

**29th Meeting of the Council of Experts Concerning the Follow-up of
Japan's Stewardship Code and Japan's Corporate Governance Code**

1. Date and Time: April 18, 2024 (Thursday) 15:30-18:00
2. Venue: Common Special Conference Room No.1, 13th floor, Common Government Office No.7

[Kanda, Chair]

We will now hold the 29th meeting of the Council of Experts Concerning the Follow-up of Japan's Stewardship Code and Japan's Corporate Governance Code. Thank you very much for taking time out of your busy schedule to join us today.

The meeting is held on a face-to-face basis and thank you very much for taking time to come to this conference room. Today's meeting is being broadcast live on the web as usual. The minutes of the meeting will be prepared as usual and published on the Financial Services Agency's website at a later date.

First of all, the secretariat would like to introduce one of our new members who is joining us for the follow-up meeting.

[Nozaki, Director, Corporate Accounting and Disclosure Division, FSA]

I am Nozaki from the Corporate Accounting and Disclosure Division of the Financial Services Agency, and I will serve as the officer in charge of the secretariat. Thank you. I am pleased to introduce to you the new member of the Follow-up Council. Mr. Takahito Katayama.

[Katayama, member]

My name is Katayama, and I am in charge of the economic and social policy at the Japanese Trade Union Confederation, or JTUC-RENGO. This will be my first participation today, and I am pleased to join the meeting.

[Nozaki, Director, Corporate Accounting and Disclosure Division, FSA]

Thank you very much. For the other members and observers who continue to participate in the meeting, please refer to the list distributed to you. There have also been some changes in the secretariat, but due to time constraints, I would like to substitute my introduction with a seating allocation chart.

[Kanda, Chair]

Thank you very much. We will begin by explaining today's agenda. Today, the FSA and the Tokyo Stock Exchange, the secretariats of the Council, will present the materials. Thereafter, we will move on to a question-and-answer and discussion session. Let's begin with an explanation from the FSA. Mr. Nozaki, please go ahead.

[Nozaki, Director, Corporate Accounting and Disclosure Division, FSA]

I would now like to explain an agenda item from the FSA based on material two. This is a document entitled, Follow-up on the Action Program for Accelerating Corporate Governance Reform and Future Direction. We have presented the relevant issues in the form of questions in various ways, and we would like to update them based on today's discussion.

First, let us begin with the Introduction in I. In April 2023, exactly one year ago, the Action Program was formulated at this follow-up meeting. The Action Program's message was that in order for companies to achieve sustainable growth and increase corporate value over the medium to long term, it is important to promote autonomous awareness raising on the part of both companies and investors, rather than merely establishing a formal system. We believe it is important to follow up on the status of each policy initiative based on the actual situation, and to continuously examine the future direction.

II shows a follow-up and draft future direction. Various initiatives are underway for the measures shown in the Action Program at the relevant government agencies, the TSE, and other organizations. Based on these efforts, we have received feedback that both companies and investors are changing their mindset.

On the other hand, as mentioned in the Issues section, when we look at the specifics, there are some comments that the status of compliance remains only formal and that there is a large difference in the quality of efforts among various entities. As a more specific factor, it has been pointed out that there may be a lack of engagement personnel in accordance with the size of the company.

As for the proposed future direction, we believe that it is necessary to return to the principle that each Code takes a principle-based, comply-or-explain approach, and have all companies and investors consider the necessary measures in detail. From this perspective, we noted it is important to carefully explain each Code rather than to just formally comply with it. I believe that it is important to reaffirm the outcome-oriented approach of pursuing results in accordance with the objective of increasing corporate value over the medium to long term, and to steadily put this into practice.

We will then move on to each of the individual issues with material two. The first is about Substantiation of Stewardship Activities. Toward the end of last year, the Financial System Council proposed the promotion of collaborative engagement. In addition, recommendations have been made to review the large shareholding reporting system and to ensure transparency for substantial shareholders.

Regarding the issues, some have pointed out that formal dialogues are conducted like filling in check boxes, and that constructive and purposeful dialogues based on a deep understanding of the investees are not conducted in a bilateral manner. There is also an argument that collaborative engagement is important, but it is important not only to collaborate, but also to focus on meaningful responses to specific themes. In addition, some have pointed out that the department in charge of dialogue, that in charge of exercising voting rights, and that in charge of asset management are separated and do not work well together, and as a result, effective engagement that integrates dialogue and exercise of voting rights is not being carried out.

As an issue to be tackled, in the UK, the FRC checks compliance with the Stewardship Code, but in Japan, there is no such check in place. There are various entities that have signed the Stewardship Code, and some have pointed out that it is necessary to inspect the actual efforts of asset managers, asset owners, voting advisory firms, and other such entities.

In terms of future direction, the next step would be to review the Stewardship Code with regard to the issues I just mentioned. I would like to ask for your opinions on what we should keep in mind in such a review and what other points you think need a review.

Going to page three, there are specific examples of desirable and undesirable engagement, and there is also a discussion that it would be more useful to have a certain perspective. Regarding this, the FSA

and TSE conducted hearings with several companies from March to April. For example, we have received several comments that it was very helpful in promoting their own initiatives, including internal feedback, by sharing other companies' case studies by investors and sharing such case studies in accordance with the business content and growth stage of the companies with which they are engaged. In addition, there was an opinion that continuous discussions contribute to constructive dialogue, not just a one-time discussion.

We introduced the opinion in detail in the secretariat's material. I would appreciate it if you could take a look at these perspectives in your discussions to realize more effective engagement.

The third point is about improving the effectiveness of the board of directors, et cetera. As mentioned in the Issues section, while there has been considerable progress in the appointment of independent directors and the establishment of the nominating committee and compensation committee, there is still a lack of shared recognition of the roles to be fulfilled by each of the directors or the committees, and there is a sense that the board of directors is not functioning well.

In response to these issues, I think it is important to share a better understanding of the roles and functions that should be truly fulfilled by focusing on outside directors and the secretariat of the board of directors, which supports the administrative operations of the board. We would like to share messages from the companies that we interviewed earlier on page 27 of the secretariat's explanatory material, which we hope will contribute to practical references.

Number four is Management Being Conscious of Profitability and Growth Potential. This is where the request was made by the TSE in March last year. Regarding the issues on the next page, it has been pointed out that there is a polarization between those companies that have a sense of urgency and positioned the issue as an important management issue and those that are merely formal in their response to the request.

As for the proposed future direction, I think it is important not only to confirm the status of disclosure, but also to focus on whether there is a discrepancy between the content of disclosure and actual initiatives, and whether specific discussions are held at board of directors' meetings and in dialogue with investors. There is also a discussion about whether or not companies have the resources to deal with this kind of overall governance. I would like you to express your views on the point.

Number five is about Enhancement of Information Disclosure and Promotion of Correspondence with Global Investors. The TSE is making English-language disclosure mandatory for the companies listed on the prime market, and these efforts are steadily progressing.

On the other hand, as mentioned in the Issues section, there is a need to enhance timely disclosure and to provide information required by investors in an effective and efficient manner, including the timing of disclosure of the securities report prior to the annual general meeting of shareholders, or AGM. This is a point that has been made by some parties. With regard to the disclosure of the securities report prior to the AGM, at the meeting held on April 3 at the Prime Minister's Office to exchange opinions on the promotion of corporate governance reform, the Prime Minister stated that he would have the FSA and other related ministries and agencies work together to improve the environment so that more companies will disclose their securities reports prior to their AGMs. We would like to proceed with the discussion on this matter as well.

This is a draft direction for the future. We believe that increased transparency through information disclosure will lead to market confidence, but we would like to ask what we should keep in mind in order to enhance substantive disclosure in companies. In addition, in order to visualize a group of companies that respond autonomously and proactively to the expectations of global investors, a specific list of companies that meet certain requirements, such as capital return, market valuation, growth potential, and other indicators, and corporate governance status, such as the appointment of independent directors, could be created. The secretariat's explanatory material shows a proposal on page 23, and we would appreciate your discussion on how to promote dialogue with global investors, including such efforts.

Next, number six is Resolution of Issues Regarding Market Environment. In December last year, TSE released enhancing information disclosure on minority shareholder protection and group management and expected roles of independent directors at listed companies with controlling or quasi-controlling shareholders. In addition, regarding the efforts to cope with cross-shareholdings, the FSA has been working to enhance the disclosure of information on securities reports, and in March this year, the agency published a review of securities report information and pointed out some of the issues that need to be addressed.

As mentioned in the Issues section, while there is an assessment that each company is making considerable progress in reducing its cross-shareholdings, there are also indications that appropriate measures such as disclosure based on the actual situation, including how voting rights are exercised, are not being taken. In particular, we have seen several cases where the purpose of holding has been changed from policy holding to pure investment, but the reasons for the change are not required to be disclosed, and some have pointed out that the actual situation is quite unclear.

In terms of future direction, we would like to reaffirm the importance of verifying and disclosing the appropriateness of the purpose of holding shares in light of the Corporate Governance Code, especially with regard to cross-shareholdings, and to further deepen the discussion on how such holdings should be made.

The last issue is Management Being Conscious of Sustainability. See page five. The disclosure of sustainability information in securities reports started in the fiscal year ended March 2023. Late last year, the FSA compiled a collection of good practice examples of sustainability information disclosure. In October last year, the TSE revised its listing rules regarding diversity, setting numerical targets for the ratio of female directors and officers, and various other efforts are underway. In addition, the General Meeting of the Financial System Council consulted on the disclosure of sustainability information in February this year, and a specific working group has been discussing the issue since late March. Globally, the OECD Principles of Corporate Governance were revised last September, and a new chapter on Sustainability and Resilience was added, so this is an area of particular significance.

As mentioned in the Issues section, many companies are taking various measures to address issues related to sustainability, but some point out that it is still considered an issue of execution and that there is a lack of recognition of the supervisory role to be played by the board of directors. In terms of ensuring diversity, there has been steady progress in setting numerical targets, but there are also discussions about taking it a step further from the perspective that ensuring diversity of opinions and discussing management issues from diverse perspectives will contribute to improving corporate value over the medium to long term.

In addition, we are aware that there has been a considerable advance in discussions, especially in the UK, that each company's unique corporate culture is the foundation for creating and maintaining corporate value. In light of this, it has been pointed out that one of the perspectives of management and dialogue should be to always return to corporate culture and further enhance corporate value over the medium to long term with an awareness of the culture.

In terms of future direction, I would like to ask you to discuss whether there are any other important aspects of addressing sustainability issues that will enhance corporate value over the medium to long term.

The last point is that corporate management is exposed to various risks such as pandemics, cyber security risks, geopolitical risks, etc. In such a situation, management with an awareness of resilience, in which the supply chain as a whole demonstrates resilience in emergency situations, has also been discussed at the OECD and other organizations, and I would like to ask you to discuss this issue as well. That is all from me.

[Kanda, Chair]

Thank you very much. Now, please continue with the explanation from the TSE. Mr. Ao, please go ahead.

[Ao, Director, Senior Executive Officer, TSE]

I am Ao, Senior Executive Officer of the Tokyo Stock Exchange. Thank you in advance. I would like to provide an explanation based on the reference material number four. I would like to introduce some of the major efforts that the exchange is implementing, as mentioned earlier in the Action Program on Governance by the FSA.

Please see page three of the material. As you are already aware, we reorganized the market classification in 2022 in order to provide an attractive cash market that supports the sustainable growth of listed companies and the enhancement of corporate value over the medium to long term, and that is highly supported by a wide range of investors. Especially in the prime market, we aim to enhance corporate value through constructive dialogue with global investors. The listing standards have been raised to about 10 times the level of the previous listing standards in terms of market capitalization, and our listing standards are among the strictest in the world.

However, since the actual work after that is very important, we established a follow-up meeting in July 2022 to review the market segmentation, and we are now proceeding with our efforts while holding various discussions. In particular, we are working on a variety of initiatives from the perspective of creating a framework that will motivate companies to take autonomous actions to improve their corporate value over the medium to long term.

Specifically, from page four, we have a section on promoting management that is conscious of the cost of capital and stock prices.

Please see page five. Here is an international comparison of PBR and ROE, which we have used often in the past. The discussion was triggered by the fact that there was a situation where Japanese companies were not doing enough. However, PBR and ROE are just examples. We believe that there are various ways of considering which indicators to use and how to discuss them with investors, depending on the situation of each company. We have just listed these indicators as the most representative ones.

Please move on to the next page. Based on the situation of PBR and ROE as mentioned earlier, we requested in March 2023 that each company, as a subsequent response, should aim to improve its corporate value autonomously. A summary of the request is described below. Basically, as you can see in the first line, one of the first things we are trying to do is to improve corporate value over the medium to long term. We would like companies to be particularly aware of the cost of capital and return on capital based on their balance sheets. This is a point that is particularly emphasized by investors, and there is a slight discrepancy in awareness of the point between the investors and companies. Therefore, the TSE requested that the companies cope with dialogue while they well recognize the point.

In fact, as you can see in the second point, the management of a company should take the initiative in thinking about various issues based on the basic management policy set by the board of directors, while naturally including sustainability and social relations. Above all, in the context of medium- to long-term growth, it is desirable that they also engage in discussions on issues like making sound investments and reviewing their business portfolios.

As indicated by the star mark below, we do not expect transitory measures, such as a share buyback or dividend increase, to be taken by a company just to raise its PBR. By clarifying that point, we have shown our stance of focusing on essential initiatives.

We are trying to create an environment from the viewpoint of facilitating dialogue between companies and investors, with a focus on an approach that encourages autonomous actions by companies. For this purpose, we are encouraging dialogue centered on disclosure, and through such dialogue, we are helping companies to brush up their skills.

Page seven is the status of disclosure in response to our request. Of course, the most important thing is that before disclosure, each company should fully consider what it intends to achieve and how it will engage in dialogue, as well as how its profitability has increased as a result. However, we request companies to disclose their information as the first tip for the dialogue.

As of March 2024, 65% of the companies listed on the prime market made some form of disclosure, and 26% of those listed on the standard market did the same. Of course, the content of the disclosure and the content of the study are the most important factors, so these figures alone cannot tell the whole story, but we believe that we can see progress in the situation.

Next, page eight. In addition to these measures, we have also announced several measures that we will continue to implement in order to improve the effectiveness. What we are particularly focusing on those shown in the second item in the table below, the key points and examples of initiatives. We are focusing on summarizing and presenting initiatives that have been taken by companies from the standpoint of investors and favorably received and supported by them. As you can see in the third section below, the public notice status of responses by companies, we are helping listed companies by informing them of the feedback from investors so that they will be able to take actions in a better direction.

The second theme shown on and after page nine is the expansion of English disclosure.

Please see page 10. The prime market is a market for companies that focus on constructive dialogue with global investors. Since they have chosen the prime market, we are strengthening the dissemination of information in English to ensure that this market is well established. As shown in

the graph at the bottom left of the page, English-language disclosure has made considerable progress in the prime market, with 98% of the companies making some form of disclosure in English.

However, although progress has been made, and we are still making improvements, as you can see at the bottom right, 72% of investors are still dissatisfied with some aspects of the disclosure. As you can see in the second point above, there is a difference in the amount of information between releases in Japanese and those in English, there is a time lag in disclosure between them, and while large-cap stocks are making progress, small- and mid-cap stocks are not making as much progress. These are the main points that we have received.

Page 11 shows the response to that. Basically, as you can see on the top part of page 11, we would like prime market-listed companies to make efforts to disclose important corporate information in Japanese and English at the same time and in the same volume to the maximum extent possible. This is the fundamental point.

However, please see the second point, even so, there are some practical burdens on companies, such as the need for a considerably organized system to disclose in both English and Japanese at the same time, as well as the situation for preparation. In light of this, we have decided to request that member companies start English-language disclosure with information that has a particularly large impact on investment decisions and that requires prompt disclosure, such as financial statements and information for timely disclosure. They are required to announce even a part or outline of the information as soon as possible.

Of course, there are risks involved when companies translate their disclosures into English, so the English versions are positioned as reference translations of the original Japanese versions. We will continue to consider how we can further improve the English-language disclosure of information, while keeping an eye on the situation.

Page 12 and beyond are the considerations for listed companies that are dependent on their listed parent companies.

The graph on page 13 shows that the number of listed subsidiaries has been gradually decreasing, while the number of listed companies with major shareholders, such as those with 20% or 30% controlling shareholders, which are not necessarily subsidiaries, has been gradually increasing.

Page 14 shows our policy for this situation. With respect to the dependent listed companies, regardless of whether the parent companies are listed or not, conflicts of interest between minority shareholders and controlling shareholders can still occur. Therefore, we have set two points as what we should cope with.

The first point is to enhance information disclosure. We are asking the listed parent companies, subsidiaries, and companies accounted for by the equity method to explain the situation and how to resolve the conflicts of interest in the parent-subsidiary relationship, etc. to us. In such companies, the roles of independent directors are highly expected from the viewpoint of protecting minority shareholders, so as you can see in the lower section, we would like to improve the actual practice by our presenting the roles expected of independent directors. The following information is for reference only and will be omitted.

We are making efforts to make the capital market work in these ways. Thank you very much.

[Kanda, Chair]

Thank you very much. Before moving on to the discussion, I would like to ask the secretariat to provide a brief overview of the written opinion submitted by Mr. Toyama, who is absent today.

[Nozaki, Director, Corporate Accounting and Disclosure Division, FSA]

I would now like to explain the outline of the written opinion received from Mr. Toyama. First of all, regarding the first point, institutional efforts by the FSA and the TSE to improve corporate governance, including the PBR issue, are steadily producing outcomes. In terms of corporate performance, Japanese companies with "ambidexterity" are steadily increasing. They are entering a virtuous cycle of profit and growth, in which they increase profitability by concentrating on business areas where they can leverage their fundamental strengths at the organizational capability level, while at the same time reducing business areas where they no longer have such strengths, and using the cash generated from these to invest in exploration of new business opportunities and innovation.

As for the second point, the Japan Association of Corporate Directors' annual Corporate Governance Award use sustainable growth potential, profitability, and governance adequacy as its basic criteria for selection. In recent years, Japan's leading traditional manufacturing companies have

won the Grand Prize, indicating that corporate governance reforms are becoming more substantial. This trend must not be stopped, and the reforms should be accelerated further in the current direction.

Meanwhile, it is pointed out that the hollowing out of engagement is becoming a serious problem. As for the point at the bottom, the percentage of index funds and passive funds among institutional investors is expected to increase further due to the introduction of the new NISA, and there is a concern that the presence of active funds, which have the motivation to actively engage, will decline. Therefore, the role of so-called activist funds is attracting attention. Even if their claims are aimed at sustainable corporate value enhancement, there is an unavoidable bias to focus on undervalued stocks in order to aim for high investment performance, and their engagement coverage will inevitably be limited.

Please go to the next page. That is why collective/collaborative engagement is discussed. It is true that formalistic engagement, such as filling out a checklist, is not effective in improving corporate value. The hollowing out of engagement cannot be stopped unless a specific mechanism is created in which first class professionals with high expertise, knowledge, and experience in both finance and business become the bearers of engagement. Not only the slogan but also such effective efforts should be studied jointly by the public and private sectors.

Furthermore, it is true that the importance of "corporate culture" is emphasized in the discussion on sustainability, but it should be noted that the Japanese word for "culture" has a very soft nuance like an art term. The term "culture" used in English in context of management theory, as implied by the fact it is derived from "cult", refers to a mode of thinking and behavior that is deeply ingrained in people and cannot be explained by superficial rationality alone. It can be described as an intrinsic motivation mechanism. We should be careful not to misunderstand the nuance.

Lastly, Mr. Toyama says in advance that his following remarks are apart from today's agenda, but he gave a comment that we should move forward to a more harmonized design of the board of directors with a company-with-committees system in accordance with global standards. That is all.

[Kanda, Chair]

Thank you very much. We will now have time for discussion in which you can ask questions and express your opinions. Since time is limited, we have calculated that it will take no more than about

five minutes for each of you to speak. I would be very grateful if you could follow such a time limit. Then, anyone is welcome to start. Now, Mr. Tsukuda, please go ahead.

[Tsukuda, member]

Thank you very much. This is Tsukuda. Ten years have passed since the introduction of the Stewardship Code and nine years since the introduction of the Corporate Governance Code, and thanks to the efforts of the FSA, the TSE, the Ministry of Economy, Trade and Industry, and of course companies and investors, corporate governance in Japan has shown steady progress. This is highly regarded as a major achievement of the introduction of both Codes. We believe that the most important thing is still to continue this trend. On top of that, one year has passed since the last meeting, and the environment surrounding Japanese companies is changing drastically, so I would like to comment on four points today.

The first point: you see material two and on the first page of the Follow-up and Future Direction, draft, there are the General Remarks. I would like to talk about the Future Direction, draft. As Mr. Nozaki explained earlier, each Code is principles-based, and it is important to look at the purpose of the comply-or-explain approach and to carefully explain the purpose of the Codes.

It is truly regrettable that this principle of comply or explain is still not properly understood by some companies, some corporate managers, and some shareholders. If there is a principle or supplementary principle of not complying, corporate managers should explain it without hesitation, and shareholders should listen to the explanation and make a substantive decision. I would like to take this opportunity to reemphasize the importance of not falling into a formalistic approach with regard to both Codes, as this is very important for the substantiation of governance. This was the first point.

The second point is about the substantiation of stewardship activities, as shown in two of material two. In the Future Direction, draft, there is a question as to whether there are any points that should be kept in mind when reviewing the Stewardship Code. I would like to express my awareness of this issue in my interactions with corporate executives and in my own role as an independent director of a prime market-listed company.

First, in order to make engagement even more effective, we urge you to revise the Stewardship Code to promote collaborative engagement and ensure transparency for substantial shareholders.

Particularly, I think it is time to seriously consider the need to raise the level of people in charge of engagement. Many corporate executives still comment that engagement with domestic institutional investors tends to be somewhat formal. From this perspective, I believe it is desirable to inspect the status of compliance with the Stewardship Code and actual efforts as pointed out in the Issues section.

On top of that, there is the substantiation of voting rights. As mentioned in seven of the Future Direction, draft, the importance of being aware of diversity in terms of gender is indisputable, but the reality is that many companies are having difficulty in inviting female independent directors. Under such circumstances, we believe it is sometimes necessary for institutional investors to carefully look at the efforts of companies that are making sincere efforts to utilize women within their companies over a long time and watch them closely, rather than making formal judgments because their action, or inaction, conflicts with the voting standards.

Then there is the third point. I would like to comment on improving the effectiveness of the board of directors. First, individual dialogue between independent directors and investors should be more active. While we recognize that engagement between corporate management, CFOs, as well as IR/SR departments, and investors/shareholders is becoming more active, opportunities for investors to engage with independent directors individually have not increased to the same degree. Since independent directors are essentially in a position to supervise corporate management as agents of shareholders, investors should check whether independent directors appointed by investors are fulfilling their expectations and roles. Conversely, independent directors should understand investors' awareness of the issues and expectations of the company and return those issues and expectations to the board of directors to contribute to improving the board's effectiveness, including strengthening its supervisory function.

It is also necessary to substantiate the exercise of voting rights on the appointment of independent directors. For example, there is an increasing number of cases in which shareholders vote against the president, who is the head of the executive management, on the grounds that the ratio of independent directors is insufficient or that the company is not making progress in ensuring diversity, which violates the voting standards. However, nearly 10 years have passed since the enactment of the Code, and the number of companies in which a majority of the boards of directors is composed of

independent directors is increasing. We believe that the time has come for the independent directors to assume more responsibility for violating the voting standards than the president, who is the chief executive officer. As the percentage of independent directors at the board of directors increases and the role of independent directors in improving the effectiveness of the board of directors grows, we believe that it is essential to improve the effectiveness of the board of directors by encouraging shareholders to set high expectations for independent directors and to urge them to fulfill their roles and responsibilities as directors when they exercise their voting rights.

Finally, as the fourth point, I would like to comment on the institutional design of the board of directors. Mr. Toyama's opinion exactly shows what I want to talk about. I believe that the time has come to review the design of the board of directors. Concerns about the risk of uncontrollable conduct of the nominating committee, in which only part of directors participate, are, in fact, heard from some corporate managers, or the secretariats of the board of directors and the nominating committee. We recognize that it is extremely difficult to control such risk in practical terms and that institutional measures are necessary. That's all from me. Thank you very much.

[Kanda, Chair]

Thank you very much. Now, Ms. Waring, please go ahead.

[Waring, member]

Thank you. I agree 100% with what Mr. Tsukuda has just said. The ICGN appreciates the FSA's Action Program to accelerate corporate governance reform, as well as the efforts of the TSE and the METI. As a result, global investors are highly confident in Japan as an attractive financial center, as evidenced by the strong performance of its stock market today. Going forward, I am in favor of an approach that focuses on the seven areas listed in the meeting materials and focuses on substantive, rather than formulaic, market reform.

First, we believe that for corporate governance to be effective in any market, there must be constructive dialogue between companies and shareholders in the mutual pursuit of long-term corporate value creation. Corporate governance codes can facilitate this dialogue by setting high standards, but sometimes companies deviate from particular provisions of a code, and when they do, they are expected to provide a meaningful rationale for their alternative approaches. At the same time,

investors are expected to consider this carefully and give due consideration to the individual company's situation.

We appreciate the FSA's efforts to address potential legislative obstacles to facilitating investor-company dialogue in Japan. We welcome the amendments to the Financial Instruments and Exchange Act, or FIEA, and the definition of joint holder. We understand that the FSA wishes us to consider investor stewardship as it relates to the exercise of investor voting rights. In this regard ICGN's Global Stewardship Principles recommend good disclosure practices that investors might consider. For example investors should consider disclosing how voting rights are prioritized? Does this vary by jurisdiction, investment mandate, and asset type? Who is responsible for voting decisions (and to what extent does this depend on the nature of the resolution, the region, and the size of the assets held)? How are internal conflicts of interest identified and addressed? What is the basis for voting decisions, especially when the company or shareholders vote against or abstain from a resolution, or when the exercise of voting is inconsistent with the investors' voting policy?

We are pleased that 95% of the prime market-listed companies have at least one-third of independent directors serving on their boards. Ideally, we believe that there should be a majority of independent directors serving on a board, whether in the standard or growth market, especially for companies with controlling shareholders. Additionally, we recommend that the appointment of independent directors be subject to a formal and transparent procedure based on appropriate and objective selection criteria initiated by the board's nominating committee.

The ICGN welcomes the FSA's focus on encouraging management to be more aware of a company's profitability and growth potential based on its cost of capital. Many ICGN members are taking advantage of the new data provided by the TSE's recent requirement for companies to disclose their capital allocation. We believe that the board of directors should oversee the company's capital allocation policy in line with its long-term strategy and explain its rationale to shareholders. Examples of rationale might include new business acquisitions, major capital expenditures, discontinuation of operations, and research and development expenses.

It is commendable that the TSE has recently mandated that prime market-listed companies must simultaneously publish statutory disclosure information in English and Japanese. Over time, we

encourage the application of this requirement to extend to non-statutory disclosure and to a broader range of companies. We strongly recommend that all companies listed on the JPX prime market publish their annual securities reports in English prior to the AGMs of shareholders so that investors can better use the reports and which influence decisions on how to exercise their voting rights.

We are encouraged by the decline in the ratio of cross-shareholdings, and some companies have disclosed numerical reduction targets and schedules. However, often the disclosure regarding the rationale for cross-shareholdings is vague, e.g., to facilitate business relationships, and investors are demanding clearer relevance as to how cross-shareholdings affect a company's return on capital. More generally, we recommend that the boards of directors disclose their plans for reducing the percentage of cross-shareholdings over a certain period of time and their progress toward achieving these goals. This includes parent-subsidary relationships, holding suppliers' shares, and other forms of cross-shareholdings.

The ICGN welcomes the SSBJ's efforts to develop country-specific corporate sustainability reporting standards that are functionally consistent with the ISSB's global baseline. The ICGN supports the Japanese government's goal of having companies appoint at least one female director by 2025 and increasing the ratio of female directors, audit & supervisory board members, and executives to 30% by 2030. We also encourage companies to describe their efforts in diversity policies that specify measurable and time-bound goals that align with the company's purpose, values, and long-term strategies. Thank you very much for your attention.

[Kanda, Chair]

Thank you very much. Mr. Katayama, please go ahead.

[Katayama, member]

I am Katayama from JTUC-RENGO. Thank you very much for giving me an opportunity to make some remarks. I would like to make three comments on seven, Management Being Conscious of Sustainability in the Follow-up and Future Direction, draft.

The first point is about management and dialogue with an awareness of corporate culture. While we do not disagree with the notion that each company's unique corporate culture is the foundation for creating and maintaining corporate value, we believe that daily dialogue with a wide range of

stakeholders is important in order to be aware of corporate culture in the management of the company. In particular, workers in a company are particularly important stakeholders who transmit and practice the corporate culture to society and customers on a daily basis. For this reason, I hope that you will take into consideration the importance of active dialogue with labor unions, which represent workers, in your future discussions.

The second point is investment in human capital, including ensuring diversity, etc. While there is mention of ensuring diversity in the Issues section, we believe that understanding, penetration, and practice of respect for human rights, including that in the supply chain, is necessary as a prerequisite for this. In order to visualize the efforts of companies in respecting human rights, we would like to request that respect for human rights be added to the criteria for the disclosure of sustainability information, although this is separate from the subsequent discussion. As Japan's labor force continues to decline, attracting human resources from other countries is an urgent issue. I believe that demonstrating Japan's world-leading stance in respect for human rights will encourage foreign human resources to choose Japan as a place to work.

The third point is about management being conscious of resilience in the event of an emergency. The importance of resilience-conscious management is increasing year by year as a means of preparing for various risks such as the frequency and severity of natural disasters and pandemics, as well as from the perspective of protecting workers' employment and creating a safe working environment. In light of international trends, it is important to encourage contingency preparedness, including the formulation of appropriate business continuity plans, not only for one company but for the entire supply chain, which will also enhance corporate value over the medium to long term. That's all.

[Kanda, Chair]

Thank you very much. Now, Ms. Matsuoka, please go ahead.

[Matsuoka, member]

Thank you very much. I would like to comment on the Future Direction, draft, but before I do so, I would like to express my great appreciation for your efforts to achieve sustainable growth of companies and to enhance their values over the medium to long term.

First, regarding number one, General Remarks. I agree very strongly with the direction that it is important not only to adhere to the formalities of the code, but also to explain its content carefully. In order for this explanation to be effective, we believe it is important for investors to have a structure in place whereby such explanation is heard and evaluated, as stipulated in the Stewardship Code. To this end, I would like to urge the FSA to do follow-up efforts for investors who do not engage in substantive dialogue or who focus only on compliance with the Code.

Next, I would like to comment on number two, Substantiation of Stewardship Activities. In order to promote dialogue between companies and investors, I believe it is essential to improve transparency on the part of investors as well. In particular, we believe that there is an urgent need to make it easier for companies to identify their substantial shareholders, and we would like to seek for developing an effective environment while giving due consideration to practical matters. We have seen a series of delays in the submission of large shareholding reports, and we would like to request that strict measures be taken to deal with these delays.

After all, there is no point in revising the Code, unless the effectiveness of the Code is ensured. Therefore, in order to ensure its effectiveness, we would like to request all concerned parties, especially the FSA and the TSE, to establish a system to monitor the status of compliance with the Stewardship Code by investors. On the part of corporations compliance with the Corporate Governance Code affects the listing of a company on the stock exchange itself, but on the part of investors, compliance with the Code has no real impact, which leads to the issue of fairness.

It has also been pointed out that the engagement infrastructure on the investor side may not always be sufficient. It may be helpful to provide back-up to asset owners for its cost of stewardship activities. We believe it is important to create an environment where both invested companies and investors can engage in dialogues on a fair and equal footing under a certain level of discipline under the Code, and work together towards medium-to long-term growth of companies. In particular, as some voting advisory firms, despite their having signed the Stewardship Code, have not yet established structures or have engaged in dialogues with companies as stipulated in the Code, we would like to ask that certain action be taken towards such firms.

Next, I would like to discuss number four, Management Being Conscious of Profitability and Growth Potential. I believe that it is important to avoid short-term initiatives, such as share buybacks just for improving PBR. We would like the TSE to follow-up with investors' requests and corporate actions from the perspective of whether they have led to improved profitability and growth in line with the original intent of the TSE's request, to avoid excessive pursuit of making PBR and ROE numbers.

Next, I would like to discuss number five, Enhancement of Information Disclosure and Promotion of Correspondence with Global Investors. The visualization and listing of top companies that meet high expectations of global investors is expected to provide some incentives for companies to enhance information disclosure, leading to a virtuous cycle.

With regard to Prime Minister Kishida's comment related to the submission of annual securities reports prior to AGMs, as explained by the secretariat, while we understand the advantages of realizing this, it is not really realistic to expect companies to achieve this only through their self efforts under the current structure/environment. We encourage the FSA to work closely with the Ministry of Justice and other relevant organizations, and demonstrate leadership in attaining a fundamental structure/environment, including sorting out the relation between the FIEA and the Companies Act.

As companies diversify and globalize their businesses, the number of subsidiaries increases, the volume of information handled increases, and the complexity of the information becomes much greater. Companies are still making every effort to release their annual securities reports as early as possible, including audit work. However, it is difficult for companies to accelerate release timing solely by their individual efforts. The amount of information to be disclosed in securities reports continues to increase. It is anticipated that sustainability information will also be added in the future. Under the Financial System Council, the first meeting of the Working Group on Disclosure and Assurance of Sustainability Information has been held. Discussions on the domestic institutionalization of sustainability information have just begun. Since sustainability information is contains more qualitative and forward-looking information compared with financial information, such characteristic should be taken into consideration in discussing the risks and assurance of disclosure, and how such information should be presented.

Next is about number six, Resolution of Issues Regarding Market Environment. In response to the request from the FSA, each company is now taking measures to deal with its cross-shareholdings. On the other hand, as I mentioned earlier, we have received concerns from companies that some voting advisory firms are engaging in only form without any dialogue. While it is important to promote verification and disclosure of the purpose of cross-shareholdings, it is also important that there be opportunities to explain, and would very much ask that this issue be followed-up.

Finally, I would like to discuss number seven, Management Being Conscious of Sustainability. The importance of resilience has just been strongly acknowledged by the COVID-19 pandemic. The Japan Business Federation, or Keidanren, has been also calling for its member companies to take initiatives required in a disaster-prone country, including a shift to an all-hazard BCP that addresses a variety of risks. On the other hand, resilience is highly unique to each company and is part of its management policy. We believe that it would be better to encourage companies to take voluntary actions through, for example, the sharing of good practices, rather than adding resilience as a new disclosure item. We appreciate your patience for the length of my comments. Thank you very much.

[Kanda, Chair]

Thank you very much. Now, Mr. Sampei, please go ahead.

[Sampei, member]

Thank you very much for your nomination. First, I thank you for reflecting the points I raised in my preliminary explanation session regarding material two. Thank you very much. I generally agree with the issues and future direction that are described.

Based on that, I believe that there are the two most important things that must be common throughout the entire process of substantiating corporate governance reform: One is to never lose sight of the objective of increasing corporate value over the medium to long term, and the other is to examine the outcomes achieved in relation to the objective and change behavior to improve the outcomes. In other words, the substantiation is the pursuit of positive outcomes. In the explanation given earlier by Mr. Nozaki, he used the term outcome-oriented. That is exactly what I mean.

Next, I will comment on individual issues. Regarding two, Substantiation of Stewardship Activities, I think the key point for future direction is verification of outcomes, regardless of whether it is

individual engagement or collaborative engagement. As Mr. Nozaki mentioned earlier, the FRC in the UK has been evaluating stewardship reporting of investment management institutions since 2021 and providing examples of effective initiatives. Guideline 7-4 of the Japan's Stewardship Code states that the results of stewardship activities should be disclosed, and many investment management institutions now disclose their reports. However, I believe that disclosure of results and verification should focus not on the fact that engagement meetings were held per se or the number of such meetings, but rather on what the purpose of the engagement was and whether the positive outcomes were achieved according to that purpose.

As you can see on page 20 of the TSE's explanatory material, in March 2023, the TSE requested all listed companies in the prime market to promote and disclose dialogue with shareholders. So we are starting to see some disclosures from companies. Based on this, we can compile a collection of case studies from both disclosures from these investment management institutions and from companies regarding issues and outcomes of desirable and undesirable engagement, etc., and reflect them in such a way that we can further obtain feedback comments from asset owners. This could provide tips to promote effective engagement.

This is important to note because there is a concern that simply promoting engagement, including collaborative engagement, will lead to an increase in undesirable engagement that is just formal and does not constitute two-way dialogue. In order to promote effective engagement, we first need to define what engagement is, and then the investment management institutions need to support engagement organizationally by building a framework and using training programs to improve their skills.

Good practices include, for example, sharing the agenda in advance, presenting management issues to be solved, providing examples of solutions from other companies, confirming expected action points, and monitoring progress as described in 3.5 Company engagement on page two of the ICGN's Statement submitted by Ms. Waring. In addition, the same Statement's 4.4 Voting rationale on page three states that when voting rights are to be exercised, the issuing company should be informed in advance if shareholders intend to express opposition or abstention or override the investor's voting

policy. Such practice contributes to building mutual trust and is the key to be shared in all countries. I think that there is the need for training with regard to these things.

Next, with regard to three, Improving Effectiveness of the Board of Directors, I believe that priority should be given to the fulfillment of shareholders' expectations of the functions of independent directors, rather than simply increasing the number and ratio of independent directors. Currently, if one asks whether the standpoint and thinking of independent directors are closer to management or institutional investors, the answer would be, "They are closer to management." That's because they were former corporate management or have a lot of contacts with current executive management and not so many contacts with institutional investors. Their information is also dependent on the executive management side, and I think it is difficult to say that the situation is in line with institutional investors' expectations. Therefore, I think independent directors should meet more with institutional investors to hear their expectations of such directors and understand the actions they should take.

The other one, which relates to internal directors, is that the disclosure of the skills matrices is underway. However, I think the usage is to display the current situation and they are not used for the original purpose of visualizing and improving the gap between as is and to be. In particular, it is noticeable that there are fewer checks on the financial skills of internal directors, which are supplemented by outside directors or outside *Kansayaku*. It is the executive management side that draws the picture of specific strategies, and I think this is a challenge to be addressed.

Next, regarding four, Management Being Conscious of Profitability and Growth Potential, the TSE is currently conducting a following-up on the status of disclosure, and I think we should focus on the outcomes from now on. In other words, I believe that capital return, growth potential, and market valuation should be monitored and published.

With regard to six, Resolution of Issues Regarding Market Environment, I think it is necessary to closely monitor how responses to the TSE's request to controlled or quasi-controlled listed companies last December will be disclosed in their corporate governance reports to be updated after the AGMs. On that basis, I feel that the issue remains to be explored as to how the responsibilities and obligations of controlling and quasi-controlling shareholders to minority and general shareholders can be effectively managed.

Finally, with regard to seven, Management Being Conscious of Sustainability, attention is currently focused on the disclosure of initiatives and KPIs. In other words, they are only responding to requests rather than coping with the issue of management. For example, investment in human capital is of course a top priority, but if we consider this in three stages: input, output, and outcome, investment in human capital is in the input stage. What we want to pursue is outcome. The outcome stage is sustainable growth and a medium- to long-term increase in corporate value, and it is the market that evaluates corporate value. Therefore, while being aware that it is the market that evaluates corporate value, I believe it is important to communicate the rationale for management decisions and the image of outcomes envisioned beyond the management strategy to foster investors' expectations. That is all from me.

[Kanda, Chair]

Thank you very much. Professor Kansaku, please go ahead.

[Kansaku, member]

Thank you for your nomination. I am Kansaku of Gakushuin University. I would like to discuss three points. Regarding two, Substantiation of Stewardship Activities, as stated in the Future Direction, draft, I believe that we should positively consider reviewing the Stewardship Code to ensure transparency for substantial shareholders. In order for stewardship activities and engagement to be effective, it is essential that they be conducted with substantial shareholders who are willing and able to exercise their voting rights or give instructions to do so. Ultimately, legal action will be required, but until legal action is taken, I think that the Stewardship Code, which is regarded as a soft law, could require institutional investors that have signed up for the Code to provide a service of revealing who their substantial shareholders are. I think this would be a good idea.

Another point I would like to make regarding the substantiation of stewardship activities is that communication between asset owners and asset managers will become very important as asset owners begin to make investment policy and investment target decisions with their clients' best interests in mind. For asset managers, they act with a full understanding of the asset owners' investment policies and the benefits to be considered for end investors. On the other hand, communication between asset

owners and asset managers will be very important and useful also from the perspective of accurately appointing, controlling, and supervising asset managers.

Next, I would like to discuss three, Improving Effectiveness of the Board of Directors, etc. In a previous comment, there was concern about uncontrollable conduct of the nominating committee. I think that there is certainly an aspect as was mentioned, but I think that the roles of the nominating committee are quite different when it comes to naming candidates for executive directors and when it comes to naming candidates for independent directors. I still feel that it would not be right, or at least not formally right, for members of the executive team to join the nominating committee when it selects candidates for independent directors. I understand to a certain extent the concern about the nominating committee's uncontrollable behavior, but I think there is still something to be considered for the nominating committee in the Code, especially with regard to the selection of candidates for independent directors.

Thirdly, I would like to discuss five, Enhancement of Information Disclosure. I basically agree with what is written in the Future Direction in this regard as well, but in particular, I think that the disclosure of annual securities reports before AGMs is very important. In order for shareholders to exercise their voting rights in a reasonable manner or conduct effective engagement, it is not very meaningful if the annual securities reports are disclosed just before the AGMs, so I think it is important that the reports be disclosed some time before the meetings.

As pointed out by Ms. Matsuoka, the integration of financial statements under the Companies Act and those under the FIEA has been proceeding quite well, but we need to address this issue from a legislative perspective, including legislative provisions, and also ask issuing companies to do what they can. For example, the date of the AGM could be moved later from the current schedule, or conversely, the end of a fiscal year could be moved earlier. In addition, the empty voting issue should be avoided to the maximum possible extent. I do not think it is absolutely necessary or reasonable that shareholders on record at the end of a fiscal year become those at the record date. Therefore, I would be very grateful if you could positively consider such points that companies should and can work on other than legislative discussions, such as the establishment of a reasonable record date. That's all from me.

[Kanda, Chair]

Thank you very much. Mr. Matsumoto, please go ahead.

[Matsumoto, member]

Thank you very much. I am the chairman of Sumitomo Electric Industries, Ltd. and also the chairman of the Kansai Economic Federation, Kankeiren, so I may have a slightly different opinion.

First, I would like to discuss II-1 General Comments of the Action Program, draft. The General Remarks stress the need to consider necessary measures in detail according to the size and situation of each entity, and state that it is also important to carefully explain one's own stance rather than formally comply with each Code.

However, the fact that voting advisory firms, which have a strong influence mainly on institutional investors, mechanically make recommendations based on a number of formal requirements such as ROE levels, etc., may be a major factor or pressure for companies to hesitate to explain their stances and to conduct easy share buybacks and similar measures or put priority just on compliance. Therefore, I believe it is important to recommend that companies explain their stances, but also to require investors to have a system in place that allows them to evaluate explanations by companies.

Next is about collaborative engagement. I would like to discuss II-2 Substantiation of Stewardship Activities. Although I do not fully understand the intent of collaborative engagement, I am uncomfortable with the idea of the FSA taking the lead in promoting it by revising the Stewardship Code, and I believe that it should be done with caution.

The Report of Working Group on Capital Market Regulations and Asset Management Task Force, published in December 2023, states that it is also useful to actively utilize collaborative engagement initiatives from the perspective of supplementing qualitative and quantitative resources and reducing costs. However, collaborative engagement can also put undue pressure on companies by concentrating a very large amount of voting decision-making influence on the representatives who conduct the engagement. I am concerned about whether such measure can promote truly constructive dialogue.

While I agree with the idea of substantiating the Stewardship Code, I think it is a bit short-sighted to lead in a one-sided direction as if collaborative engagement is desirable as a means to achieve this. I hope that you will listen carefully to what companies have to say. I think there is something legally

wrong with a clique of people coming together to deal with one company although this wording may be strange. They share information that should not be shared, and then come to one company as a group with it. I think there might be a problem, but I am not an expert on this, so I will leave it to the judgment of experts.

Also, there is mention of the need to ensure transparency for substantial shareholders by revising the large shareholding reporting system, but I think that it is necessary to have in-depth regulations such as not approving shareholder proposals in cases where shares have been bought up by wolf pack tactics.

Next, with regard to II-3 Improving Effectiveness of the Board of Directors, etc., I am aware of the same issue of outside directors not being able to effectively fulfill their functions, but I would like to ask what you mean by confirming whether constructive discussions are taking place at Board of Directors meetings. In fact, the number of candidates for independent directors is actually small, and we are concerned that the uniform rule of appointing at least one-third of the candidates for independent directors has led to an excessive increase in the number of roles served concurrently by independent directors, and that they are not able to properly fulfill their functions in terms of time and energy. In light of this situation, I believe that we must review the rules that formally require criteria for independent directors, so that they will secure sufficient time and effort to serve as independent directors, and that we must also introduce certain restrictions on appointments of concurrent roles as an option.

Next, regarding II-4, Management Being Conscious of Profitability and Growth Potential-Future Direction, draft, the section states that you should pay attention to whether there is a gap between the content of disclosure and actual initiatives, and whether specific discussions are held at board of directors' meetings. As I mentioned earlier, this point could be taken as confirmation of the content of the discussions at board of directors' meetings. Therefore, I would like to confirm what you mean as I would like with regard to II-3 Improving Effectiveness of the Board of Directors, etc.

Uncertainty always exists in the business environment. If we were to go too far in confirming whether or not there is a discrepancy between what is disclosed and the actual results of future

initiatives, I think there is concern that companies will retreat from disclosing future management policies and other information.

Next, I would like to discuss II-5 Enhancement of Information Disclosure and Promotion of Correspondence with Global Investors. I agree that we should make effective use of English disclosure to promote constructive dialogue. On the other hand, when encouraging English disclosure for this purpose, I believe that the system should be designed with a certain degree of freedom and with an appropriate amount of time before application, paying close attention to the practical burdens on companies.

Some companies outsource the translation of English disclosure materials to external companies, but from the viewpoint of information management, such as insider information, many companies outsource the translation to outside vendors after the Japanese disclosure has been finalized and published. In that case, I assume it is quite difficult for those companies to deal with simultaneous disclosure in Japanese and English.

In addition, it can be difficult to secure a certain number of personnel who can translate legal and accounting terms and new technical terms and expressions into English. I would very much like to request that the rules be designed with due consideration for the actual conditions of these companies.

Furthermore, there is concern that the disclosure of securities reports prior to the AGMs may lead to shortening the preparation period for the reports at the companies, so I believe that sufficient consideration should be given to practical issues.

Next, in II-6 Resolution of Issues Regarding Market Environment, it is noted that, on the other hand, it is not always desirable to sell cross-held shares formally, and that there are cases where the rationale for holding such shares can be explained through support for the management of the issuing company, etc. I agree with this point as I have said since earlier. I would very much appreciate a response based on the purpose of such shareholdings.

I am sorry this is a bit too long. Here is the last part of my remarks. Finally, we recognize the importance of management being conscious of sustainability and resilience as described in II-7 Management Being Conscious of Sustainability. However, I do not intend to add a new item to the Corporate Governance Code and further elaborate it by requiring companies to provide formal

explanations, but rather, I would like both companies and investors to recognize this idea as a premise for dialogue between them. That is all.

[Kanda, Chair]

Thank you very much. Now, Ms. Okina, please go ahead.

[Okina, member]

In general, the FSA and the TSE have been making various institutional efforts for corporate governance, and I believe that they have been successful in achieving their goal. However, looking at individual companies, as was pointed out, some companies only formally comply with the Corporate Governance Code, and I believe that it is very important to place a strong emphasis on the explanation of compliance.

However, as pointed out by the TSE, there are cases in which the explanation itself has become just a formality, so I think it is very important to ensure that the engagement is conducted properly. Although there is a shortage of engagement personnel and the resources are limited, I believe that the investor side has still a major challenge.

In this regard, I believe that the Substantiation of Stewardship Activities mentioned in two, is an extremely important issue right now. In light of the FSA's discussion and other proposals to ensure transparency for substantial shareholders, I believe it is very important to review the Stewardship Code this time.

I am particularly aware of the issue of much importance of having discussions in engagement with investors on how to improve long-term corporate value through a business model that combines business, finance, and sustainability with a high level of expertise.

At the same time, as mentioned in the paper, I believe it is also very important that dialogue and the exercise of voting rights are firmly combined for engagement. In this sense, I think it is very important to improve the system on the investor side and to develop human resources.

Although it is necessary to consider the number of companies that comply with the Stewardship Code and what kind of disclosure is appropriate, I think it would be very meaningful for the FSA to consider disclosing the status of compliance every year on a regular basis. I believe that the Corporate Governance Code and the Stewardship Code are the two wheels of a cart and need to be checked

firmly and continuously, just as the progress of the Corporate Governance Code can also be checked through periodic disclosure from the TSE.

The TSE is also following the track record of the cases of management being conscious of growth and profitability and is now earnestly tackling the issue after confirming the status of disclosure. As shown by the TSE's paper, however, companies on the standard market are still facing a lot of challenges.

However, overall, I believe that the role of the TSE is to be a catalyst for creating such an environment, and I hope that stewardship activities will be substantiated in this aspect as well, since a diverse range of investors will not only abide by formal criteria but also consider what types of engagement and requests they will make for themselves. I hope that investors will be more involved in long-term growth and improvement of profitability, and I believe that such corporate management will be realized through such efforts.

Regarding globalization, I think it is a good proposal to create a specific list of companies that are meeting the expectations of global investors. The companies on the prime market have chosen to be listed there by committing themselves to having dialogue with investors, including overseas ones. As mentioned in the TSE document, more than 70% of investors are dissatisfied with English disclosure. Though the TSE provides a minimum level of disclosure in English, I think it is important to use another approach to encourage companies to further globalize themselves by showing that there are such companies with such good quality. Lastly, regarding cross-shareholdings, I think it is good that companies are working to reduce their cross-shareholdings, but as was pointed out in the paper, it is undesirable for the manner of reduction to be uniform and formal. If a company keeps holding other companies' shares for the purpose of corporate strategy, the board of directors should thoroughly discuss the reasons for holding the shares. The board of directors must then verify the reasons, and furthermore, I believe that it is required to explain the reasons for the shareholdings in a way that investors can understand them clearly. That's all.

[Kanda, Chair]

Thank you very much. Ms. Takayama, please go ahead.

[Takayama, member]

Thank you for your nomination. First, I would like to talk about the current situation of Japanese companies. It has been nearly 10 years since the establishment of both Codes, and looking at the situation during this time, I believe that both the Japanese boards and the Japanese management have changed significantly.

I have observed the situations and discussions of many corporate boards, and I believe that the content of discussions in many boards has deepened considerably. Correspondingly, I realize that the way of management and the thinking of the management teams are also changing considerably.

While not all of these will lead to an immediate increase in corporate value, I believe that the conditions for such an increase are now in place. This situation should be highly appreciated.

I believe that they have come this far largely because of the efforts made by companies and investors from their respective standpoints, and also because of the efforts made by all of you here who are working to make both Codes effective.

I would then like to discuss some of the issues and responses in the materials you have provided. Among the several issues raised, I would like to talk about the third one, Improving Effectiveness of the Board of Directors, Demonstrating Function of Independent directors.

I believe that improving the effectiveness of the board is the most important aspect of corporate governance. In this context, it has been pointed out that there is a lack of shared recognition of the roles to be played by independent directors and the chairpersons of committees, and that the quality of independent directors, etc. is not substantially evaluated. I agree with you on this content. While there are differences from company to company, I believe that these issues are common to many of them.

There are three possible ways to address these issues. First of all, as for the roles to be played by independent directors, etc., I think it is necessary for each company to establish more detailed policies regarding what it expects from its independent directors. In fact, some Japanese companies, though few in number, have established such policies.

Generally, each company has its own corporate governance policy, but I think that a large part of the content of such policies is abstract explanations that are taken directly from the Corporate Governance Code.

Rather, I believe that each company should establish a policy that describes in detail, after considerable discussion, what kind of independent director is desirable for the company, regardless of whether or not it is made public.

And secondly, I think the role of the nominating committee needs to be strengthened based on that policy. In relation to the role of the nominating committee, the subject of institutional design was raised earlier, but I will refrain from commenting on the pros and cons of the current institutional design at this time.

On that note, I would like to talk about the role of the nominating committee. Currently, I believe that in many nominating committees, statutory or voluntary, the CEO succession is being discussed in earnest with a lot of effort. On the other hand, with regard to the succession of independent directors, I think there are rather many cases where, for example, the executive sides bring basic proposals, which are then reviewed and approved, and there are not many cases where the independent directors, who are the core members of the committees, take the initiative.

As for the future, I think it is important that the committees, and especially the members who are independent directors, take the lead in promoting independent director succession, and that when they do so, they do so in accordance with the policies established by each company that I mentioned earlier.

In this way, I believe that appropriate independent directors can be selected, but in addition, it will be necessary in the future to evaluate whether the independent directors already in office are appropriately fulfilling their duties and roles. That is the third point.

There was an explanation of the ICGN's statement. I think you will find the Board Evaluation on page four of the statement. That will be helpful for reference. The recommendation from the ICGN states that in addition to the board of directors as a whole, the committees and then individual directors need to be evaluated.

Currently, the Governance Code requires the evaluation of the entire board. In addition, quite a few Japanese companies do committee evaluations as well. On the other hand, the evaluation of individual directors, including independent directors, has not yet been fully implemented. I believe that, in the future, the improvement of the quality of independent directors can be achieved by evaluating individual directors, using this ICGN statement and others as a guide. That is all from me.

[Kanda, Chair]

Thank you very much. Now, Mr. Oguchi, please go ahead.

[Oguchi, member]

Thank you very much. I participated in the 28th meeting last year in my former position at an investment management institution, but this time I am participating from the standpoint of an advisory firm on the corporate side, so I would like to speak today from both the institutional investors and the corporate perspectives.

First of all, regarding the effectiveness of corporate governance, management that is conscious of cost of capital and stock price is now widely recognized in Japan, and it is clearly written in Principle 1-3 and Principle 5-2 of the Corporate Governance Code. I have heard that the compliance rates for these principles were high, but I think it was difficult to say that the purpose and spirit of the principles were fully confirmed.

I am sorry to say, accordingly, as written in one, General Remarks of material two, that I believe this management with awareness of the cost of capital and stock prices is a typical example of formal compliance.

Of course, autonomous raising of awareness should be promoted, but as a countermeasure, as indicated in four, or as explained earlier by the TSE, the so-called TSE request has been effective in encouraging companies to take action, even outside of the Code. I believe that this is a very good example of how a specific and flexible approach in line with the spirit and purpose of the Code was effective.

Therefore, I hope that you will consider various approaches like this in the future. On the other hand, according to a questionnaire survey for member companies of the Japan Investor Relations Association, the companies have identified the following problems in their efforts to realize management that is conscious of cost of capital and stock prices, as mentioned earlier in the written opinion by Mr. Toyama, i.e. the ratio of passive asset management, which invests in the market as a whole, is increasing rather than active management that chooses individual companies. There are also those who say that the number of analysts who analyze corporate value from a medium- to long-term perspective is decreasing.

Considering that the role of the TSE's request this time should have been fulfilled by the institutions that signed the Stewardship Code, it is a bit unfortunate that the TSE had to help them because they were unable to fulfill their functions.

Passive management is an investment method that covers the entire market, and I have no intention of denying that, but to begin with, the Stewardship Code requires institutional investors to have a deep understanding of the companies in which they invest and their business environment as a prerequisite for engagement. Although this is clearly stated, I believe that the engagement activities of so-called active asset management, in which individual companies are actually analyzed, selected, and invested in, are not easily visible from the outside.

When viewed in the investment chain, active management has features that passive management does not have. One is the price discovery feature. This company is undervalued, this is overvalued, and the decision is to buy undervalued ones and sell overvalued ones. And then the method has a fund allocation function that actually allocates money based on such decisions.

Therefore, I think it would be desirable for the investment chain to have active asset management fulfill its stewardship responsibility, and then have passive management hold the shares after the stock prices are made appropriate.

Many Japanese investment management institutions operate both active and passive management, and when viewed from this perspective, I think that passive management tends to hide the stewardship activities of active management. Therefore, I think that verification and disclosure of active management is necessary.

As pointed out in the issue of Substantiation of Stewardship Activities in two, effective engagement that integrates dialogue and voting rights is not being conducted because the departments in charge of dialogue, voting rights exercise, and investment management are separated and do not collaborate sufficiently. In the first place, compliance with the Stewardship Code has not been confirmed, so the issue of the need to inspect actual efforts has been recognized.

Today, many members commented on the exercise of voting rights by institutions that have signed the Stewardship Code. As Guideline 5-1 of the Code prescribes, institutional investors should strive to pave the way for all shareholders with voting rights exercising their rights and in exercising their

voting rights, institutional investors should make decisions on whether to approve or disapprove of proposals based on the situation of the investee company and the content of dialogue with the company, etc., and Guideline 5-3 requires disclosure of the results of such decisions.

As I was on the investment management institution side, I can understand that passive investment management, which covers the whole market, and active investment management, which selectively and separately invests in companies in the market, are two different departments because they have different functions, but they are in the same entity for an investee company. They are parts of the same management company, such and such Asset Management. When considered on a company-by-company basis, those who have the deepest understanding of the companies in which they invest should be the active managers who are analyzing the stocks.

So, I think the active management staff are actually having dialogue, but in that case, there is concern whether the exercise of voting rights written in this Substantiation of Stewardship Activities is ultimately implemented in accordance with the passive management policy that is common to a wide range of stocks. I think that is one way to think about it, but another way is to exercise voting rights by overriding the passive management standards after careful examination of the content of the dialogue. I also think that by requiring disclosure under Guideline 5-3, we can realize the flexible and realistic exercise of voting rights that some other members have pointed out earlier.

From the corporate side, there is a mood of resignation regarding the exercise of voting rights, thinking that even if they engage in dialogue, their decisions are likely to be judged in a uniform manner anyway. However, if they respond based on the actual situation and disclose their behavior, I think it would be useful feedback. If we could see what the officers in charge of the dialogue actually say and how it is reflected in the voting rights, I think it would increase the conviction, not just the criticism, as we see today, of the exercise of voting rights. I believe that this would help to substantiate stewardship activities.

Some of the members also pointed out that, from the corporate side, asset managers, who directly interact with companies, are somewhat visible, but asset owners are not visible at all. Although invisible, they play a very important role in the investment chain, allocating funds to asset managers. They also play an important role in evaluating asset managers with regard to the exercise of voting

rights and stewardship activities, which I have already mentioned. In this regard, we expect that the Asset Owner Principles, which we have heard will be formulated in the future, will stipulate how to ensure the effectiveness. First of all, however, the exercise of corporate pension plans' functions as asset owners is described in Principle 2-6 of the Corporate Governance Code. It stresses the importance of their roles. And it states that human resources with proper features should be secured to implement the principle. Although there is no mention in the Issues section here, I think there is a limit to what we can tell individual asset owners to do to secure appropriate personnel.

In terms of staffing the entire investment chain, we have various human resources as represented by asset managers, but how do we deploy the resources to make the investment chain effective? Without this concept, no matter how hard we ask asset owners to do their best, they will not be able to show what they do not have, so I think it is necessary to create a concrete framework. That is all from me.

[Kanda, Chair]

Thank you very much. Now, Mr. Kawakita, please.

[Kawakita, member]

I am Kawakita from Kyoto University. I would like to make a brief statement. I basically agree with the Future Direction indicated in material two. In particular, I would like to express my strong agreement with the reference to the importance of explanation, and the linkage between two-way dialogue and the exercise of voting rights, as well as ensuring transparency for substantial shareholders.

However, I hope you will be very cautious about adding more to the Code. The more it is written, the more likely it is for formal compliance, so I wonder if it would be a good idea for you to respond by, for example, presenting a collection of good practices.

In particular, with regard to compliance with the Stewardship Code, each public pension plan also requests asset management companies to show what they are doing and discloses the results collected. Therefore, I would rather leave this point to the public pension funds. I think it is a great waste of time and effort for asset management companies to respond to the new situation and devote their efforts to it.

In this regard, especially with regard to public pensions, there is the issue of fees, which has been discussed since earlier. I hope you will ask for a response to this as well.

In addition, I would like to point out the following three points. Actually, I was going to say something about the effectiveness of the board of directors, but since various other people have mentioned this, I will leave it unmentioned.

Regarding material two to four, Profitability and Growth Potential, one of the points I see in various dialogues that asset management firms particularly tend to focus their discussions on dividends, but I think it is a problem. The discussion should be in this order: the cost of capital, the level of investment opportunities, how much of retained earnings is allocated to investment opportunities, and dividends as the residual. I think it is a problem if they focus on dividends at first. Therefore, I hope that both companies and asset management firms will organically discuss the cost of capital, investment opportunities, and retained earnings.

One more point in this regard: In discussions with analysts, they said, for example, in the current era of inflation, with prices rising by about 2%, when they discuss with company officers whether it is volume or price that is boosting their company's earnings, especially sales, the officers were very often unable to give an immediate answer.

I hope that the corporate side will also have a system in place that allows for discussions based on the economic environment and the investment opportunities I mentioned earlier.

Then, one more thing, regarding the discussion on Promotion of Correspondence with Global Investors in five or Sustainability in seven, I think that most companies do not present information on total labor costs including labor expenses, which I think is the most important factor from the human resources perspective. I looked at some companies, and while some of the larger companies are showing it properly, most of them are not.

This means that we do not know the extent to which individual companies are making efforts to respond to the virtuous cycle of labor costs and economic growth that the government is currently focusing on, and the effects of this cycle. In particular, more and more companies are rewriting resources of human resources as assets, and if so, how much they are paying for their assets, and whether they are paying to secure such human resources, should be very important. I believe that

dialogue between analysts and companies would be promoted if disclosure of this point is also promoted.

Regarding the market environment and minority shareholder protection in six, I think there are still some very half-hearted loopholes, not to say abusive, regarding the listing of parent-subsidary companies.

So, I think the ultimate goal is for parent companies to establish such a relationship whereby they completely own important businesses, securing 100% of them for themselves, and conversely separating out 100% of the businesses that are not important or are considered unnecessary. I think it would be difficult to go that far at a glance for a number of reasons, but I hope that the FSA will be able to take steps toward that end. That's all.

[Kanda, Chair]

Thank you very much. Next, Mr. Oba, please go ahead.

[Oba, member]

I would like to comment on three points, and since the chairperson has asked us to limit our remarks to five minutes or less, I will be very conscious of this. The first point is an assessment of the current situation. I think this is true for both the corporate side and the investor side or the asset owner side, that it is important to check the facts first. According to our estimate, as the Nikkei Stock Average is reported rising to a 34-year high, the number of companies that have increased their corporate value during the period is a level above 300, according to the data available from various sources. Conversely, the other companies have failed to increase their corporate value. I think it is important to show this fact at first.

In other words, it would be confusing if we do not clearly state where there are the target companies, to which the message of this follow-up meeting is to be conveyed. I guess many companies understand the details of the message, so I think it is important to show that the companies that are formally responding to this issue are facing a very big challenge this time.

The second point is to return to the starting point of comply-or-explain. This is something that has been pointed out by some other members, so I will mention it briefly, and I think we have a code that works well enough. I believe the guidelines are also quite detailed. First of all, I think it is important

to ensure that these are done thoroughly, so that we do not have to create new guidelines and do further work.

Thirdly, among the engagement themes that you have shown, I think the focus of the engagement should be on four. In other words, sustainable enhancement of corporate value is a common challenge and objective for companies, asset managers, and asset owners alike. While it is true that there are many challenges, other challenges are means rather than an end. I think we could put a little more emphasis on the point that the engagement should focus on increasing corporate value.

To this end, as another member has pointed out, I think it is very important that active investors increase further. In this sense, the Asset Owner Principles, which are expected to be formulated by this summer, should attract a great deal of attention. As was pointed out earlier, it will be very important, including the issue of cost burdens, how to expand the range of active investors, in other words, it will be extremely important to create an investment chain in which money can flow to those areas that can sustainably increase corporate value. I think it is very important that engagement focused on this is strengthened. That's all.

[Kanda, Chair]

Thank you very much. Now, Professor Ueda, please go ahead.

[Ueda, member]

Thank you very much. First of all, I was thinking about some assumptions for today's issues. One of them is that there is a polarization occurring. This polarization between companies that are making substantive efforts to address governance and corporate value, or investors that are voluntarily engaging in dialogue, and those that are only doing this formally, or are not doing so, including whether they lack awareness or resources to do so. This polarization is becoming more pronounced. I think this is what we have seen over time since the Corporate Governance Code was introduced.

There are about 1,660 companies in the prime market, and it would be impossible for investors to have dialogue with all of them. Naturally, where there is a positive effect, such as in the case of active management as was mentioned, I think this kind of trend is a topic for discussion. Basically, I believe that the quality of the market as a whole will be enhanced by the substantial efforts of individual companies.

Therefore, I believe that we are now at a point in time where we must proceed with discussions with a firm awareness that ensuring the quality is not only about the quality of individual companies, but also about the impact on the market as a whole.

In light of this, I would like to first discuss the revision of the Stewardship Code. As mentioned by some other Council members, as a prerequisite for the revision, I think it is necessary to check the status of compliance with the Stewardship Code by institutional investors. In this regard, I believe that the checking for the Corporate Governance Code has well been done.

For example, in the UK, the next CEO of ICGN, Ms. Jen Sisson, is here today, and I think that at the FRC, where she was working, tiering or evaluation of the UK Stewardship Code, for example, is done regularly. It may be a burden on the FSA, but I thought it would be helpful to have this kind of verification and evaluation once, so that we can see the whole picture.

In addition, I believe that collaborative engagement, for example, is a good opportunity for companies to recognize the common awareness of issues shared by investors. With individual investors, discussions are inevitably deep and individualized, and the commonality is lost in the process. On the other hand, management also wants to know the common awareness of issues shared by investors, so I think it is desirable to create an environment that facilitates this kind of approach.

And since transparency for substantial shareholders has already been established in practice in many countries, I think it would be a good idea for Japan to proceed with the Code without waiting for the law to be amended. In any case, we would appreciate it if you could revise the Code as needed.

There have already been considerable discussions about directors, so I will just make one point. The number of female directors is important, but the quality of the directors is also important. Experience, skill, and training are also needed. I wonder if the attribute of being a woman has become an objective. I think what is really needed is a combination of skills and diversity, so I thought it would be necessary to be creative in this area.

Regarding the recent topic of disclosure of securities reports prior to AGMs, they are also published by most companies on the day of the AGMs or the next day. I do not think it would be a big burden to accelerate the announcement of the information a few days earlier and prior to the AGMs. However, I do not think it would be an easy matter to make such announcements, for example, up to five business

days prior to the meetings, because global investors need the time to prepare for exercising their voting rights, as well as to respond to the future requirement for sustainable disclosure. As mentioned earlier by another member, I hope that the current timing will allow us to start discussions on the overall structure, including, for example, how to deal with the overlap with business reports and how the record date should be.

Regarding disclosure in English, since the prime market is positioned as a global market, it would be desirable from the standpoint of market positioning that all information be disclosed immediately in English as well as in Japanese. However, I think there is a burden in terms of cost and resources. Nevertheless, I think it is important to realize that the prime market is a market that requires this level of demand from the perspective of ensuring the quality of the market. It may not be easy, but I think it is necessary for companies to be aware that the prime market is such a market and that member companies are listed on such a market.

I would like to talk about management being conscious of sustainability and resilience. I have also read the OECD Principles, and I believe that there is an aspect of not only about being aware of sustainability factors, but also about the sustainability of corporate management and businesses, and the sustainability of the company itself in conducting sustainable management. Therefore, I think this is connected to resilience. That is why I would like to emphasize the meaning of sustainability in corporate management itself, whatever that may be.

Finally, as for corporate culture. There was a report on corporate culture published by the FRC in the UK some time ago. I happened to be in the UK at the time and researched on it, and I got the impression that it was completely different from Japanese corporate culture. In Japan corporate culture is often thought of as a warm and welcoming atmosphere, but there corporate culture was of a bit more demanding nuance. I believe that the basic idea was the board of directors being responsible for fostering and establishing a kind of culture, and by doing so, trying to improve governance in ways that cannot be handled by rules, and establishing a variety of initiatives.

I was wondering if the use of katakana for the term corporate culture here might also reflect this nuance, and I wondered if it was okay to use katakana. That is all. Thank you very much.

[Kanda, Chair]

Thank you very much. Now, Mr. Okada, please go ahead.

[Okada, member]

I am Okada. This follow-up meeting is a follow-up on the substantiation of corporate governance reform, which I would like you to do. I would also like you to substantiate stewardship activities as well.

From the corporate side, it is undeniable that there is a sense that investors are scary, and that they attack companies. With this follow-up meeting, it is very important that the other side will become visible. I hope that this will lead to further progress in dialogue and engagement. On the other hand, I think that the corporate side also needs to enhance disclosure rather than just playing defense.

In three, Enhancing the Effectiveness of the Board of Directors, there is a description that the board of directors does not work effectively. One example is the evaluation of the effectiveness of the board of directors, which I believe everyone has already done, but there are some companies that conduct it just formally and others that conduct a self-evaluation and state that everything is functioning properly. However, I think it is important to have at least one third-party organization join the evaluation to create a formula and disclose it to the public, as recommended. I think this is important.

With regard to disclosure, I see the tendency of Japanese companies that watch and imitate what other companies are doing and what leading ones were doing. Therefore, a collection of good examples is a very good attempt, and is easy for Japanese to be familiar with, but I also wonder if good examples are just good examples within Japan.

In other countries, the effectiveness evaluation is described in great detail, and in some cases, the details of the skills of directors, especially outside directors, are also described, along with an explanation of what activities such and such directors have performed. I hope that some Japanese companies will take the initiative to be on the cutting edge of the field and do such things. I think that if a collection of good examples is to be compiled, including such examples, the level would be enhanced, albeit gradually.

Continuing on the topic of the effectiveness of the board of directors, I think another challenge is to improve the quality of outside directors. I believe that they undertake training after taking office as outside directors and the training tends to focus on explaining the company's business and financial

results, but in reality, it is also necessary to educate them on past cases of misconduct, cases of governance failures at other companies, and cases of frauds. I think it is also necessary to educate them based on simulations of past cases of scandals, cases where governance did not work at other companies, or cases of frauds, as well as investment cases, such as successful and unsuccessful investments. I would like you to do this.

You mentioned the nominating committee and the compensation committee, but I would like to mention audit & supervisory board members, since that is my position. I believe that the role of audit & supervisory board members is equivalent to that of a corporate audit committee in the US. This committee is defined as those charged with governance. This means that it is given the role of monitoring governance. I believe that audit & supervisory board members should play this role in Japan as well. I think it is also important for a company to have a system to support these members firmly.

When we look at the various securities reports of companies, we find that in the governance section, each company discloses information about its audit & supervisory board members. There are also many disclosures that show the governance systems in detail, and state that the systems are so well organized. So this is another good example. In this sense, I believe that by proactively disclosing the fact that the audit committee or audit & supervisory board members are well supported by the company, the company can demonstrate that it has a solid governance system, and this can provide material for dialogue with investors.

Finally, I would like to briefly discuss the disclosure of securities reports prior to the AGMs. In Japan, there is talk that three months is just barely enough time, but please tell me if I am wrong, it is my understanding that the deadline for filing a Form 10-k report, the US equivalent to a Japanese securities report, is two months. This is for large companies, and for smaller companies it is 75 or 90 days, but large companies file their 10k reports in two months. I understand that those companies also publish their annual reports at that time.

In that sense, I wonder how they are able to disclose the information so quickly. During your discussion with the Prime Minister earlier, I heard that the establishment of a system for the early disclosure of the securities reports was also a topic of discussion. I do not believe that this issue can

be solved only by the efforts of companies, so I would like to ask the FSA, the TSE, and investors to join a substantive study on how this can be achieved.

In that sense, though foreign investors ask for early disclosure, they are also hesitant to ask for too early a date, just saying that they need two or five days, but I believe that from their point of view, 90 days may be perceived as very late, so I would like you to consider this. That is all from me.

[Kanda, Chair]

Thank you very much. Now, Mr. Iwama, please speak.

[Iwama, member]

Thank you very much. I understand that you all have various opinions. Basically, I have no objection at all to the basic direction of this paper. I would like you to proceed in that direction. I would like to make two points. First, how can we improve the effectiveness of engagement? This really has to be done firmly by asset owners and asset managers. Basically, I personally believe that the ultimate goal of a governance code and stewardship code is to generate returns that exceed the cost of capital in a sustainable manner over the medium to long term.

In fact, I am currently an outside board member of an asset management company, an advisor to a sovereign wealth fund in Tokyo, and have recently become an outside director of a company listed on the prime market, so in short, I have been in the same circle. From this perspective, I think it is very important for us to examine the effectiveness of stewardship activities of asset management companies and asset owners.

A company I am assisting tried to register with the UK Stewardship Code. It failed in the first year. In the second year they were finally accepted and registered with the UK Stewardship Code, which was a surprise, and they were the first and only company in Japan to do so. Last year, it was very difficult to renew the registration, but they managed to pass it, and this is the third year for them.

Looking at the progress, the level of engagement in Japan has also improved. In short, a global team in a company is now working on the project from a global perspective, which has led to a more coordinated approach, whereas before, for example, the teams in Japan and the UK were working separately.

In that sense, the UK is in a sense a leading country in terms of stewardship code, and while there is no need to imitate the practices of another country, I would like to see the FSA to consider what can be done more efficiently. I understand that the FSA has provided detailed information on the causes of both good and failed cases, so I would like to see more information on these.

Another point is the role of directors. The role of the board of directors is to increase corporate value over the medium to long term by providing returns to investors that exceed the cost of capital, and I believe this is the fiduciary duty of directors. In this sense, governance must be strong, but how is the executive team supported? I think that the core of the board's role is to support the strategies and various measures developed by the executive team, basically by working together with them.

In this respect, I think there are many cases where outside directors are seen as unreliable due to their lack of knowledge, which may be true in terms of details, but I have seen many times where discussions are organically structured to produce good results when there are a wide variety of outside directors. In that sense, I think it is important to evaluate the diversity of the board of directors, and of course the presence of female directors is important, but I think it is also important to evaluate how well such diversity is being achieved. I think that self-evaluation is important, and I also think that third-party evaluation is necessary. I believe that these two things are very important.

I am sure there are many more details to be worked out, but if they are developed properly, foreign investors have recently been paying a lot of attention to Japan, and many of them are showing up directly, so this is an opportunity, and I think this is a very important story for turnaround. That is all. Thank you very much.

[Kanda, Chair]

Thank you very much. Now, Mr. Obata, please go ahead.

[Obata, member]

Thank you very much. Based on last year's Action Program, I also have a similar impression that there is a good progress that has been made in raising the awareness of companies and investors in an autonomous manner. I believe we are moving in a very positive direction. I myself am in a position to oversee practical matters of a company, so I would like to make comments on four points from that perspective.

The first one is about the Stewardship Code. As mentioned in the FSA's material, I have the impression that there is variation in the positions taken responses by investors, and I agree with the FSA's opinion that it is necessary to review the efforts of investors from this perspective.

In doing so, my request is that, although this will not be organized from a legal perspective, it would be good to review the efforts of investors once they have sorted out what kind of responsibility and role they are expected to have against the company and its shareholders.

Another request in connection with the Stewardship Code is, as was mentioned last year, it is clear that Japan is lagging behind Europe and the US in terms of transparency for substantial shareholders, so I would like to ask you to take prompt action to catch up such behind by enacting new laws or amending the existing laws. In addition, I would like you to strictly enforce the rules regarding delays in the submission of large shareholding reports.

The second point is related to corporate governance reports. Regarding your point that there is a discrepancy between the disclosure and the actual situation, I think you are probably right from the abstract standpoint, but I think we should first ascertain the fact of how much there is a discrepancy between the disclosure and the actual situation. If there is in fact a certain degree of discrepancy, then I think we should also sort out how to consider what kind of liabilities a company should be in connection with such misstatements.

I understand explanation by the FSA about the concept of the Governance Code saying that even if there is a discrepancy, it is expected to be resolved through a self-cleansing process of dialogue between the company and investors. However, I think we should consider what kind of sanctions should or should not be applied for obvious misstatements.

I think it would be a good idea to create a body like the FRC in the UK, which was mentioned today, and I think it would be good for audit & supervisory board members and others to be more involved in the process of making the corporate governance report. There may be various arguments as to whether the corporate governance report should be subject to audits like the business report, or whether it should be audited from the viewpoint of the execution of important duties by directors like the annual securities report, but I think that simply requiring audit & supervisory board members to

check the content of the corporate governance report would eliminate the gap between the disclosure and the actual situation to a considerable extent.

The third point is related to disclosure. While we are very grateful for the fact that the FSA has compiled and presented a number of good practices, as it makes it easier for us to compare our own disclosure cases with those of others, we believe that disclosure beyond what is required by law should be handled on an autonomous basis by companies.

When a large number of examples of good practices are presented, there is risk that companies will be pulled in by them, and I fear that this may result in a gap between the actual conditions and disclosures. I think it is also necessary to reconsider how good practices should be handled and presented.

There has been a lot of talk about early disclosure of the annual securities report, and while companies are working hard to achieve early disclosure, I think there may be a problem with the resources of the accounting auditors who engage in audits. The easiest way for a company to respond to this is to prepare the annual securities report according to the current schedule, while moving back the date of the AGM, which has been moved up, to around the concentrated date for the AGM so that the annual securities report can be submitted about one week before the AGM. However, this would make it difficult for individual shareholders to go to the actual AGMs due to the concentration of the meetings on specific dates, which would be a serious disregard for individual shareholders.

Therefore, if we demand the early disclosure and submission of the annual securities report too much, we may end up running away from the true purpose of the report. Rather, taking an essential way of handling, at first the information required for the business report and annual securities report should be adjusted, then, for example, the information needed before the AGM should be included in the business report - I believe this is the right solution.

Finally, the fourth point is about improving the effectiveness of the board of directors. I believe it is desirable from the standpoint of diversity that the number of outside directors is increasing at each company and that people with diverse backgrounds are joining the board of directors. However, as mentioned in the FSA's comments, different people have different ideas about their respective roles,

and I feel that there is possibility that the roles may become misaligned. Therefore, I completely agree with you on the need to share a minimum level of awareness.

In addition, while the increase in the number of outside directors is a good thing, I believe that the role of the secretariat that supports outside directors is becoming very important in order to make the most of them. This includes the secretariat of the board of directors, those of the nominating and compensation committees, and the supporting office for the audit & supervisory board. Now that we have a variety of people on the board of directors, we think it would be good if you could focus more on the importance of the secretariat that supports these outside directors. These are my four comments.

[Kanda, Chair]

Thank you very much. Now, Mr. Takei, please go ahead.

[Takei, member]

Thank you very much. I will express my opinion briefly. First of all, as mentioned earlier, the governance reform over the past 10 years has steadily produced positive results. As Ms. Takayama mentioned earlier, the operation of the board of directors has changed significantly, and in this sense, we have seen steady progress. Of course, there are always challenges, and these must be tackled, but looking back over the past 10 years in Japan, I think we have changed considerably.

Based on that, regarding the substantial functioning of governance, I feel that the issue is whether or not companies are devoting adequate resources to the governance function.

Mr. Oba mentioned earlier that there have only been 300 companies that increased corporate value in 34 years, and I think that innovation and challenges have yet to occur. I believe that one of the reasons for such slow innovation is that companies have not been able to allocate sufficient resources to governance function. Resources mean people, facility and budget.

There are two types of people belonging to governance function: One is those who support decision making on challenging issues. These are the people in the second line within the so-called three line model. People related to legal affairs, general affairs, human resources, and so on. The resources related to such people are not properly allocated as I just mentioned.

The other kind of people is the governance personnel to show the outside world that the company is doing it right. They are related to IR, SR, the board of directors' secretariat, or other such board-related functions.

I believe that companies have not yet truly allocated sufficient resources to the governance function, including those on the second line. These functions have long been referred to as cost centers and are still considered incurring expenses. However, in the recent human capital reform in Japan, these people are considered human capital, not a part of personnel costs or other expenses, but of investments. It is difficult to evaluate people in governance function because they do not have sales figures linked to business results. It is easy to discern people with sales figures and they are likely to be promoted earlier. However, if we do not go one step further in considering whether companies are allocating their resources to governance function, the circumstances that promotes challenges by Japanese companies, especially sound risk-taking challenges, will not be provided. I believe that it is very important from the perspective of the substantiation of governance to go one step further in allocating human and financial resources to governance function. This was my first point.

Secondly, regarding the formal response mentioned earlier, I feel that on the institutional investor side, there are some asset managers, especially with respect to the issue of cross-shareholdings, who are not willing to listen to what companies are saying, no matter how much they are talking about the economic rationale for their holdings and insist on reducing their holdings by such and such amount.

This is because nowadays, especially if Japanese companies try to do DX or GX, there is a considerable rationale for working with various companies, and also because it is a medium- to long-term project that takes years to complete, there is a rationale for enhancing trust as an equity holder rather than doing it only on a contractual basis. However, I am not sure if this is just a formal response by the asset managers, or if they want to explain to the asset owners as an obvious accomplishment that we can have reduced their holdings by such and such amount, but I think it is necessary for them to listen to what the individual companies have to say rather than just taking a formal approach. I think that the formal response of eliminating all cross-shareholdings may be going a little too far.

Also related to the current point, I think there is another issue of formal responses on the part of institutional investors, as mentioned earlier with regard to advisory firms, I think there is also the issue

of formal responses on the part of asset owners. For example, asset managers are asked by asset owners why the results of their exercise of voting rights are different from their standards or those of proxy advisors. If the asset manager has to explain each and every one of them, asset manager may feel such explanation just burdensome. This is why the asset manager is motivated to take a formal approach, including consideration for the other party's stance, and to follow the standards.

So, if we are really going to go into the formal responses within institutional investors, I think we should include the asset owner principle and go as far as eliminating the formal responses on the part of asset owners in the asset manager-asset owner relationship.

I think that we should go into several possible causes of formal responses on the part of the institutional investors, including various types of implied consideration for what asset owners would react, or the decision to strictly follow the standards because of the costs involved.

Lastly, regarding resilience in sustainability-related issues, the disclosure of non-financial information has been increasing in various forms, especially in recent years, and legislation has been enacted on a global scale with a view to the entire supply chain.

As Mr. Katayama mentioned human rights earlier, and while human rights due diligence has made considerable progress, Japanese companies also need to think about sustainability and resilience in terms of various other areas, such as the environment, decarbonization, and natural capital, including forests, oceans, and the blue sea, Japanese companies need to think about these issues from the perspective of sustainability and resilience. From this perspective, I believe that conducting due diligence on sustainability and resilience is one of the important elements that should be addressed in order to substantiate governance. In a real sense, this will be a process for companies to address sustainability and resilience. Also, in terms of resilience, recently, in the area of DX, the guidelines for AI business operators have been issued, and in the context of these guidelines, it is also important to work on improving the governance structure.

Due diligence, or the proper execution of due diligence with regard to sustainability and resilience, is now required. I believe that this is one of the most important points in the context of governance substantiation in the sustainability-related efforts. That's all.

[Kanda, Chair]

Thank you very much. We have received comments from all of you present today, and I would like to thank all of you for your very wide-ranging and invaluable suggestions. I believe some of you also asked questions. If there are any answers from the FSA, please go ahead.

[Nozaki, Director, Corporate Accounting and Disclosure Division, FSA]

Earlier, Mr. Matsumoto asked about the purpose of the confirmation on page three, which includes the description that it is important to confirm whether constructive discussions are held at board of directors' meetings. For example, there are many examples of good practices in disclosing discussions at board of directors' meetings in the securities reports, or individual companies voluntarily disclose some of their board discussions to the public. We think it is important to share what we should learn from those cases.

In particular, as we discussed today, the fact that the secretariat of the board of directors does not know what kind of measures to take is partly because they cannot see what other companies are doing, so we have included the word confirmation in this section with the hope that you will take the next step by sharing good initiatives. We wrote this in the hope that we will be able to share our experiences through dialogue with investors and by listening to various companies.

The section in the back of the report on Management Being Conscious of Profitability and Growth Potential is also a statement to that effect.

[Matsumoto, member]

Thank you.

[Kanda, Chair]

Is that all right? There are still many matters to be discussed by you and we are in the situation to seek your advice. As you may remember, in April of last year, this Follow-Up Council formulated the Action Program for substantiating the corporate governance reform.

We used to revise the two Codes every three years, but we have decided to stop the formal triennial revision and instead promote the substantiation of the Codes.

One year has passed since then. Today, we would like to present the follow-up to the Action Program for the substantiation of the corporate governance reform, which is presented in material two,

and to share our views with the world on the follow-up in the past year and on the future direction of the Program. We hope that this Council will be able to communicate our opinions to the world.

Although there are still many related matters that need to be discussed, we presented a draft, or rather a preliminary draft, of material two to you in advance, and after receiving your individual opinions and comments, we have incorporated them into today's version. I am aware that most of the participants agreed with the proposal today. However, I am aware that there were some members who had different opinions.

We would like to show the formal minutes later and make further revisions to material two, which was discussed today, based on the comments we received today, but we may probably not need to hold another meeting, or rather, we may ask you to confirm our opinions through e-mail or other means, and at a later date, based on what you have discussed today, we may be able to release the revised version of material two that reflects those comments. Would you be okay if we proceed in this manner?

(Sound of people saying “no objection”)

[Kanda, Chair]

Thank you very much. I am very sorry, but I would like to ask you to leave the final examination of the content to me, after making sure that the content is in line with your opinions. I also would like to ask you to leave wording, expressions, and so on to me.

(Sound of people saying “no objection”)

[Kanda, Chair]

Thank you very much. We will proceed as such. I know that some of you would like to have further discussions, but thank you very much for the many substantial and rich points you have made today. This concludes today's meeting. Thank you very much.

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