder's fiduciary duty | Mainly prior process regulation and information disclosure |
| Regulation | Mainly listing rules | Mainly precedents | Mainly listing rules |
| Advance procedural regulations | <ul style="list-style-type: none"> ➤ In a material transaction with the controlling shareholder, etc., obtain an opinion to the effect that matters prescribed in such items will not undermine the interests of the minority shareholders of such listed company (listing rules) | <p>Prior procedures, such as approval by a majority of minority shareholders or the establishment of a special committee, will make it easier to determine that the trust obligation has been fulfilled.</p> | <p>For regarding listed companies on the premium market,</p> <ul style="list-style-type: none"> ① Conclusion of legally binding agreements to ensure compliance with the arm's-length transaction standards for transactions with controlling shareholders, etc. (listing rule) ② In principle, require a resolution of the general meeting of shareholders for transactions between the company and related parties, including major shareholders. (Listing rule) |
| Disclosure rules | Disclosure of transactions with related parties in business reports, etc. (Companies Act, etc.) | <ul style="list-style-type: none"> ➤ Disclosure of Material Definitive Agreement (SEC regulation) | <ul style="list-style-type: none"> ➤ Disclose in the annual report whether the company is complying with the agreement in (1) above, and if not, the reasons for not complying. (listing rule) ➤ Disclose the transactions with related party transaction (Listing rule) |
| Judicial remedies | (An unlawful act, etc.) | <ul style="list-style-type: none"> ➤ (Claim for damages based on breach of fiduciary duty, etc.) | <ul style="list-style-type: none"> ➤ Order for relief from unfair infringement (Companies act) |
| Appointment of directors of listed subsidiaries | — | — | <ul style="list-style-type: none"> ➤ For listed companies on the premium market, approval by a majority of minority shareholders (Majority of Minority) is required for the appointment of independent outside directors of listed subsidiaries. (Listing rule) |

(*) In Germany, the protection of minority shareholders is provided by a systematic legal system for corporate groups (stock law).

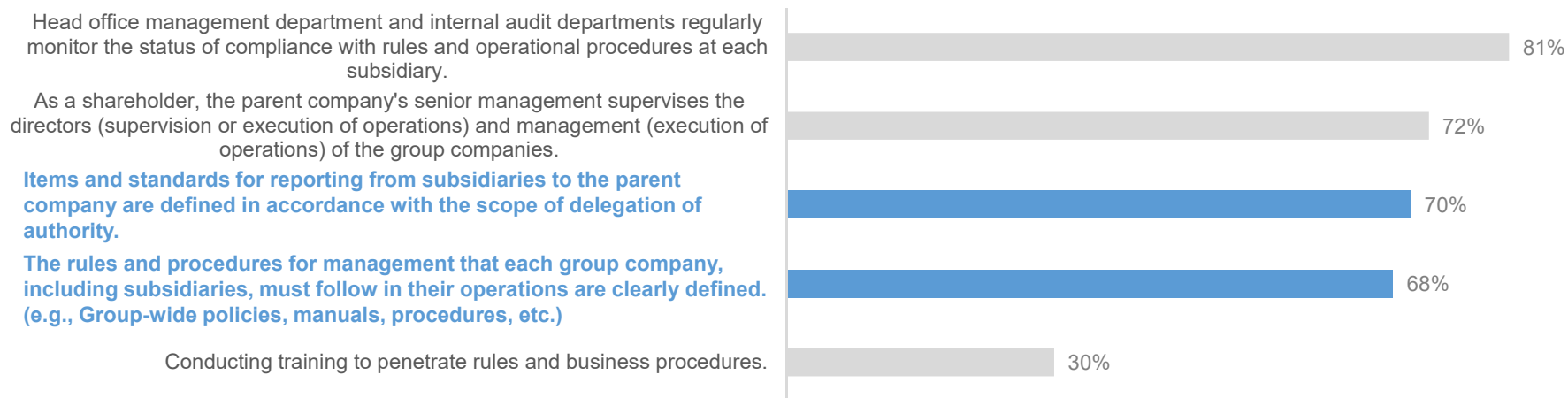
(3) Optimization of group management

(3) Optimization of group management (Policy decisions on group management and business portfolio management (i))

- According to the questionnaire conducted by the METI for listed companies in FY2018, **about 70% of the companies have clarified management rules and business processes** to be followed by each company in the group as an effort to ensure that the framework for decision-making and authority functions as a corporate group.
- On the other hand, **25% of the companies confirm the penetration of the management philosophy etc. and report it to the management.**

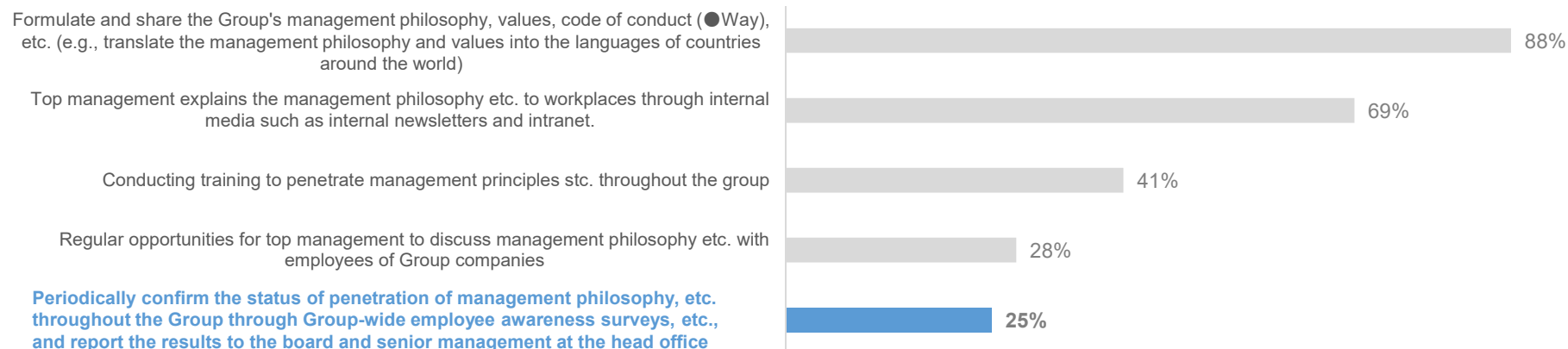
Efforts to ensure the functioning of the decision-making and authority/responsibility framework as a group

(N = 770)
Multiple choices possible



Status of efforts to ensure unity as a corporate group for effective management of subsidiaries

(N = 755)
Multiple choices possible



Source: Prepared by JFSA from the Ministry of Economy, Trade and Industry, "Practical Guidelines for Group Governance Systems(Group Guidelines)(June 2019)."

(3) Optimization of group management (Policy decisions on group management and business portfolio management (ii))

- ❑ Some companies have expressed **their desire to review their business portfolio strategies** in order to build a business model that can cope with the post COVID-19 economy and society.
- ❑ In this regard, investors have pointed out the importance of **proactively reviewing the business portfolio and, in such cases, working as a group led by the Group CEO.**



Companies

- The role of **the management of a company with many business lines is to successfully manage the portfolio and create synergies, which is the minimum requirement.**
- It is important to **constantly restructure businesses and implement structural reforms, to foster a culture in which this becomes common practice,** and to keep the system running.
- It is important to **create an environment in which we can combine the strategic aspects of the company with the time frame of business decisions from a long-term perspective beyond the perspective of short-term profitability.**
- Based on the changes in the demand structure after the COVID-19 pandemic, we are **selecting and concentrating core businesses** where demand is expected to continue, and on providing services in regions and locations where demand is expected to recover quickly.
- Past business models will not work in the new normal era, so **we consider restructuring our business portfolio.**
- This is not to say that we are reviewing our **business portfolio** just because of COVID-19 pandemic, but **our basic stance is that management decisions should be made in a timely manner.**
- It is required to respond by **establishing a new business model** (by further promoting digitalization, which we had been promoting before the COVID-19 pandemic).

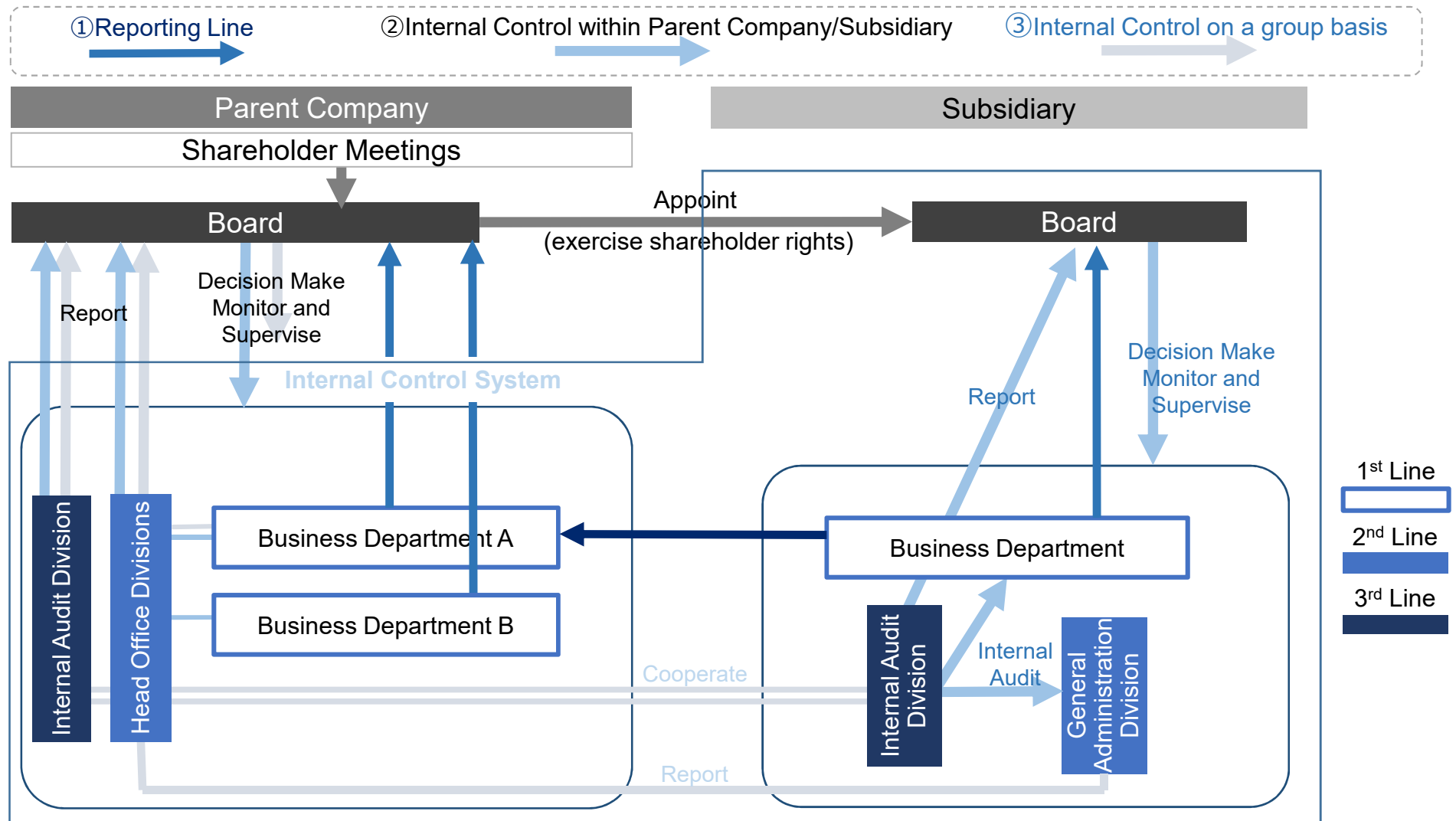


Investors

- As the primary role of a Group CEO is to pursue synergies, he/she should pursue the maximum synergies from the existing business portfolio, and if this is not possible or not optimal, **he/she must restructure the business portfolio.**
- In the future, there will be a need to communicate more clearly with the capital markets about the rationality of the current business portfolio and the direction of future business portfolio changes, both from the perspective of risk, such as resistance to external stress, and from the perspective of maximizing growth. **It is important for the group to constantly review its business portfolio.**
- Japanese companies tend to have management teams and boards that are composed of internally promoted members. The said members often represent the interests of their respective business units. **In such a situation where it is a little difficult for the management and the board to have a bird's eye view of the business portfolio management as a company, it is important to devise various ways to manage the business portfolio.**
- After the COVID-19 pandemic, **the competence of management will become extremely important.** If Japan as a whole moves to pursue corporate social responsibility, **it will be important to perceive the movements of the world ahead of time and formulate short-, medium- and long-term strategies.**

(3) Optimization of group management (risk management on a group basis)

- It has been pointed out that **risk management on a group basis is important** as one of the changes in group management.
- It has been pointed out that it is important for *kansayaku*, supervisory committees and audit committees to cooperate with and utilize the internal audit divisions to audit the entire internal control system.

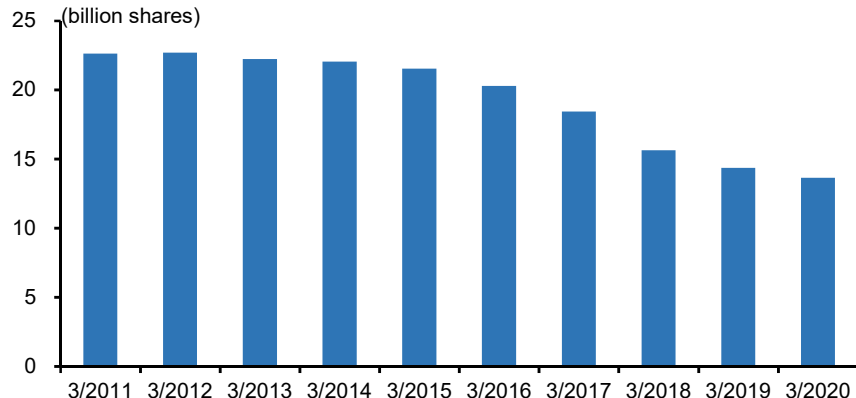


(4) Cross-shareholdings

(4) Cross-shareholdings (Trend)

- ❑ The total number of cross-shareholdings has been on a downward trend since the mid-2010s.
- ❑ In particular, the ratio of cross-shareholdings held by financial institutions has been decreasing, but the ratio held by business companies and other entities have remained high.

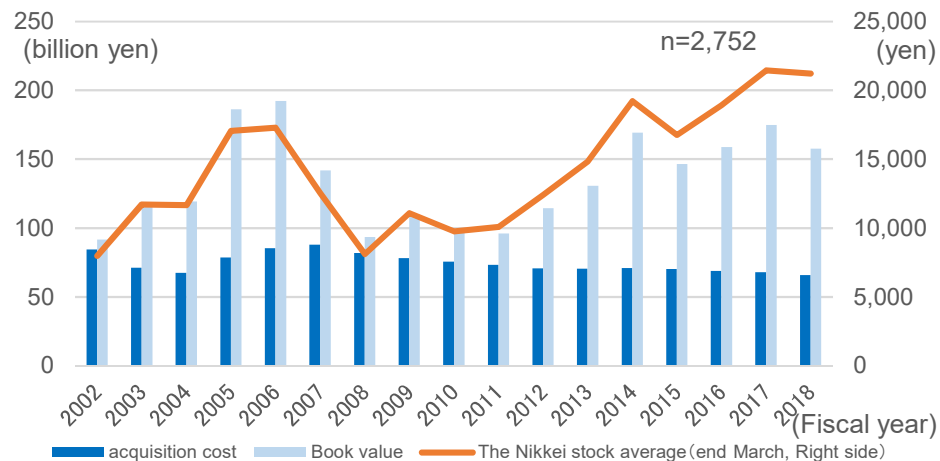
Total number of cross-shareholdings held by companies



(Note) For all listed stocks, Number of cross-shareholdings for which market value can be calculated. 2,094 companies that have been available for 10 consecutive fiscal years since the fiscal year ended March 31, 2011 were selected. As of August 12, 2020.

Source: Annual securities reports and prepared by Mizuho Securities from QUICK Astra Manager

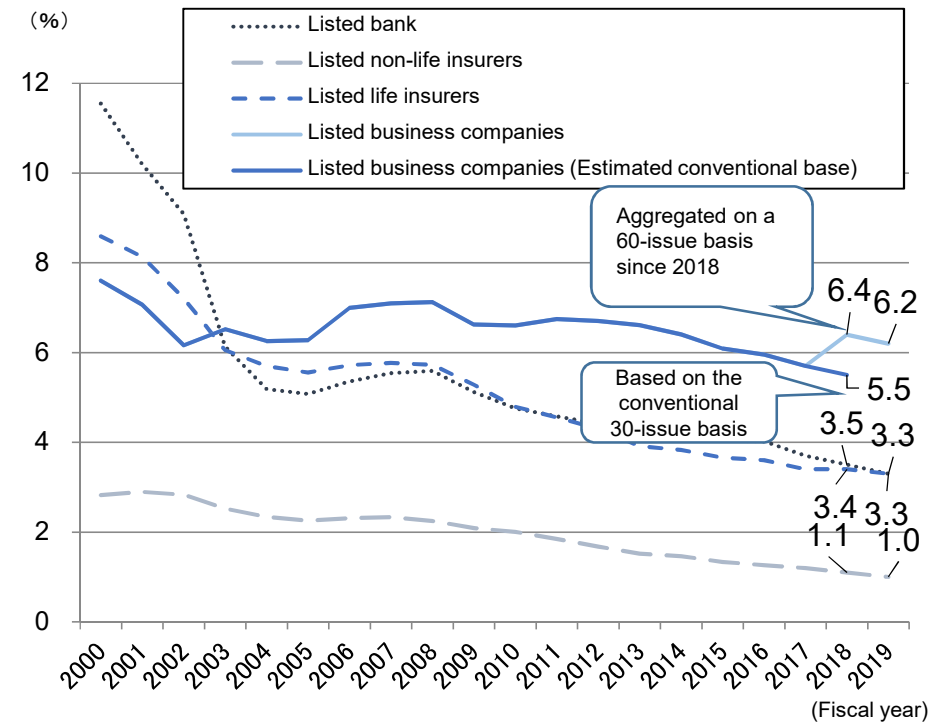
Acquisition cost and book value (market value) of cross-shareholdings



(Note) Prepared for companies using JGAAP only.

Source: TSUMURAYA Shoichi, "Empirical Analysis of Cross-Shareholdings"(Nikkei BP, 2020)

Breakdown of cross-shareholding ratio by Type of Shareholder (Market value-based ratio)



(Note) The ratio of shares of other listed companies held by listed companies and insurance companies (on a market value basis) to the total market capitalization of the market (excluding shares of subsidiaries and affiliates).

(Note) Due to a partial revision of the Cabinet Office Ordinance on Disclosure of Corporate Affairs, etc., from the annual securities report for the fiscal year ending March 31, 2019, the criteria and approach for classifying net investments and policy investments, and more specific explanations, including quantitative effects, of the purpose and effects of individual policy stock holdings are required. In addition, the number of stocks held subject to exceptional disclosure has been expanded from 30 to 60 in principle.

Source: Prepared by JFSA from "Financial Information Update" (September 14, 2020), Nomura Institute of Capital Markets Research.

(4) Cross-shareholdings (Opinions from investors and companies)

- ❑ With regard to cross-shareholdings, there is still strong demand on the part of investors **to reduce the cross shareholdings and to enhance the explanation of the rationales for such cross-shareholdings** from the perspective of making voting rights more effective and improving capital efficiency.
- ❑ According to interviews conducted by the FSA, some companies have indicated that their finance departments are **working to reduce their cross-shareholdings, but they need to coordinate with business partners and business departments.**



Investors

- With regard to cross shareholdings and stable shareholders, companies and shareholders cannot receive the benefits provided by the capital market disciplines if, as in Japan, shareholder proposals are rarely approved and company proposals are rarely rejected. In order to ensure the effectiveness of the Stewardship Code and the Corporate Governance Code, **Japanese companies should break away from their dependence on stable shareholders and allow dynamic, disciplined, swift and global shareholders to become the mainstay.**
- **Cross-shareholdings are risk assets on the balance sheet**, and a decline in stock prices must be assumed as a risk. **In the wake of the COVID-19 pandemic, we can say that such risks are now becoming apparent.**
- **The results of the exercise of voting rights related cross-shareholdings should be disclosed.**



Companies

- When disposing of or acquiring cross-shareholdings, there are cases where the counter-party has indicated that there will be a negative impact on the transaction.
- Business/Sales departments tend to be reluctant to sell the cross-shareholdings from the perspective of maintaining transactions, and it takes time to make arrangements.
- We approached regional banks with a three-point plan of lowering borrowing rates, closing accounts, and selling cross-shareholdings, but this plan was strongly opposed.

(4) Cross-shareholdings (disclosure in securities reports)

- ❑ The Cabinet Office Order was revised to encourage **the enhancement of disclosure** of cross-shareholdings **in securities reports**, effective from the fiscal year ending March 31, 2019.
- ❑ It also requires disclosure of **policies for cross-shareholdings, methods for verifying the rationality of holding such shares, and the purpose and effect of holding each individual brand.**

Before the revision

- Number of companies in which cross-shares are held. / Total amount of cross-held shares on the balance sheet (Not distinguish between unlisted stocks and other stocks.)
- Individual issues of policy investment stocks (other than unlisted stocks)
(Last year)

| Company | Shares | B/S Amount | Objective of holdings |
|---------|---------|------------|-----------------------|
| A | xxx,xxx | xxx,xxx | |
| B | xxx,xxx | xxx,xxx | |
| ⋮ | | | |

(This year)

| Company | Shares | B/S Amount | Objective of holdings |
|---------|---------|------------|-----------------------|
| A | xxx,xxx | xxx,xxx | |
| B | xxx,xxx | xxx,xxx | |
| ⋮ | | | |

- Total amount of shares for pure investment purpose on the balance sheet, received dividend, profit/loss from disposition of such shares, shares of stocks for which the purpose of holding has been changed, and total amount on balance sheet

Expected status after revision (changes shown in blue text)

- **Definition and concept** of shares for pure investment purpose and shares for other purpose (cross-held shares)
- **Policy** of cross-share holdings, **process to verify their rationale for holding them**
- **Details of verification at Boards, etc. regarding the appropriateness of holding individual issues of cross-share holdings**
- Number of companies in which cross-shares are held. / Total amount of cross-held shares on the balance sheet
(Distinguish between unlisted stocks and other stocks.)
- **Number of brands where the number of shares increased, total amount of acquisition price and reason for increase, number of brands where the number of shares decreased, total amount of sale price**
- Individual issues of policy investment stocks (other than unlisted stocks)

| Company | (This year) Shares B/S Amount | (Last year) Shares B/S Amount | Objective of holdings Benefit of holdings Shares held by counterparties Reason for increase |
|---------|-------------------------------------|-------------------------------------|--|
| A | xxx,xxx xxx,xxx | xxx,xxx xxx,xxx | |
| B | xxx,xxx xxx,xxx | xxx,xxx xxx,xxx | |
| ⋮ | | | |

(*) Describe in more detail, including quantitative effects (if not possible to describe, a statement to that effect and a method for verifying the rationality of holding the information) in relation to the strategy, business activities, and segments.

- **The number of brands** and total amount of shares for pure investment purpose on the balance sheet, received dividend, profit/loss from disposition of such shares, the total number of stocks for which the purpose of holding has been changed, and total amount on balance sheet

(4) Cross-shareholdings

(Main points of "Good Practices for Disclosure of Descriptive Information" (November 2019))

- ❑ Descriptive information (information other than financial information) plays an important role in supplementing financial information and enabling investors to make appropriate decisions.
- ❑ In March 2019, "[Good Practices for Disclosure of Descriptive Information](#)" was published to promote efforts to enhance the disclosure of annual securities reports beyond formal compliance with the rules.
- ❑ Based on the revision of the Cabinet Office Ordinance in January 2019, which expanded the disclosure of executive compensation and cross-shareholdings, FSA added good examples of [executive compensation](#) to the above "Good Practices" and published the points of good disclosure expected by investors regarding [cross-shareholdings](#).

○ Executive Compensation

- A study group consisting of investors/analysts and companies was held, and [examples of disclosures introduced by investors/analysts at the study group were added to and updated in the "Good Practices for Disclosure of Descriptive Information"](#).
- Examples of disclosures that specifically describe the following information were added.
 - ✓ Remuneration program, including the calculation method of performance-linked remuneration
 - ✓ Remuneration performance based on KPIs
 - ✓ Activities of the Board and Remuneration Committee in determining remuneration, etc.

The image shows a screenshot of a Japanese financial disclosure document. It contains several tables and sections of text. The tables appear to be related to executive compensation and cross-shareholdings, with columns for names, positions, and financial data. The text is in Japanese and includes headings and sub-sections. The document is presented in a grid-like format with multiple columns and rows of data.

○ Cross Shareholdings

- In response to comments from investors and analysts that [there is a large discrepancy between what they consider to be good disclosure and current disclosure](#), instead of publishing examples of good practice, FSA has [published examples of points of good disclosure based on the opinions of investors and analysts](#).
- The main points of good disclosure are as follows.
 - ✓ Describing holding and selling policies of cross shareholdings in relation to management strategies
 - ✓ Describe the effect of holding such shares in relation to management strategy, not just verification by market value (unrealized profit) and dividends.
- It is hoped that these points will be used as a reference in discussions for better disclosure.

(4) Cross-shareholdings (key opinions from investors and analysts)

- Investors and analysts commented that the disclosure of cross-shareholdings, while improving, was still insufficient.

| Main items | Main comments from investors and analysts |
|--|--|
| How to verify the rationality of cross-shareholdings | <ul style="list-style-type: none"> In some cases, the "schedule for verifying the rationality of shareholdings, negotiations, and reductions" is shown in a chart, which is highly useful because it shows that the company is committed to reducing its shareholdings. The rationality of cross shareholding should be verified from the perspective of the degree of contribution to business earnings, rather than evaluating returns based on market value (unrealized profit) and dividends as in the case of net investments. While some companies have shown some ingenuity, such as using charts and graphs to illustrate the process of verifying rationality, the specific reasons for determining "rationality" are unclear in some cases. |
| (Individual brands) Purpose of holding and quantitative effect of holding | <ul style="list-style-type: none"> While some companies have made improvements, such as describing the purpose of their holdings in relation to their business and transactions, there are few companies that provide quantitative information on the effects of their holdings for each individual brand. |

(5) Subjects to be discussed at the 23rd Council

- With regard to the nature of listed subsidiaries, etc., the following points have been made.
 - In light of the recent moves to examine the nature of group management, further consideration should be given to how to protect minority shareholders of listed subsidiaries, such as by strengthening governance systems.
 - In doing so, listed subsidiaries should pay sufficient attention to the fact that the existence of a controlling shareholder enables them to enjoy the benefits of investing management resources and supervision.
- With regard to group governance, from the perspective of optimizing group management, it has been pointed out that the optimal allocation of management resources for the entire group, including a review of the business portfolio, and risk management of subsidiaries are issues that need to be addressed.
- In light of the above perspectives, what do you think about the following issues related to the shareholding structure, including group governance?
 - How to establish a framework for protecting minority shareholders from controlling shareholders, including the involvement of independent directors in listed subsidiaries and the disclosure of such information.
 - Roles and functions to be played by the board (especially of listed companies with group management)
 - Issues of cross-shareholding
- Are there any other issues related to the structure of shareholdings, including group governance, that should be considered?