Minutes of the 5th Council of Experts Concerning the Corporate Governance Code

1. Time and date: 2:00–4:00 pm, October 31 (Friday), 2014
2. Place: Financial Services Agency

[Ikeo, chairman] It's already the scheduled opening time. As all the prospective attendees are here, I'd like to open the fifth Council of Experts Concerning the Corporate Governance Code. Thank you very much for taking time from your busy schedule for the Council.

I would like to start the proceedings. Taking the previous discussion into consideration, today we will be discussing the Responsibilities of board, focusing on the composition, institutional designs, and procedures, etc. First, the secretariat will explain the topic, and then we will have free discussion. Furthermore, during the fourth progress review meeting of the Industrial Competitiveness Council held on October 24, the member in the private sector pointed out some matters concerning the Corporate Governance Code. Such matters are compiled into Material 4, which is distributed to you.

In light of the previous discussion on the functional aspect, we will enter into a discussion on the organizational aspect. Now I turn it over to the secretariat for the explanation.

[Yufu, Director of the Corporate Accounting and Disclosure Division] I'll explain Material 1 first, and then Material 4. Please turn to page 1 of Material 1.

It describes the responsibilities of the board, focusing on the composition, institutional designs, procedures, and training. The right column of page 1 reads, "(a)t the last meeting, we discussed that key roles/functions of the board include: (1) setting the broad direction of corporate strategy; (2) developing an environment that supports appropriate risk-taking by management (ensuring acountability); and (3) monitoring the management and directors effectively from the independent and objective standpoint; in order to increase the company's profitability and capital efficiency and facilitate sustainable growth, taking into account fiduciary responsibility to shareholders. Furthermore, it was pointed out that such roles/functions should be fulfilled adequately and equally regardless of which form of company organization each company adopts (such as Company with *Kansayaku* Board and Company with Three Committees)." Taking such remark into account, I'd like your comments on the matters described on page 2 and thereafter, which are roughly divided into two parts.

Please turn to page 2 with the subhead reading "Independence/Objectivity, Knowledge/ Experience/Competency." The first bullet point reads, "(t)o ensure the exercise of objective and independent judgment on corporate affairs, what should be kept in mind?" The next bullet point reads, "(w)hat should we think about expectating independent directors to play the following roles?" Four roles are listed here. First one is to provide advice for improving management efficiency. The next one is to oversee the management through participating in significant decision-makings such as the evaluation and selection/dismissal of the

management. The third one is to oversee conflict of interests between the company and the management/controlling shareholder. The fourth one is to appropriately reflect views of shareholders (including minority shareholders) and other stakeholders to the board, from the standpoint independent from the management/controlling shareholder.

I'll be moving on to the next bullet point. Listed companies are subject to the independence standards provided by the stock exchanges. They appoint independent officers [directors and *kansayaku*] who satisfy the standards, and disclose related information. Is there anything we should keep in mind regarding the independence standards and the related disclosure? As for this point, the Tokyo Stock Exchange, the co-secretariat, will provide explanations after my presentation. Now, please take a look at the following statement with an asterisk (*). It reads, "(i)n case of a community-based company, some argue that it is difficult to nominate independent directors, because many potential candidates have certain buisiness relationships with the company. What should we think about it?"

Please turn to page 3. The next bullet point: considering the expected roles of an independent director, what should we think about their knowledge, experience, competence, aptitude and other factors? The note with an asterisk (*) is what was pointed out several times in this Council. Some argue that because independent directors do not have profound knowledge of the company and industry, we cannot expect sufficient performance /contribution from them. Others counter-argue that such argument is not necessarily true, given that the function which independent directors are required to perform is not execution, but rather oversight, and requirements of knowledge, expertise and other factors should be satisfied by the board as a whole. What should we think about these arguments?

The next bullet point is about balanced board composition in terms of knowledge, experience and competence, or a kind of diversity, as well as the optimum size of the board for effective discussion. What should we think about diversity and optimum size of the board?

Below that, according to the TSE rules, which is of course also related to the amended Companies Act, an obligation is imposed on listed companies to make an effort to secure at least 1 independent director.

Please turn to page 4. Regarding the number of independent directors, adverse effects of setting numerical standards are sometimes pointed out. In the meantime, it is also pointed out that the board, in general, needs to secure a sufficient number of independent directors so that independent directors effectively perform their expected roles." It continues that taking such arguments into account, for instance, how should we consider the following provisions of the minimum number of independent directors? Then the examples of required numbers are listed.

The first option is "at least 2 directors," as shown in the recommendation of the Liberal Democratic Party quoted on the next page. When we consider holding a meeting of independent directors – which is often called executive session – or selecting a chief independent director who chairs such a meeting – who is called as a lead independent director, requiring "at least 3 directors" may be another option. Next, in French and Singaporean codes, it is stipulated as "at least one-third of the board members" for certain cases. Also in the Viénot Report in France, which I explained in the first council, it is

stipulated as “at least one-third.” With regard to the next bullet point, “At least a half of the board” – strictly speaking, this includes the cases described as “the majority of the board” – is the requirement in the UK, French and Singaporean codes for certain companies, as well as in the US exchange rules.

On page 6, an excerpt from the related part of the Japan Revival Vision proposed by the Liberal Democratic Party is indicated as the background explanation for suggesting “at least 2”.. It reads, “[The issuers of listed equities] must secure two or more independent directors.”

From page 6, the points of consideration under the subhead reading “Administration, Committees, Training and other related matters” are described for the second half of today’s discussion. The first bullet point here is about the administration of the board, with 6 sub-bullet points. The next bullet point is about how we think about the leadership of chairperson of the board in order to realize such board administration.

It continues to page 7. The next bullet point is one of the major focus areas in the US and Europe. What should we think about combining the roles of chairperson of the board and Chief Executive Officer (CEO)? For your information, the data on the current situation in the US and the UK is quoted: companies which separate these roles account for 45% in the US, and 94% in the UK.

The next bullet is also about the same subtopic. For the objectives of securing appropriate board administration, and appropriately reflecting shareholders’ views to the board, what should we think about making independent directors play such a role through designating chairperson of a meeting of independent directors – which is called an executive session -, or a lead independent director?

I’m moving on to next bullet point. As discussed in the previous session, concerning nomination and remunerations of directors and senior managements, it is pointed out that relevant committees should be established under the board to ensure objective and independent judgment. For example, in case of Company with *Kansayaku* Board, or in case of Company with Audit and Supervisory Committee, what should we think about establishing optional committees, or advisory committees for nominating directors and senior managements, and deciding their remunerations?

Then, what should we think about establishing special committees other than the nomination and compensation committees to address individual companies’ special circumstances?

The next bullet point. In case the board establishes optional committees, what should we think about the idea that their mandate, composition, and working procedures should be well defined and disclosed by the board? The note marked with an asterisk (*) refers to the opinion raised in our previous session: in case optional committees are established, they should consists mainly of directors, including independent directors, who have the duty of due care as a prudent manager and can make objective and independent judgments.

Please turn to page 9. It is written that directors should secure sufficient time to effectively fulfill their responsibilities.

Following that, there is another bullet point. What should we think about the number of board memberships in multiple companies by the same person - specifically, whether the

Code should specify the maximum number of board memberships that one person could assume in multiple companies? Under the current circumstances where it is said to be difficult to find candidates for independent directors, who have appropriate knowledge, experience, competence and aptitude, what should we think about balancing multiple board memberships with the current circumstances?

Page 10, is about board training – training for the board, namely directors, and *kansayaku*. In order to fully play their expected roles, directors and *kansayaku*, including newly-appointed members, should gain better understanding of such roles, and learn and develop themselves to acquire/update necessary knowledge. Furthermore, the companies are expected to offer/arrange such training opportunities and bear the training costs, as needed. What should we think about these ideas?

The next bullet point. What should we think about disclosure of training policy?

The third bullet point refers to a question that training may not be suitable for all matters, which directors and *kansayaku* must learn. How should we consider this point?

Today, we will be finishing discussions on all items covered by the OECD Principles. As written in last line of the material – outside the column, I'd like to ask you if there are any supplementary comments or considerations for drafting the Code, taking the previous discussions into account.

Now please take a look at Material 4. The Council for Industrial Competitiveness under the Cabinet Secretariat holds progress review meetings from time to time. At their fourth meeting, we explained the progress of drafting the Corporate Governance Code. At that time, council members from the private sector pointed out three things. As the formal meeting minutes have not yet been released, we prepared this material on our own account, based on what we heard during the meeting. So there may be some inaccurate descriptions.

First, other countries see that the biggest concern about corporate governance in Japan is cross-shareholding. In this regard, although there is a problem with capital efficiency, the most serious problem is that it dilutes voting rights. Accordingly, it was pointed out that the companies should not grant voting rights to shares held as cross-shareholding. My impression is that the member suggested that they should, as a general rule, abstain or not exercise their voting rights, rather than that "there are certain cases" where they should abstain or not exercise their voting rights.

Second, as for executive remunerations in Japan, in addition to the fact that the remuneration level is low, remunerations do not serve as an incentive. In foreign companies, a significant portion of executive remunerations is stock-based, so it was pointed out that Japanese companies should also increase the portion of such incentivized remuneration.

Third, in Japan, there are many "reciprocal transactions" – according to his expression – between the group companies. In many transactions, costs are inflated by approx. 3%, with an excuse that their financial results are consolidated anyway. Those who in charge of such transactions constitute a cost center. Besides, there also are government-driven markets in Japan. If we exclude them, the markets in the real sense are small. These are the factors to lower economic competitiveness of Japan. So the member asked whether this Council can address such issues, I think.

They requested us to consider these points at this Council of Experts, so we compiled

and distributed Material 4 to you.

Now I hand it over to TSE, the co-secretariat for the explanation of Material 3.

[Watanabe, Head of Planning Section, Listing Department, the Tokyo Stock Exchange] I'm Watanabe from the Tokyo Stock Exchange (TSE). I'll explain an overview of the independence criteria stipulated by the exchange and the related disclosure. Please take a look at page 1 of Material 3.

First, I'll explain the purposes of the independence criteria established by the exchange. Outside directors are expected to play an important role as a mechanism to represent the interests of general shareholders on the board and facilitate shareholder-conscious management. What we call general shareholders here are shareholders, the composition of which may constantly change by trading on the market, and who do not have influence over the corporate management because they have a minority stake. In short, they are minority shareholders of listed companies.

General shareholders basically do not have a stake in the listed company other than that of being actual shareholders. Accordingly, they are stakeholders who can gain benefit solely from a pure increase in corporate value. To represent such general shareholders, the mere fact that such individuals are from outside the company is not sufficient. Such individuals need to be independent not just from the management, but also from all stakeholders who may have interests that are in conflict with those of the company, such as business partners and/or financial institutions. Otherwise, they may put the interests of their own organizations ahead of corporate value enhancement or the interests of the company in question, thus being unable to represent general shareholders' interests.

On the other hand, in the requirements for outside directors under the Companies Act in 2009 when the independence criteria were established, the Act solely focused on employment relationships between listed companies and their subsidiaries, such as executives of listed companies and executives of their subsidiaries. Thus, independence was not sufficiently secured.

The revised Companies Act that was passed in June this year set out stricter requirements for outside directors, yet does not cover all aspects of independence. Therefore, the exchange rules stipulate independence criteria that are aligned with global standards.

The chart at the bottom of page 1 shows specifically which types are regarded as lacking independence. They are largely classified into 2 categories. Individuals in the red boxes are likely to significantly control the management. In other words, they are likely to manipulate the management's decisions in a way to put the interests of their organizations ahead of those of the listed company, which is shown in the white box in the center. Officers, employees and family members of the parent company, fellow subsidiaries, and major business partners of the listed company in question cannot be considered independent, in the sense that they could directly or indirectly exert their influence over the management of the listed company for their own interests.

The other type is individuals in the blue boxes at the bottom. In contrast, they are likely to be controlled by the management. In this case, even if the management fails to pay attention to general shareholders' interests, they can hardly challenge the management, and thus cannot be expected to fulfill the role. Officers, employees, etc. of the listed company, or

its subsidiaries and subcontractors may be controlled, in the sense that they can hardly challenge the intention of the management of the listed company. Similarly, consultants who get paid by the listed company can hardly challenge the management. Their family members may also feel indirect pressure.

Among these independence criteria, there are some criteria which require substantive judgment, such as 'major' business partners or receiving a 'large amount' of money. Concerning whether or not it is major, or whether or not it is a large amount, listed companies make similar judgments under the framework of the Companies Act. In practice, we expect that judgment regarding the independence criteria are made in the same manner as those under the Companies Act.

That is the outline of the current independence criteria.

From page 2 onwards is the current situation of disclosure of information on independence. Listed companies disclose information on independence in order to enable shareholders to appropriately judge whether each outside director is independent. There are 3 items to be disclosed. The first item is whether or not all outside directors violate any requirement of the independence criteria.

The second item is concerning situations that are similar to a violation, even though an outside director does not exactly violate the independence criteria. In this case, listed companies are required to clarify whether they consider that the outside director in question is "independent", and, if so, provide reasons. Concerning the term "similar to a violation", one possible situation is the case where an outside director violated the independence criteria in the past, but no longer does so. For example, a person who used to be an officer of a company, which is currently a major business partner, will fall under this category. If a company judges that such a person is independent, the company must explain, for example, that the person does not have influence as time has passed since his/her resignation. Another possible situation is the case of, not a parent company but, a major shareholder or large shareholder of the listed company. Although such a shareholder may not have the same influence as that of a parent company, it may force the company to serve one's own interest first, putting minority shareholders' interests aside. So, an explanation of independence is required for such cases.

Page 3 shows the third item to be disclosed. In cases where there is any relationship between an outside director and the listed company that may raise concerns about independence, the listed company is required to disclose an overview of such relationship. Specifically speaking, the first type is transactional relationships with all business partners, including those that are not major. They include, for example, remuneration payments to part-time corporate advisors or honorarium payments to advisory board members. The second type is cross-directorship, or cross-appointments of outside directors/ and *kansayaku*. It is the case where two companies reciprocally second outside directors and *kansayaku* to each other. The third type is where listed companies make donations to outside directors or organizations they belong to, such as universities or foundations.

The listed companies are required to describe the overview of such relationship in a manner enabling shareholders and investors to appropriately judge the independence of outside directors. For instance, in the case of transactional relationships, listed companies

are expected to describe the nature of the transaction, the approximate amount and the timing of the transaction. However, as for the scope of the descriptions, it is sufficient to describe what they found as a result of reasonable investigations, and it is not necessary to cover all transactions, including those of no significance. As for the depth of descriptions, even if specific amounts are not quoted, it is acceptable to disclose sufficient information, based on which shareholders and investors can make their judgment.

Furthermore, taking Seven & i as an example, its outside director may purchase sandwiches at a Seven-Eleven store. This is an ordinary consumer transaction. Or in the case of a bank, its outside director may take a housing loan. As for these transactional relationships which are unlikely to influence independence, we assume that listed companies can judge that it is unnecessary to explain the outline of such transactions. We stipulated that it is sufficient to explain reasons for such judgments instead of outlining the transactions.

Finally, on page 4, we explain how information on independence, mentioned earlier, is disclosed to shareholders. Generally speaking, such information is provided to shareholders via 3 channels. The first is Independent Directors/*kansayaku* Notifications. This is a document that is intended to provide information on the independence of outside directors and outside *kansayaku* before shareholders exercise their voting rights. Listed companies are required to file the notifications at least 2 weeks prior to the general shareholder meeting where proposals for the election of officers are resolved – in other words, on or before the date the convocation notices are sent. TSE makes such notifications available to the public on its website immediately after they are filed.

The second is corporate governance reports. This is a document that provides information on the status of a listed company's corporate governance in a format that can be compared. While the Independent Directors/*kansayaku* Notifications, which I explained earlier, can be regarded as disclosure of preliminary information, this report can be regarded as formal disclosure of ex-post information. It is filed after the general shareholder meeting and made available to the public on the TSE website.

In addition to these channels, listed companies may also provide information on the independence of outside directors in disclosure documents under the Companies Act, such as reference materials or business reports for the general shareholder meeting. Furthermore, some companies have their own standards for nominating outside directors and disclose these in their securities reports under the Financial Instruments and Exchange Act. Shareholders and investors refer to such information for exercising their voting rights and making investment decisions.

[Ikeo, chairman] Thank you very much.

Now I'd like to proceed to free discussion where you share your opinions. Before that, let me make some announcements. We have an opinion paper from Mr. Ota, who is absent today. We also have opinion papers from Mr. Toyama and Mr. Mori, who are present. You can find the papers on the table. I believe the members have already received the papers yesterday or earlier. So I won't read them out here, but please take them into consideration for our discussion today.

As for the free discussion, the agenda items described on Material 1 are roughly divided into two parts. So we will have a separate discussion on each part in the first and second half

of this meeting. First, we will discuss "Independence/Objectivity, Knowledge/Experience/ Competency, etc." of the board, as shown on page 2 of Material 1. Then, in the second half of the meeting, I'd like you to discuss "Administration, Committees, Training, etc." on page 6 and thereafter. Now, who wants to start the discussion of the first half of the agenda?

Mr. Toyama, please go ahead.

[Toyama, member] I feel I'm expected to start the discussion, so let me start.

To discuss the first half of the material, I'd like you to refer to my paper at your hand. I will not be reading it out.

My specific arguments on this topic start from page 3. I'm going to explain, focusing on that part. First, relating to the composition, institutional designs, and procedures, I'd like to discuss the roles of independent directors. Looking at page 2 of Material 1 prepared by the Financial Services Agency, I would say yes to all the questions raised. Essentially, as discussed in the last meeting, maybe the important point of consideration would be their roles at a hybrid-type Company with *Kansayaku* Board. Roughly speaking, the board is primarily in charge of offensive governance, and the *kansayaku* board is primarily in charge of defensive governance. Such balanced segregation would be the easiest definition for everyone to understand. From this viewpoint, considering that listed companies are public institutions and are expected to create long-term corporate value, I think the central role of independent directors would be essentially the oversight of the management through appointment/removal of executives, evaluation of the entire management system, and other significant decision-making by the board.

Next, regarding the issue of requirements/qualification, many people argue that detailed knowledge of the industry or the company is important. From my own experience, I have never felt such knowledge is that important. Perhaps I'm one of the people who have served most on boards in Japan. Including the period I have worked on corporate turnaround at the Industrial Revitalization Corporation Japan, I won't say I was or am familiar with the details of a cosmetics company. If you ask me, I will frankly tell you that such arguments make no sense. Even though outside directors have not worked for the company in question or are not familiar with the relevant industries, it is much more important that they have experience in organizational/corporate management or social norm and reasonable knowledge of social trends. Basically, their essential role is the monitoring; especially, what independent directors do is the monitoring, I think. Therefore, with an appropriate level of support from the company in question, they can sufficiently fulfill their roles. Conversely, the board had better select individuals who are capable of that.

Next, I'd like to talk about the independence criteria. As explained by TSE just now, the most important thing is disclosure. The independence issue is not a black or white issue. As in the example of Seven Eleven, I also do shopping at Seven Eleven every day. If we pursued formality, in an extreme case, it would be best to bring a young man walking on the street onto the board. Conversely, in reality, there would be a risk of losing substance. In that sense, disclosure is a fundamentally important issue, and imposing excessive formality standards may pose a risk of running against the reinforcement of corporate governance.

One more point. Proposals for election of directors are ultimately resolved by the general meeting, and thus the related information should be disclosed in the proper way. If the

shareholders find any candidate inappropriate, they can vote against such a candidate. When such direct procedures are secured, I think the disclosure is the fundamental issue.

The next point is about diversity. Needless to say, diversity is extremely important. Page 8 and page 9 of the reference material attached to my paper show survey results by a consulting firm called Booz & Company. They conducted a survey to find, for instance, what type of people are in management positions in Japan compared to other countries. From the data, we can find that the selection methods and background of CEOs in Japan are a little eccentric. To be frank, it's "Galapagos syndrome" – isolated from the world. Before talking about the UK or US model, Japan's position is so isolated from the rest of the world. Top management and the board at the top layer must practice what they preach. It is a matter of course that the board ensures such diversity. This Code is expected to play a pace-setting role to show the Japanese standards [of diversity] to the world. So I believe this should be clearly stipulated in the Code.

As for the issue of the optimum size, speaking from my experience of participating in various boards, there are some boards consisting of as many as 20 to 30 members, although I won't tell you the company names. On such boards, the reference materials are typically thick. They read them out, using about 2 hours, and "no objections" are raised. When the board has 20 to 30 members, this is inevitable. Then, in a sense that they – or the management – are essentially responsible for corporate governance, in either case, they cannot have constructive discussion under such a circumstance. It is obvious, if we consider the time allocated to each member to express his/her opinion. Accordingly, I think the optimum number of the members would be 10 at most. Besides, as I do support the participation of outside *kansayaku* in the board discussions, so 2, 3 or 4 members will be added to the total number. So I think, in effect, the upper limit of the number of directors should be 10.

The next point is about the number of independent directors. It's my policy to speak in a straight forward and easy to understand way. So I would say the biggest weakness, or functional defect of the Japanese-style governance is, in short, the nature of Japanese people who are easily influenced by the atmosphere of the community. Especially, considering the nature of the management, directors, and *sikko-yakuin* who receive salaries from the company in question, it is crucial to create an environment where independent directors can express their opinions consciously ignoring the atmosphere. Then, if there is only one independent director, he/she will become isolated from other members. Accordingly, it is obvious that the board should have multiple independent directors. As I mentioned during one of the previous meetings – although this is a topic to be discussed in the latter half – I believe a Nomination Committee or a Nomination Advisory Committee and a Compensation Advisory Committee are indispensable. This is more indispensable in the case of the hybrid boards. When the majority of the members are, in effect, independent directors, the committee has good reason to have multiple independent directors. Ideally, if one-third of the board members are independent directors, there will be an atmosphere allowing for free discussion of various matters. I believe this is a crucial point.

That's all for the time being.

[Ikeo, chairman] Thank you very much.

Well, Mr. Callon, please go ahead.

[Callon, member] I think Mr. Uchida has made a number of very important points.

First of all, I think the cause for Japan entering into a period of low growth was not Japanese companies. The strengths of Japanese companies are valid and enduring. The purpose of this Council is to improve and advance the corporate governance of Japanese companies and to bring Japan's economic growth strategy to fruition – it is not a venue to seek to assign responsibility for what has gone wrong. I totally agree with Mr. Uchida.

Going forward, what should be done? As I have argued in previous Council sessions, innovation is a strength of Japan. Japanese companies should make use of their innovative power in the corporate governance system, so we should not be trapped by previous forms or surface appearances.

I'm so sorry that I will have to leave early today to attend a conference in the United States where I will make a presentation about attractiveness of Japan as an investment destination. As I will be leaving early, please let me share my opinion on the number of directors.

As Mr. Uchida mentioned, it is critical that directors are fully qualified to fulfill their responsibilities. However, what is needed is not only high-quality directors, but also establishing a structure to support the best use of qualified directors. Put another way, if there is only one outside director, his or her input is at risk of not being fully accepted and considered, and he or she will be prone to isolation. Therefore, in Europe and the United States not only qualification standards but also numerical standards for directors have been established.

Japan is currently moving forward in an extremely positive way with corporate governance reform. By securing outside directors' pro-active governance, shareholder-focused governance will be further realized. In pushing forward this reform whether we aim for incremental evolution or radical change is a significant point of consideration. I would suggest incremental evolution. For example, if at least half of the board members must be outside directors, there may be problems with securing the required number of outside directors and ensuring their quality. I think it is preferable to seek at least two members, or in case of companies listed on the TSE First Section, three members or one-third of the board members. If we aim for gradual evolution in this way, we will be able to prevent confusion at the introductory phase and have a stronger sense of stability, thus realizing the intended corporate governance reform in high-quality way. Having said that, considering the importance of each individual vote on the board, I do believe that securing multiple outside directors, not just one, is important and will be beneficial for Japan.

By the way, I will meet with a very long-term investor during the business trip I am about to depart upon. It is a foundation with a several hundred year history. In interacting with long-term global investors, I find that they highly regard Japan's corporate governance reform. And Japan is going to further advance reform going forward. It may 10 years, 20 years, 30 years, or even a hundred years, but Japan will achieve best-in-class corporate governance. I believe that fund inflows from such high-quality, long-term investors will contribute to revitalizing the Japanese economy. I apologize for such a long comment, but in conclusion first I'd like to say yes in support of Mr. Uchida's statement, and on that basis, I'd

like us to achieve further reform on behalf of Japan in an appropriate and optimal way. Thank you in advance for your consideration.

[Ikeo, chairman] Ms. Nakamura, it's your turn.

[Nakamura, member] My opinion is close to what was just mentioned. I understand, to some extent, that if there is only one outside director, it is not easy for him/her to speak at the board meeting. Our company has multiple outside directors, and I believe they are sufficiently functioning. On the other hand, the number of the board members is slightly more than the number suggested by Mr. Toyama. This is partly because our company is a holding company: we have presidents of the subsidiary operating companies as our board members other than executive members of the holding company and outside directors, and basically, I think, we need a certain number of the executive members at the board to discuss the management of the company. Under this circumstance, if the Code sets a high ratio of outside directors, we will be unlikely to maintain the optimum size. On the premise that the board should have multiple outside directors, and considering that there are also multiple outside *kansayaku*, I think the appropriate provision for the Code would be that the number of outside directors should be "more than two".

That's all for this point.

[Ikeo, chairman] Mr. Oguchi, please go ahead.

[Oguchi, member] Thank you very much.

Regarding the long slump of Japanese companies, Mr. Uchida cited 3 causal factors, and pointed out that the slump was not attributable to the weak corporate governance, and there were many other reasons. I think nobody recognizes that corporate governance was a single problem, needless to say. We have to work on the revitalization of Japan now. Concerning this issue, we have to do all that is possible, which certainly includes corporate governance issue. That's why this Council was established. Although corporate governance may not be the only issue, I do think corporate governance is also a key to the revitalization of Japan.

Let me digress a little here. Previously, we had an argument over stakeholder-oriented vs. shareholder-oriented. Although the concept of "stakeholder-oriented" does not exclude, but includes shareholders, stakeholders were treated as opposed to shareholders in our discussion. Similarly, this time, the way we deal with corporate governance and other issues which were pointed out earlier should not be OR, but AND. I consider that corporate governance is one of the important viewpoints for revitalizing Japan.

As for the roles of independent directors, my opinion would be the same as what other members already mentioned. The roles of independent directors described on pages 2 and 1 of Material 1 are very convincing. Precisely because independent directors have knowledge and insights which inside directors do not have, it is meaningful to appoint them. They can fulfill their roles only through contributions which inside directors cannot make. Therefore, although we talked about the familiarity with businesses of a company in question, if we just look at the familiarity with the businesses, outside directors are no match for inside directors. I think independent directors are expected to be capable of challenging the board members – mostly inside directors who are familiar with the businesses, thus making the board of directors dynamic.

That is related to the issue of knowledge, experience and competence. The independence

alone is insufficient. Because they engage in significant decision-making of the company, I think each member is required to have a capability to offer diverse viewpoints, ask adequate questions and challenge [the board/management], based on their experience and expertise. I think it is not reasonable to require everything of one person. So if the board intends to have such a function, it should have multiple independent directors who have various viewpoints. This would be related to diversity. Independent directors fulfill their functions as a team – I think that is the role of independent directors, as both individuals and the team.

Regarding the number of independent directors and the board composition, I'd like to make comments from two perspectives. One is the perspective of roles/functions of the board of directors, which we discussed in the previous meetings; and another is the perspective of shareholders being outsiders. The latter has some overlaps with Mr. Callon's comment. I'd like to discuss them from these 2 perspectives.

As for the first one concerning roles/functions, some important roles of the board of directors may involve conflict of interests. To tell you without fear of misunderstanding, they have some roles which may be perceived as self-serving. As described under item E on the left column on page 2, such roles have to do with remuneration, succession, change in control, takeover defense, audit function, etc. It may be easier to understand, if we look at the underlined statement on page 8. The OECD Principles refer to ensuring the integrity of financial and non-financial reporting, the review of related party transactions, nomination and remunerations of the board members, as the cases of potential conflict of interests, and stipulate that independent viewpoint is needed.

Therefore, including the functions illustrated in the material, in order for the board of directors to make objective judgments, which are not criticized for being self-serving from outsiders' perspective, the most straight-forward solution is that the entire board is independent: in other words, the majority of the board is independent directors. I'm sorry for going back and forth, but this is related to the option presented on page 4 - at least a half of the board – as explained earlier. The US and Europe, specifically the UK, the US and France, adopted the majority standard. If companies satisfy this standard, all the directors can ensure the transparency and fairness and become free from false accusations from outsiders. And thereby agency costs decrease, and the board of directors can focus on their top priority, which is enhancement of corporate value. However, as Mr. Callon mentioned earlier, that being said, realistically, the current situations do not always allow such a requirement, as with the situation of Japan, if you look at it objectively. If that's the case, as the OECD Principles also mentioned, I think there is an alternative approach where companies set up committees dealing with specific matters, of which agency costs are especially high, such as auditing, nomination, remunerations, and related-party transactions, where the majority of the members are independent.

Japan has 3 forms of company organization, including a new one. Under the regime, there are such statutory bodies as the *kansayaku* board, Audit and Supervisory Committee which is a new organization, and Nomination Committee, etc. under so-called Three Committee System. All of them have functions which may involve conflict of interests, and the statutory bodies dealing with such conflict of interests should maintain the high level of independence. And in terms of functions, as described on page 1 of Material 1, the board of

directors should properly fulfill its functions regardless of institutional designs. Based on these approaches, if there are no such statutory institutions regarding the matters described in the OECD Principles, such as related-party transactions, nomination, and remuneration, I believe companies should set up advisory committee(s) to handle such matters – I think this is the hybrid-type. According to the OECD's logic of functions, I assume that establishing such advisory committees is a natural result.

I apologize for taking a long time, but let me continue. How does it look from shareholders' viewpoint? As is often pointed out, Japanese companies are admired for being very sensitive to consumers' needs and respond to them in an excellent manner. Shareholders want listed companies to extend such attention to them. They want listed companies to pay attention to the needs of shareholders who purchase their listed stocks, to the same extent as to the consumers' needs. It was pointed out earlier that domestic institutional investors do not care about it. However, I heard that some companies received letters directly from foreign institutional investors, who invest across the world, requesting the companies to have at least one-third of the board to be independent directors, which is the same level as Singapore as shown on page 4 of Material 1, if not the majority as in the US and Europe. Regarding this one-third requirement, for example in other Asian countries, it is argued that at least 3 members or one-third of the board should be independent directors. Our company is often told by foreign institutional investors, whom we work with, to look at the stipulations of Singapore or other Asian countries such as Hong Kong and Thailand – although these are not included in today's material. For instance, in Hong Kong, the Listing Rules require at least 3 members, and its Code requires one-third of the board. In Thailand, SEC Rules have the formality standards where one-third of the board AND at least 3 members should be independent.

Some members earlier expressed their concerns about adverse effects of the formality standards. I can understand such concerns, but the 3-member requirement or one-third requirement, which I just mentioned, is widely adopted in Asia. Such requirements are based on empirical rules which were established through considerations for securing a meaningful and practical balance of internal and external viewpoints, in a way not placing excessive burden on independent directors when they play their expected roles. I'd like you to understand that these are not formality standards, but practical standards widely understood by globally experienced institutional investors.

To examine whether this one-third requirement is really feasible in Japan, I reviewed the reference materials distributed to us in advance, and found the related data, the number of independent directors, on page 6 of Material 3, although it was not explained today. The data shows the number of independent directors. We can see the numbers of companies which meet the one-third requirement and the 3-member requirement in Japan. Actually, more than 100 companies listed on the TSE first section already have at least one third of the board members who are independent directors. I think this fact reflects the shareholders' voices which I just mentioned, or the companies' initiatives toward the effective use of independent directors. I think these forward-thinking 100 companies have already developed their understanding of these requirements.

One last point. This may have some overlaps with what Mr. Callon mentioned earlier. All

foreign institutional investors, with whom we work, are aware of the Council of Experts Concerning the Corporate Governance Code. We are often asked by them how they can participate in the discussion. We told them to wait until the solicitation for public comments. This Council of Experts was established upon the revision of the Japan Revitalization Strategy in 2014, while the Stewardship Code was established and obtained certain international reputation. Similarly to Mr. Callon, I can feel that this Council is drawing attention among long-term foreign investors, as a symbol of a possible real change of Japan. I think this is not a groundless expectation, but an expectation as a result of announcing several measures and actually implementing what seemed impossible – what was said was done.

This Corporate Governance Code, especially the ratio of independent directors which we are discussing now, would be the bottom line of the final series of the governance reforms. If the Code does not meet global expectations, I'm afraid Japan may at once lose international confidence, which has been earned through these efforts. Therefore, we should be aware of such a downward risk, and aim at establishing the Code which wins international reputation – as expressed in the Japan Revitalization Strategy revised in 2014 –, or obtains international understanding. I didn't mean to be smart, but I couldn't help but add this comment, because I believe we have such a responsibility.

[Ikeo, chairman] Thank you very much. Certainly, we have such a responsibility.

Mr. Mori, please go ahead.

[Mori, member] Thank you very much.

I have almost the same opinion with other members. I understand that drafting the Corporate Governance Code is included in the Emergency Structural Reform Program under the Japan Revitalization Strategy, and positioned as a critical initiative. Considering that Japan has achieved a rapid growth, the current or the past corporate governance has functioned well in a certain sense. As a result of considering what should be further added in light of the current situations, the Stewardship Code was established first, and the Corporate Governance Code is now being established. I think it is based on an approach that they work together like two wheels of a cart for sustainable corporate growth.

What was insufficient is being disucussed here. From my experience of observing various companies through accounting audits, I think it is important, in corporate governance, that the board fulfills its fiduciary responsibility with transparency, and accountability of companies is extremely important. Although it varies from company to company, companies in general seem not to sufficiently fulfill their accountabilities. Governance functions of the board of directors and Audit & Supervisory Board vary depending on institutional designs. In order to achieve accountabilities, as other members mentioned, each company needs to clearly explain under which institutional design, it fulfills what kind of fiduciary responsibility and what kind of accountability. We are talking about the Code now, so companies need to sufficiently explain these points concerning not only the bodies (institutions) stipulated in the Companies Act, but also other bodies such as management committee. Unless it is certain that corporate governance is functioning, the companies cannot receive investments from overseas. So I think they need to properly fulfill their accountabilities.

In Japan, Companies with Audit & Supervisory Board account for 98% of all the companies. Almost all the companies adopt Company with *Kansayaku* Board system. *Kansayaku* have rights to attend meetings of the board of directors and express their opinions there, but do not have voting rights. Therefore, I think it is necessary to supplement it [the absence of voting rights]. It never is true that governance is not properly functioning under Company with *Kansayaku* Board system. Excellent companies in Japan are doing it right under such an institutional design, thus I think it is necessary to consider how to explain it. And the number of outside directors on the board and other relevant matters are related to accountabilities for an institutional design which each company chose.

Furthermore, as Audit & Supervisory Board is required to be made up of a majority of outside members, it has a majority of outside *kansayaku*. Therefore, I believe that the cooperation between outside directors and outside *kansayaku* is also a very important element. Especially in case of Company with *Kansayaku* Board, I think that companies should ensure cooperation between outside directors and outside *kansayaku*, and cooperation with accounting auditors, as well as two-way communications, and incorporate such explanations in establishing corporate governance.

That's all I have to say.

[Ikeo, chairman] Thank you very much.

We are behind the schedule. You may continue the discussion on the first topic, if you'd like, but I'd appreciate it if you could also discuss the second topic "Administration, Committee, and Training, etc." from page 6. Please express your opinions on it.

Please go ahead.

[Callon, member] Thank you. I'm sorry that I have to leave soon,so I'd like to make a brief comment on board training,whichI think it is extremely important. Let me return to the quality issue which Mr. Uchida raised. I think it is important that both outside and inside directors participate in board training for the purpose of sharing understanding of their fundamental roles and responsibilities. In fact, the TSE has a very convenient online training system. The Board Director Training Institution Japan (BDTI), a non-profit association, also offers well-developed training courses. Japan already has the infrastructure for such board training in place, and I think this training is extremely important to ensure the quality of directors.

[Ikeo, chairman] Please go ahead.

[Toyama, member] Maybe you can guess what I'm going to talk about. It's written on my opinion paper - No. 3 on page 6. As I already mentioned before, the essence of 'offensive' governance is the appointments and dismissals of senior managements including the CEO. That is the overwhelming reality of corporations. In this regard, discussions on objectivity and transparency are crucial. My standpoint is that even Company with *Kansayaku* Board and Company with Audit and Supervisory Committee should establish a nomination advisory committee and a compensation advisory committee consisting of a majority of independent directors.

Concerning nomination and compensation, obviously, positions, treatment (pays and benefits), and evaluation are handled as a set in personnel affairs. Naturally, when they consider appointments of CEOs and senior managements, compensation should also be

discussed by a body consisting of a majority of outside members, and the relevant decision and criteria should be disclosed. Speaking from my experience, as I mentioned before, Omron discloses all of these types of information. Tasks necessary for the disclosure are not a big deal. Mr. Sakuda and I had a talk for about an hour, and the dialogue was disclosed as it was. This is sufficient. It's not a heavy burden. This is one point.

And as written in the last paragraph, I'd like to refer to committees other than the said ones – there are some overlaps with Mr. Mori's comment. Aside from whether it should be included in the Code, particularly in terms of cooperation with outside *kansayaku*, etc., let me share the case of Omron, which has a corporate governance committee. For instance, Company with Audit and Supervisory Committee was newly introduced by the Act, and whether or not Omron adopts it is virtually determined by this corporate governance committee, which consists of outside officers and outside *kansayaku*. Companies could be innovative in many ways like Omron.

As we are allowed to discuss the first topic, I'd like to go back to page 1. As several members mentioned, we are discussing the Code, which is an extremely soft rule allowing freedom for each company as long as they provide a reasonable explanation. For this reason, upon drafting the Japanese Code, we should show best practices which serve as high standards of corporate governance. I believe we should have such understanding as our basic premise.

Conversely, as I wrote at the bottom of page 2, some point out the difficulty of providing an explanation. Yet being a CEO myself, I believe the issue of "how corporate governance should be" is the most basic issue of corporate management. If a company does not comply with the Code, it should explain that it has taken a certain policy due to certain background or certain philosophy. If top management of a listed company cannot provide such an explanation, he/she is not qualified for the position. Frankly speaking, it's out of the question. Right from the start, something is wrong. I'd like to repeat that freedom of each company is secured. All they have to do is to openly and squarely explain reasons for the number of outside directors they have: for instance, they could explain what history they have, in which business domains and in which form they do business, and what roles to expect from outside directors, and thereby prove that they have an appropriate number of outside directors. This is not a question of honesty. They should honestly and fairly explain the reasons. The Code allows room for it.

By the way, earlier today it was mentioned that some people see this issue as an "already done deal." As I was involved in the discussion on the Companies Act a year ago, I have to inform you of the factual situation at that time. The previous discussion on the Companies Act was carried out under the initiative of the Ministry of Justice solely to discuss the Companies Act being a hard law, and thus did not cover what we've been discussing here, which are matters of a soft law. Besides, no discussion was made using the term "the Corporate Governance Code" at that time. As some members mentioned, discussions at this Council are under a brand-new framework based on the Revitalization Strategy adopted in June this year, aiming at drafting the Corporate Governance Code to further promote corporate governance reform. If we forget about the said starting point of our discussions, we will miss the direction and not be able to achieve a desired outcome. At least, considering

that *Keizai Doyukai* (Japan Association of Corporate Executives) submitted its opinion paper on the Code in a similar manner it did previously, a number of people in the financial circles do not regard this initiative as bringing up the same old story, and thus compiled the opinion paper, which was approved by the Chairman and Vice Chairman's meeting as well as the board meeting, thus constituting a consensus.

I totally agree with Mr. Uchida that the strengths of Japanese companies come, for instance, from being community organizations, or *gemba* power. In this regard, our views are not different. In fact, I also expressed such a view in my book. Besides, Omron, of which I have served as outside director for a long time, has a high regard for such a community and employment– which would be the most typical feature of Japan in a certain sense. Although Omron depends heavily on technological innovations, it seems I have somehow regardless contributed to the company as outside officer.

Aside from it, what I'd like to mention is the roles of outside officers. Indeed, there are problems such as quintuple or sextuple whammy(the 5 or 6 main struggles that Japanese companies are facing which is a concept often spoken about), as Mr. Uchida mentioned earlier. There is a problem with employment, too. What should outside officers do? They should not say that they cannot contribute much because of the quintuple or sextuple whammy. Instead, they should make recommendation to top management regarding how the company can overcomethese issues. That's our job - outside officers' job. Consequently, as you know, Omron was not affected by these so-called prevalent issuesor various aspects of Japanese employment practices, and has kept on steadily increasing its corporate value for the past 10 years.

Therefore, that's an important job. In that sense, as someone mentioned earlier, we do not intend to solve all problems by corporate governance, nor are we discussing matters in order to establish the one and only universal governance model here. But we are aiming at setting a standard, which can be easily understood by domestic and foreign investors, or the public all over the world. Needless to say, it is impossible that one corporate management model will fit all companies universally. I cannot help repeating that the essential role of the Code should be to show a certain best practice standard, and say "let's go ahead with this."

Let me repeat that each company certainly has its own way, and each industry has its own way. As it is the basic premise that each company should explain according to its independent and individual circumstances, management should be able to and want to explain certain things properly. I serve as an officer for Pia and Omron, and if the established Code contradicted with the policies which we believe are right, I'd never easily say "Comply." Instead, I'd like to say "Explain."

That's all.

[Ikeo, chairman] Mr. Oba, please.

[Oba, member] Concerning the first topic of today's discussion and training as he just mentioned, I'd like to express my opinion. There are 3 points.

First, I'd like to make a comment on training, etc. I'm not comfortable with what was written on the material. It is written that sufficient time should be secured, or the frequency of training should be scheduled. This is related to the issue of qualifications. I think it is important to create an environment where outside directors can ask specific questions. It is

rather strange that such training courses are prearranged. It is outside directors who should take initiatives. In terms of qualifications, I think companies should select outside directors who are willing to ask various specific questions. Let me share the practical experience of our company. It is an unlisted asset management company. As of October 1, we appointed independent directors for the first time, and just had a meeting of the board today as well. Prior to each meeting, we receive many specific questions from the independent directors, and all questions are answered by persons in charge. After that, independent directors attend the board meeting. Unless outside directors voluntarily act like that, I think it doesn't work. So while it is also important that companies provide training opportunities, it's more important to select independent directors who have enthusiasm as well as qualifications.

The second point is that maybe qualifications, board composition, and applicable companies should be discussed as a set. Other members expressed specific opinions to support the one-third requirement or multiple-member requirement. However, considering qualifications, board composition, and applicable companies, when there are so many listed companies potentially subject to the Code, I think we should first set the minimum standard. Of course, some would criticize the level as too low especially for global corporations. Whether we should set different standards for different markets for listing stocks would be an open question, yet I think there could be an option to set dual standards: the minimum level and a higher level which can be accepted by the global community.

My third point is a response to Mr. Uchida's statement: there is no consensus on causes for the low growth for the past years, past decades. In a certain sense, this is very important. However, if we pursue it, we will face an extreme difficulty of bringing diverse views together and reaching a consensus. As pointed out by Mr. Uchida, sextuple whammy or employment practice would be one of causal factors, but they are not all, as a matter of fact. At least, speaking from our experience in observing listed companies for 30 years as an investor, there certainly are several hundreds of companies which respond to investors' expectations, while they have the same employment practice and operate in the same environment as other companies. What does this mean? In my understanding, these companies have certain original products, original models, and/or original services. Original means unique. What is the driving force? Of course, there would be various things including the capacity of technological development, but it could be also said that the board is leading such initiatives. Accordingly, there are Japan-specific problems such as sextuple whammy issue and employment practice issue; but while solving such problems, the board should focus their discussions on how to differentiate their businesses. In that sense, I believe it is necessary to reinforce governance.

That's all.

[Ikeo, chairman] Thank you very much.

Mr. Uchida, please go ahead.

[Uchida, member] Concerning the last point Mr. Oba just mentioned, I do not negate the usefulness of outside directors. Companies should make the best use of outside directors for their corporate strategies. I just thought it would be better to show some examples of how they can contribute, and introduce them based on the historical analysis. I share the common view that outside directors should be effectively used.

Concerning committees, I again have an opposing view to Mr. Toyama's. If the Code stipulates that Company with *Kansayaku* Board and Company with Audit and Supervisory Committee should establish nomination and compensation committees or advisory committees, I'm afraid it will be perceived as a message that these 2 systems are inferior to Company with Three Committees system. If the Code were to be based on the thought that 2 systems are inferior, we should go back to the discussion of the Companies Act.

In the first place, for ensuring the system with Nomination Committee and Compensation Committee functions well, I think it is an essential prerequisite that various systems and social structures in Japan change. There are various deficiencies such as the absence of an executive job market, lack of liquidity in the labor market, lack of supporting education system, and organizations which cannot easily shift their corporate management policies upon a change of the management. Taking the current situations into account, we should thoroughly consider whether the committees can perform their governance functions properly.

Currently, some companies set up advisory committees or something like advisory boards concerning nomination and compensation. Nonetheless, they have not necessarily succeeded in nominating appropriate top executives or determining appropriate compensation owing to those committees. Rather, they established such committees as a voluntary initiative to enhance transparency of corporate management. For the objective of enhancing transparency, the establishment of committees would be a solution. Yet there should be other solutions. For instance, companies could achieve such an objective through developing and disclosing basic policies. There is no need to limit their ways to one method. It will be better if each company canhave alternatives and choose a method by its own discretion.

Under the Comply or Explain approach, companies do not have to comply so long as they explain the reasons. However, similarly to the Companies Act which requires companies to write "reasons why having an outside director is not reasonable," if companies are told to explain something they cannot express reasonably, it will constitute an obligation as companies have no choice but to comply. Surely, it is beneficial to have high-quality outside directors, whereas you cannot generally say having an outside director may cause an adverse effect. Everybody said they cannot explain such reasons. Concerning the Comply or Explain rule, it should be OK, if the Code requires companies to state, "we adopt this method because of these reasons." Yet, if the Code stipulates this requirement in a way companies cannot explain, it will cause big trouble. I'd like you to know such opinions of the industrial circle.

Japanese companies are serious and honest. If they are told to Comply, they naturally consider how they can comply. If we set a high standard, they will make desperate efforts to Comply. In the meantime, Japan has a high ratio of listed companies, and such listed companies are diverse in terms of size and types. Under such a circumstance, even if it is a soft law, I'm not sure whether it is realistic to set a high standard and tell them to Comply. Besides, if the Code asks for reasons why the compliance is not reasonable,like the Companies Act, it will constitute an obligation. I'm very much concerned about it.

[Ikeo, chairman] Professor Kanda, please go first.

[Kanda, member] I do not have new points to add, but let me tell you my impression from these discussions.

To be abstract the primary problem is how to write the Code. Concerning today's topics, whether the Code should focus on substance or specify forms, or just require disclosure. Broadly speaking, I'm conscious about two issues. One is the nature of Comply or Explain. Another is how the Code should write about the matters like today's topics – whether the Code should leave decisions up to shareholders, if they are to be resolved at the general shareholder meeting, or stipulate specifics and formal norms.

Concerning Comply or Explain, I've also been bothered by the approach for a long time, although it's different from what Mr. Uchida mentioned. I may not be able to express it well. For instance, it is said that best practices are introduced under the Comply or Explain rule, but because it is Comply or Explain, companies do not necessarily comply with, or adopt such best practices. Instead, they may choose to explain if they do not comply. That can be understood. However, imagine the case where the Code shows best practice and 98 out of 100 companies choose to Explain. I am very much uncomfortable with drafting such a code. You could say, "These are best practices. So it is OK, even if no company complies as far as all 100 companies explain." Logically, it certainly is possible. However, I think that we should present the Code, with which a considerable number of companies comply. This is my long-standing concern.

Several years ago when the Tokyo Stock Exchange introduced the Independent Director/*Kansayaku* System, which was explained earlier today, research was conducted. Professor Ikeo was also there. Among companies listed on the TSE first section by industrial sector, the research looked at top 10 companies in each industrial sector, and found there was no outside director in any top company in each industrial sector. All companies ranked No. 2 or further down in each sector had outside directors. Under such circumstance, if the Code recommended the adoption of outside directors even as a soft law, top companies in all industrial sectors would have to "Explain," although lower-ranked companies would not be affected. This would look quite strange to overseas investors. In fact, overseas investors did not have any complaint against such top companies, because their performance was actually the top in the relevant sector. Despite that, even if you called it best practice, it would be rather difficult to require the companies to have independent directors – this is the term used at that time – under the Comply or Explain rule. Consequently, we concluded that it would be better to start from the Independent Director/*Kansayaku* System, specifically, requiring independent directors OR *kansayaku*. Today's discussion reminded me of it.

Nonetheless, those top companies now all have outside directors. Therefore, I am aware that the situation or environment of Japan has changed. At present, I understand stipulating that having independent directors is a best practice will not cause any problem which I was concerned about at that time. Yet, in general, although this is a repetition, as a member of this Council, I'm not comfortable with establishing the Code, under which most companies explain [instead of comply] in abstract terms.

I apologize for taking a long time. I'll briefly go over my second point. As for such matters as whether and how many independent directors are required, to be abstract, there would be an approach to consider that such matters should be determined by shareholders at

the general shareholder meetings: if shareholders think a certain candidate is not independent, they could vote against the proposal; or if they think the number of independent candidates is not sufficient, they could vote against the proposal. If that is the case, the Code could stipulate that the relevant information should be disclosed to shareholders and other investors.

On the other hand, there would be another approach to show forms to some extent, given that codes and the like in other countries stipulate the number for clarity. I don't think there is any definite decisive factor, but I was somewhat impressed by how the OECD Principles describe this issue, as shown on today's reference material: the independence of directors is described on a disclosure basis, and the number as well as optional committees are described in substantive terms. I have almost the same opinion as other members. I do think that it is necessary to have independent persons in the board of directors, but concerning what the independence criteria are, and who satisfies the criteria, it would be better if companies just disclosed such information – I think the OECD also takes this approach. As for the number [of independent directors], it should be "a sufficient number" as in the OECD Principles, but in substantive terms, it would be better to show how many is sufficient for the sake of clarity as well as balance with other countries. In doing so, as pointed out earlier, a question here is whether or not we should consider it depending on the size of the companies. It is also written on Material 3. Actual conditions differ from company to company. I think the bottom line would be "at least multiple members, and if possible one third of the board." Yet, we should consider whether the Code can be written in a manner tailored for companies of different sizes.

Concerning optional committees, again we need to consider substantive vs. form. The OECD Principles describe them in substantive terms. If we also take the same approach, I think it would be better to stipulate that independent directors are involved in preparing proposals for election or remunerations. This is because we need to write the substance in the same sense as the OECD Principles under the current Companies Act and other regulations in Japan. On the contrary, I rather hesitate to stipulate a specific form by stipulating that setting up optional committee is a best practice. As I mentioned earlier, it may lead to a situation where most of the companies must explain. Although I'm not familiar with actual situations of the companies, I think we have to make a choice [substance vs. form].

Discussions of training also have a slight similarity. I think we should write the substance – at least we should write in substantive terms.

I apologize for taking a long time. This is all I wanted to say.

[Ikeo, chairman] Mr. Oguchi, please go ahead.

[Oguchi, member] I'd like to briefly make 2 points. Professor Kanda referred to substance vs. form. Certainly, the substance is important. It's more important. Yet as I said many times, shareholders are outsiders who can only see the appearance from outside of the company, so it would be easier for them to understand if certain forms – forms which have substance – are stipulated.

There was a discussion on committees related to page 8 of Material 1, and as Professor Kanda mentioned, it would be an issue of substance or form. Yet rather than the issue whether or not committees MUST be set up, it would be necessary for companies to

demonstrate how well they manage tasks where outsiders consider there is a potential for conflict of interests – regardless of the reality – such as auditing, related-party transactions, nomination and compensation as written in the OECD Principles. On such an occasion, when we look at functions, there are 3 institutional designs in Japan. There is an institutional design with 3 committees [i.e. auditing, nomination, and compensation committees]. There also is another design which has the *kansayaku* board or Audit and Supervisory Committee to address auditing, but does not have [committees for] other functions. In case of the latter, the companies could establish relevant committees to fill the gap, so that people outside the company can easily understand their efforts. This would be a good idea in terms of explicitness.

In that sense, the discussion on splitting the roles of CEO and chairperson of the board might be the same. I think nobody would be opposed to achieving an appropriate balance of power as stipulated by the OECD Principles. For that objective, we separate these roles. By this separation, even within the single tier board, monitoring and management functions could be separated – in terms of appearance as well. In the right column on page 7 of Material 1, there are reference data of the US and the UK. In the US, more companies have one person holding the dual roles as CEO and chairperson. This is because a vast majority of the board are outside members, and CEO/chairperson is the only person from within the company – although there may be a case where CIO [Chief Information Officer] is also an inside officer. In such a board, the majority of independent directors monitor the CEO/chairperson in whom power is concentrated. Certainly, there may be another issue that outside directors are his/her friends. Anyway, there is such a structure behind holding the dual roles. At this point, we are not sure about the final decision on the board composition in Japan. Yet on the premise that we cannot expect the majority of the board to be independent directors, in order to ensure check and balance on the board, I think it is effective to split the roles of CEO and chairperson of the board.

That's all.

[Ikeo, chairman] Mr. Takei, please.

[Takei, member] I know time is running out, but let me share my opinion with you.

I have several points to make. First, it's about wording. Material refers mainly to independent directors – the term consists of 3 elements: "independent," "outside," and "director." So my first point is the independence criteria described on page 2. The term "independent" is globally used in other codes, and thus gives an impression that it is internationally harmonized and unambiguous. However, that's not true. Especially in the current situations of Japan, the scope of the independence is actually very much limited and quite narrower than other countries's scope, just like, I would say, a narrow fairway at a golf course.

Why is it narrow in Japan? One reason is the unique distinction between outside and inside in Japan I will mention later. Another reason is that each institutional investor or institution which exercises its voting rights sets an independence criterion without any mutual coordination. As a result of so many restrictions imposed by various parties, currently there are only few people who can satisfy all these independence criteria.

For instance, according to a standard for exercising voting rights, a person, who has

worked for a bank which has any transaction with the listed company in question, is regarded as not independent. Even if such a bank is not the main bank of the company, and the company took a small amount of loan just for the sake of good relations, according to that standard, all persons who worked for the bank are regarded as not independent. Although many highly capable human resources are from financial institutions and banks in Japan, when companies find candidates for the position of their director, the companies must exclude them from the list of independent candidates. Furthermore, concerning what are significant transactional relationships with the companies, the criteria for listing on NYSE and NASDAQ specify that if the value of such a transaction is within 2% of consolidated gross earnings, it does compromise the independence. In contrast, in Japan, definitions of significant transactional relationships vary depending on institutional investors or criteria for exercising voting rights.

In reality, the companies must try to find independent candidates well in advance. They have to start looking for the candidates at least 6 months to 1 year prior to actual appointments. Compared to other countries, the scope of the independence criteria is too limited and narrow, and the companies have hard time finding appropriate persons.

When the independent officer system was adopted as the first phase several years ago, the current independence criteria were established. If the Corporate Governance Code squarely addresses the issue of independent directors, I think we enter into the second phase where clearer independence criteria should be established. The criteria of NYSE and NASDAQ provide clear distinctions between independent and non-independent officers. Upon drafting the Code, I think we should also refine the independence criteria by referring to the criteria of other countries.

Furthermore, even though we call them “independent outside directors,” the second word “outside” is used only in Japan. In the US and European codes, there is a distinction between executives and non-executives, as well as distinction between independent or non-independent. However, they do not refer to a distinction between inside and outside. In case of Japan, when the independent officer system was designed, it was defined that officers other than outside officers cannot be regarded as independent in the first place. Even after the recent revision of the Companies Act, an officer who used to work for the company in question cannot be regarded as an outside officer only until 10 years have passed since he/she left the company. In contract, according to the independence criteria in the US and Europe, from 3 to 5 years after the resignation from the company, former employees or officers of the company have the independence. Therefore, I believe we should re-establish the independence criteria, including the review of the criteria that only outside officers can be independent officers.

In this paper, two words – “outside” and “independent” – are used to describe them. However, I’m wondering if the Code really needs to add the word “outside.” Isn’t it better to simply call them “independent officers” or “independent directors” without adding “outside”? We should have a broad consideration regarding whether we really add the word “outside” to allow for flexibility in response to any future development.

Anyway, I believe that Japan should have refined, clear independence criteria in place, responding to listing rules and independence criteria under the codes of other countries.

Then we could ask institutional investors to follow the independence criteria to the possible extent, or to Comply or Explain. If any institutional investor does not follow such refined criteria set by TSE, we should even demand them to comply. Unless we simultaneously clarify what the independence is, there will remain a concern that companies cannot find any candidates for independent officers in this narrow fairway. Therefore, my first point is that we should refine the independence criteria in parallel with drafting the Code.

The second point is related to the first one. When the board invites an independent officer, he/she could be a total stranger to the company without any acquaintanceship or transactional relationship. Naturally, the company wants to see what kind of person he/she is, and that an independent officer wants to see what kind of company it is. For instance, the company could establish a management advisory committee or something, and work together there for a year or two to get to know each other. I think this is practically good to increase the effectiveness of an independent officer. Instead of starting from "Please take the position of our independent officer." "Okay," it would be better to provide an opportunity to know each other by establishing a certain committee. Then I'd like to request that the independence criteria clearly stipulate that the fact of joining such a committee will not adversely affect the judgment of his/her independence. This is my second point.

The third point. The Council emphasizes independent and "non-executive" directors. The functions of non-executive directors include the function of resolving conflict of interests. In Japan, conflict of interests tends to be resolved by all non-executive directors. We should not ignore the functions of non-independent, non-executive directors.

Non-independent, non-executive directors are classified into two categories. One is inside non-executive directors, and another is outside non-executive directors. Outside non-executive directors would include independent directors and non-independent directors.

In Japan, those who fall under the first category, inside non-executive directors, are typically full-time audit committee members or full-time *kansayaku*. Such full-time *kansayaku* are very familiar with the company. For instance, they attend the management board meeting, obtain various information and provide feedback to independent outside non-executive directors at Audit and Supervisory Committee or the Kansayaku Board. And thereby independent non-executive directors can obtain various information, based on which they can express their opinions at the board of directors. In this way, the inside non-executive directors in this category perform the function of distributing information smoothly or securing the information route. Independent non-executive directors typically have other primary jobs, and it would be difficult for them to work full time. Even though there may be some full-time independent non-executive directors, it is not easy to be a full-time independent non-executive director. There certainly are functions and roles to be performed by non-executive directors in full-time positions. I'd like to request that the Code will not negate such functions by stipulating everything should be done solely by independent outside directors.

Another category is outside non-independent non-executive directors. Even if non-executive directors from banks or large shareholders fall under the category of non-independent non-executive directors, their interests do not always conflict with general shareholders' interests. They often serve the interests of the company. We should not focus

solely on outside independent non-executive directors, but look at non-executive directors as a whole, including inside non-executive directors and outside non-executive directors. This is my third point.

My fourth point is related to the Nomination Committee written on the material. I think the Code should provide various options. Surprisingly, the name "Nomination Committee" is also ambiguous. What is done by the Nomination Committee in the governance codes of OECD and other countries, as well as the Nomination Committee within Company with Three Committees in Japan is, strictly speaking, limited to the nomination of Supervisory Board members. The Management Board members are selected by the entire board of directors.

Taking it into account, we should not look at nomination alone. I think it would be better and more effective to establish the Corporate Governance Committee which discusses nomination together with such matters as desirable board composition, diversity, and directors' qualifications, which we have been discussing since the last meeting. In the US, they had the Nomination Committee until 10 years ago, but now have the Nomination and Corporate Governance Committee. They do not separate nomination from other issues. Instead, they evolved to establish a committee to look at overall corporate governance. If we refer to committee, I think it would be better to introduce something like this Corporate Governance Committee.

No one is sure which department within each Japanese company is in charge of corporate governance. I am afraid there is no specific department or person in charge of corporate governance. We are not sure whether the department in charge is corporate planning department, general administration department, legal department or elsewhere. The absence of department or person in charge sometimes means that no financial budgets or human resources are allocated. I believe that establishing a visible organization like the Corporate Governance Committee provides good effect on the operation of the company, because it would provide a chance to create a new company department in charge of corporate governance matters. When the Code refers to the Nomination Committee, it could lead to a question about whether Company with Three Committees system is good or bad. Therefore, it would be better to provide an option to establish a certain committee like the Corporate Governance Committee. It would also help people understand that Company with Kansayaku Board has the supervisory function within it.

Let me make some more points. Concerning the limitation of seats written in the material, currently it is difficult to find independent officer candidates in Japan. So although it would be better to limit the number of seats, I think it is premature to do so.

My next point is about the separation of chairperson and CEO. I think we could have two options, either to separate these two roles or assign a lead director. The separation is not a MUST. I think it would be better if companies could choose either the separation or assignment of a lead director.

Finally, this is related to the timing of the implementation of the Code. As it is stated "taking the reality into account" in the Revitalization Strategy, and considering the current situation where it is difficult to find independent officer candidates and we have more listed companies than other countries have, when the Code is to be established to increase medium

to long-term corporate value, the Corporate Governance Code should also have a medium to long-term plan: specifically we should plan which parts should be complied by the general shareholder meeting in next June, and which parts should be done later. If we demand the companies to comply with everything by next June, I think there will be adverse effects. Like an action plan, the Code should be gradually implemented phase by phase, for instance, up to this point by next June, up to this point by 2016, etc.

In fact, a famous proxy adviser named ISS [Institutional Shareholder Services Inc.] has recently released a public consultation document on advisory standards for proxy voting, and therein stated that the requirement for electing at least 2 outside directors is effective from the AGMs in 2016 instead of 2015. If we force the companies to comply with everything by next June or the timing of next general shareholders' meetings, as other members mentioned earlier, the companies may elect unqualified independent officers who do not contribute to corporate governance. It would be better to show a plan for the phased implementation.

That's all. I apologize for talking so much.

[Ikeo, chairman] We have little time left. We covered all items [in the OECD Principles] by now. As written at the bottom of the last page, page 10, of Material 1, are there any supplementary comments or points of further consideration, although time is limited? In addition, the secretariat introduced opinions of the Council for Industrial Competitiveness as summarized in Material 4. We cannot ignore them. Does anyone have suggestions as to how we respond to them? Let me repeat. Does anybody want to make any supplementary comments or points of further consideration, or respond to the opinion of the Council for Industrial Competitiveness shown in Material 4?

Okay, Mr. Uchida, please go ahead.

[Uchida, member] I'd like to make a comment on cross-shareholding, because this was my homework, and because the Council for Industrial Competitiveness made a comment about it.

In the US and the UK, shares of the companies are mostly held by institutional investors and other outsiders, accounting for more than 90% of the total shares. Accordingly, the companies are subject to strong pressures from institutional investors. Some foreign institutional investors take a long-term investment strategy, but the range of their holding periods is 3 to 5 years. Mr. Callon said he was going to meet with longer-term investors, but most of them usually hold shares only for 3 to 5 years. In general, we should consider that foreign institutional investors pursue short-term return on investments. It hampers the corporate management from the long-term perspective. Accordingly, especially in the US and the UK, the companies are increasingly going private. According to the date, between 1996 and 2012, I hear that the number of listed companies decreased by 38% in the US, and by 48% in the UK, representing only a half.

Foreign investors are concerned that cross-shareholding may dilute their influence. However, we should carefully consider whether it is really desirable to deprive cross-shareholders of voting rights and increase pressures from institutional investors to the same level as the US and the UK. Such an initiative would facilitate a shift toward short-term market, short-term investments, and going private, thus we need to consider it carefully.

When we discussed the issue of cross-shareholding in the third Council, I said that I would talk with various companies and provide feedback to you. I talked with more than 20 leading companies in Japan, mostly JPX400 companies. Let me share my findings with you.

First, the companies generally perceive that holding equities of their business partner is a meaningful business approach in terms of obtaining information and nurturing a trust relationship. So many companies are very uncomfortable with the blanket denial of cross-shareholding. I was even surprised by their unexpectedly strong opposition.

Shareholding for "policy" reasons is that companies hold shares of business partners for purposes of establishing/strengthening a long-term stable relationship with the business partner as well as facilitating/reinforcing a business alliance or joint venture toward medium to long-term corporate growth, upon making an individual business judgment from the viewpoint of increasing medium to long-term corporate value. What we call cross-shareholding is the case where a company holds shares of its business partner for policy reasons, and the business partner also holds shares of the company for policy reasons, and thus they have cross-ownership. If the Code limited shareholding by companies only for certain purposes, it would reduce options for corporate initiatives for strengthening their competitiveness: this is their concern.

It was also pointed out that such companies with shareholding do not clearly explain whether they can secure return proportionate to such risks as stock price movement. However, the purposes and significance of shareholding for policy reasons are related to company secret concerning individual business/project, so it is not appropriate to demand disclosure of specific details of each shareholding. Besides, many companies voiced an opinion that when companies engage in various investment activities, it seems unbalanced that only such stock investment is subject to the explanation of risk and return. As far as I heard, even among institutional investors, because investee companies vary in terms of business conditions,shareholding is not a decisive factor in their investment decisions,and it is not appropriate to require uniform explanation as to shareholding. Thus,theysaid that it should be judged case-by-case.

In the first place, in the background of criticizing cross-shareholding or holding shares for policy reasons, there would be a stereotypical view that cross-shareholders unconditionally vote in the affirmative on all proposals without considering the corporate value enhancement or medium to long-term growth at all. In reality, many companies exercise their voting rights to enhance not only their own corporate value, but also corporate value of the investee companies. By responsibly exercising their voting rights, they are trying to fulfill their responsibilities to their own shareholders, I think.

Shareholding for policy reasons is based on the premise that companies generally hold shares for the purposes of achieving sustainable growth of their own companies and investee companies, increasing earnings and establishing Win-Win relationships. Therefore, the shareholders could exercise their voting rights, from the viewpoint of increasing medium to long-term corporate value of the investee companies. Considering the current problem of the shift toward short-term investments, I think we should rather regard them as desirable shareholders. Some argue that we should restrict the exercise of voting rights of the shares held for policy reasons and cross-shareholding. However, it may rather cause damage to

corporate value. If they really want to restrict it, I think it is an issue of the Companies Act.

Nonetheless, I think that disclosure of basic thought on shareholding for poicy reasons and policies for exercising their voting rights is a way to obtain understanding of shareholders and investors. Some companies disagreed with such disclosure, especially the disclosure of the policy for exercising their voting rights. Yet I think we could consider such a direction.

That's all.

[Ikeo, chairman] Okay, please make it short.

[Toyama, member] As this is a rare occasion where I have the same conclusion as Mr. Uchida, I'd like to briefly make a comment on the first point.

I think, essentially, his last point is rather important in this discussion. If cross-shareholders exercise their voting rights in an irresponsible manner, such cross-shareholding will not achieve the original purposes. If cross-shareholders find the management of the investee company is not doing well, they should openly and squarely say "No" to them at the general shareholder meetings. I also think this is a critical point, and the essential solution should be that Code provides guidance on this point.

I think the second point is also important, but it should be an issue to be solved by the market discipline through disclosure.

The third point is also significant, but it is an issue of industry structure. From the perspective of corporate governance, or from the perspective of ROE or earning power, as a result of well-functioning corporate governance, companies should in effect be able to do business efficiently. This is as it should be. So, I also think we should leave it to the market discipline.

That's all.

[Ikeo, chairman] The time is already up. As usual, if you have any comments which you could not share today due to time constraints, or additional opinions or requests, please send them by e-mail to the secretariat. Your comments are always welcome. Please do submit your opinions.

Now I close the discussion. We have successfully gone through all items described in the OECD Principles. From the next meeting, we will move on to in-depth discussions or further consideration of points raised. Thank you in advance for your cooperation.

Finally, I'd like to ask the secretariat to make any necessary announcements.

[Yufu, Director of the Corporate Accounting and Disclosure Division] The next Council is tentatively scheduled to begin at 10:00 on Wednesday, 12 November, although the secretariat is still coordinating the schedule. We will inform you of the details later.

[Ikeo, chairman] Thank you very much for your cooperation.

I'm sorry that the meeting was extended by 5 minutes.

END