Financial Services Agency

(Provisional translation)

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

1. Date and Time: March 13, 2018 (Tuesday)　10:00-12:00

2. Venue: 13F, Central Government Building No. 7, Meeting Room

[Ikeo, Chairman] It's already the scheduled opening time. I'd like to open the fifteenth Council of Experts Concerning the Follow-up of Japan's Stewardship Code and Japan's Corporate Governance Code.

Thank you very much for taking the time from your busy schedule.

Today, first, the secretariat will provide an explanation on the materials that have been distributed that include the Revision of the Corporate Governance Code and Establishment of Guidelines for Investor and Company Engagement (Draft), Japan's Corporate Governance Code (Draft Revision), and Guidelines for Investor and Company Engagement (Draft).

OK, you are free to speak.

[Tahara, Director of the Corporate Accounting and Disclosure Division, FSA] I would like to provide an explanation on the Material, Appendix 1, and Appendix 2.

First, I would like to look at the "Revision of the Corporate Governance Code and Establishment of Guidelines for Investor and Company Engagement (Draft)". In the same manner as the introduction written in the Code when it was established, this document explains the background behind the recent revision of the Code and the establishment of the Guidelines.

The first paragraph of the "Introduction" describes the background behind the holding of the council, namely the necessity of encouraging substantive engagement between investors and companies and the further advance of corporate governance reform. The second paragraph describes the developments leading up to the recent revision of the Code and the establishment of the Guidelines.

Next, I would like to explain Ⅱ "Ideas Underlying the Revision of the Code and the Establishment of the Engagement Guidelines". In "1. Management Decisions in Response to Changes in the Business Environment", it states the original purpose of the establishment of the Code

is to promote sustainable growth and increase corporate value over the med- to long-term by encouraging decisive decisions by management, and describes the reasons which have been pointed out why these are not being conducted effectively yet, as well as the response to this issue.

In “2. Investment Strategy and Financial Management Policy”, the importance of strategic and systematic investments is described. It was also pointed out that it is important in making such investments to conduct appropriate financial management with recognition of the company’s cost of capital, and this is stated here.

It was pointed out that the role of the CEO is important so that 1 and 2 are effectively conducted, and this is described in the first half of “3. CEO Appointment/Dismissal and Responsibilities of the Board”. The main responsibilities required of the board that supports management including the CEO are described after that.

Next, 4. describes cross-shareholdings that were pointed out as important for getting corporate governance reform to take root effectively. It was pointed out that while cross-shareholdings have decreased recently, the decrease by non-financial corporations is modest, and the ratio of voting rights accounted for by cross-shareholdings remains high.

In addition, it was pointed out that it is important for investors and companies to deepen their engagement on cross-shareholdings, and to that end companies need to assess whether or not to hold each individual cross-shareholding, and clearly disclose and explain the results of this assessment.

It was also pointed out that it is important to clearly disclose policies regarding the reduction of cross-shareholdings.

With respect to “5. Asset Owners”, it was pointed out that for the effective implementation of 1. to 4., it is important to promote the smooth functioning of the investment chain and to that end, the role of asset owners who are positioned closest to the ultimate beneficiaries and are able to encourage and monitor asset managers that are the direct counterparties in engagement with companies is important.

It was pointed out that among asset owners, while there have been some public pension funds where progress has been made in response to the revision of the Stewardship Code in May of last year, corporate pension funds’ actions have not necessarily been adequate. It is stated that plan sponsor companies should also take measures in response to these issues.

Lastly, in “Closing Remarks”, it is stated that the Corporate Governance Code will be revised and

that the Engagement Guidelines will be established in accordance with this proposal draft.

That is all for the explanation on the Revision of the Corporate Governance Code and Establishment of Guidelines for Investor and Company Engagement (Draft).

Next, I would like to look at Appendix 1 “Corporate Governance Code (Draft Revision)”.

First, please look at the page 6. The revised points regarding cross-shareholdings include the clarification of the policies with respect to the reduction of cross-shareholdings in the policy regarding cross-shareholdings. In addition, the board should assess individual cross-shareholding from the viewpoint of having effective engagement, and in doing so, the board should specifically examine whether the purpose is appropriate and whether the benefits and risks from each holding cover the company’s cost of capital, and the results of this assessment should be disclosed. Also, although it has been necessary to establish and disclose standards with respect to the voting rights on cross-shareholdings, it was pointed out that the details of these standards were abstract, accordingly it is stated that specific standards should be established and disclosed, and companies should vote in accordance with the standards.

Next are Supplementary Principles 1.4.1 and 1.4.2. It was pointed out that companies whose shares are being held as cross-shareholdings should not hinder the sales of cross-held shares, and because this has been incorporated in the Guidelines, it is also stated in the Code. It was also pointed out that there may be some cases in which the underlying economic rationale is not sufficiently examined in transactions between cross-shareholders and listed companies, and that such cases should also be thoroughly examined and reviewed as necessary. Because this has been incorporated in the Guidelines, it is also stated in the Code.

Next is page 10. There were discussions that corporate pension funds should be included in the Guidelines in light of the importance of their roles in the investment chain, and this is also stated in Section 2 of the Code.

Next is page 12. Dismissals are clearly stated in addition to appointment.

Next is page 15. First, with regard to Supplementary Principle 4.1.3, the proactive engagement of the board in the establishment and implementation of a succession plan has been incorporated in the Guidelines, so it is also clearly indicated in the Code.

With regard to Supplementary Principle 4.2.1, the design of remuneration systems and determination of actual remuneration amounts have been included in the Guidelines, so they are also

clarified in the Code.

And with regard to Supplementary Principles 4.3.2 and 4.3.3, the appointment/dismissal of the CEO will be included in the Code as stated in the Guidelines.

Next is Principle 4.8 on page 18. Under the current Code, it is stated that at least two independent directors should be appointed. Although some council members had the opinion that at least one-third of directors should be appointed, in the overall discussions up until now there has been a difference of opinions regarding whether to incorporate this as a new item at this time, while it was recognized that efforts should be made to increase the number of independent directors. Meanwhile, under the current Code, companies that deem it necessary to appoint at least one-third of directors as independent directors are required to disclose policies for addressing this, and in consideration of discussions regarding this point, it is appropriate for a sufficient number of independent directors to be appointed, so the Code includes the statement that is in line with the Guidelines.

Next is Supplementary Principle 4.10.1 at the bottom of page 18. It was pointed out that optional advisory committees should be established as a general rule. Because this point is described in the Guidelines, “for example” and “etc.” have been deleted from Principle 4.10.1, and the names have been clarified as “such as an optional nomination committee and an optional remuneration committee”.

Next is page 19. In the previous discussion, it was pointed out that diversity is important for the board to fulfill their role and that the inclusion of gender and internationalism as diversity should be clarified, and accordingly this is stated in the Code.

Regarding the skills of *kansayaku,* it was pointed out that some minimum knowledge of finance, accounting, and the law is required, and that there are also appropriate experience and skills that are required, and these are stated as the qualities required of each *kansayaku*. In addition, because at least one person with sufficient expertise on finance and accounting is required in the first place, this is something that is required for the structure of a *kansayaku* board.

Next is Principle 5.2 on page 23. As explained in 1 and 2 for the Revision of the Corporate Governance Code and Establishment of Guidelines for Investor and Company Engagement (Draft), there were discussions on the importance of accurately identifying the capital costs of their own companies in the establishment and disclosure of business strategies and business plans, and because this point is also incorporated in the Guidelines, it is stated in Principle 5.2 as well.

In addition, regarding the approach towards the allocation of management resources, the inclusion

of reviewing the business portfolio as a current issues and investments in fixed assets, R&D, and human resources was clarified.

That is all for the explanation of the Corporate Governance Code (Draft Revision).

Lastly, I will explain the major changes in Appendix 2 “Guidelines for Investor and Company Engagement (Draft)”.

First, looking at the area in the middle of the square box, it was pointed out the previous time that this area states what the nature of the Guidelines is and whether comply or explain is required.

As I explained at that time, these Guidelines were established from the perspective what should be focused in the argument for corporate governance to become more effective in adopting comply or explain effectively for both Codes.

Accordingly, comply or explain is not required for the Guideline itself. However, we would like companies to adopt comply or explain when implementing each principle of the Corporate Governance Code or explaining the reason for not implementing each principle based on an understanding of the purpose of these Guidelines and the discussions by the council up until now.

As mentioned above, the nature of these Guidelines is a supplementary document to both Codes, and this point is clearly stated in the second paragraph.

Next is the footnote. In addition to comply or explain, there have been discussions on the importance of comply and explain for some time, and Footnote 2 states this in order to be also clarified in the Guidelines for Investor and Company Engagement.

In addition, it was pointed out that because the interpretation of the Code and Guidelines is principles-based, companies conducting group management should incorporate group governance, for example, based on such a perspective in interpreting the Engagement Guidelines or Code. This point is clarified in Footnote 3.

Next, let’s look at the changes in the body. First is 1-2. A comment was received at the previous meeting that the nature of cost of capital should be clarified for assessing the cost of capital and the business risk is one of the major factors, so this point is clarified.

In addition, a comment was received that there should be a clear explanation of the reason for setting targets such as capital efficiency, and this point has been added in the second line from the bottom.

Next is “2. Investment Strategy and Financial Management Policy” on page 2. 2-1 states that the effective use of assets held should be considered. In addition, it was pointed out that capital structure

decisions and use of cash on hand in recognition of the cost of capital was important, and this point is stated in 2.2.

Next is “3. CEO Appointment/Dismissal and Responsibilities of the Board”. First, in terms of the appointment, dismissal, development, etc. of the CEO, it was pointed out that the development of CEO candidates should include the selection of external human resources as necessary, so this point is clearly stated in 3.3.

Next is the Responsibilities of the Board. As mentioned above, at the previous meeting it was pointed out that it should be clarified that the diversity of the board includes gender and international experience, and this point is also stated in the Guidelines. In addition, it was also pointed out that there should be engagement on whether women have been selected as directors, and this point is also stated.

Furthermore, it was pointed out that the evaluation of the effectiveness of the board is extremely important for the PDCA cycle and that this should also be stated in the Guidelines, and accordingly this point has been added in 3.7.

Next is the Appointment of Independent Directors and Their Responsibilities. For 3.8, it was pointed out that some minimum knowledge is required of independent directors. Although it was pointed out that it might be better to conduct some kind of tests, considering the principles-based perspective, it is believed that the Guidelines should state what qualities are required and that the specific initiatives such as tests or training should be considered in engagement between companies and investors, and accordingly this point regarding such qualities has been stated here.

In relation to the reappointment or retirement of independent directors, it was pointed out that the prolongation of terms could damage independence and that there could be difficulties in the development of new perspectives if all independent directors are from a high age group, and accordingly it is stated that reappointment or retirement, etc. should be conducted appropriately in consideration of the issues and changes the company facing.

Next is the Appointment of *Kansayaku* and Their Responsibilities. It was discussed that *kansayaku*, audit committee members, and audit and supervisory committee members should have the minimum required knowledge related to finance, accounting, and the law, and as explained above, 3.10 of the Guidelines has been modified to reflect this.

In addition, although the importance of the support structure for work by *kansayaku* and the importance of appropriate coordination with the internal audit department had been stated in the Code

already, comments were received once more, so this has been stated in 3.11 as an engagement theme.

Next is “4. Cross-Shareholdings” on page 4. As stated above, the Guidelines have been revised in consideration of the discussions on cross-shareholdings up until now.

The same applies for asset owners.

That is all for the explanation on the revised points in the Guidelines and the revisions from the previous time. Thank you.

[Ikeo, Chairman] Thank you.

I would now like to have some time for free discussion as always, but before that, opinion statements have been submitted from the members Mr. Uchida, Ms, Ueda, Ms. Waring, and Mr. Toyama. In particular, I would like to ask the secretariat for a simple introduction of the opinion statements from Ms. Ueda, Ms. Waring, and Mr. Toyama who are not in attendance today. In addition, a comment has been received from Mr. Kawamura who is not in attendance today, so I would also like for this comment to be introduced.

Thank you for your attention.

[Tahara, Director of the Corporate Accounting and Disclosure Division, FSA] I would like to provide an explanation on the opinion statements received in order.

First is the opinion statement from Ms. Ueda.

An opinion mainly on cross-shareholdings, the nomination committee, the remuneration committee, and independent directors was received from Ms. Ueda., and in which it was first stated that she agrees with the Guidelines draft and Code draft revision, and she would like to leave up the future direction to the chairman.

Ms. Ueda highly approves of the clarification of an approach to reduce cross-shareholdings in Principle 1.4 of the Code revision and believes that the Code indicates the ideal approach towards the issue of cross-shareholdings.

In addition, she also believes that Supplementary Principles 1.4.1 and 2 are significant for dispelling concerns of cases that could prevent the approach of reducing cross-shareholdings and harm the common interests of shareholders.

In addition, she believes that the issue of cross-shareholdings should be resolved through engagement, and she hopes that the contents of Supplementary Principles 3.1.1 that stipulate “These disclosures, including disclosure in compliance with relevant laws and regulations, should add value

for investors, and the board should ensure that information is not boiler-plate or lacking in detail." are respected.

The opinion regarding the nomination committee and remuneration committee and the independent directors, that the establishment of a transparent and independent CEO appointment and dismissal process is important is stated.

The opinion regarding the remuneration system is stated that designing a transparent and objective remuneration system that functions as an incentive is important so that the CEO and other members of the management team can effectively contribute to the sustainable growth of the company while in office, and that from this perspective companies other than those with a nomination committee, etc. should establish an independent nomination committee or remuneration committee.

The opinion was stated that it would be preferable for an independent director to serve as the committee chairman and for the majority of members to be independent directors.

The opinion was also stated that because there will be some cases lacking of independent directors if there are only two independent directors in line with the minimum standards stipulated in the Code, she hopes that a sufficient number of independent directors is appointed in consideration of diversity and qualities such as gender and internationalism.

That is all for the opinion from Ms. Ueda.

Next is the opinion from Mr. Toyama. Instructions have been received to read the entire statement from Mr. Toyama, so I will read the two pages of the statement in full.

"The proposed revision draft generally covers without excesses or deficiencies the important best practices related to reform issues that listed companies in Japan should be working on. Accordingly, further action based on this draft should be entrusted to chairman.

In particular, in relation to the CEO succession plan, it is extremely important for the establishment and utilization of nomination (advisory) committees and remuneration (advisory) committees to be stated as a fundamental best practice, and this is something that should absolutely be maintained. To ensure that tough managers capable of leadership through drastic changes in the business environment are selected, selection, development, and appointment/dismissal through a more objective and transparent process while fully using the wide range of knowledge and perspectives of independent directors is extremely important, and it is clear that the establishment of nomination (advisory) committees and remuneration (advisory) committees to ensure this process and the full-scale

application of this process is a best practice.

In a questionnaire survey presented at a CGS study group of the Ministry of Economy, Trade and Industry recently, it became clear that there is significant divergence between surface-level compliance and reality in this area, and that the main reason for this divergence is that the nomination of a successor remains an exclusive right of the current management and the management has no desire to change this (they do not want independent directors to get involved). In other words, not only are effective structures not in place, people do not have the will to put them in place in the first place, and it is also obvious that formal norms have to be further advanced to develop substantive structures in response to the issues faced.

Although negative opinions towards the adoption of such best practices as principles can be expected from some members of the business community, in some sense it is only natural that there will be negative opinions in consideration of the results of the questionnaire that show a lack of motivation, and for this very reason we cannot afford to compromise. The abandonment of norms that govern manager because of objections from the managers themselves without true motivation towards reform would be the same thing as the folly of making the school curriculum easier to reflect the voices of students who do not want to study. Much more, the people we are dealing are the managers of listed companies who are among the most elite of the corporate world in Japan. We cannot pamper this elite.

Furthermore, over many years it is Japanese listed companies that have lost revenue share and presence in the world, that have not been able to contribute to the asset formation or pension financing of citizens due to low profits and low stock prices (although household financial assets have increased by approximately 3.3 times over this period of 20 years in the US, household financial assets in Japan have only increased by 1.53 times), and that have also lost share in terms of contributions to the employment of workers in Japan. During this time, employee household income has also continued to decline. While I'm sure there is a variety of excuses, the results are everything for management. Unfortunately, for the majority of management now, you cannot really say that they have performed excellently as leaders of the economic society for the sustainable development of society. Now is the time for us as business leader to reflect deeply, instill the strictest discipline on ourselves, and take pride in our position as leaders of the economic society.

If managers with pride feel that certain best practices do not apply for their own company, they should openly and proudly explain. The fact that the compliance rate is extremely high as a result of

doing what others do is proof that many Japanese companies that have been affected by conformist decision making, long-term stagnation, and transformation into zombie companies have not undergone fundamental changes. The emergence of companies that will openly and logically explain in this process is actually what is expected by the corporate governance reform that is currently underway. To speak frankly, Japan has no need for managers that take no pride in strict self-discipline through the Code, or that take no pride in explaining. They should leave immediately.

The purpose of this Code is for companies to once again contribute to the social welfare and asset formation of the citizens of Japan including pensioners through sustainable growth and the investment chain as a corporate citizen. Reflecting the opinions of business leaders who have no pride as leaders of economic society, some of which have become corrupted, in decisions on important public policy measures is a betrayal of the citizens who are the ultimate beneficiaries of such measures. While it is understandable that there are organizations and members that have to object as their position, as a whole, this Council does not need to reflect and should not reflect such opinions in policy decisions.

A reality that I have to lament as the Vice Chairperson of the Japan Association of Corporate Executives is that a decline in prestige of so-called business community in Japanese society is evident. The era of “first-rate economics, third-rate politics” is now in the past. Young managers and entrepreneurs who should be playing a leading role in the future Japanese economy in the age of innovation are losing interest in so-called business world activities. I am a parent with children in their twenties to thirties, and fortunately my children have studied at so-called elite universities and graduate schools in Japan and abroad and managed to find appropriate work. However, they and their friends don’t even know about the existence of the three major economic organizations, nor are they interested if I try to teach them about these organizations. To speak honestly, we are already relics of the previous era.

If we listen to the opposition from some business community and their poor arguments in response to our current discussions, I feel it will be impossible to stop the decline in prestige of the business community, becoming a relic of former times, and the accelerating transformation into zombie companies. As a person representing the business community. I strongly hope that all of the business community takes a stronger position than anyone else towards this code revision being a revision that imposes the strictest self-discipline.”

This is the opinion statement from Mr. Toyama, and that concludes the reading.

Next, I would like to explain an overview of the opinion statement from Ms. Waring.

First, at the beginning it is stated that he is in agreement with this draft as ICGN. The opinion is then stated that the following points should be incorporated in the Engagement Guidelines and Corporate Governance Code in the future.

Specifically, in relation to 3.2 in the Guidelines, the incorporation of a nomination committee is welcomed.

Then, the opinion is stated regarding the composition of the board that independent directors make up of one-third of the board should be aimed for in the future.

An opinion is stated that it is important to make specific disclosures regarding the authority of the nomination committee, such as regular reviews of the composition of the board or confirmation of a skills matrix describing desired board composition aligned with the company's strategic objectives. An opinion is also stated that the CEO succession plan should be regularly reviewed and that independent monitoring and oversight on the CEO appointment and dismissal procedures are important.

Next, in relation to 3.5 of the Guidelines, an opinion is stated that the incorporation of a remuneration committee is welcomed, and that the specific authorities of the remuneration committee such as the establishment of the remuneration policy and the monitoring and evaluation of short and long-term incentives for the CEO should be disclosed.

In addition, in relation to 3.6 of the Guidelines, an opinion is stated that a policy related to the diversity of the board that stipulates specific targets and deadlines should be disclosed.

Regarding the evaluation of the board's effectiveness in 3.7 of the Guidelines, it was stated that an evaluation should also be conducted on individual members of the board including the chairman of the board and the board should be subject to regular external evaluations.

Next is 3.9 of the Guidelines, but I believe this is an error for 3.8. The opinion statement mentions that he welcomes the reference to the reappointment or retirement of independent directors.

In addition, 3.10 is mentioned, but I believe this refers to 3.9. The opinion statement states that he welcomes the reference to the roles of independent directors.

Lastly are issues that are not mentioned in the current Engagement Guidelines, and the opinion is stated that three points should be themes for engagement. The issues are whether the current CEO is involved in and has an impact on the CEO appointment process, whether there is an appropriate

explanation if the CEO serves concurrently as the chairman of the board, and whether one independent director has been given the responsibility as the main contact point for engagement with shareholders.

That is all for the explanation of the opinion statement from Ms. Waring.

Lastly, I would like to introduce the comments that were received from Chairman Kawamura this morning. I will also read the comments that were received as is.

"I fully agree with Guidelines for Investor and Company Engagement (Draft) created by the Financial Services Agency and the Corporate Governance Code (Draft Revision). I hope that things go forward with no back pedaling.

Although there have been rumors that Keidanren will water down the draft, I fully oppose water downing."

That concludes the reading of the comment.

[Ikeo, Chairman] While the explanation took a bit of time, I would like to start the free discussions now.

Because I would like for many members to be able to speak, I would like to request everyone to take this into consideration as always when making a statement.

OK, you are free to speak Mr. Iwama.

[Mr. Iwama] I will share my impressions and comments regarding the future.

Overall, I think a very good direction has been presented this time.

One of the things that I am interested in is the major issue of the revitalizing the stock market. If the trend of short-term holding is extended to slightly longer holdings, I think the responsibility of institutional investors in particular is important in this area.

However, this would also lead to the long-term holding of cross shareholdings in some sense, and if cross shareholdings are prolonged it would result in an extreme dilution of the tense relationship between shareholders and management and lead to massive damage. I think this is the biggest factor behind opposition to cross shareholdings.

In light of these issues, long-term holdings and long-term investors are made possible through the holding of effective dialog based on a sense of responsibility through proactive engagements, and I believe that the two Codes are a form of infrastructure for such engagement. I believe that these Guidelines define what effectiveness is in order for such engagement to be effective.

Although there are many things that have to be considered in the future, I hope these efforts are

ensured to take firm root in the future.

That is all for my impressions.

[Ikeo, Chairman] Thank you.

How about everyone else? I think the discussions have matured considerably.

OK, you are free to speak Mr. Uchida.

[Uchida, member] Thank you.

I submitted here today an opinion statement that includes some of the opinions of other companies I heard. Although there are many repeated opinions that I stated in the previous councils, I would like to verbally explain the important areas of the statement I have submitted (hereinafter, the statement).

First, in relation to the revision of the Code, as recognized by the government in the Future Investment Strategy 2017 that was decided on by the Cabinet last year, I believe that steady progress is being made in corporate governance reforms by Japanese companies. In relation to reviews of business portfolios through M&As, business sales, etc., according to an M&A advisor that I know, there has been a steady increase in M&As by Japanese companies, and while there had been considerable resistance towards the selling and spinning off of businesses, this is something that Japanese companies are also seriously pursuing or considering recently. In this manner, the number of companies that are working on reviewing the business portfolio is increasing, and it can be recognized that efforts aimed at sustainable growth and medium to long-term improvements in corporate value of companies that is the focus of the Code are progressing steadily.

However, on the other hand, it is my understanding that many have pointed out that initiatives in corporate governance reforms by Japanese companies are still insufficient, and that this leads to revising the Code now. It is of course important to consider such individual comments. However, in considering whether it is necessary to review the Code, I think it is critically important to conduct an objective and comprehensive examination of what kind of effects have been achieved and not achieved through the introduction of the Code, and to share the same recognition. Where there is this shared recognition, companies will naturally address seriously corporate governance issues. If the Code is revised without sufficient examinations and fostering of shared recognition, there are concerns that the initiative of companies in response to the revisions could only be surface level.

One point related to this is the establishment of committees as mentioned in I. in the statement. An independent advisory committee is one of the measures that can be taken, and I don’t think that

methods for seeking appropriate involvement and advice from independent directors are limited to this. Accordingly, I think that wording such as “for example” should be inserted before “the nomination committee and the remuneration committee” in accordance with the wording of the current Code.

As written at the beginning of page 2 of the statement, I believe whether or not appropriate involvement and advice from independent directors is being implemented at companies that have not established a committee should be examined a bit more. In a questionnaire conducted by the Ministry of Economy, Trade and Industry, some responded that involvement and advice from independent directors was being gained through a different method from establishing a committee. I think we should explore this further through methods such as interviews with companies that have not established a committee or the independent directors of these companies, because there could be some other good methods besides establishing a committee. If we find that there are no other good methods, then it will be appropriate to say that a committee should be established and used. This process of examination, confirmation of the facts, and analysis of the current situation is not sufficient. At the very least, I feel that it has not been conducted by this council, or that it has been insufficient. Because it seems like measures are being suddenly implemented without any analysis of the current situation or confirmation of the facts, I feel that it may be difficult for companies to accept it. This is a very concerning point.

Note that the mentions in I. (2) and (3) of the statement are opinions from the interpretation of the Companies Act. I have nothing to add on these points.

Next, I would now like to state my opinion on cross-shareholdings in II. 1. of the statement. Although Principle 1.4 of the Code Draft Revision states “When companies hold shares of other listed companies as cross-shareholdings, they should disclose their policy with respect to doing so, including their policies regarding the reduction of cross-shareholdings”, this phrasing could be interpreted as meaning that cross-shareholdings should be reduced across the board, or in other words, that cross-shareholdings are wrong. I don’t think this type of interpretation should be allowed for.

I have done some research and asked around, and according to my findings, most major Japanese companies that are moving to Companies with Three Committees structure in a direction toward a monitoring board also have a stance that they hold cross-shareholdings that are reasonable or improve corporate value through the enhancing of mutual cooperation. Japanese companies decide holding and

reduction on a case by case basis, and even for companies who have introduced a monitoring board that is close to the structure of American companies, the same approach have been adopted.

I think that stating “policies regarding reduction and holding” rather than “policies regarding reduction” in Principle 1.4 of the Code revision draft would be more aligned with the approach of Japanese companies.

As stated at the previous council, companies are currently reducing holdings that no longer hold significance. While it has been pointed out that the speed of such efforts has been moderate, it is also true that shares cannot be suddenly let go of or sold off, and I think that we should give a bit more time to observing the situation under the current Code.

Continuing, I would now like to state my opinion on Ⅱ.“2. Disclosures on assessment of cross-shareholdings.” In Principle 1.4 of the Code revision draft, there is a section that states “the board should annually assess whether or not to hold each individual cross-shareholding” and “the results of this assessment should be disclosed”. However, as stated in the section on reasons in the statement, particularly the latter part, the results of such assessment also involve details of business transactions and corporate strategies, and it can be assumed that many companies would have the view that individual disclosure is not possible from the perspective of corporate confidentiality. Accordingly, for “the results of assessment” that “should be disclosed” in Principle 1.4 of the Code revision draft, I think we will have to take the approach of disclosing an overview or outline rather than disclosing individually. I hope that you understand this because companies may be put in a disadvantageous position in terms of strategies if competitors, etc. are made known about the individual contents of assessment.

In addition, in talks with various companies, many have expressed the view that it would be difficult for all individual shares to be examined by the board.

Although Mr. Sampei has stated that all cross-shareholdings are major in relation to this point, as I mentioned previously in this council, because there are also cases in which it will not be possible to reduce holdings within a short period of time even if companies decide to reduce holdings, and also because there could be cases of holding some shares to improve the presence at the partner companies, the word “major” should be kept as contained in the current Code.

II. 3. of the statement is as stated here.

In regard to asset owners in III. on page 4 of the statement, there are various sizes of corporate

pension funds as I have mentioned continuously. In terms of the number of plans, there are 600 fund-type funds and at least 11,000 trust-type funds. Among these funds, there are nearly 120 fund-type funds with assets of less than 5 billion yen, and at least 10,000 trust-type funds of this scale.

I think that it would be difficult in practice for such small-scale funds to bear the costs for conducting stewardship activities. Meanwhile, if all of these corporate pension funds start monitoring activities, there is also the question of whether asset management companies will be able to respond to request for reports and engagement at current cost levels. If the costs were to increase, these costs would be borne by corporate pension funds in the end. For that reason, I think that first we should study structures more carefully and rebuild structures that allow for corporate pension funds to conduct stewardship activities or build such frameworks. I think that it is still too early to suddenly make statements on what should be done without studying the situation in this manner.

Reason (2) is as stated in the statement.

IV. of the statement is as stated, so I will not provide an explanation on this point.

Lastly, I would like to state my impressions and opinion on the opinion statement draft of the follow-up council that was distributed today. I believe this is the first time that it is distributed, and although the discussions in the follow-up council up until now were initially focused on establishing a “guidance” for improving the quality of Code implementation, but from the middle of this process these discussions have led to the incorporation of matters that have been strongly claimed in the Code.

Looking at the beginning of this opinion statement, one can infer a nuance that the intention was to revise the Code from the beginning, and my impression is that the events up until now are different.

In addition, at the bottom of page 1 of the opinion statement it states “it has been pointed out that many companies are not making management decisions decisively in response to changes in the business environment,” and “For example, it has been pointed out that the reviewing of business portfolios is not necessarily sufficient at Japanese companies, because management still does not adequately recognize a company’s cost of capital.”

While this may be the case for some companies, writing things in this manner could give the wrong impression that Japanese companies have little initiatives in corporate governance reforms in general. I think that this is not necessarily the case, as there are some companies that are addressing these issues seriously, as well as some companies that have not sufficiently addressed these issues yet. If we say that efforts are still insufficient for Japanese companies in general, I get the feeling that many

companies will say “my company is making sufficient efforts.” I believe there are some problems with how things have been written here, and some positive elements should be incorporated as well.

That is all for me.

[Ikeo, Chairman] Thank you.

Is the interpretation of this statement regarding page 6 of the Corporate Governance Code (Draft Revision) that while there are disclosures on cross-shareholdings, the disclosures are not individual?

[Uchida, member] Do you think this interpretation is acceptable?

[Ikeo, Chairman] That is also my interpretation. There is also a need to conduct examinations on individual shares.

How about everyone else?

OK, you are free to speak Mr. Sampei.

[Sampei, member] Thank you.

Thank you for preparation of these three documents, namely the Corporate Governance Code revision draft, the explanation document, and the Guidelines.

I believe that the discussions up until now have been incorporated considerably in these documents. Among them, some points have been mentioned by Mr. Uchida, and I would like to talk about the points I believe are important once more.

First is page 18 of the Code revision draft, specifically Principles 4.10 and 4.10.1.

I think the removal of the words “for example” and “etc.” here is very significant. As mentioned above regarding the questionnaire by the Corporate Governance System Study Group, on what I believe is page 6 it is stated that 77% of companies say that they are complying. On the other hand, looking at TSE First Section-listed companies, 32% of them have actually established a committee equivalent to a nomination committee. From this perspective I feel there is quite a discrepancy or divergence in the numbers. Out of these companies, 31% of companies with a board of *kansayaku* (statutory auditors) have established an optional committee equivalent to a nomination committee.

From this perspective, I believe that it is uncertain how the meaning of compliance should be understood in these situations. I think that this is because what comply or explain means in this context is also unclear.

Accordingly, because “for example” and “etc.” expand the meaning of things considerably, I believe this may have led to some of the discrepancy above, and for this reason, deleting them is very

significant now for clarifying what is being complied with or explained.

One more point is written in the box for Principle 4.10. I am referring to the meaning of "In adopting the most appropriate organizational structure that is suitable for a company's specific characteristics" and "employ optional approaches, as necessary". For example, because the function of the board is both business execution and oversight in the case of a company with a board of *kansayaku* (statutory auditors), I believe that it is very important to clarify that the board of *kansayaku* (statutory auditors) is the forum for organizational decisions, if not for final decisions, regarding nomination or remuneration, and that there are such bodies as advisory bodies.

For example, when you look at the corporate governance page of the securities report, there is a diagram that illustrates the structure of organizational design. Because committees are included in this, it clarifies where proposals are drafted in an organization, and whether opinions were formed as an advisory body. Although it has been explained that an individual response for each issue is actually adopted in some cases, if that is the case, it is not clear where the responsibility is and whether a decision-making process is followed.

We are asking individually what is being decided on and where and how it is decided in the actual engagement, and there seems to be a major crossroads of cases in which this is clear and cases where it is vague and not clear. Accordingly I believe that the establishment of a committee as such a body is an important point, which is why I have decided to mention it specifically.

Next, please refer to page 6 of the Code draft revision. I would like to thank you for the significant revisions that have been made here.

The opinion was stated that one form of evidence, such as objective verification, is required. However, the fact is that, for example, 160 companies have reduced cross-shareholdings, and 78 of these companies have made a double-digit reduction. If these figures are converted to the TSE First Section as an example, the reduction would be 8% for 160 companies and 4% for 78 companies. Accordingly, the reverse argument can be made that the progress that has been made is only this.

In this sense, progress can be viewed as very insignificant compare to the number of companies that have introduced independent directors, which is an example of an area where progress with corporate governance is said to have been made.

In addition, 22% of Japan's stock market capitalization is owned by non-financial corporations. Furthermore, according to post-general shareholders' meeting research by Shojihomu, at least 40% of

companies overall recognize that the majority of shareholders are stable shareholders, and there have been no major changes in these figures over the past several years.

In this sense, there are areas in Principle 1.4 where progress has been slow if we look at things objectively. For that reason, I believe it is necessary to make some dramatic changes in this recent revision.

Among these, one of the things that concerns me is the wording in the Guidelines and 1.4.2 of the Code. 1.4.2. of the Code and 4.4 in the Guidelines state “Companies… without carefully examining the underlying economic rationale,” l if you think about this point carefully, I believe that what we are really talking about here is legitimacy or fairness.

Actual economic rationale is “whether the purpose is appropriate and whether the benefits and risks from each holding cover the company’s cost of capital” as stated in the box for Principle 1.4 which discusses economic rationale. I believe that the section’s “appropriate” and “cover” in the box now for Principle 1.4 refer to economic rationale when this section is translated into English. On the other hand, the “economic rationale” of transactions in 1.4.2 is actually legitimacy or fairness, so I think this should be legitimacy or fairness. Overall, I think it would be better for the phrasing to be more clearly compare economic rationale and legitimacy.

Could I also say a little something about the Guidelines?

Please refer to 3.7 on page 3 of the Guidelines. The evaluation of effectiveness has been added to 3.7. At the end, the question is asked “are the evaluation results clearly disclosed and explained?” In most disclosures now, common explanation is that the verified results show that all have been implemented appropriately. In light of this, I think that the last part would be clearer if it included words such as “including issues” to be phrased as something like “are the evaluation results including issues identified clearly disclosed and explained?”

Lastly is 3.10 on this page.

There was an opinion that this section could describe the necessary knowledge, etc. for *kansayaku* overall. However, as was stated in the opinion statement from Mr. Uchida, because a single-person decision-making system is used for *kansayaku*, effective oversight should be conducted by even once person, and I believe that it is necessary to select such a person. For this reason, I believe that the wording related to this point has an important meaning.

That is everything from me.

[Ikeo, Chairman] Thank you.

The results, etc. of the company questionnaires, etc. were mentioned above. Because Deputy Director-General Kimura from the Ministry of Economy, Trade and Industry has come here today, I would like for him to give an explanation.

[Ministry of Economy, Trade and Industry, Economic and Industrial Policy Bureau Deputy Director-General Kimura] Thank you. I am Deputy Director-General Kimura from the Ministry of Economy, Trade and Industry.

Although I am attending in the position of an observer, I have gained permission from the chairman to provide a simple explanation of the material titled “Reference Material on nomination Committees and Remuneration Committees”.

The CGS Study Group, that was previously mentioned by a member, was held on February 22 and some of the members at the council today also attended the CGS Study Group. The contents of this material was explained there.

This material include a questionnaire survey on the status of initiatives by companies related to corporate governance and an economic analysis on management performance.

Next, I would like to look at page 2 for an overview of the survey. Look at the box to the left in the middle of the page. A questionnaire survey was conducted with companies listed on the First Section and Second Section of the Tokyo Stock Exchange from the end of last year to January of this year, and responses were received from 941 companies.

For the main points of the questionnaire survey results, please go back to page 1 where there is a summary.

First, let’s look at the first circle. I would like you to look at this together with the two bar graphs on page 3. 55% of companies have established a committee, and 58% of companies are considering or planning to establish a committee.

Next, let’s look at the second circle. Please refer to the second and fourth bar graphs from the top on page 4. This indicates the companies that responded that independent directors fulfill a role in oversight on decisions on president or CEO appointment and dismissal. The percentage of companies that have established a committee is 76%, while the percentage of companies that have not established a committee is 48%. I believe this suggests that the establishment and use of committees is important for the fulfilling of roles by independent directors.

Next, the third point is the third circle on page 1. Please refer to question 38 at the very bottom of page 5. Among the companies that have established a committee, the percentage of companies that responded that the purpose of establishment of strengthened transparency, objectivity, and accountability or improvements in the stability of the decision-making process had been achieved or more or less achieved was a high level of 95%.

Next, let's look at the fourth circle. Please refer to the bar graph on page 6. When companies without a committee were asked the reason for not establishing a committee, 37% responded that they did not feel that involvement and advice from an external party was required for nomination or remuneration. I believe that this suggests that there is a possibility of appropriate involvement and advice from independent directors related to the consideration of nomination, remuneration, etc. based on the Code not being sufficiently gained.

In relation to this point, the voices of people in the field from various companies that have not established a committee are introduced on page 7, so you can refer to it later.

Lastly, I would like to introduce the economic analysis in the fifth circle on page 1.

This economic analysis has been conducted based on the 874 companies that responded to the questionnaire survey for the previous fiscal year. While the details are described from page 8, this analysis was conduct by comparing the growth in the average ROA from 2013 to 2014 and the growth in the average ROA from 2016 to 2017 while receiving advice from researchers.

The results are summarized on page 10. Roughly speaking, a trend of significant growth in ROA can be seen at companies that have established and used a nomination committee, particularly at companies where the nomination of the president or CEO is discussed by a nomination committee. And these results are statistically significant.

Although there are some limitations to the results that I explained just now, such as the fact that they were within a survey period and the number of samples was limited, the situation that has been revealed by the survey suggests the need to review the approach towards the establishment and use of nomination or remuneration committees according to the draft proposed by the secretariat of the FSA. I hope that you consider it in the discussions today as one objective fact.

That is everything from me.

[Ikeo, Chairman] Thank you.

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[Ministry of Economy, Trade and Industry, Deputy Director-General for Economic and Social Policy Kimura] Thank you. I am Deputy Director-General Kimura from the Ministry of Economy, Trade and Industry.

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Next, let’s look at the second circle. Please refer to the second and fourth bar graphs from the top on page 4. This indicates the companies that responded that independent directors fulfill a role in oversight on decisions on president or CEO appointment and dismissal. The percentage of companies that have established a committee is 76%, while the percentage of companies that have not established a committee is 48%. I believe this suggests that the establishment and use of committees is important for the fulfilling of roles by independent directors.

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Although there are some limitations to the results that I explained just now, such as the fact that they were within a survey period and the number of samples was limited, the situation that has been revealed by the survey suggests the need to review the approach towards the establishment and use of nomination or remuneration committees according to the draft proposed by the secretariat of the FSA. I hope that you consider it in the discussions today as one objective fact.

That is everything from me.

[Ikeo, Chairman] Thank you.

OK, you are free to speak Mr. Tsukuda.

[Tsukuda, member] Thank you.

Due to the time limitations, I will limit what I have to say on two points related to the revision of

the governance Code.

The first point is Principle 4.8 “Effective Use of Independent Directors” in the Code revision draft on page 18 of the material at hand. This was also previously explained by Director Tahara. Although I personally think that it would be extremely unfortunate not to adopt the standard of one-third regarding to the first half of this section at this time, I have heard there will be replacements in the top management of economic organizations at this time, so perhaps reform can be accelerated once replacements have been made in top management. I have hopes for the next Code revision.

Next, looking at the second half of this section, as I explained two councils ago, I said I was not fully convinced, but now I think I am convinced about 70%.

One point that I would like people to give consideration to if possible, although this might be rhetoric, is that is the section in three lines from the bottom that states “Irrespective of the above, if a company believes it needs to appoint at least one-third of directors as independent directors...it should appoint a sufficient number of independent directors”. Rather than “if a company believes it needs to”, I think this should “as expected as a listed company”. What I mean is that it doesn’t matter what companies think. I believe that listed companies should appoint a sufficient number of independent directors as expected from society, the capital markets, or from a global perspective, so I really hope that this point is considered. Personally, I think this is an important point.

The second point regarding Supplementary Principle 4.10.1 was pointed out by several members and explained this time by Deputy Director-General Kimura from the Ministry of Economy, Trade and Industry. I would like to also state a bit of my personal opinion while including the opinions expressed in this explanation from the Ministry of Economy, Trade and Industry and from Mr. Uchida previously.

Although I understand that of course Mr. Uchida’s standpoint puts him in a bit of a difficult position, in regard to the opinion statement submitted by Mr. Uchida on Supplementary Principle 4.10.1 of the Code that states three reasons, I feel that the reasons (1), (2), and (3) for opposing the revision in Supplementary Principle 4.10.1 lack persuasiveness in consideration of the discussions at the follow-up council up until now, and going back further, the situation when the follow-up council submitted Opinion Statement No. 2.

The reason I feel the reasons lack persuasiveness is that the perspective in opposition to the revisions is a company’s perspective. I think that global perspectives and the perspectives of shareholders are decisively lacking. For this reason, when I read the rebuttal from Keidanren, I don’t find it convincing

at all.

For example, although the words “for example” and “etc.” have been deleted and the phrasing “independent advisory committees … such as an optional nomination committee and an optional remuneration committee” has been used for 4.10.1, the core meaning of this is the undeniable fact that a degree of correlation has been observed as in page 9 of the material from the Ministry of Economy, Trade and Industry that was just explained by the Ministry of Economy, Trade and Industry.

In consideration of this, the claim that detailed analysis and studies in the future are required is false, and it is correct to revise 10.4.1. at this time. When we look back at this in the future, I think we will see that we made the correct revision at the correct timing.

Now for some individual points, I would like to make some comments on (1) to (3). First for (1), it states that the “the facts should be examined at companies that have not established a committee regarding whether or not appropriate involvement and advice from independent directors are insufficient” under “it is not necessary to limit the means to the establishment of a nomination or remuneration committee”. This revision of course does not interfere with not establishing a committee, and I believe that companies that do not establish a committee should just explain.

Accordingly, if such companies explain, explanations that there is also the approach of not establishing a committee could become more common, or in some cases, that could become a best practice. If this becomes the case, I believe that it could lead to the evolution of corporate governance in Japan.

For this reason, I believe that the approach of having to consider things after validating the facts should be in the opposite order, and that it is first necessary to advance with 10.4.1 at this time and adopt a stance of encouraging the explain approach.

Next is (2), in the third line from the bottom. Although it states “uniform requirements on the involvement of committees like that at companies with a nomination committee could compel governance in a manner that is not appropriate in accordance with the selections made by the company”, personally I feel this is groundless. Because this is about companies with a board of corporate auditors, at which l advisory committees are optional and not statutory, there is a degree of freedom in who can be a member and how the committees can be run. Because it is acceptable to explain, or comply or explain after ensuring a degree of freedom here, I don’t think the concept of “compelling” is incorrect here.

Finally, for (3), there is the statement that “Further careful discussions are necessary on requiring the establishment of a committee that would have broader authorities than those stipulated in the Companies Act.” Because we have made progress over the last few years including making independent directors effectively obligatory in the world of soft law rather than hard law, I find the logic of the claim that careful discussions are required for achieving things beyond hard law to be strange. Of course, soft law exceeds hard law. I think the basic understanding relating to this issue is incorrect.

That is all for my comment.

[Ikeo, Chairman] Thank you.

OK, you are free to speak Mr. Kawakita.

[Kawakita, member] I would like to state my overall impression and state a few separate opinions if possible.

In principle, I personally don’t really like things like these Codes or Engagement Guidelines that have been newly formed being presented by the government. Although I have the opinion that such things are interference, unfortunately when Japanese companies or investors are compared with American companies, they are really losing. They are really losing in terms of average values.

In terms of investors themselves, while there are of course some decent investors, for the most part the situation is unchanged, and investors immediately focus their attention when something has been pointed out.

In light of these circumstances, I think that it makes perfect sense that these Guidelines are being presented at this time. I feel that making these revisions to the Code and establishing Guidelines in this manner is unavoidable.

Conversely, I think that Japanese companies and investors should self-reflect once more and feel a bit ashamed that such Code and Guidelines are being presented by the government.

In summary, I don’t have any particular opinions regarding the Guidelines and the revision of the Code at this time. Although I am roughly 99% in favor of the revision because I understand that it has incorporated the main points of my statements as well, I would like to make some comments and state some wishes on some of the more detailed points.

Although I have nothing in particular to say about the Code revision, I would like to express my thanks for the inclusion risk in “understand the business environment and risks appropriately” in 1.3

of page 1 in the Engagement Guidelines. However, if you read through this section quickly, you could interpret the risks surrounding a company to mean how the Trump Administration or North Korea will act, and for this reason I think this area could be specified a bit more to mean specifically business risks.

My second point is “Investment Strategy and Financial Management Policy” on the following page 2. It states “including capital structure decisions and use of cash on hand in recognition of the company’s cost of capital”, but before that I would like to look at one more point, how most Japanese companies currently have a dividend payout ratio of about 30%. I believe that what they are thinking is that because everyone is providing a dividend of about 30%, that is sufficient, and that the status quo has been maintained as a result. If possible, I would like for the phrase “dividend policy” to be included in the section mentioned above in hopes for lively discussions during engagement. Because there are various types of companies, there are companies where a dividend payout ratio of 100% would be appropriate and companies such as Google and Amazon now where there are no dividends or a dividend payout ratio of 0% even if profits are made, so I would like for more discussions like these to be encouraged.

That is all for me.

[Ikeo, Chairman] Thank you.

I think that institutional investors will most certainly ask about the policy on returns to shareholders.

OK, you are free to speak Mr. Tanaka.

[Tanaka, member] Thank you.

Firstly, I get the really strong impression that opinions in economic circles are not monolithic. Personally, I have quite a good number of acquaintances, and when I ask various people about their opinion, there are people who feel that further progress should be made and people who feel that there are various issues, so it is hard to summarize things into one opinion. Because everyone has their own individual position, I think that asking people their opinion is just that necessary and important.

I have actually served as an independent director for a company that just got listed last year, and this is a company that have just been established and listed. When I reviewed the Corporate Governance Code one more time and thought about how I could explain, I felt that things were so different that I would have to change almost everything that had been said up until now. I think this is an issue of proportionality.

In light of these circumstances, and after listening to the opinions provided today, I honestly have doubts as to what degree of impact there would be on a practical level from doing things like including the word “for example”, or including the phrase “reduction and holding” as stated in the opinion statement from Mr. Uchida, and I also feel that people in the practical world feel this way as well.

If for example, the company where I am serving as an independent director now were to create principles or comply or explain in response to the Corporate Governance Code, even if things were to change as stated in the opinion statement, I honestly get the feeling that there would not be much change in the contents of discussions at the company.

Meanwhile, although various things are written in the opinion statement from Mr. Toyama, a section that I feel is extremely important is the passage in the middle of page 2 that states “The purpose of this Code is for companies to once again contribute to the social welfare and asset formation of the citizens of Japan including pensioners through sustainable growth and the investment chain as a corporate citizen”.

Accordingly, while what kind of phrasing to be used in the Corporate Governance Code may have meaning in a sense, I think that it is necessary to confirm once more the reason we have gathered for discussions now.

Unfortunately, Japan’s financial system, that I recently frequently refer to as a debt chain, has hardly supported the national welfare or asset formation, due in part to the effect of negative interest rates. It has also become extremely weak from the perspective of the provision of risk money. I think that our true purpose should be how to encourage the flow of money in this environment for the wealth of our nation and to ensure that citizens can build up their assets.

If that is the case, while I understand that people at companies have various circumstances and various duties they must bear, I think they should be a bit more aware that one of the obligations of corporate managers is to improve corporate value and shareholder value as a responsibility, and fully recognize that it is through this investment chain that asset building by citizens that forms the wealth of our nation is ultimately benefited.

Although there are many small details besides this, I think that what we have discussed up until now is basically reflected in this, and that even if minor changes are made, it doesn’t actually change the contents of our discussions or really change what we need to do. While I would like to leave the rest up to the chairman, I basically feel that we need to focus on our purpose again and that it is necessary

to consider once more our true purpose in these discussions.

That is all for me.

[Ikeo, Chairman] Thank you.

OK, you are free to speak Ms. Takayama.

[Takayama, member] First, I agree with the contents of the Engagement Guidelines and the Governance Code revision draft.

Based on this premise, I would like to make some comments on three points.

First, I have a comment on Principle 4.8 on page 18 of the Code revision draft. Here, it clearly states "if a company believes it needs to appoint at least one-third of directors...it should appoint a sufficient number of independent directors".

I think that the most important elements for improving the effectiveness of the board and the effectiveness of the oversight function of independent directors are the number of those directors and ratios.

From a global perspective, a consensus has currently been established by companies and investors that at least one-third of board members should be independent directors in order to ensure the effectiveness of the board based on various experiences and discussions over many dozens of years in Europe, Asia, and the US.

Looking at the situation in Japan, for example at TSE First Section companies, nearly 30% of these companies have appointed one-third or more independent directors, and it is hoped that this ratio will increase even more with the proposed Code revision.

Next, I would like to look at the diversity of the board in 4.11 on page 19. Gender and internationalism have been added recently as important concepts for diversity. Although there might not be any immediate efforts as a result of this inclusion, it will be easier for companies to make efforts through this further clarification of what is important when thinking about the composition and diversity of the board. In addition, I think this will make it possible for investors to have more focused discussions in engagement with companies. I have high hopes for the efforts to be made in the future.

Next is the point of the nomination committee that has been a topic up until now. Before looking at the nomination committee specifically, I would like to talk about "4.3 Roles and Responsibilities of the Board" on page 16. Here, the most important role of the board is described as the effective oversight of the management and directors from an independent and objective standpoint. The

appointment and dismissal of the CEO is then included as one of the responsibilities of the board.

Let's consider the importance of committees within this framework. As everyone has stated up until now, committees are of course necessary from the perspective of theory and logic. In addition, I believe that the presence of the nomination committee is also essential in terms of practical aspects.

The reason for this is that highly effective oversight in consideration of the appointment and dismissal of management by the board is made possible through sufficient discussions by the board in terms of actual practice.

However, it is not possible to conduct sufficient discussions on the appointment and dismissal at the board. This is the case anywhere in the world as well as for Japan. I think this is something that anyone who is involved in actual practice at a board is able to understand very well.

If this is the case, and it is not possible to conduct detailed and sufficient discussions at board, I don't believe there is a practical means of resolving this situation other than establishing a separate committee recognized by the board. I believe that the establishment of a nomination committee is important from this perspective.

However, just because a nomination committee has been established, I don't think it necessarily means that an appropriate process for the appointment or dismissal of a CEO has been established or that the oversight function has been improved. While this is a topic that is also raised when discussing the pros and cons of independent directors, just because an independent director has been appointed, it doesn't necessarily mean that the effectiveness of the board will be instantly improved. However, the appointment of independent directors is a minimum required condition for improving the oversight function of the board.

In the same manner, I believe the presence of a nomination committee is a minimum required condition for oversight of the directors on the board and oversight that includes the appointment and dismissal of the CEO. However, because it is not a sufficient condition, various efforts are required to improve effectiveness.

From this perspective, the composition of the members is also important, as reflected in the use of the word "independent" in reference to a nomination or remuneration committee on page 18, for example. It is important what the percentage of independent directors is and who the chairman will be. In addition, I also think that how committees are managed is important.

By writing things like these concerning the nomination committee clearly in the Code revision draft,

it is hoped that effectiveness and substance will be gradually improved.

I would like to note that what I have said about the nomination committee applies for the remuneration committee as well, and I think that an independent remuneration committee plays an important role as well.

That is all for me.

[Ikeo, Chairman] Thank you.

OK, you are free to speak Mr. Oguchi.

[Oguchi, member] Thank you.

First, I would like to thank everyone at the secretariat for summarizing the various opinions that have been presented up until now.

Based on that, I agree with what Mr. Tanaka has said about wording and phrasing. I don't personally intend to go into the small details, and I would like to leave these areas up to the secretariat.

Putting such wording aside, I would like to make some comments by returning to our starting point. The Corporate Governance Code has been distributed today, and the subtitle of this, as well as that of the Stewardship Code, includes "sustainable corporate growth". And what both Codes share is the premise of the sustainable growth of companies, and by extension, a contribution to the development of the economy overall, as is stated in the beginning of both Codes. A word that appears in the No.7 of the preface of the Corporate Governance Code [final proposal] and the back of the Code published by TSE as materials is "growth-oriented governance". The focus is on stimulating healthy corporate entrepreneurship, supporting sustainable corporate growth and increasing corporate value over the mid- to long-term rather than excessively emphasizing on avoiding and limiting risk or the prevention of corporate scandals. I think these are common concepts understood by everyone including those gathered here today up until now.

However, when the council was resumed in October of last year, there were comments in the materials prepared by the secretariat stating that decisive management decisions were not being sufficiently conducted and that cash and deposits, that never exceed the cost of capital, were not be allocated to capital investments, R&D, or human resources investments for sustainable growth. This means that unfortunately the growth-oriented governance that is being aimed for with the Corporate Governance Code has not been achieved sufficiently in practice.

While I mentioned this when the council was resumed, and while I believe that everyone shares the

awareness that some progress has been made in practice, if the developments up until now had been sufficient, there would be no need to hold discussions here today, make revisions of the Code, or have the Guidelines.

The reason that I am saying this is that while companies may have various opinions as was recently mentioned by Mr. Tanaka, at the very least the consensus has not been reached within the investment chain that the efforts up to now are sufficient.

In the new economic policy package decided on by the Cabinet in December of last year that was also distributed at this council, “corporate governance revolution” was positioned as driving force of “supply system innovation through improved profitability and investment promotion of corporations”, and because this follow-up council has been called upon to study the drivers of such reform, I believe that the government had the same awareness of the challenges.

When I read the current revision draft with this in mind, I believe that the most important thing is the Code, particularly because it will be within the scope of comply or explain, and excluding the section on corporate pension funds in Principle 2.6, the draft fully consists of modifications to or reinforcements of existing principles.

Accordingly, this is proof that in a sense sufficient substantive progress had not been seen under the phrasing used up until now, and I think that the matter at hand now is how to support such progress.

In terms of the section on corporate pension funds in Principle 2.6, while this is perhaps a problem that should be addressed and resolved within the Stewardship Code, because this turns out to be difficult in practice, I believe it can also support changes in the current situation in consideration of the expectations towards plan sponsor companies.

While we have had various discussions today, in the first place governance is viewed as a never-ending journey overseas as well, and because it is necessary to constantly change in response to the environment, there are some areas that are incomplete no matter how much progress is made.

From this perspective, the important thing is how to move forward in areas that have not been achieved up until now or areas that have been insufficient. Although different people may have different ideas toward this process, at the very least it is important to move forward, and in this sense, although there were opinions that the sudden development of these Guidelines in a situation in which there had only been the Code up until now is difficult to understand, I personally believe that this is an important and necessary measure for the evolution from form to substance.

What is actually important is for these Guidelines to be used effectively and to carefully watch whether the things written in the Guidelines are really achieved in the future. If the things that have been written here through such great efforts are not put it practice, I believe that we should change the Guidelines or the Code again.

I would like to reiterate that I don't intend to make the argument whether what has been written here is sufficient or not, but rather I think if it proves insufficient for moving further forward in the future, we should change it. In addition, because it is comply or explain, companies can choose to explain if measures are really unnecessary, so I don't think that anything negative will occur from what has been written. I think that it would be most reasonable to understand the proposed revisions from that kind of perspective.

That is all for me.

[Ikeo, Chairman] Thank you.

OK, you are free to speak Professor Kanda.

[Kanda, member] Thank you.

I don't feel uncomfortable about the overall flow.

While perhaps these are things that I should have said the previous time, there were some time limitations, so I would like to state somewhat detailed points at this time regarding my impressions in the form of questions so that they are easier to understand. Ultimately, I would like to leave it up to the chairman.

I would like to use the Engagement Guidelines as an example.

The first point is regarding 3.2 and 3.5 where the phrases "independent nomination committee" and "independent remuneration committee" are used. What does it mean that the committee is independent in this case? Does it only mean that the committee is independent from management? I would like it to be clarified if this also means independence from controlling shareholders in the case of listed companies with major shareholders, controlling shareholders, a parent company, etc.

The second point, and I apologize for mentioning such a detailed point, is regarding the use of the phrase "*kansayaku*, etc" to lump several different things together in 3.10 and 3.11. I believe it was 3.10 where this was written clearly as far as I remember. And I looked closely, however I could be wrong, I remember that use of phrasing that lumps things together like "kansayaku, etc." was avoided in the Corporate Governance Code. As far as I can see, the phrase "directors and kansayaku, etc." is

used in a completely different context in Principle 4.5, and this has a completely different meaning. Rather than lumping everything together, I think it would be better to clearly write kansayaku, audit committee members, and audit and supervisory committee members separately because each is different from each other. Although there is no difference in what the contents are saying, I am concerned about the phrasing.

The third point is regarding 4.1, which is the only place where the word “stakeholders” is used. Although I don’t think that there is anything wrong with this sentence, if stakeholders are only used here, does this conversely mean that the “clearly disclose and explain” section that appears next about three lines below does not have to be something that is clear to stakeholders? Of course, there is also the problem of who stakeholders are, but why is this something that is only mentioned here? It seems like it could mean that it would be acceptable for other things not to be understandable to stakeholders, so I think this is something that should be clarified.

The fourth point is regarding 5.1. The word “asset managers” is used here and also in Principle 2.6 of the Corporate Governance Code that is added at this time and I believe this word is in the Stewardship Code as well, and while it may be due to my misunderstanding, I have felt from the past that the concept of an asset manager is extremely vague. My understanding is that traditional fund managers are people who buy and sell stocks and have the expertise for selecting stocks.

However, because stewardship activities consist of engagement and exercising voting rights, I think the nature of this expertise is different. For example, looking from the asset owners being referred to here, if activities requiring these two types of expertise are entrusted to third parties, lumping two entrusted parties into one concept of asset managers is extremely vague and confusing from the perspective of functions at the very least.

Of course, there would be no problem if there are people within one asset management firm with both types of expertise and both tasks are entrusted to such firm. However, I think logically it would be natural to entrust traditional stock trading to specialist A and stewardships activities to specialist B.

In consideration of this, and although this may be due to my misunderstanding of the concept of asset managers, it seems that asset managers have been lumped together since the Stewardship Code, and I believe it is necessary to take the opportunity to provide an explanation of the concept in an easy to understand manner, and it doesn’t necessarily have to be included in the body text.

I apologize for having so much to say, but my fifth point is regarding group management. In

reference to the statement written in footnote 2 in the Engagement Guidelines, while I have no problems with this as a sentence, I wonder how many listed companies are engaged in group management. It seems like this could be read as a kind of exception. To put it differently, are the Engagement Guidelines saying that group management applies for accounting and the governance and engagement are on a non-consolidated basis? I think that it is difficult to understand here that this is definitely not the case.

Lastly, a very general point that I would like to make as my sixth point is, and I will not ask a question for this point. In regard to the previous council when it was pointed out that the Corporate Governance Code compliance rate was extremely high and it was explained that the comply or explain approach is not applied to these Guidelines but rather these Guidelines are made to improve the effectiveness of the Governance Code. There were some important comments from several people today regarding this matter. I think there were comments from Mr. Sampei and Mr. Oguchi regarding this point.

Although I basically agree with the essence of these comments, ultimately, I think that what the problem of the high compliance rate means is that these Codes or Guidelines are not functioning as codes of conduct for not only companies, but also market players. Ultimately, they are not functioning as soft law.

To phrase things differently, it seems like we are just giving preachment to companies. For example, if a company says “OK, we will comply” and then they are told they are not complying when something happens, then they says “We apologize, we intended to comply, we deserve criticism if we are told that we did not comply as a result”.

The reason that we are having this follow-up council as has been repeatedly emphasized by several people is that we want to improve the Japanese economy and improve Japanese companies so that they can do better things. For this reason, as was also emphasized by Mr. Oguchi, I feel that the people involved including this follow-up council have a big responsibility to cooperate going forward to ensure that this does not end up just giving preachment.

That is all, thnak you.

[Ikeo, Chairman] Thank you.

OK, you are free to speak Mr. Takei.

[Takei, member] I understand that the current version is almost final.

I have some questions and comments. I would like to confirm some points, rather than proposal for change of wording. The first one is 4.10 regarding the nomination committee. When comparing the phrasing now and the phrasing in the current 4.10, page 34 of the current Governance Code that has been distributed states “Background”, under which it is stated “the use of an advisory committee” and then “With respect to Companies with Supervisory Committee, the supervisory committee can be used to full advantage, given that the committee has the statutory right to state its opinion in relation to nominations and remunerations of directors at general shareholders meetings”, I would like to confirm whether the option to use an audit and supervisory committee as an advisory committee for nomination and remuneration is denied. In fact, audit and supervisory committee members have the same statutory investigation rights as *kansayaku* have under the Companies Act. I think that a nomination committee or remuneration committee includes a member of an audit and supervisory committee is a good option, because the committee may exercise such statutory investigation rights. While I don’t think that the code under a comply or explain approach is not in a positon to deny such an option, I would like to ensure the message that such an option is not denied even after this revision to the wording of the Code. Some legal people who tend to pay deep attention to the wording of the Code might wonder the difference between the two versions. Of course, the important point is whether the audit and supervisory committee is actually functional. I would like to confirm this point.

My second point is also related to the nomination committee. I understand that the main purpose of this revision to the Governance Code is to encourage decisive decision making as much as possible. Not only the changes to 4.10, but several other points including the changes in relation to the CEO and the succession plan in 4.1.3 are very important as a whole. In Japan, I think that some have skeptical views regarding the function of a nomination committee, and such views seem to be based upon a misunderstanding that a nomination committee means the structure that outside directors will decide on all of the nomination matters. However, such structure will not work as well as will not be taken globally. The nomination process is conducted with the proper involvement of internal officers as well. So it is better to send a message to avoid such misunderstanding, which can be a basis for substantive compliance of the Code.

The appropriate selection of the CEO has a significant impact on whether Japanese companies are capable of decisive decision making. First of all, is it possible to properly explain to the outside officers why a given person will be the CEO or continue as the CEO in consideration of various sustainability

issues faced by the company? As was also mentioned in the survey from the Ministry of Economy, Trade and Industry distributed today, the appropriate involvement of outside officers enables the company to demonstrate to the stakeholders that the company is properly appointing the CEO and directors. As Chairman Ikeo mentioned Sunshine Policy earlier, I do hope that nomination committees approach will surely step forward in an effective manner.

That is all for me.

[Ikeo, Chairman] OK, you are free to speak Mr. Callon.

[Callon, member] Thank you.

I am in strong agreement with this proposed revision, which has incorporated this committee's discussions very well. I am also happy to leave any small language revisions up to the Chairman.

While I am sorry to have to say this, in terms of Mr. Uchida's views regarding the revisions, as has been already stated by the other members, this Code revision process has moving forward with reform as its fundamental premise. And while of course the responses to the Code will vary depending on the company, I believe that Japanese companies should explain openly and vigorously any and all provisions where they choose to explain rather than comply. In short, I believe that the proposed draft is good as is, and look forward to it generating positive results for Japanese corporate governance.

To explain things in a bit more detail, in Supplementary Principle 4.10.1 I think that it is necessary to include language about independence to improve the effectiveness of the voluntarily-established advisory committees. In addition, with respect to Principle 2.6, because corporate pension funds have a responsibility to protect the futures of employees and their family members, I believe that the newly established responsibilities for asset owners are beneficial.

Finally, I would like to address the issue of cross-shareholdings. Including all of us gathered in this room today, in our daily lives we all have various roles and positions. In my case, I am a foreigner who is a permanent resident of Japan. I am also an investor who is an executive at a TSE First Section Japanese company. Perhaps because I am a foreigner, I find that global investors often tell me what they are really thinking. About Japan itself, they say nice things, such as: "Japan is a lovely country" or "I really like Japan – the food is delicious, and the Japanese people are nice" or "I always enjoy myself when I come here on business trips." However, when it comes to investment, the same individuals unfortunately tell me fairly clearly that they believe Japan is uninvestable. There appear to be not a small number of global investors who have the impression that while Japanese society and

economy are disciplined, Japanese equity markets are not.

There are two root causes for this belief that discipline does not function in Japan's equity markets. The first is that there are not enough independent directors on boards. The second is that because Japanese shareholder meeting voting is influenced by the mutual back-scratching and logic of Japanese companies voting based on cross-shareholdings, minority shareholders cannot help to feel concern that discipline is not functioning at Japanese shareholder meetings as well.

Although the number of independent directors has increased recently, the last obstacle to effective governance in Japan is cross-shareholdings. While I understand the positive element of cross-shareholdings in the context of long-term corporate relationships and business strategy, as a whole cross-shareholdings create too many negative side-effects and generate too much damage. In sum, I believe Japanese shareholder votes being decided by cross-shareholding shareholders with conflicts of interests relative to other shareholders damage shareholder democracy itself.

Data has been presented today on the reduction that has been occurring in Japanese cross-shareholdings. One interpretation of the reduction trend is that there is no problem in encouraging further reduction. In short, I believe that reducing cross-shareholdings is fundamentally correct.

Finally, the importance of Supplementary Principle 1.4.1 is in preventing harassment of weaker companies in cross-shareholding relationships. As I indicated in a previous meeting, I think something like the Subcontractors Act (which protects subcontractors against commercial abuses by their generally larger customers) is necessary for cross-shareholdings. We should eliminate as much as possible the possibility of companies in weak positions being forced against their will to hold shares of companies in strong positions.

I sincerely hope that this Code revision will promote reform and increase the credibility and vibrancy of the Japanese stock market. As such, I think we should approve this proposed revision as is, and strongly hope that it does not get watered down. Thank you very much.

[Ikeo, Chairman] OK, you are free to speak Mr. Oba.

[Oba, member] I will keep it simple because we don't have much time.

On the whole, I would like to welcome the Corporate Governance Code revision draft and Engagement Guidelines draft overall, as everyone else has expressed. I believe this is the direction that we should adopt.

I would like to leave up the final details to the chairman and the secretariat.

There are two points that I would like to share, including my impressions. The first point is regarding the opinion from Mr. Uchida. I think that we should give a bit more consideration to this viewpoint. The reason for this, and this applies for the Stewardship Code as well, is that in my view companies can be roughly divided into three types.

The first is companies who believe that the things written in the Corporate Governance Code are only natural and that they are something that should of course be engaged in, the second is companies that feel they cannot avoid following the Code because it is government policy and they only respond on a surface level, and the third is companies that are not very interested in what is written in the Code, although there may not be very many companies like this.

In other words, it is a fact that there are companies that will engage in governance in recognition of governance as their own issue, so we should think about what kind of phrasing to use in the Code so that such companies will accept it as something that is only natural. Although I do not have any particular ideas myself, I do think this is a point we should think about a bit.

At the time of the Stewardship Code there were many asset management companies that thought it was natural to engage in what was described in the Code as their own business among the various types of investors, and I think that getting these types of forward-looking companies to express a spirit of welcoming towards the Code is important. That is one point that I would like to make.

The other point is the importance of confirming once more the perspective from the capital markets.

There are five basic principles in the Corporate Governance Code, and the subject for all of them is listed companies. This Code makes you think about what it means to be a listed company.

For this reason, although I stated that there are some companies that are not interested in the Code, I think these companies really need to leave the market if that is the case in consideration of the perspective of capital markets. That is what they should do if they are not interested. I think it is also a problem as this is no longer the case.

Accordingly, although Mr. Uchida made the comment that we should first objectively and comprehensively examine sufficiently what kind of effects the introduction of the Code has had from this perspective, I think a strong appeal is being made from the capital markets. The reason for this is that corporate value is not being improved. Of course, there are some difficulties because there are about three different types of companies, looking at the market overall, it seems there is no clear increase in corporate value. I think that companies need to recognize the view from the capital markets

in this manner.

While I am speaking of the view from the capital markets, there are many people here today, and they are all shareholders as I mentioned at the first follow-up council. I think that companies need to be aware of what shareholders, like all of the shareholders here today, have doubts toward when they look at companies.

I have one more point, and this may be a bit of a digression. In regard to the cross-shareholdings that were mentioned in the comment from Mr. Callon, Konosuke Matsushita wrote various papers, and one of these papers written 50 years ago points out regarding cross-shareholdings that the collection of shares by a certain corporation leads to the degeneration or retrogression of capitalism. I would just like to introduce this point.

That is all for me.

[Ikeo, Chairman] Thank you.

We are almost out of time, and while I do not want to forcibly close the debate and I would feel no reluctance toward having a council once more, so we can have discussions one more time, I feel that we have already fully debated the items on the current agenda.

Based on the understanding that an agreement has been gained today for the Code revision draft and Guideline efforts overall including revisions because we want to avoid wording that suggests all Japanese companies are not good and fully support the efforts of people who are out there doing their best as has been stated today, I will send a revised version that incorporated the comments received today by email for your confirmation. After that, the secretariat and I will review the final grammatical details and while we may need to hold a council once more at a later date, we will assume that this is not necessary at this time and that things can be handled by email. Would it be acceptable if I circulate a revision draft based on the discussions today and release it at a later date? Are there any objections?

(“No objections” was stated)

[Ikeo, Chairman] OK, then that is what I will do,

Not everything will be decided on just here after the release of this documents, I believe we will have to broadly solicit opinions and submit the document to public comments. I would like to ask the secretariat to explain the procedure for the public comments, etc. subsequently.

[Tahara, Director of the Corporate Accounting and Disclosure Division, FSA] Thank you.

For the final drafts that are adjusted based on the discussions today, we will broadly solicit the

opinions of stakeholders by accepting public comments for a period of about one month for the Corporate Governance Code revision draft through the Tokyo Stock Exchange and for the Guidelines (draft) through the Financial Services Agency. Of course, we would like to accept international opinions as well, so public comments will also be accepted for the English versions of these documents. [Ikeo, Chairman] Thank you.

In that case, I would like to proceed by finalizing and releasing the final versions of the Code revision draft and Guidelines draft in consideration of the opinions submitted in public comments.

We may have to get together to hold another council during this process in some cases, so I would like to request your cooperation if that is the case.

Although this possibility does exist, for the time being I would like to close the discussions on the Code revisions and establishment of the Guidelines as of today.

However, because this follow-up council does not end today, as mentioned by Mr. Oguchi, I would like to ask for everyone's continued cooperation as we continue the follow-up council in the future.

Now I declare the meeting adjourned. Thank you very much for the vigorous discussions. I would like to close the council now. Thank you for your participation.

END