(Provisional translation)

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

1. Date and Time: February 15, 2021 (Monday) 15:30-18:00
2. Venue: 9F, Central Government Building No. 7, Meeting Room

[Kanda, Chair] It's time to start the meeting of the Council of Experts Concerning the Follow-up of Japan's Stewardship Code and Japan's Corporate Governance Code. This is the twenty-fourth meeting. Thank you very much for taking time out of your busy schedule to participate in this meeting.

First, let me explain today's schedule. We will start with a representative from the Financial Services Agency (FSA) explaining "medium- to long-term sustainability, including ESG factors" before moving on to explain our second topic, "enhancement of the dialogue between companies and investors/managing conflicts of interest between corporate pension beneficiaries and sponsor companies". After that, I'd like to ask members to discuss these two topics.

Today, Ms. Waring will express her opinion in English, and there will be consecutive interpretation. Now, I'd like to move straight on and ask the FSA to explain "medium- to long-term sustainability, including ESG factors" as well as, "enhancement of the dialogue between companies and investors/managing conflicts of interest between corporate pension beneficiaries and sponsor companies".

Director Shimazaki, please go ahead.

[Shimazaki, Director of the Corporate Accounting and Disclosure Division] Thank you. I will base my explanation on Material 1 and Material 2. Material 1 concerns mid- to long-term sustainability, including ESG factors and includes a general overview on page 2. In terms of what is written in the current Corporate Governance Code and Stewardship Code, Principle 2.3 of the current Corporate Governance Code states that appropriate measures should be taken to address sustainability issues. Section 3 also refers to disclosure of non-financial information in relation to so-called ESG factors. The need to consider sustainability was added to latest version of the Stewardship Code (March 2020).

Page 3 refers to climate change as a factor of ESG. The majority of companies and investors now view climate change as a risk as well as an investment and business opportunity. 69.7% of the companies and 77.8% of the investors that responded to our survey responded that there are both risks and business opportunities.

I would like to explain the initiatives these companies are taking as outlined from page 4 onwards. The first initiative is Challenge Zero, which is being promoted by the Japan Business Federation as an initiative to develop, disseminate, and implement net-zero emission technologies, and provide financing to companies that are engaged in such initiatives. I think we are now at a stage in which companies are transmitting, both domestically and internationally, information on the innovative efforts they are making to achieve a decarbonized society.

Page 5 is about sustainable financing. In October 2020 the Japan Business Federation published a Basic Approach to Sustainable Finance on Climate Change and Concrete Actions. The relevant parts have been marked in blue. At the bottom of the page it states that “given that Japan’s Corporate Governance Code is to be revised next spring, Japan should also consider the need for further enhancement of existing institutional foundations, including clarifying the role of TCFD Recommendations in the field of climate change, while ensuring the independence and flexibility of corporate disclosure”.

Some examples of sustainability initiatives being taken by companies are given on page 6. In some cases, initiatives are positioned as activities by an advisory body to the board, while in other cases they are positioned as activities by the highest decision-making body on the executive side. Page 7 outlines discussions by the Davos Agenda, an international discussion group. (January 2021) In September 2020 the World Economic Forum published a report on quantitative ESG metrics and recommended disclosures, and 61 global companies have made declarations based on this report. The report is organized around the four pillars of principles of governance, planet, people and prosperity, and existing ESG disclosure frameworks are also used as the main reference standards. Page 8 concerns interviews we held last year on governance issues we would like to focus on post-COVID-19. In addition to the environment (E), focus is being placed on social (S) factors, including the role of employees and consideration for their safety.

Page 9 indicates the trend of increasing ESG investment in each region.

Page 10 gives an example of increased interest by investors. BlackRock has announced that it will strengthen its ESG-focused management of investee companies and client investors and will require them to disclose their plans for adapting their business models.

An extract of the Japanese Government's Green Growth Strategy can be found on page 11. The Green Growth Strategy Through Achieving Carbon Neutrality states that the position of the TCFD will be clarified in the future in regard to finance.

Page 12 concerns the telephone call between Prime Minister Suga and US President Biden, during which they agreed that Japan and the US should work together closely on climate change issues. Page 12 also includes information on issues affecting the entire international community, including climate change, measures for handling COVID-19, and innovation.

Page 13 onwards is about sustainability disclosure, which is taking hold at companies in Japan. Page 14 shows that there is an proactive movement towards the disclosure of non-financial information, including disclosure in integrated reports, and including information on TCFD, SASB, and CDP as well as data from integrated reports.

Page 15 outlines frameworks for disclosure of non-financial information. These frameworks have been formulated and announced by a number of organizations, and include the TCFD Recommendations, SASB Standards, GRI Standards, and the International Integrated Reporting Framework.

Page 16 provides details of the TCFD Consortium, an initiative in Japan to support the voluntary disclosure of TCFD.

Page 17 outlines trends overseas. Overseas, and especially in Europe, there is a growing movement to legislate disclosure based on the TCFD Recommendations. In November 2020, the UK announced a roadmap to make TCFD disclosure mandatory by 2025. From January 2021, companies listed on the premium market will be required to disclose TCFD in under Comply or Explain rules. In the US, the Biden administration has pledged to require listed companies to disclose their climate-related risks and greenhouse gas emissions, and President Biden has addressed this issue by issuing an executive order. France and Germany meanwhile are also working on a TCFD proposal.

I'm now moving on to page 18. With regard to the organizations I just mentioned, with respect to standards that stand together and side-by-side, the IFRS Foundation, the body that established the IFRS International Financial Reporting Standards, issued a consultation paper in September 2020 in which is stated that it will establish a new standard-setter to develop international reporting standards.

The paper proposed establishing a new standard setting body, to work on climate-related information at the new standard-setter in collaboration with existing organizations, and provide useful sustainability information to investors and other market participants. Page 19 has a rough image of the new standard-setting body. The IFRS Foundation is proposing to establish the body under the Board of Trustees to develop international accounting standards and standards for sustainability reporting.

In response, Japan issued a comment letter on November 27 last year signed by the IFRS Council of Japan. Related organizations also participated in the discussions. The letter indicated support for the establishment of a new standard setter for sustainability reporting. It went on to say that Japan believes that the primary audience for sustainability reporting should be capital market participants, with investors at the center, and that the scope of materiality should be based on the impact on corporate finance. It also noted that member diversity should be ensured, and ESG factors, especially S (Social) and G (Governance), should be addressed in parallel to climate change. It also stated Japan's stance on securing financial resources. According to press releases issued by the IFRS Foundation, there is currently growing demand for the Foundation's sustainability reporting initiatives. Given this high demand, we believe the Foundation has announced an intention to finalize a final proposal by the end of September that includes a roadmap with a time frame.

Page 21 concerns the Sustainable Finance Council. The Sustainable Finance Council was set up by the FSA and focuses on the topic (proposal) of linking carbon neutrality to a virtuous cycle between the economy and the environment by 2050, which is an issue for the entire government. For example, in relation to climate-related disclosure, which relates to this matter, I understand that the council held a meeting on February 10 to discuss the importance to investors and other stakeholders of disclosing useful information, how to ensure such disclosure, international trends and voluntary and compulsory disclosure.

On page 23, we have included reference materials concerning the concept of corporate value, which has been discussed in the past. As shown in the diagram, we believe that there is corporate value for shareholders, etc. for which measurement methods have been established. By which we mean major measurement methods have been established, such as the DCF method and the EBITDA multiple method. And there is corporate value that encompasses a wider range of stakeholders, for which measurement methods are being sought and developed.

In addition to corporate value evaluations, the DCF method, and the EBITDA multiple method, etc., shareholder value can also be calculated using EPS, BPS, PER, and PBR, etc. We could say that it is mainly defined by current profitability and expected future profitability. Here stock prices act as a market valuation. With regard to non-financial capital intangible assets that are not included in the balance sheet, studies on the principles of evaluations and information disclosure are, as I mentioned earlier, being undertaken internationally. This is expected to contribute to more accurate corporate evaluations, including sustainability reporting trends, and we have compiled details on one page, based on a variety of published materials, literature, and so on.

The issues we would like to discuss today are laid out on page 24. The importance of sustainability (mid- to long-term sustainability, including ESG factors) is increasing as a means to enhance corporate value over the mid- to long-term, and Japanese companies are working to increase sustainability-related disclosure. With regard to sustainability, while the focus on E (Environment) factors continues to increase, in addition, in recent years, the importance of S (Social) factors has also been pointed out. Given this context, I would like to discuss the factors related to sustainability that should be considered in order to improve corporate value over the mid- to long-term. The aspects of corporate sustainability disclosure that are important from the perspective of deepening constructive dialogue with investors, and ways companies can be encouraged to disclose information. As well as, how corporate governance systems should be designed from the perspective of enhancing corporate value through sustainability initiatives.

I will now move on to material 2, and explain the enhancement of dialogue between companies and investors, and the management of conflicts of interest between corporate pension beneficiaries and sponsor companies. With regard to dialogue in the context of corporate governance reforms, we have had many discussions on dialogue at this meeting and in recent meetings and so I will start by summarizing those discussions. The Stewardship Code and the Corporate Governance Code are cart wheels. In June 2018, as initiatives were being undertaken to deepen corporate governance reforms, we formulated Guidelines for Dialogue Between Investors and Companies as supplementary materials to both codes to enhance the effectiveness of dialogue between institutional investors and companies.

Page 2 provides an overview of the Guidelines for Dialogue Between Investors and Companies. Capital costs and a review of the business portfolio have been included in Management Decisions in

Response to Changes in the Business Environment. Capital investment, research and development, human resource investment, and financial management policy are included in Investment Strategy and Financial Management Policy. The appointment and dismissal process for CEOs and ensuring diversity are included in the Appointment and Dismissal of CEOs and Fulfillment of Board Functions. The verification of the purpose, benefits and risks of shareholdings and policy clarification, are cited as "four pillars" with regard to cross-shareholdings. Finally, Asset Owners refers to measures such as systematically recruiting and assigning qualified personnel.

Page 3 is a summary of the opinions expressed during discussions so far regarding the importance of enhancing dialogue.

Page 4 concerns asset owners. Principle 2.6 of the Corporate Governance Code and the Dialogue Guidelines refer to the importance of efforts such as the systematic recruitment and assignment of appropriately qualified personnel, which I mentioned earlier, and the management of conflicts of interest between corporate pension plan beneficiaries and companies. Page 5 includes the opinion that it is important to make an effort to manage conflicts of interest, which we received recently when we solicited public comments on the recent revision of the Stewardship Code. This is a matter that is expected to be discussed further by the follow-up council and by related parties, including the FSA, while taking the actual situation into account. I hope that you will discuss this matter today.

Page 6 presents the results of a fact-finding survey of corporate pension fund managers. The results indicate the existence of corporate pension funds that place importance on the business relationship with the sponsor company in deciding fund managers.

I'll now move on to page 7. Of the matters we wish to discuss at this meeting, to date we have heard comments on the importance of enhancing dialogue, including dialogue between companies and investors on issues such as capital efficiency. Given this, we would like to discuss the measures that should be taken to make dialogue between companies and investors more effective so as to improve corporate governance. The matters that should be included in the Guidelines for Dialogue Between Investors and Companies to further enhance dialogue. And what you think about the relationship between corporate pension funds as asset owners and their sponsor companies (management of conflicts of interest).

That is the end of my explanation.

[Kanda, Chair] Thank you very much.

I would now like to spend some time hearing opinions and discussing the issues raised. Today, based on the explanation we just received, the secretariat has presented some matters to be discussed and these are on the last page, page 24, of Material 1, and the last page, page 7, of Material 2. I'd appreciate it, if you would give your opinion focusing on these points.

As always, please keep your comments and opinions to roughly five minutes per person. As usual, if you would like to speak, please use the chat function, and send a message to all participants, and I will ask you to speak. Please state your name when you start speaking.

Today we are joined by Ms. Waring. If no one objects, I would like to ask Ms. Waring to speak first. I hope that is okay.

[Waring, member] I would like to start by thanking Chair Kanda and Fellow Council members for the opportunity to present the ICGN's opinion at today's meeting. Companies and investors share a mutual interest in improving the maintenance of long-term corporate value and ultimately in contributing to sustainable economic growth and social prosperity. The world is currently facing challenges of a major scale. I am of course referring to COVID-19 and climate change. We need to manage these risks at the same time and reboot the global economy while decarbonizing the planet in order to create a healthier and more sustainable world. Urgent action is needed to stabilize global warming at 1.5 degrees Celsius and to set a net-zero target so that carbon emissions generated equal the amount removed from the atmosphere. Otherwise, future generations will be unfairly burdened with the enormous social, ecological, and economic effects.

So, what action is needed? All governments need to establish and disclose action plans and net-zero targets for their economies. Companies working on the transition to net-zero will not only defuse the negative impact of climate change, but will also benefit from business opportunities that arise from renewable energy, resource efficiency, and smart technologies.

So, how can corporate boards be more responsible and accountable with regard to climate change? They could appoint independent directors well versed in sustainability issues, or they could set up a sustainability committee led by an independent director, and of course, they could make the entire board jointly responsible. Companies could also educate people about the impact of climate change, and explain to investors how the impact of climate change is being incorporated into business models, thereby demonstrating that risks are being properly identified, measured, monitored and managed. Regarding reporting methods, we recommend aligning with TCFD. Specifically, boards should assess the impact of climate change on their business model and ways in which the business model can be applied to meet net-zero economy and long-term strategy needs. Further, boards should disclose, with shareholder approval, their goals and plans to reduce carbon emissions, including a timeframe for achieving such goals. On the assumption of approval of shareholders, such plans can then be closely linked to bonuses for the CEO and officers.

Disclosure related to such acts helps investors understand a company's resilience and assess its progress. Information should be disclosed in annual reports, announced before shareholder meetings, and translated into English. Investors cannot identify and extract climate change risk from their investment portfolios. However, with better disclosure, risks can be reallocated to sustainable environmental and social infrastructure, to promote economic growth while optimizing the world's limited resources. Given that, generally, IFRS and US GAAP provide virtually no insight into the intangible aspects of risk and return, such as human and natural capital, establishing a single global approach to sustainability reporting would be extremely useful.

Investors themselves are also committed to achieving a net-zero portfolio by 2050. TCFD requires asset owners to disclose how their portfolios are positioned for the transition to net zero carbon emissions. In France, Article 173 of the Law on Energy Transition for Green Growth requires asset owners to disclose their carbon risks and climate change policies. In the UK, pension funds must explain how economically significant factors, including ESG, are taken into account in corporate engagement and voting. In 2021 ICGN plans to collaborate with the UN's Global Investors for Sustainable Development (GISD) to review the ICGN model mandate (model contract clauses). This model mandate provides examples of conditions that asset owners should consider when drafting stewardship obligations in contracts with fund managers. For example, conditions relating to duration, incentives, and ESG integration.

The COVID-19 pandemic has revealed serious social inequalities and spread public distrust of capitalism. How to improve the situation and return in a better state is an important priority for companies and investors in all markets. Companies need to ensure the health, safety, and welfare of their employees while meeting short-term liquidity requirements to remain solvent. They should then publicly define their social significance from a long-term perspective with regard to social responsibility, equality, and sustainable value creation. From there, they should take a general and equitable approach to capital allocation decisions, while taking into account the workforce, stakeholders, and capital providers. Companies are also being called on to disclose better information about their human capital policies as part of a long-term strategy for value creation. This includes improving transparency relating to job security, total workforce costs, diversity, and human resource management. These priorities have also been included in this year's revisions to the ICGN's global governance principles.

The question here is how we can improve dialogue between companies and investors to address these issues. First, we need to better understand how the Corporate Governance Code and the Stewardship Code relate through the "comply or explain" system. This requires companies to disclose how they apply the principles of corporate governance and how they have been applied to investors. This disclosure requires information to be consolidated in a single report, called an annual report. The explained approach is useful when companies have a legitimate reason to deviate from specific code principles. For the system to function effectively, explanations from companies must be meaningful, and must explain to investors the clear rationale for alternative approaches and their potential impact. Investors also need to carefully consider such explanations and give adequate consideration to each individual company's situation.

In other words, when voting, there is a need to avoid the approach of simply ticking check boxes. Shareholders, and all stakeholders, focus not only on a company's financial capital, but also its human and natural capital. Therefore, as investors we also need to act as guardians of good governance through stock ownership and responsible stewardship codes. Thank you very much.

[Kanda, Chair]　Thank you very much for your valuable comments, Ms. Waring.

Now, I would like to invite other members to comment. I understand that Mr. Matsuoka from Sony is planning to leave the meeting early. Ms. Matsuoka, if you are still here I would like to hear your comments.

[Matsuoka, member]　Thank you. I am grateful to have an opportunity to speak. First of all, I would like to talk about mid- to long-term sustainability, including ESG factors. We agree that sustainability is becoming increasingly important. From the perspective of deepening constructive dialogue with investors to enhance mid- to long-term corporate value, each company has been enhancing its sustainability disclosure, and I am sure that all companies intend to continue to make constructive efforts in the future.

As was just mentioned, ensuring mid- to long-term sustainability, including ESG factors is steadily becoming a major trend throughout the world, and each company is in the midst of undertaking various individual initiatives based on their situation and the environment, and I am sure they will continue these efforts in the future. For example, climate change was mentioned during the discussion of environmental issues. Companies have been and will be tackling various environmental issues such as waste plastics and the circular economy.

I feel that the interests of investors are diverse, and that there are a variety of international frameworks for ESG disclosure. Since no “one size fits all”, going forward we need to consider how to respond to these diverse approaches. I am aware that moves are starting to be made towards standardizing international disclosure standards for ESG, and I would like to keep abreast of these developments while working, as a company, to ensure mid- to long-term sustainability, including ESG factors.

With regard to the enhancement of the dialogue between companies and investors and managing conflicts of interest between corporate pension beneficiaries and sponsor companies, mentioned in the latter part of the explanation, naturally we are aware that dialogue between companies and investors, one of their key stakeholders, is very important, and that companies are making progress in this regard. For reference, Sony places great importance on providing careful explanations and promoting understanding, and we go to great lengths to hold fulfilling dialogues. We have been focusing our efforts on dialogue while also paying attention to various changes in the environment and the current state of such issues.

With regard corporate pensions, I believe that there are various circumstances at each company. Given this, and this is also an example for your reference, let me tell you about the situation at Sony. For many years we have been working to create a system that eliminates conflicts of interest as much as possible. In recent years, we have shifted to DC, and while receiving various proposals and advice from outside the company, from consultants and various financial institutions, we have been working hard every day to improve the familiarity and sophistication of our internal and external personnel, and to create a system capable of responding to needs that we expect to becoming increasingly diverse in the future. Therefore, we are generally expecting to make a lot of progress on this front in the future.

That’s all from me. Thank you.

[Kanda, Chair]　Thank you very much.

I would now like to hear comments from members. Please let me know in the chat if you want to say something. Okay, Chairman Kobayashi, please go ahead.

[Kobayashi, member]　First of all, I would like to start with the concept of corporate value, referred to on page 23 of Material 1. In the previous era of shareholder capitalism, corporate value was exclusively a financial factor. I take this to be management of efficiency or management of economics, and I think it was determined by factors relating to capital efficiency in particular. However, as we move to capitalism which takes a wide range of stakeholders into account, we need to consider factors such as employee value, and consequently employee health, or contribution to sustainability, and technology including intellectual property. In other words, the weight of factors that can be expressed as management of sustainability and management of technology is increasing by 20, 30, or 40 percent.

Amidst this situation, the pandemic of the last year has led to a rapid expansion of the virtual economy, specifically GAFA related activities, which I guess is a weightless economy based on the internet, and in fact, GAFA's market capitalization far exceeds the market capitalization of all listed companies in Japan. What do you think about the value of the virtual expectation business of such tech companies, whose market capitalization has quickly grown to 700 or 800 trillion yen? I think it is fair to say that they are generating huge cash flows, and completely deviating from the traditional, physical corporate values associated with previous financial statement-based capital efficiency, equity spread (ROE less cost-of-equity) and simple proportionality, thereby creating new economic spaces in the virtual arena, and on the internet, and increasing value greatly by embodying a virtual economy.

This is reflected in the rapid increase in the market capitalization of virtual companies. On the other hand, the market capitalization of heavy chemical companies is naturally declining or it is normal for them not to reach their PBR. In this situation, on the other hand, how the corporate value of such real-based companies is expressed and thought about in the future has become a critical issue. Now, for example, it is companies in the real economy that can be concrete solution providers for carbon neutrality. It is not enough to just use the power of finance to change the economic and social system towards carbon neutrality. As far as technology is concerned, unless real solutions are provided to achieve carbon neutrality in the form of concrete action plans from people in the real economy, such as conventional oil, coal, iron, and automobile industries, we will not be able to make concrete steps towards carbon neutrality.

This means that intellectual property is going to be very important when we talk about future solutions and innovation. I feel that the secretariat's materials do not pay enough attention to the way intellectual property is expressed, by which I mean, the importance of utilizing intellectual property as an intangible asset and the disclosure thereof. The materials list shareholder value, employee value, customer value, business partner value, and social community value, but perhaps the most important part of non-financial capital and intangible assets, the source of these values, is intellectual property and trademarks, as well as investment and utilization strategies. Unless there is full disclosure in this area, I feel that important information relating to the management of technology and management of sustainability I referred to earlier, will be lacking. In reality intellectual property generates carbon neutrality and circular economy. Therefore I would argue that this should be described in some way. The other issue was dialogue with investors. In my experience, investors are essentially interested in what management thinks about risk strategies, and what they think about portfolio management and portfolio transformation as the business environment undergoes major transformations, including carbon neutrality, digital transformation, and the recent pandemic. Therefore, I think that the key point is to disclose how companies manage their portfolios, and approach capital allocation as a result, in response to major trends such as climate risk, carbon neutrality, and digitalization, in a manner that is consistent and relevant.

Also, in the course of specific dialogues, rather than only executive officers and internal directors meeting with institutional investors, I think there is a need for outside directors, and specifically people like the chairman of the board, to engage in dialogue with institutional investors at least once a year to discuss the items I have mentioned. I believe this is important not only simply in terms of execution, but also in terms of ensuring that the direction of the company as a whole is consistent, and it is also very important in terms of giving individual outside directors a chance to learn.

Finally, I would like to reiterate that I of course have no objection to today's topic of enhancing non-financial relationships that focus on sustainability. However I would like to suggest that we discuss investment and use of intellectual property and intangible assets in general at the next meeting.

That's all from me.

[Kanda, Chair]　Thank you very much.

Next, Mr. Haruta, please go ahead.

[Haruta, member] This is Haruta. Thank you for the opportunity to speak. I would like to comment on sustainability and the importance of dialogue. I will start with sustainability. The “matters to be discussed in this meeting” section of the document, states that “while the focus on E (Environment) factors continues to increase, in addition, in recent years, the importance of S (Social) factors has also been pointed out”.

From the standpoint of those working people, I believe that factors such as S, labor, and human rights are very important in ESG. One of the major issues is that companies are not making much progress in disclosing information on indicators relating to labor and human rights. Information that is, how should I put it, inconvenient, such as information on the percentage of non-regular employees, turnover rates, and the situation surrounding occupational accidents, does not always come to light, so I think that disclosing such information is a key point.

I believe that the Corporate Governance Code will push companies to disclose information, and I believe that this will lead to improvements in the working environment and working conditions, corporate sustainability, and ultimately to the sustainability of society. I would like that the Corporate Governance Code to include these areas.

Regarding the second matter, as I have already mentioned, we are keenly aware of the growing importance of dialogue amidst the COVID-19 pandemic. As we experience a shift in our industrial structure I believe that it is important to collaborate and talk not only to investors, but also to stakeholders such as employees, business partners, and local communities. It is also necessary to reinforce the importance of dialogue in corporate governance.

We are focusing on the so-called digital recovery and green recovery, and I think it is important to support the development of human resources to improve innovation, as mentioned earlier. On the other hand, from the standpoint of workers, as supply chains are rebuilt, we are aware that the optimization of transactions is a problem in particular. I believe that the entire supply chain needs to work on the optimization of transactions. There are still cases in which business partners, which are small and medium-sized enterprises, are forced to bear inappropriate costs or place orders with impossibly short delivery times, and so in this respect, dialogue with business partners will become very important in the future.

From the perspective of initiatives throughout the supply chain, there is a declaration on partnership building, agreed upon by government, workers, and management, and I think it is important for companies to sign on to this declaration and there is a need to incorporate this perspective in the Corporate Governance Code.

Finally, the materials refer to the concept of corporate value in terms of dialogue with investors, and I would like to spread the awareness that non-financial information conscious corporate action will lead to improvements in the corporate value. It is often said that ESG investment does not pay back in returns. It is extremely difficult to prove causality, but if we can be properly aware of such causality then I believe that the disclosure of non-financial information and ESG investment will progress further. I think it is particularly important to clarify that the causal relationship between ESG initiatives and improvements to the corporate value through dialogue between companies and investors carries great significance, and I hope that the Corporate Governance Code will promote such thinking.

That’s all from me.

[Kanda, Chair] Thank you very much.

Based on the order in which I received requests to speak in the chat I would like to ask Mr. Obata to speak next.

[Obata, member] This is Obata. Thank you. Due to problems with my telecommunications environment, I would like to speak with my camera turned off.

Regarding the ESG factors in the first half, like everyone else, I have absolutely no objection to the board being properly involved and looking at this area as a company. However, as some members have said today, I understand that companies are undertaking various initiatives in this area based on their own circumstances. So if the Corporate Governance Code, etc. requires a certain level of disclosure and discipline, I would like to list-up expressions and items that can be applied as mutually as possible. From this perspective, on the one hand, it is easy for companies to disclose information and to talk, but on the other hand, for parties that seek such information, such as investors and NPOs, if the information is consistent with the greatest common denominator, companies will be able to disclose information focusing on this area and this will make things much easier.

Regarding the dialogue guidelines in the second half, having re-read them, my impression is that they were very well written. In the future, as mentioned earlier, I think we will see companies disclosing more non-financial information, and since this is mentioned from the perspective of companies holding dialogue while being aware of such issues, it will be extremely easy to follow. Finally, regarding conflicts of interest in corporate pension funds, companies have taken various measures to prevent conflicts of interest, such as using qualified pension fund managers, and I get the impression that companies are doing whatever they have to do, so I would appreciate being informed of anything companies are not doing enough.

That's all from me. Thank you.

[Kanda, Chair]　Thank you very much.

Next, Ms. Takayama, please go ahead.

[Takayama, member]　On the topic of sustainability, which is the last item listed in the Matters to be Discussed at this Meeting, currently on the screen, I would like to talk about how it can be considered from the perspective of the corporate governance system, and how the text of the Governance Code will be revised. I will talk about three points.

The first is sustainability opportunities and risks. The text of the current Governance Code is on page 2 of Material 1. Supplementary principle 2.3 states that companies should realize that addressing sustainability is an important part of risk management. On the other hand, the following pages refer to the way investors think, and there is a statement from the Keidanren on page 5. These both show that companies and investors view sustainability not only as a risk, but also as a growth opportunity. In light of this awareness by companies and investors, I think it would be better to consider writing the Governance Code from the perspective of opportunities as well as risks.

For my second point, I would like to express my opinion on the stance and attitude toward sustainability. Principle 2.3 of the Governance Code states that companies should take appropriate measures to address sustainability issues, but this feel somewhat passive to me. I believe that the bit written under that supplementary principle that refers to addressing matters positively and proactively could be taken on board more fully. In other words, I think it would be better to word the text more strongly so that it is proactive in its attitude toward sustainability.

Finally, I would like to talk about management and supervision, the role of executives and the role of the board. I think this point is extremely important. The material refers to sustainability committees, but there are two types of sustainability committee. One is a sustainability committee on the executive side, while the other is a sustainability committee under the board, led by independent directors. These are different in character, so I think it would be better to make a clear distinction between them when discussing the Governance Code.

The sustainability committee on the executive side is positioned as a management committee engaged in sustainability management. Meanwhile, the sustainability committee under the board is a committee that oversights sustainability management by the executive side. When discussing the Corporate Governance Code and corporate governance, the main topic is naturally how the board should fulfill its supervisory function. Therefore, how the board will fulfill its oversight function with regard to sustainability, and how it will supervise sustainability management are important. Global companies are gradually developing best practices for overseeing sustainability management.

For example, companies are gradually developing practices relating to how the board should discuss and supervise sustainability as a whole, how committees such as the nomination, remuneration, and audit committees should supervise sustainability issues according to their roles and responsibilities, and how sustainability committees, at the few companies where they exist, should discuss issues. Regarding how to incorporate them into the Governance Code, including all of them would not be consistent with the purpose of the Code, which is to be concise and clear. Therefore, I think it would be a good to first include a comprehensive description of the board as a whole, and to write in the code that the board is responsible for overseeing sustainability management.

The part of the opinion issued by the follow-up meeting in December last year that refers to diversity can act as a point of reference for this. The opinion stated that companies should undertake initiatives to ensure diversity. It goes on to say that the board should take the lead in promoting and overseeing such initiatives. If we emulate this example, I think it would be better for the revised code to state that the board shall promote and oversee sustainability management through execution. By indicating such an overall direction, I believe that the boards of each company will be able to think about how to oversight sustainability management based on their own situation. Another reference in this regard is the ICGN principles. As Kerrie-san mentioned earlier when offering the ICGN's opinion, the ICGN is currently in the process of revising its governance principles, and will include a comprehensive description of how boards should oversight sustainability. I think it would be good to refer to such descriptions when considering the text of the Governance Code.

That's all from me.

[Kanda, Chair]　Thank you very much.

Next, Mr. Okada, please go ahead.

[Okada, member] This is Okada. I would like to talk about disclosure of non-financial information and dialogue between companies and investors. As stated in the Materials, disclosure of non-financial information is becoming more common, and non-financial information, including ESG, is becoming increasingly important. This is particularly true in the case of E disclosure. Investors are also starting to use such non-financial information as an important basis on which to make investment decisions. However, non-financial information is outside the scope of audits by financial auditors. Financial auditors merely read non-financial information and point out any discrepancies to the financial information.

Therefore, there is no guarantee that the disclosure of non-financial information is accurate, and guaranteeing accuracy is extremely difficult. On the other hand, as stated in the Materials, there are many standard setters for different purposes, and their disclosure requirements are becoming increasingly complicated. Under such circumstances, what should the average investor rely on when making investment decisions? I understand that the IFRS is working on a consistent standard, but I am sure it will take some time to complete and that it will not be easy to compile. I also believe that there is a lack of experts who understand ESG disclosure in general.

Of course, improving the situation for investors and companies is important, but I also think that training analysts who have developed specialized knowledge is an urgent issue. I am not sure if this is included as a subject on the securities analyst examination, but I think it would be good to make non-financial information, especially E, a subject on the examination in the future, and to incorporate it into the continuing professional education system after passing the exam, to ensure analysts keep up to date with the latest developments. It goes without saying that it is also necessary to train experts within companies.

Once the number of analysts with such knowledge has increased, I think it will be important for them to engage in dialogue with companies. By which I do not mean that dialogue should only take place after knowledgeable analysts have been trained, but that dialogue could take place at the same time. I think it is important for analysts to analyze ESG to a certain extent, and to engage in dialogue with companies based on the results of such analysis. The Guidelines for Dialogue Between Investors and Companies includes sections on investment strategy and financial management policy. I think it would be good to include dialogue on ESG disclosure as well.

I think the Corporate Governance Code should not only encourage dialogue with investors, but also require companies to disclose the details of such dialogue as and when necessary. In order to earn the understanding of investors, and non-professional investors in particular with regard to ESG, I think it would be better for companies to disclose the details of dialogues, in addition to reports by analysts who participated in the dialogues. I think there is a need for companies to explain their viewpoint on the questions and opinions put forward by investors and analysts, including their policies, in a way that can be understood by the average investor. This will, as a result, enable the average investor to be able to understand a company's initiatives and stance with regard to ESG and will be useful when they make investment decisions.

That's all from me.

[Kanda, Chair]　Thank you very much.

Next, Professor Kansaku, please go ahead.

[Kansaku, member]　Thank you. I would like to start by commenting on sustainability. As reported by the secretariat, a new provision that sustainability should be considered in stewardship activities was added the second revision of the Stewardship Code published in March last year. The Stewardship Code defines sustainability in its preamble as "mid- to long-term sustainability, including ESG factors" and defines stewardship responsibility as the responsibility to increase the mid- to long-term investment returns of ultimate beneficiaries by promoting improvements to corporate value and sustainable growth at the relevant company through constructive engagement based on the consideration of sustainability. The code defines sustainability in this way and explains its significance.

In the Corporate Governance Code, as Mr. Takayama introduced earlier, Principle 2.3 already states that listed companies should take appropriate measures regarding issues related to sustainability, including social and environmental issues, and supplemental principle 2.3 (1) states that the board should recognize that addressing issues related to sustainability is an important part of risk management and should take appropriate measures. In order for management and institutional investors to engage in constructive dialogue and discussions, it is desirable to align in the same basic direction, consideration of sustainability by institutional investors and listed company's views of sustainability.

Given that the Corporate Governance Code and the Stewardship Code define sustainability as "mid- to long-term sustainability, including ESG factors", sustainability here should essentially be examined in line with the company's business, and discussions should focus on the process of generating profits in relation to that business. If sustainability is viewed in this way, I believe that sustainability issues will be identified and addressed according to each company's business and profit generating process, and that examinations will be focused on the processes that generate returns, which are closely linked to risks. If sustainability is viewed in this way, I believe that further discussion on disclosure, and especially on the nature of disclosure of human capital, one of the factors of S, should be encouraged.

As with climate change, I think it is also possible to specifically mention in both codes matters that can be assessed as imminent risks common to both society as a whole and to all companies.

On the other hand, using the term sustainability, a concept that varies from company to company and which is unclear, runs the risk of increasing the discretion of management and raises corporate governance concerns. Dialogue with institutional investors is important, but it is also necessary to pay attention to the company's governance system. When considering sustainability as a significant concept as I just described, it is important for boards to share their understanding as part of their management policy and strategies, of how issues should be identified and addressed from the perspective of sustainability. At the same time, leaving aside whether to require the establishment of an organization such as a sustainability committee, control by external unbiased individuals, mainly consisting of independent outside directors, will be necessary.

Next, I would like to comment on the enhancement of dialogue. Principle 2.6 of the Corporate Governance Code and the Guidelines for Dialogue Between Investors and Companies points out the importance of initiatives by the sponsor company, such as the systematic recruitment and assignment of appropriately qualified personnel to manage the company's corporate pension fund. While a closer relationship between the sponsor company and the corporate pension may have its advantages, there is a concern that it may further increase the possibility of conflicts of interest in which the best interests of the corporate pension beneficiaries, the ultimate beneficiaries, are not realized. This is not desirable either from a corporate governance perspective or a stewardship activities perspective. This issue should be dealt with through hard law. However, there is a great need to address conflicts of interest by reconfirming the need to strive for the best interests of employees and other retirees, as well as by making arrangements, including potential arrangements to, for example, disclose matters concerning conflicts of interest between the sponsor company and the corporate pension and to provide detailed information on the relationship between the two. It would also be desirable to go beyond mere disclosure and provision of information, and take proactive measures to mitigate or eliminate situations in which conflicts of interest may arise.

Finally, I would like to make one point that I feel should be mentioned regarding the guidelines for dialogue between investors and companies. Guideline 3.8 questions whether a sufficient number of appropriately qualified personnel are appointed as independent outside directors. I think it is desirable to clearly state, as topics for dialogue, the process for appointing independent outside directors, which are considered to be most the important appointments, and what roles are expected of independent outside directors by the board and various committees.

I'm sorry for talking for so long. That's all from me. Thank you very much.

[Kanda, Chair] Thank you very much.

Next, I would like to call on Mr. Oguchi. Please go ahead.

[Oguchi, member] Thank you. As stated in the items to be discussed at this meeting in Material 1, I don't need to say anything more about the increasing importance of sustainability. Here, sustainability is explained as mid- to long-term sustainability, including ESG factors, as Professor Kansaku pointed out earlier. Meanwhile Ms. Matsuoka commented that there are various schools of thought regarding so-called ESG investment.

For example, the CFA Institute, which has about 180,000 investment professional members in over 160 countries, has organized various schools of thought on ESG investment and is planning to publish a concrete proposal in May this year. The institute conducted a consultation last year for this purpose, and I would like to briefly introduce the ideas presented in that document. First, there is the concept of ESG integration that takes into account ESG factors that are important for investment returns and risks. This concept is shown on page 2 of Material 1 and is consistent with the definition in the Stewardship Code, which aims to increase investment returns over the mid- to long-term, as explained earlier by Mr. Kansaku.

That said, there are also other approaches to ESG investment, such as divestment, which eliminates investments that do not conform to one's own beliefs, as well as investment based on ESG performance regardless of investment performance, ESG factor themed investment, and investment based on the impact on solving social issues. I would like to say, from the perspective of deepening constructive dialogue with investors, which is what we are being asked to discuss, that there are various kinds of ESG investment, and so if companies do not understand where investors are coming from when trying to talk with them, talks will not go well and there is a chance that dialogue will not be deepened.

Moreover, I do not mean to deny the various ESG investment concepts that I just introduced, but I agree with what Mr. Kansaku said earlier, and I believe that for the purpose of the Corporate Governance Code, which aims to enhance corporate value over the mid- to long-term, we should engage in dialogue on ESG integration in the investment world, in line with the definition in the Stewardship Code.

In which case, as a disclosure framework, as has been introduced today, I think we should consider adopting rules that have already been widely accepted, such as TCFD. I think this is important. Many members have today pointed out the importance of the "S" factor, and Mr. Kobayashi also pointed out the importance of intangible assets, such as intellectual property, which also came up in the previous materials. When thinking about all of these, while information on climate change is a very important topic, we shouldn't stop there, and I think it would be beneficial to have a framework for integrated reporting, in which financial information and important non-financial information are integrated into one report. In this respect, Code Principle 3.1 aims to enhance information disclosure, and I think it should be specifically mentioned there.

Another point I would like to discuss relates to Material 2. The management of conflicts of interest between corporate pension funds as asset owners and their sponsor companies has been raised as a topic for discussion. Conflicts of interest among institutional investors is a very important issue, which is why the Stewardship Code, which has eight principles, indicates in its second principle that this is a superordinate concept.

This second principle requires the management of conflicts of interest by corporate groups to which institutional investors belong, and the source of the problem is the same as that of conflicts of interest between corporate pension funds and their sponsor companies. In terms of corporate pensions, as several members pointed out earlier, I think it is a realistic solution to ask the sponsor company to support the personnel and management aspects of its own corporate pension plan. But if, as a result, there is an increase in the trend in which the relationship between the sponsor company and the corporate group to which the corporate investor belongs is taken into consideration and the fund manager is decided based thereon, as stated on pages 5 and 6 of Material 2, such a trend may already be increasing or may increase in the future, but if this happens, it cannot be overlooked from the perspective of conflicts of interest. This is the same concern that Mr. Kansaku voiced earlier.

Therefore, it is easy to say, that conflicts of interest with the sponsor company will be managed from an independent standpoint, while receiving support from the sponsor company, but we need to understand that it is difficult in practice. Since the Corporate Governance Code targets listed sponsor companies, I think it is necessary for corporate pension funds, as asset owners, to sign the Stewardship Code and respond to Principle 2. Even if they do not sign the Code, they should consider building a system that requires accountability with respect to managing conflicts of interest.

That's all from me.

[Kanda, Chair]　Thank you very much.

Next, Mr. Sampei, please go ahead.

[Sampei, member]　This is Sampei. Thank you for the opportunity to comment. I'd like to start by commenting on the discussion topics in Material 2. Regarding the enhancement of dialogue between companies and investors, the term "engagement" describes "constructive 'dialogue with a purpose'". However, in reality, it is used to cover all kinds of communications and can be anything. If a company and an investor hold some kind of conversation or communication, some investors considered it as a dialogue. When engagement, a concept that was new to Japan and we were not familiar with, was first introduced, I think the idea was for it be broad with as few limitations as possible, but I think the time has come to clarify the definition a little more. First, if we do not require results from our dialogues, we will end up with dialogues that are a waste of time and unproductive.

So, what kind of results are we looking for from dialogue? I think there are two main results. One is the results that investors seek from companies. The other is the results that companies expect from investors. I believe that even the UK, a leading dialogue country, is now facing this issue. In 2010, the UK created the Stewardship Code, and in 2012 it created the Kay Review, but before that, only a small number of competent investors were involved in dialogue. At that time, dialogue produced results, but following the establishment of this code and the promotion of dialogue in the Kay Review, a large number of institutional investors were forced into engaging in dialogue, and as a result, I think the quality of dialogue has declined.

Last year, in 2020, the UK Stewardship Code was revised to require disclosure of the results of dialogue in the form of an Activities and Outcomes Report. This goes to show that even if we encourage more and more dialogue, without requiring results, this issue will come up somewhere down the road. Therefore, I propose focusing more on the outcome of dialogue and on clarifying the definition of dialogue.

Moving on, with regard to the management of conflicts of interest in corporate pensions, Page 9 of Material 4 includes excerpts from three companies, A, B, and C. While I don't mean to criticize these three companies, when explained here, the reality is that deemed shareholdings held by the retirement benefit trust is not included in the scope of management. Retirement benefit trusts were created with the introduction of retirement benefit accounting in 2000, and their purpose is to solve risk of deficit. That's all well and good, but a trust agreement was made that contributes to cross-shareholdings. This is where 'deemed shareholdings' comes into play. 'Deemed shareholdings', as I'm sure you know, is a situation in which the sponsor company has the authority to exercise voting rights or give instructions despite the sponsor company not owning the shares.

This creates blank areas that are not managed by the corporate pension office. We have been talking with companies that have a large balance of 'deemed shareholdings' in relation to their pension assets, and we have learned that the corporate pension office does not manage these retirement benefit trusts. When asked why this is, one of their answers was that retirement benefit trusts are not within the scope of the Defined-Benefit Corporate Pension Act. Consequently, I think we should consider corrective measures by conducting a fact-finding survey on the relationship between retirement benefit trusts and pension assets, as well as their management responsibilities. If we don't do this, as another member pointed out earlier, the problem of pension asset distortion, in which assets are included in pension assets but no one manages them, and the problem of no one managing conflicts of interest, whereby the sponsor company only takes the voting rights, will be left unresolved.

Next, I would like to make three points regarding sustainability in Material 1. My first point is that when considering sustainability, companies disclose what they consider to be material issues by identifying materiality. However, in recent years, there has been lots of discussion about double materiality, dynamic materiality, and single materiality, and the situation has become complicated. Put simply, one double materiality is to identify the key issues for corporate sustainability. Another double materiality is to identify key issues in terms of the order in which companies tackle social sustainability. Regarding this, I think in many cases companies and investors are not currently clearly aware on where they stand. Therefore, when holding dialogue, I think we need to first clarify where we stand, inform the other party where we stand, and then start to engage in dialogue.

My second point is that there is always capital allocation when tackling and promoting sustainability initiatives. However, the fact that there is capital allocation means that the measurement of return on allocated capital must be disclosed. However, capital is not only financial, there is also human capital. So, the reality is that it is actually difficult to measure allocation.

Take intellectual property for example, as others have mentioned, in the case of investment results in intellectual property and intangible assets including human capital, it would be better to show results numerically. If that is not possible, if the results can be shown in a causal relationship with financial performance, then there is a possibility of gaining the understanding and support from investors will increase. Here, for example, there is a straightforward, numerical indicator, called productivity. However, when we show this productivity, it is not as an improvement in productivity through cost reduction, or as an improvement in productivity through a reduction in the denominator. This is not sustainable. With this in mind, companies must think about how to present their data and how to use it in dialogue, and investors can also present data and make proposals. In fact, there are a few Japanese companies that have been doing this successfully.

My third point relates to the establishment of sustainability committees. I don't have any objection to their establishment per se, but I think there is one important point to note. When receiving a report from a sustainability committee, the focus of the report is to take some kind of initiative to solve common issues in society, and this may include, for example, expressing support for global initiatives or taking initiatives that follow guidelines. This in itself is not a problem, but there are potential risks.

This makes everyone conformists. Or it could be called herding or flocking together. The result is a red ocean. This will make value creative capital allocation impossible. Japanese companies are prone to all move in the same direction or to be conformists. Therefore, while it is of course good to tackle sustainability now, when doing so I would like boards, an important decision-making body for executing business, to pay thorough attention to ensure that there is no herding or red ocean tendency as a company.

That's all from me.

[Kanda, Chair]　Thank you very much.

Next, Ms. Ueda, please go ahead.

[Ueda, member]　This is Ueda. Thank you for the opportunity to speak. I would like to start with two comments about sustainability in Material 1. This has been particularly prominent over the last year, and I think that investors, companies, and workers have recognized that the economic and social structure will change discontinuously as a result of COVID-19 and carbon neutrality. Given this, I think that this topic, sustainability, is now recognized as a strategy that will lead to future corporate value, and such perspective is necessary in making management decisions.

However, because of this, and this is a topic discussed extensively when discussing the Code, I think it is essential to have a governance system that is based on flexibility and the responsiveness of the organization. This is something not just judged by companies, but also by fund providers, who are investing and lending. In order to evaluate this, information disclosure and disclosure of non-financial information will need to be more specific than ever before. In this sense, I think it would be good for the Corporate Governance Code to include a more detailed description of this point. First, with regard to governance information, corporate governance reports are truly a treasure trove of governance information, and while considerable progress is being made, I think E and S are the issues currently being discussed. Regarding E, as stated in today's materials, TCFD is mandatory in some countries around the world, and I think it has become a well-established disclosure framework. Since this is already well established in Japan, leaving aside whether to specifically use the name TCFD, I think it would be a good idea to include some specific details in the code or dialogue guidelines. This is an international tug of war for funds, so I think we need initiatives that are somewhat aware of this.

Moving onto S. I've been talking to overseas investors recently, and I have found that while human rights are a universal issue, human resources and workforce issues are issues more closely related to companies. In particular, in the future, as the discontinuous environment changes, I think it will be important to use or discuss what kind of people will be employed and how to retain them, including discussions on corporate culture. The existence of frameworks for disclosure relating to such a workforce is included in ISO, but is not that well established. Discussion of these points is expected to proceed under IFRS, and I hope that the discussions will move forward and that Japanese stakeholders will be able to participate in them.

Further, as various members have mentioned, in the future, we are now entering an era in which we must aim for a corporate value that far exceeds book value as the total value including human resources. So while this may include intangible assets and intellectual property, intangible assets may also include intellectual property. The disclosure framework for intangible assets, which may be very complex, should really establish what companies expect to achieve during dialogue, and initiatives for intangible assets that companies want to transmit, and I would like to see these resolved through dialogue that includes strategies relating to such issues.

My second point is about the governance structure that makes this possible. Integrated reports are one of the most important media for disclosure. In terms of why integrated reports are published, it is important to clarify that rather than being an extension of CSR reports, one of their purposes is fundraising, and so they need to be strongly focused on IR, finance, and corporate planning. In addition, as for the development of such a system, as mentioned in the secretariat's report today, I think it would be useful to establish sustainability committees that also provide support to boards.

Next, regarding Material 2, and the guidelines for dialogue, which I think are very important. In terms of sustainability in particular, for example, I have had some rather unfortunate experiences with CO_2. Some passive investors overseas have a zero carbon goal, for example, switching to EV in the automobile industry, when that happens, I sense that people are not paying much attention to the future existence of the company or the industry in which the company operates as a whole.

Consequently, accepting the words of Laurence Fink of BlackRock on this occasion, I would like to see clarification of the purpose of sustainability through dialogue guidelines, which I believe is also want investors want, with regard to how sustainability will link to future corporate value and how it can be incorporated into strategies and business models, rather than being an aim itself. I think that the dialogue guidelines will be more developmental if they are useful not only to investors but also in dialogue with stakeholders, as also mentioned earlier by another member.

I'm sorry for talking for so long, but lastly I would like to say something about conflicts of interest in corporate pensions. I believe this was introduced in detail by Mr. Sampei, as stated on the previous page, the sponsor company has considerable influence over the selection of the asset management company, and this is even truer when it comes to asset allocation. The question here is what to do about retirement benefit trusts. We have held substantial discussion on the issue of cross-shareholding, and I suspect that there may be cases where cross-shareholdings are being transferred to retirement benefit trusts and held as deemed holdings. In such cases, especially in the case of cross-shareholdings, it is often the case that voting rights are retained by the sponsor company, and

I think this is the part that relates to the conflict of interest. I would like to see these points resolved through specific discussions relating to the Code or dialogue guidelines.

That's all from me.

[Kanda, Chair] Thank you very much.

[Ueda, member] Thank you.

[Kanda, Chair] Next I would like to call on Mr. Tanaka. Please go ahead.

[Tanaka, member] Thank you. I would like to talk a bit about sustainability and mid- to long-term sustainability, including ESG factors, from a practical perspective. For example, I think the Oumi merchant's principle of sanpo-yoshi (three-way satisfaction: what is good for the seller, is good for the buyer, and is good for society) has already taken root in Japanese culture and corporate culture, so I believe that we have a culture in which each company has a very natural way of dealing with this issue. For example, at my company, I believe it was in July of last year, when COVID-19 became a serious problem, we provided PCR tests to all employees who wanted to be tested. We also distributed masks to medical institutions throughout Japan, and donated antiviral coating. These were natural things for us to do.

We are engaging in so-called DX investment in aging facilities. In terms of investing and so on, we are, for example, currently rebuilding our head office in Shinagawa. According to a hazard map, the area will be inundated with five meters of water in the event of a major flood, so we decided to design the building so that it will be able to double as an evacuation center for about 100 local residents. For example, I think we are all doing this kind of thing. I think I mentioned it before, but we have announced that we will raise employee wages by 3%. When we do things like this, the sell-side analysts immediately ask how much it will cost, and how much costs will increase. Then, of course, a report will be published that says that this will result in a drop in profits and cause stock prices to fall.

This is because the investor community has been highly vocal in various places about the importance of ESG investment. I don't have any objection to that, but the fact that this is actually happening right in front of our eyes shows that while on the one hand investors say that they are promoting ESG investment, on the other hand, they have not been able to free themselves from investment analysis methods that inhibit such investment. In order to promote ESG investment, I think it is essential to change the current investment analysis index used by analysts to a new investment index that promotes ESG investment and ESG activities.

Another enormous topic relating to sustainability is the global environment, and the need to reduce greenhouse gas emissions to net zero. I am sure that all Japanese companies are well aware of this, but as you know, this is divided into Scope 1, Scope 2, and Scope 3.

Scope 1 for example concerns fuel and vehicle fuel, which does not really directly relate to my company. Then there's Scope 2, which is relates to electricity purchasing. This indirectly relates to my company. In Japan we generate a total of 47,000 tons, which is not that much. Scope 1 can be dealt with by, for example, building new factories. But ultimately electricity purchasing is indirect. If the government or the industry does not take action to reduce greenhouse gas emissions, it will be difficult for the companies to move forward, even if companies engage in dialogue with investors, and this is a big problem.

Moreover, 80% of my company's operations are conducted overseas, in more than 30 countries, and given this, this figure which I just mentioned of 47,000 tons in Japan, is actually 280,000 tons for the entire group worldwide. 12 of these tons are actually generated in China. In such cases, companies will have to think not only about Japan, but also the world. The response of the government in each country will have an enormous impact. So this is not a problem that can be solved by the Japanese government or Japanese industry alone. I think it is necessary to take an extremely careful global approach, and to engage from the angle of how companies will respond to such an approach.

Next, with regard to ESG, there are currently multiple and complex ESG rating and disclosure standards, and these are extremely complicated and inefficient for both the information issuer and the recipient. I am hoping that there will be a move toward commonality with regard to this issue. On the one hand, this ESG issue is not only a cost issue. In fact, each company is required to take a stance to address social issues by creating new business. As an example, there are actually wind turbines in water, and this is a very important new source of electricity, but it has to withstand sunlight, sea breezes and the tide. My company has paints which are highly weather resistant, and which can be used in such new endeavors. These aspects also exist.

Therefore, it is not just about cost. The emergence of such new businesses is clearly a new development and should be taken into account as such. However, as I mentioned earlier, this is not necessarily the approach taken by analysts. I think analysts need to develop analysis methods with this in mind.

I will now move onto Material 2 and the enhancement of dialogue. Our corporate pension plan signed on to the Stewardship Code in December of last year. We have indicated to asset managers that we require them to implement and monitor activities that are in line with the policies in the Code. In reality, looking at the state of activities since then, I understand from asset managers that there are no reports on activities in response to the Guidelines for Investor and Company Engagement. The results of dialogue on issues that the dialogue guidelines state should be discussed intensively, in terms of how much dialogue asset managers are having and the progress being made, are not being disclosed.

With regard to the pension consultants who receive reports on stewardship activities from asset managers, I have heard that very few asset managers are providing reports in accordance with the dialogue guidelines. So while we have accepted the Stewardship Code, we are starting to see issues emerge such as these. The Stewardship Code calls for the promotion of dialogue with a constructive purpose based on the sustainability code, but there is nothing in the dialogue guidelines to represent this. There is only one reference to asset owners which comes at the end of the dialogue guidelines, in 5.1, but other than that, there is no mention of sustainability, carbon neutrality, or ESG. I think such matters should be included in the guidelines.

That’s all from me.

[Kanda, Chair] Thank you very much.

Next, Mr. Kawakita, please go ahead.

[Kawakita, member] This is Kawakita. Thank you for the opportunity to speak. First, with regard to ESG, as many others have said already, I think that companies and investors need to respond from a high vantage point. Merely copying E and S trends in Europe and the US or at other companies is not the true meaning of ESG. I am not sure if this example applies to companies, but I think it is questionable to simply copy the argument for the complete abolition of coal-fired power stations. Developed countries were developed using coal. This is especially true in Europe, and if that is not good, then calling for the complete abolition is a bit egotistical of developed countries. There are many developing countries that are short of electricity. We need to consider the position of coal while looking at the actual situation, and this is what E is really about, and will lead to S. Therefore, I think this an issue that should be discussed while picturing the supply of electricity in developing countries and how to achieve zero CO_2 emissions in the future.

Also, deforestation has become a problem in the Amazon in Brazil. But we should not ignore the fact that developed countries developed their economies by cutting down forests that had grown in their own countries. Therefore, if we are going to talk about the Amazon, we should evaluate how much CO_2 it can absorb as well as biodiversity, and so on, and we should actively use the Amazon. Developed countries should compensate for such use. We should bear this in mind when discussing and acting on this issue. In other words, rather than only discussing E or S, we should also have a discussion that looks at both. G may of course also be included, and should be included, that would be quite advanced! I think the government has a large role to play here, and I also think that companies should be aware of and act accordingly.

Given this, I would like to see companies evaluated and they should be evaluated for engaging in such activities from a high vantage point, as this will enhance their corporate value, so I would like to see proactive disclosure, and for dialogue with investors to be based thereon. Therefore, I think it would be good and I think it would be efficient to have a format for disclosure, but it is not simply a matter of following that format, rather it is, of course, an issue that should be dealt with using "comply or explain", and analysts should base their discussions on such disclosure. However, that E and S will improve corporate value is not something to talk about today or tomorrow, It is an issue that should discussed properly as it leads to long-term corporate value.

As was touched on when in reference to dialogue, there are a number of issues such as CO_2, COVID-19, and digitalization relating to E and S. I think that we should engage in dialogue with investors from a long-term perspective to find out what companies are doing to tackle these issues, and how companies are responding to society, their ability to respond, and what they are manifesting, and investors should evaluate companies' actions. I want to emphasize that this is a long-term perspective. I know this is also written in the code, but I would like to emphasize it again.

Another point relates to cost of capital. I think this should also go down to major businesses and disclose of cost of capital, or making assumptions as a company, and then talking to investors based on those assumptions. This is a repeat of what I said at the last meeting. Also, regarding cost of capital, I think the role of outside directors is very important, so it would be good to listen to the opinion of outside directors, and to bear their opinions in mind, and I suppose it could be written into the Code to some extent.

Lastly, with regard to pensions, I think that other members have already discussed defined contribution pensions. I think the Code should be written taking into account the fact that plans such as defined contribution pensions and iDeCo are rapidly becoming more widespread. How do companies select investment products for their employees to choose from, and how do they go about providing investment education? For example, I think there is going to be a big problem if companies are choosing vendors based solely on their business relationships. How are companies setting up and managing their pensions from an employee's perspective? I think we need to hear about these issues from companies.

That's all from me.

[Kanda, Chair] Thank you very much.

Next, Ms. Okina, please go ahead.

[Okina, member] Regarding sustainability, as explained by the secretariat, sustainability relates to various factors, and the environment and society in particular. As the secretariat explained, the environment is increasingly perceived as a risk as well as an investment opportunity and a business opportunity. Viewed this way, everyone emphasizes the expectation of improving the corporate value, but I think it is extremely important to look at how intangible assets exist at companies and how they are going to be used.

In particular, although carbon neutrality has been raised in Japan, I think we need to talk about how technological innovation and innovation will be achieved, how intellectual property, human capital and intangible assets will be properly evaluated and disclosed, and how these resources will be allocated and linked to corporate value. So my first point is that I believe that intangible assets will become even more important in the future in terms of both disclosure and engagement.

Regarding my second point, page 23 shows the relationship between the environment, externalities, and corporate value. The environment has externalities. In terms of how to internalize it, in addition to taxation, ESG investment is cited as a response. I think this is very important. Carbon pricing is often perceived as a tax or an emissions trade, but I think the financial market needs to incorporate the corporate value of companies that emit CO_2 and reflect it in procurement costs and pricing, as shown in this diagram.

In this sense, as has already been pointed out, the infrastructure for disclosure, the development of credit ratings, and accounting standards are extremely difficult issues, but I think it is important to develop systematic infrastructure and to think about infrastructure while being aware of how externalities can be priced.

Next, I have two more points I would like to make. As others have already pointed out, the other social aspect is also very important. In particular, in addition to considering how business can solve social issues and enhance corporate value, we need to acknowledge that it is human resources that create long-term innovation. In this sense, this is very relevant to previous discussions. It is important to properly disclose what kind of human resource development is being carried out to achieve diversity and create a comfortable working environment. As Mr. Tanaka pointed out earlier, I think that investors are now required to evaluate these issues and engage with them from a long-term perspective.

Lastly, I think it is extremely important for boards to properly discuss sustainability and supervise the execution of sustainability. In particular, I think it is important for independent outside directors to fulfill such a role, for executives to consider management strategies that take ESG factors into account, and for boards to properly supervise such strategies. I also think it is important for discussions to take a proper look at S as well as E. Establishing committees such as sustainability committees is one option, but even here, I think we need to discuss these issues not only from the perspective of risk management, but also as an opportunity for growth.

That's all from me.

[Kanda, Chair] Thank you very much.

Next, Mr. Tsukuda, please go ahead.

[Tsukuda, member] This is Tsukuda. Thank you for the opportunity to speak. It goes without saying that I have a basic awareness of the importance of sustainability. On top of that, as stated on page 24 of Material 1 currently on the screen, we need to ask what factors, related to sustainability, should be considered to improve corporate value over the mid- to long-term? And, how corporate governance systems should be designed from the perspective of enhancing corporate value through sustainability initiatives? I would like to comment on these two questions by introducing some examples drawn from recent experience.

My first example is of a company listed on the first section of the Tokyo Stock Exchange that decided not to establish a sustainability committee under the board, in other words, on the supervisory side. The independent outside director who opposed the establishment of sustainability committee believes sustainability to be extremely important. The director opposed the establishment, questioning whether it right to discuss the issue amongst a limited number of members, and asked why it should not be discussed by with all the directors. Furthermore, the director felt that the establishment of a discretionary committee in addition to the three statutory committees could weaken the function of the board. Personally, I thought the director's argument was perfectly legitimate. Personally, I am not directly opposed to the establishment of a sustainability committee, but I think it is important to carefully consider the purpose of such a committee, as well as the benefits and costs to be gained from its establishment.

My second example is of a leading Japanese listed company, whose market capitalization is gradually increasing, which has a very good reputation in the capital market, and has already established a sustainability committee on the supervisory side. I had a chance to talk with the president of the company about how to link sustainability to the company's growth. I asked whether it will link to profit. Put simply, I asked how to make money from sustainability. I was told that the sustainability committee was established on the supervisory side from this perspective. This is exactly the kind of attitude that Japanese companies are looking for.

Essentially, it is important for each company to take action appropriate to their actual governance system, rather than simply imitating European and American examples as best practices. It is important for boards to hold thorough discussions on what sustainability really means to the company, and then to consider, from a zero-based perspective, what initiatives should be taken from the perspective of improving corporate value. I hope that this will be taken into consideration when revising the Code.

That's all from me.

[Kanda, Chair] Thank you very much.

Next, Mr. Tsumuraya, please go ahead.

[Tsumuraya, member] Thank you. I would like to add a few remarks about the revisions. First of all, I fully concur with Mr. Takayama about sustainability. I think that it should be part of risk management in supplementary principle 2.3.1, and at the same time I think that improving corporate value and sustainable growth should be added, although the wording could be brought in line with Principle 1 of the Stewardship Code. In connection to this, I think it would be good to add a new supplementary principle, similar to supplementary principle 2.3.2, which requires disclosure of the details discussed in (1), including the discussion process, with respect to material issues that have a major impact on improving the long-term sustainable value of the company.

My second point is to make dialogue between companies and investors more effective in order to improve corporate governance. Principle 4 of the Stewardship Code relates to collaborative engagement. In addition to this, is supplementary principle 5.1.2 iii) of the Corporate Governance Code, which refers to measures for dialogue aside from individual meetings, and I would like to suggest adding "collaborative engagement" here for institutional investor meetings and IR activities, for example. I mean to supplementary principle 5.1.2 iii). This is what I am thinking.

This is the end of my proposal regarding revisions. Thank you. That's all from me.

[Kanda, Chair] Thank you very much.

Next, Mr. Iwama, please go ahead.

[Iwama, member] Thank you. I would like to explain my views on the content of dialogue. As everyone else has said, it is extremely difficult to measure intellectual property and human resources. From the perspective of dialogue, I believe that it is necessary to make it easier to understand the relationship between corporate philosophy, management strategy, succession plans, and human resource development plans, and how they are organically linked specifically, and what the issues are for dialogue between investors and companies. In this sense, there is a need for the narrative in integrated reports to be properly explained and for dialogue to proceed based on that narrative.

As Professor Kawakita mentioned, there remains a DC plan related problem to be solved. The debate on how to handle conflicts of interest with the sponsor company in corporate pension plans has been narrowed down quite considerably. At the same time, it is most certainly true to say that the sponsor company has an enormous responsibility to provide, shall I call it financial education or possibly investment education, to employees after transferring to a defined contribution pension plan or when transferring to a defined contribution pension plan. I think this is a major topic in terms of employment policy, and it will have a direct impact on the corporate value itself. So in that sense, we should look at what sponsor companies are doing to improve the effectiveness of DC. Of course, I think it would be good to include an explanation somewhere of how the system is being operated so that conflicts of interest are eliminated and the system is exclusively for beneficiaries.

Another problem, as someone mentioned earlier, is the importance of corporate culture. In practice, the success of R&D, for example, depends on whether it is fostered in a way that promotes the corporate climate, terrain, and culture. I think we need to pay more attention to whether management is taking the lead in regard to such matters. Furthermore, as has been pointed out, it goes without saying that management companies and managers must properly report and disclose information, and while this may be included in the Stewardship Code, I think it would be better for investors and companies to work together to make progress in response. From my perspective, I think that the information that has been put together is excellent.

That's all from me. Thank you very much.

[Kanda, Chair]　Thank you very much.

Next, Mr. Takei, please go ahead.

[Takei, member]　This is Takei. First of all, with regard to the relationship to sustainability, as has been mentioned, human capital, an intangible asset and intellectual property are becoming increasingly critical from the perspective of competitive advantage. Therefore, I think it is important to properly explain investment strategies and utilization strategies for such assets and property to the outside world in the soft form of an integrated report. I think it is important to mention integrated reports properly in the Governance Code. Also, as everyone has said, this topic is rooted in a company's purpose and corporate philosophy, so I think it would be better to mention it in Chapter 2 of the Governance Code. Another point that relates to this, is the importance of DX governance that is associated with DX. There are also various ways to improve efficiency and handle new social issues that are associated with digital transformation, so I think it is important to mention DX governance.

In addition to these substantive and strategic aspects, I think it is important that sustainability committees will be set up as an internal organization. I think it is important for sustainability committees to first be established on the executive side, in a form that commits top management. Companies should establish new sustainability committees that are a proper upgraded version of CSR or other committees. After that, I think it is important to work on how to link the sustainability committee with the board and supervisory bodies. I think that there is considerable room for growth at Japanese companies in these areas, including with respect to the set of sustainability committees. For this reason alone, I think that strengthening the message that companies are tackling sustainability is important for future growth strategy.

Next, regarding the relationship to dialogue in the second part, I would like to make an additional point regarding dialogue, which is that I think there are still issues on the institutional investors' side that may harm the enhancement of dialogue. It is not only the short-term oriented issues which damage mid- to long-term innovations that companies are tackling, which have been pointed out in the past. I think that there are still issues in various formal responses. It is extremely important to note that the Governance Code is merely a "comply or explain" code and is not mandatory. On the other hand, more formal conduct can be seen among some institutional investors, in the form of negative votes when a company does not comply. There is a concern that if this kind of behavior spreads widely, compliance will become compulsory, which may violate the purpose of "comply or explain".

Another issue that has also been pointed out in the past is that there are still some institutional investors that take a formal approach to exercising voting rights, such as mechanically and formally applying the voting standards that have been set once, without giving much thought to the individual explanations provided by each company, or casting a certain number of negative votes in an attempt to create a record of negative votes. While there are a wide range of institutional investors, we should sound the alarm to warn others of this kind of formal response as we work on revising the Governance Code.

With regard to such formal behavior by institutional investors, while initiatives by asset managers are important, it is also important for asset owners to come up with plans and initiatives to prevent such formal behavior on the part of asset managers. In particular, if the Governance Code is to be drastically changed this time and if companies will be required to respond in various ways, I think it is extremely important for institutional investors to properly resolve issues on their side as well.

That's all from me.

[Kanda, Chair] Thank you very much.

Next, I would like to call on Mr. Oba. Please go ahead.

[Oba, member] As we have heard from everyone I would just like to add a couple of comments about sustainability disclosure. As summarized on page 24, progress is being made to improve sustainability disclosure and with this in mind, the question we should be asking is what kind of discussion is necessary in the future. I would like to make two comments based on the premise that boards should supervise their company properly, as mentioned by Ms. Okina.

Firstly, the importance of S has been pointed out, and I think there is an issue in that it is extremely difficult to define S compared to E. For example, human rights issues and job security are often cited, and how we should define whether job security is important or whether employee job satisfaction is important is an extremely troubling question. As a result, with regard to the definition of "S", which is often referred to as European taxonomy in relation to environmental aspects, how we define "S" is important as it is also the premise for how we think about sustainability.

Secondly, disclosure is expected, but here there is an issue of where to assume the disclosure will take place. I am worried that if we do not make it clear from the perspective of companies whether disclosure should be in governance reports or annual securities reports, it will be difficult to know where the information is being presented. Ideally the above should be organized.

That's all from me.

[Kanda, Chair]　Thank you very much.

I believe we have heard opinions and comments from everyone who is present here today. Thank you very much for your invaluable input. We still have some time left, so if you would like to make additional comments, please go ahead, I would like to hear them. Does anyone have anything to add? I take it that there are no additional comments? Thank you.

We are slightly ahead of schedule, but I would like to leave it here.

Lastly I'd like to ask the Secretariat if there are any announcements.

[Shimazaki, Director of the Corporate Accounting and Disclosure Division, FSA]　Regarding the next meeting date of the Follow-up Council, we will fix a date which is convenient for you, and let you know later. Thank you very much.

That's all from the Secretariat.

[Kanda, Chair]　Thank you very much.

Thank you all for participating in today's long online meeting and for your invaluable comments. I hereby declare today's meeting adjourned. Thank you very much.

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