Minutes of the 6th Council of Experts Concerning the Corporate Governance Code

1. Time and date: 10:00–12:00, November 12 (Wednesday), 2014
2. Place: Financial Services Agency

[Ikeo, chairman] It's already the scheduled opening time. Although Mr. Toyama is not here yet, I think he will be arriving soon. I'd like to open the sixth 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. Based on the past discussions at this Council of Experts, we need to show the basic idea that this Council of Experts has on the Code. Today, for that purpose, the secretariat prepared the springboard of the Code – only a partial draft this time. First, the secretariat will be explaining the springboard, and then we will be discussing it.

Now I'd like to hand it over to the secretariat for the explanation of the springboard.

[Yufu, Director of the Corporate Accounting and Disclosure Division] Okay, I'll be explaining the material in a vertical format at your hand. I will not read it out but just explain the essential points. In the draft Code we distributed, there are several parts with the letter P in a circle, which means "pending at the moment." The first one of such parts is the preamble. In response to the members' convincing opinions that "the preamble is usually written at the final stage," we leave it as pending for today.

Regarding the second half of "Responsibilities of the Board," [i.e., Chapter 4] the members discussed it mainly in the last meeting on October 31. Similarly, the issue of cross-shareholdings was just discussed in the last meeting. So we'd like to have some more time to examine and organize these matters, and therefore leave them pending – blank – this time. We'd like you to discuss the remaining parts today.

Please flip 2 pages [to Chapter 1]. I'll be explaining the overall structure first, using these pages as an example. On the left page, you can see "General Principle" with a bold outline, which shows a fundamental principle. Under the box, you can see a statement under the subhead "Notes". On the right page and thereafter, you can find "Principles" outlined with a thinner line – such as Principle1.1, Principle1.2, and Principle1.3 –, which amplify and expand the General Principle.

In this regard, we organized [different layers of] principles from the perspective that there are additional principles to be described in the Code, although they are not those to be written in the related Principle in a box. We described them in the form of "Supplementary Principles", as appropriate, such as 1.1.1 or 1.1.3 below each box. Furthermore, we added "*[Background]*" in relation to principles where we thought that readers may not understand the background information.

The secretariat prepared this draft Code on the premise that principles in all 3 categories – namely, General Principle, Principle and Supplementary Principle – are

subject to the comply or explain rules.

I assume that members who also participated in the Council for the Stewardship Code are very familiar with it, but let me confirm the general idea regarding the wordings of this Code, as press representatives are here today. This Code is a soft law, and wordings are written on the principle basis.

Therefore, if you look at this document as if you are looking at laws, or ordinances of the government or ministries, you might wonder the definitions of terms used in the Code: for instance, what is the scope of the term "management"? Or what is the scope of the term "minority shareholders"? As this is not a hard law, as a general rule, the Code does not define the scope of these terms. For instance, even though the Stewardship Code is a set of principles for institutional investors, it does not even provide any definition of institutional investors, deliberately.

As this is a soft law, we would like applicable companies to make appropriate judgments regarding the definition of each term, and we believe that such judgments as well as deliberation processes themselves are meaningful. Certainly, there may be cases where some definitions are required, but we basically do not assume that the Code should provide individual definition for each term as in laws and regulations.

Now let me explain the essential parts of the Code from the first page.

Chapter 1 is titled "Respecting the Rights of Shareholders and Ensuring Equal Treatment of Shareholders". This chapter corresponds to Chapter 2 and Chapter 3 of the OECD Principles. While the revision of the OECD Principles is underway, they are actually considering combining these two chapters. Thus, this Code, sort of, goes ahead of the revision.

Please take a look at the General Principle on page 1. Companies should fully respect shareholder rights. Then, skipping a few words, it continues that companies should develop an environment in which shareholders can exercise their rights appropriately and they should secure equal treatment of shareholders effectively. With regard to minority shareholders and foreign shareholders, it is described that given their particular sensitivities, adequate consideration should be given to the issues and concerns of them.

As for the Notes, it states that while companies have various stakeholders, suppliers of capital are an important cornerstone and shareholders are the primary starting point for the corporate governance discipline. Companies are advised to secure appropriate cooperation with suppliers of capital, and work toward sustainable growth.

The idea of the second paragraph is that while companies have legal obligations for treating their shareholders equally in accordance with the class and numbers of shares they hold, if they gain broad confidence by practically ensuring the equal treatment, it will contribute to strengthening support from the suppliers of capital.

On the right page, Principle 1.1 is about respecting shareholders rights, including the right to make a decision at the general shareholder meeting. Supplementary Principle 1.1.1 describes that when the board recognizes that a considerable number of votes have been cast against a proposal by the company, it should analyze the reason and consider whether or what kind of actions should be taken.

1.1.2 is about special rights of shareholders. In the parenthesis, the right to seek an

injunction against illegal activities is quoted as an example. Again, as this is a potential area of concern, companies should give adequate consideration.

1.1.3 and its *[Background]* are written, taking into account the members' opinions that Japanese companies include a broader range of items for resolution at general shareholder meetings than companies in other countries: in case the governance system of the board is adequately constituted, from the perspectives of agile decision-making and expertise in business judgment, it may be desirable if the general shareholder meeting delegates the decision-making to the board within the scope provided in the Companies Act.

I'm moving on to page 3. This page is related to the exercising of rights at the general shareholder meeting, including the improvement of the environment for that purpose. For instance, 1.2.2 describes that the efforts should be made to enable the early sending [of the convening notice], as well as disclosure by electronic means after the decision by the board, and prior to the sending of the convening notice. 1.2.3 is about appropriately setting the meeting date.

As this topic has been intensively discussed by the members of this Council, we summarized the discussion in 4 bullet points in the *[Background]*.

First, the period between shareholder record date and the date of the general shareholder meeting should be as short as possible. Second, it is desirable to allow sufficient time for shareholders to consider and prepare for the general shareholder meeting: the longer the better. Third, on the other hand, for the objective of appropriate accounting audits, it is necessary to secure a certain time for auditing.

In relation to the fourth bullet point, to address these 3 points, as the members have discussed in this council from various viewpoints, companies with fiscal year ending in March could consider holding the general shareholder meeting in July instead of June. However, it is not desirable if the period from the closing date of financial accounts to the date of general shareholder meeting is too long. Subsequently to such points, it is written that when moving toward to delaying the meeting date of general shareholders meeting, there may be a delay in the timing of providing audited financial information. So it would be necessary to note that it would become more important to provide information through earnings releases (*kessan tanshin*) in a timely manner.

Then, the next 3 lines conclude that: taking into account content of public comments on this issue, "as needed" – this is not a must, only on an as-needed basis –, the Council of Experts will continue to discuss whether it is necessary to reflect such comments to the Code. Although it is written as "continue", at any rate, we do not mean that the meetings will continue to be held seamlessly. We assume that we will judge whether or not further discussions are required, as needed. Thus, the *[Background]* is written in this way.

1.2.4 describes that companies should create an infrastructure allowing for electronic voting and promote English translation, considering the number of institutional and foreign shareholders.

Please turn to page 4. 1.2.5 describes that beneficial owners, who hold shares in street name and whom the company identified as beneficial owners, should be allowed to attend [the general shareholder meeting]. Principle1.3 describes that considering that changes in the capital policy of a company have significant effect on shareholders, companies should

establish and disclose their basic principle of mid- to long-term capital policy.

Then, skipping the next pending principle, there is a principle titled anti-takeover measures. It describes measures intended for making an effect of takeover defense. In the last two lines, it is written that the board and *kansayaku* should carefully examine their necessity and rationale, ensure appropriate procedures, and provide sufficient explanation to shareholders.

From page 4 to page 5, as capital policy that may harm shareholder interests, the principle describes about capital policy that may result in significant dilution. Let me introduce only the conclusion: The board and *kansayaku* should ensure appropriate procedures, and provide sufficient explanation to shareholders. The next principle is about related party transactions. Please look at the last 3 lines. They describe that the board should establish appropriate procedures beforehand corresponding to the importance and characteristics of the transaction and disclose them. The principle also notes that these procedures should be used by the board in approving and monitoring such transactions.

Page 6 is the first page of Chapter 2 titled "Cooperation with Stakeholders other than Shareholders". General Principle 2 describes that companies should fully recognize that their sustainable growth and the creation of mid- to long-term corporate value are brought about as a result of the provision of resources and contributions by a range of stakeholders, including employees, customers, business partners, creditors and local communities. As such, companies should endeavor to appropriately cooperate with these stakeholders. Furthermore, it refers to establishing corporate culture where the rights and positions of stakeholders are respected and sound business ethics are ensured.

I'll skip the Notes on page 6. Please turn to page 7. Principle 2.1 describes that companies should draft a code of conduct and ensure its compliance broadly across the organization, including the front line of domestic and global operations.

Principle 2.2 is about so-called sustainability issues. The Principle describes that companies should address these issues appropriately, and the subsequent Supplementary Principle makes two points.

First, taking into account that dealing with sustainability issues is an important element of the risk management for the companies for their reputation and other reasons, which I assume there is no objection, the board should adequately address the issues. This is the first point.

Another point is that recognizing the increasing demand and interest with respect to sustainability issues in recent years, the board should consider developing proactive initiatives, which go beyond risk management. Here, we did not describe it as "should take … initiatives", but described it as "should consider … initiatives", providing a buffer to related corporate actions.

Principle 2.3 describes that companies should promote diversity of personnel, including the active participation of women.

Principle 2.4 is about the establishment of the whistleblowing framework.

Please turn to page 9. Chapter 3 is titled "Ensuring Appropriate Information Disclosure and Transparency".

Please take a look at General Principle 3 on the left page. The first paragraph states that

while ensuring appropriate disclosure in compliance with the relevant laws and regulations as a matter of course, companies should strive to actively provide information beyond that required by law. In doing so, the board should ensure the usefulness of such information, considering that it serves as the basis for constructive dialogue with shareholders.

As for the Notes, in the middle paragraph, it has been noted that while the quantitative part of financial statements of Japanese companies conform to a standard format and therefore excel with respect to comparability, qualitative and non-financial information is often boiler-plate and lacking in detail, therefore less valuable. In this regard, the board should actively disclose valuable and useful information.

On page 10 in the right, Principle 3.1 is about full disclosure. In this box, the items to be disclosed are listed up for the objective of achieving effective corporate governance.

The items to be disclosed are listed from i) to v): business principles, business strategies, mid- to long-term business plans; basic views and guidelines on corporate governance based on each of the principles of the Code; policies and procedures in determining the remuneration; policies and procedures in the appointment and nomination; and (v) reasons for appointing/nominating certain individuals in their proposal to the general shareholder meeting.

3.2 is about external auditors - auditing firms. The external auditor and the company should take necessary actions, upon recognizing the responsibility that they owe toward shareholders and investors. Supplementary Principle 3.2.1 has 6 items.

First, establish the standard for selecting/evaluating an auditing firm. Second, verify whether the auditing firm has independence and expertise. Please turn to page 11. Third, secure adequate time for auditing to ensure high quality audits. Fourth, provide access to CEO and CFO. Fifth, ensure coordination between external auditors and *kansayaku*, and coordination with internal audit department and outside directors. Finally, (vi) is about establishing the system of the company to address the cases where external auditors finds any misconduct or inadequacies.

Page 12 is titled “Responsibilities of the Board” – the latter half of this chapter is still blank.

The General Principle is basically drafted in accordance with the chairman’s summary of the previous two meetings. Given its fiduciary responsibility and accountability to shareholders, in order to promote sustainable growth and the increase of corporate value over the mid- to long-term, and enhance earnings power and capital efficiency, the board should appropriately fulfill its roles and responsibilities, including those listed as (1), (2) and (3).

Following that, three principles to expand the content of (1), (2) and (3) are presented – each in a box.

Let me go back to the remaining part of the General Principle. In any case, regardless of the form of corporate organization, these roles/functions should be appropriately fulfilled.

Please turn to page 13. As I just mentioned, the functions of the board are classified into 3 categories, and written more specifically.

Principle 4.1: The board should view the setting of corporate goals and strategic

direction as one major aspect of its roles and responsibilities. It should engage in constructive discussion with respect to specific business strategies and business plans, and ensure that major operational decisions are based on the company's strategic direction.

4.1.2 reads that the board and senior management should do their best to achieve mid- to long-term business plan. In case the targets included in such plan are not achieved, they should thoroughly analyze the reasons for such failure, provide explanations, and reflect their findings to plan for the subsequent years.

4.1.3 reads that the board should approve and monitor the succession plan in consideration of the corporate goals and business strategy.

4.2 is about the role to support risk-taking. Please look at the second line and thereafter in the box. The board should welcome proposals from the management based on healthy entrepreneurship, conduct a thorough examination of the proposal from various perspectives independently and objectively; and once it approved the proposal, it should support the management to make timely and decisive decisions upon implementing the proposal. The Supplementary Principle below refers to remunerations of the management, concerning a decision on the appropriate proportion of remuneration linked to the mid- to long-term corporate results and so on.

Page 14 shows the third category of the board's functions, which is classified into so-called monitoring and supervision. From the second line, it reads "appropriately evaluate the company performance, and, based on the evaluation, remove a senior management(s) and select a successor(s), if necessary." Below that, it refers to the monitoring of disclosure, and internal control.

Then, Principle 4.4 describes the functions of the *kansayaku* board, which may be regarded as a part of the board. In the box, when *kansayaku* and the *kansayaku* board perform their functions such as auditing the performance of directors' duties, they should make proper decision from the independent and objective standpoint, taking into account their fiduciary responsibilities to shareholders. The important roles to be played by *kansayaku* and the *kansayaku* board include "defensive functions" such as business and accounting audits. Yet in order to fully perform their duties, they should exercise their rights in a positive and proactive manner, and appropriately express their views to the board and the management, instead of making the scope of functions excessively narrow.

The subsequent Supplementary Principle describes the *kansayaku* board based on expanded analysis. Under the Companies Act, not less than half of the *kansayaku* board must be composed of outside *kansayaku* and at least one full-time *kansayaku* must be appointed. Taking these requirements into account, the *kansayaku* board should organically combine strong independence of outside members and high ability to collect information held by a full-time member, and increase its effectiveness. Furthermore, since the *kansayaku* board has such functions, outside directors should make efforts to expand their ability to collect information through cooperation with the *kansayaku* board.

Please take a look at page 16, titled "Dialogue with Shareholders". General Principle 5 states, from the second line, that senior managements and directors - including outside directors - through a dialogue with shareholders, listen to the views of suppliers of capital, try hard to pay due attention to them, as well as clearly explain business policies to

shareholders in an understandable manner, and thereby make efforts to obtain understanding of the shareholders. Having done all these things, they should work for developing a balanced understanding of the positions of shareholders and other stakeholders, and deal with them.

The Notes describe – from the fourth line – that it is extremely beneficial also for companies to have dialogue with shareholders, who are suppliers of capital, on a routine basis, for the purposes of strengthening the foundations of management legitimacy and work toward the corporate growth.

Specifically what is to be done regarding such dialogue is written on the last page – page 17. Principle 5.1 states that if requested by a shareholder for a management meeting, companies should positively respond to the requests within a reasonable extent. Furthermore, the board should develop, approve and disclose policies concerning the measures and structures to promote the dialogue with shareholders.

5.1.1 is about who actually should meet the shareholders. 5.1.2 states that the preannounced policy to promote constructive dialogue should include the following points: (i) appointing a person who is responsible for overseeing and ensuring dialogue; (ii) positive cooperation within the company; (iii) enhancement of IR activities other than individual meetings; and (iv) relaying of views learned from them.

5.1.3 is about the identification of beneficial owner of shares.

Finally, while Principle 3.1 states that companies should develop and disclose their business strategy and mid- to long-term business plan, 5.2 notes that such strategy and/or plan should include mid- to long-term earnings plans and basic principles of capital policy. Furthermore, they should set targets concerning the profitability, capital efficiency, and explain what they actually plan to do to achieve the target in an easy-to-understand manner.

That’s all for my explanation.

[Ikeo, chairman] Thank you very much.

Now I’d like to open a discussion. Today several members are absent due to overseas business trips or other unavoidable reasons, and Mr. Callon and Mr. Mori submitted their memos (opinion papers), which you can find on the table.

The secretariat already sent them to the members yesterday. So as usual, I will not read them out here, but please take these opinion papers into account for the discussion.

I’d like to explain how we proceed with the discussion. If we do not limit the scope at all, the discussion can easily diverge into many different directions. On the other hand, chapter-by-chapter discussion can make it difficult to express opinions which are related to multiple chapters. So I’d like to divide the discussion into 2 parts – the first half and the second half of Material or the springboard.

Specifically, the first half is Chapter 1 and Chapter 2, or up to page 8. The second half is page 9 and thereafter. First, I’d like you to express your opinions concerning the first half of the springboard. You might have comments to cover both parts, but as a general rule, I’d like you to discuss the first half first, and then the second half. I’d appreciate your understanding and cooperation.

Now I’d like to hear your opinions on the first half - Chapter 1 and Chapter 2. Who would like to start? Ms. Nakamura, please go ahead.

[Nakamura, member] I'm Nakamura. I'd like to share my opinion on *[Background]* on page 3, from the viewpoint of corporate practice.

First, the draft describes that it is desirable to make the period from the shareholder record date and the general shareholder meeting as short as possible, but there is a difference in the legal structures between the UK and Japan. In Japan, the company should dispatch the convocation notice and related documents to those who are identified as the shareholders on the shareholders' register as of the shareholder record date, or there is possibility of defects in the procedure and of lawsuit for voiding a resolution.

Given that is the case, taking our company as an example, we receive information of shareholders as of the shareholder record date from the administrator of the shareholders' register approximately 20 days after the shareholder record date. Based on this information, we enclose the documents for the general shareholder meeting in the envelopes and dispatch to about 100 thousands of shareholders. So I think the practically fastest date of the end of the process will be more than a month after the shareholder record date.

I understand that further considerations will be made in response to public comments, etc. in the future. I'd like to request you to keep this point in mind, when compiling public comments. This is my first point.

My second point is going into the details. Although the draft states the date of the general shareholder meeting is in July, it is applicable only to the companies with fiscal year-ends in March. So I think it is not necessarily July.

Including this point, as I already mentioned before, it has been a common practice to set the shareholder record date on the account closing date to hold the general shareholder meeting within 3 months from both the account closing date and the shareholder record date. And the companies undergo an audit on the assumption that they will receive a clean opinion, but there is a possibility of receiving an adverse opinion. In the latter case, it is necessary to correct the financial statements and obtain an approval of the general shareholder meeting.

Then, the legal department of the company is concerned whether it is still OK to set the shareholder record date, which is different from the account closing date in this case. Under such a circumstance, for example, if the financial results are not finalized within 3 months, will there be any problem in terms of tax affairs or other? I'd like to request that this issue should be decided upon clarifying various legal considerations.

That's all.

[Ikeo, chairman] Thank you very much.

Any other comments? Mr. Uchida, please go ahead.

[Uchida, member] Concerning the point which Mr. Yufu referred to at the beginning of the explanation, I assume it will be written in Preamble – I'd like to request that the meaning of a soft law will be clearly explained. Similarly, regarding the Comply or Explain approach, I'm afraid that quite a few companies are accustomed to the rule-based approach, and thus cannot properly interpret what it means. So I'd like to request a clarification of it. I see many expressions using "should". There may be cases where shareholders do not understand the Comply or Explain approach, and, therefore, in case a company chooses to explain instead of comply, they may have an impression that the company is escaping from

the rule by providing the explanation. Accordingly, I request that the Code writes about it in Preamble in a clear and easy-to-understand manner.

Furthermore, in Principles, I can see many descriptions regarding the roles of the board. For instance, as for the roles specified in Principle 1.5 or 1.6, in Company with the *kansayaku* Board, I assume that such roles are undertaken by not only the board, but also the *kansayaku* board. Therefore, in addition to stipulating that the board plays such roles, I'd like to request to review this point, although I have not thoroughly read the entire Companies Act and I'm not sure which provisions are applicable. These are the comments on general matters.

Concerning particular matters, on page 4, it is written that when an individual is confirmed to be a beneficial owner, his/her attendance should be permitted. Many companies are concerned about such a stipulation on a practical level. They expressed their concerns that there is no definite procedure to confirm whether or not an individual is a beneficial owner, and, therefore, it may cause confusion at the general shareholder meeting on a practical level. For instance, companies could confirm it by a letter of proxy issued by a trust company. But this is an expedient method. We hesitate to judge that this method is strictly acceptable. From the viewpoint of companies, they express their frank opinion that institutional investors who hold their shares for a mid- to long- term should change the ownership of the shares, and that will make it a lot easier for the companies to deal with them. The reason for their concern is that if an individual who is not a shareholder participates in the resolution, strictly speaking, it may constitute the event of rescission of the resolution. Accordingly, companies are strictly checking at the entrance whether participants are shareholders who have voting rights at the general shareholder meeting. Unless the check procedure is established to a certain degree, taking this point into account, the companies will be exposed to risks. Therefore, they request a careful consideration.

That's all.

[Ikeo, chairman] Thank you very much.

Mr. Takei, please go ahead.

[Takei, member] Thank you. First, I'd like to ask a question about 1.1.2. I think the draft refers to minority shareholders, as they are stipulated in the OECD Principles. In Japan, when you say "since the exercise of these rights tends to be prone to issues and concerns, adequate consideration should be given," specifically what kind of cases do you have in mind? Please show some examples.

[Yufu, Director of the Corporate Accounting and Disclosure Division] I'm not sure if it is appropriate to specify the cases. Nonetheless, we sometimes hear that in relation with proxy fights, when [minority shareholders] request access to the shareholders' register – of course, they have such a right under the Companies Act –, companies do not respond quickly or do not disclose the register. As a consequence, such shareholders have to attend the general shareholder meeting before their requests are fulfilled. We heard that such cases actually happened.

However, we did not draft this principle specifically bearing such cases in mind. Instead, we wrote companies should pay careful attention in general terms.

[Takei, member] Thank you very much. I understand that what 1.1.2 mentions is not

beyond the framework of the Companies Act.

I'd like to make a comment on 1.2.5, which Mr. Uchida also referred to earlier. It's about whether or not it is appropriate to allow the participation to the general shareholder meeting only in case the companies can confirm persons in question are beneficial owners. When you use the term "attend" in the phrase "attend the general shareholder meeting", it legally means that such individuals are included in the number of attending shareholders and may exercise their voting rights. In practice, there are cases where individuals just observe the general shareholder meeting without asking any questions or voting. However, when it is written "attend" in the draft, I assume that institutional investors do not just sit in the meeting, but may exercise their voting rights.

As Mr. Uchida mentioned earlier, if they exercise their voting rights, there will be confusion if such investors already exercised their voting rights: unless voting rights of nominees on the shareholders' register are eliminated, there may be duplicate exercise of the voting rights. To avoid such a situation, I'd like to suggest that the phrase "whom the company identified as beneficial owners" should be changed to "whom the company identified as shareholders who can exercise their voting right at the general shareholder meeting." This is just one idea.

Alternatively, if it is difficult to state flatly "should allow", we could write that in preparation for cases where institutional investors who hold the shares in street name express an interest of their attendance, the companies should consider the criteria for permitting their attendance. This is another idea.

Unless the companies decide on their response to such a request in advance, given the legal nature of the general shareholder meeting, there will be confusion. Concerning the expression of 1.2.5, I think there would be various options, including "at least make arrangements concerning how to respond the request", or "only in case the companies can confirm they can exercise voting rights".

My next point is concerning Chapter 2 titled "Smooth Cooperation with Stakeholders other than Shareholders". This chapter contains important messages to be shared widely. However, speaking of my impression, the Principles concerning "Smooth Cooperation with Stakeholders other than Shareholders" start from the discussion on the code of conduct, followed by sustainability and diversity, and thus give an impression that the Principles are focusing on 'defensive governance', as the code of conduct to prevent negative consequences is written first. Before the current Principle 2.1, I think it would be better to have a principle to encourage them to formulate their business principles which serve as the basis for increasing mid- to long-term corporate value. Principle 2.1 facilitates an increase in such positive approach first, and then Principle 2.2 refers to the code of conduct. In this way, I think the Code would contribute more to 'growth-oriented governance' or an increase in mid- to long-term corporate value.

As for the example of statement, for instance, we could state "companies should realize their roles in the society, and formulate their business principles concerning how they work with stakeholders and create corporate value as the basis for activities to enhance mid- to long-term corporate value." First, we call for the formulation of the business principles, and then write particular matters such as the code of conduct. I think this is smoother.

Concerning Chapter 2, I'd like to refer to 2.4 Whistleblowing. Whether or not this should be written as a principle will be judged later, but if the Code includes it, I wonder if Chapter 2 is the right place for it. Probably because it constitutes information gathering from employees, it is written in 2.4, I suppose. Yet I think this Chapter 2 broadly talks about respecting interests of various stakeholders, especially employees. A principle to the effect that the companies should consider employees' interests is the principle concerning whistleblowing? I had a strange impression.

I think that whistleblowing better fits in Chapter 4 concerning the effectiveness of the board, which is still pending at the moment. I think it would be better to put it there as a specific discussion of internal control.

That's all.

[Ikeo, chairman] Thank you very much.

Mr. Oguchi, please.

[Oguchi, member] Thank you very much. Since we have been discussing 1.2.5 concerning beneficial owners' attendance to the general shareholder meeting, I'd like to talk about it, or offer information from the standpoint of a beneficial owner.

Usually, institutional investors who hold shares in the name of a trust bank receive information via the trust bank through proxy voting, and vote by using an electronic voting platform as written in 1.2.4. They are fully aware that they are exercising their voting rights and know the number of their voting rights.

It was mentioned earlier that they are invisible to the companies. I think it means the companies can't see parties behind the trust banks. If we try to write it to narrow down the parties behind the trust banks, it will be like this: in case an institutional investor, who holds shares in the name of a trust bank and usually exercises its proxy voting, wants to exercise their voting rights physically at the general shareholder meeting instead of proxy voting, it should be permitted.

Regarding specifically how to identify beneficial owners, I think that trust banks would be the key. This is because those trust banks know who exercises proxy voting. However, in reality, I think information of the beneficial owners is not disclosed in order to assure anonymity. So if beneficial owners who received information from the nominee shareholders can use something like a printout of the screen to prove that they exercise proxy voting, I think it will be practically feasible. In case of global electronic voting platforms such as Broadridge, the system allows such cases where they do not cast their proxy votes and inform the system of the fact, their names are excluded from the proxy system and they can vote at the general shareholder meeting. I have asked specifically how we could do that, but no specific answer was given. I assume that although there is a system, actually it does not really work.

I went into details. My point is that if those who exercise proxy voting inform them of such a fact, although it incurs administrative burden, they will be able to vote physically at the general shareholder meeting.

Next, I'd like to refer to changes of ownership from the current nominee to the institutional investors, as discussed earlier. Those institutional investors hold shares in the name of a trust bank because they are engaged in diversified investments: they own a great

variety of shares, and thus hold different shares in the name of a trust bank for the reason of efficiency. They do not hold shares in their names unless they own a significant number of shares, for example, like hedge funds that use prime brokers and individually hold shares. The point here is establishing the mechanism to allow institutional investors, who engage in long-term, diversified investment and usually exercise proxy voting, to vote at the general shareholder meeting upon their requests. I'd like to request to rewrite 1.2.5, taking it into account.

That's all.

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

[Toyama, member] Related to what was just discussed, I have experienced extremely active general shareholder meetings many times. Such companies were under a rehabilitation process, and shareholders were wondering what would happen. Such a situation is crucial, and thus the general shareholder meetings were active. Indeed, it was hard just to constitute a quorum, because of rapid changes of shareholders.

In that sense, I think it is essential to figure out a workable mechanism under such a circumstance, as the members discussed earlier. Ultimately, if the general shareholder meeting is cancelled for lack of a quorum, it will cause trouble to shareholders who were serious about voting. At any rate, rather than speaking from the standpoint of A or B, or shareholders, I think it is critical to consider a workable mechanism.

Mr. Uchida referred to Comply or Explain in connection with General Principles earlier. I also think it is better to have a mechanism for clear explanations, as this is a soft law after all.

On the other hand, if a superficial per the template explanation is provided, 'Explain' will be meaningless. It is essential to specifically explain why they chose not to comply, and what they do instead under what situation. It should be case by case. They cannot explain it by inserting data into a template prepared by someone. If they can do so, the Code doesn't work as a soft law at all. While securing the flexibility of explanations, we should require them to make a specific explanation of each case. They should explain why they adopted a different way in line with a particular situation, or that considering the current situation, they should explain why a certain way is better for the long-term, sustainable growth of corporate value.

As I mentioned in the last meeting, if the top management of a company cannot provide an explanation in this way, I would say the company should delist and go private. I really think so. I believe the top management should be served by people who are capable of management to this level. I think this is an essential point.

That's all.

[Ikeo, chairman] Thank you very much.

Professor Kanda, please go ahead.

[Kanda, member] Thank you very much. As the secretariat explained this is a soft law, maybe I should not go into too many details, but let me make some comments as this is a good opportunity, although there are several things I'm not sure about.

I think Chapter 1 is an important part, but in the title, the word "respect" as in "respecting shareholders' rights" seems a little too weak.

Next point is concerning Principle1.1. This is the first Principle, which draws readers' attention. I'm afraid three Supplementary Principles are not appropriate for supporting Principle1.1, although I'm not saying what is written there is wrong.

Principle 1.1 states that listed companies should fully respect shareholders' rights, "including the right to make a decision at the general shareholder meeting". Although I think the word "respect" is too weak, that is another story. What is the right to make a decision at the general shareholder meeting? If it means the voting right, I think it is better to write "voting right". Or if it includes the shareholders' right to make a proposal as well, it should be written in an understandable way.

In this connection, I think the order of these Supplementary Principles should be 1, 3, 2, although it depends on what 1.1.2 actually means, as discussed earlier.

Especially 1 and 3 may be rather supplementing the next Principle1.2. At this point, I cannot make a suggestion with confidence, but I'd like to request the secretariat to review them.

Next, under Principle1.2, the expression "information pertaining to the general shareholder meeting" in Supplementary Principle1.2.1 is a little confusing. Does it mean information about the general shareholder meeting itself, or various information which helps shareholders appropriately exercise their voting rights at the general shareholder meeting? I assume it should be the latter, judging from the following Supplementary Principles.

I'm not sure if it is appropriate to talk about this at the moment, but the draft frequently uses the word "etc." [*Translator's note: The member refers to Japanese word "tou", which means "etc." Please note that it is not always translated as "etc." in the English version.*] such as "providing accurate information, etc." in Supplementary Principle 1.2.3. Besides, in the latter half of the springboard, "etc." is used even in Principles.

The Japanese word "*tou*" is difficult to translate into English. In laws, it is usually translated as "etc." In case it is used in a sentence using "such as", it is okay. However, there are some cases where it cannot be properly translated into English – I'll be referring to it in connection with a Principle in the latter half – therefore, personally, I'd like to request non-use of "etc." If it is not necessarily to use "etc.", you should not use it in the Japanese version.

I'll be referring to trust banks later. First, I'd like to refer to particular wording first. The Japanese draft uses the word "*tougai*" [*Translator's note: Japanese word equivalent to "such" or "the said"*] in many places, although it does not cause any problem of translation. For instance, it is used in 1.7 on page 5.

The term is frequently used by lawyers. It's a familiar word for them. But it is not used in daily conversation. I am aware that the Stewardship Code also uses this word, and personally, I don't mind the use itself, but it would be better if the term was used less frequently. Considering this is a soft law, I think we do not have to use this term unless it is absolutely necessary.

I'm sorry for taking a long time, but I'd like to make a comment on the title of Chapter 2. It is somehow related to what Mr. Takei said. I'm wondering if we could find a better Japanese title, replacing the expression "smooth cooperation".

Furthermore, I'd like to point out a problem with the spelling: two different spellings "*surubeki*" and "*subeki*" [*Translator's note: Japanese word equivalent to "should"*] are used in the last part of General Principle 2 and page 7. I think it would be better if either one was consistently used.

That's all for my comments on particular wording. Now let me make a comment on the issue involving trust banks, which other members discussed.

As for 1.2.5, I think it would be better to consider the practical aspect and then rewrite the statement.

What is written here is that, for example, when trust bank A is recorded as a shareholder on the shareholders' register, beneficial owners B, C and D, who are institutional investors, would like to exercise voting rights as shareholders.

Let's look at the essence of the matter. Probably this is what Mr. Oguchi said. From the viewpoint of B who is an institutional investor, B is the shareholder, and trust bank A exercises shareholders' rights by proxy. However, legally, it is the other way around.

When A is a nominee shareholder on the shareholders' register, it is not impossible for companies to allow B, whose name is not on the register, to vote. The Companies Act does not prohibit the exercise of voting rights by those who are not recorded on the shareholders' register. However, for that purpose, unless the company can confirm that B holds the shares and A does not hold the shares, the company cannot do so. The Companies Act provides such rules in detail.

I think this would be the same in the US and other countries. Considering on the premise of the current book-entry transfer system for shares, in case the shareholder record date is March 31, the companies are notified concurrently of those who are registered on the book-entry account as of March 31 via General Shareholders Notification. In accordance with it, the shareholders' register is updated. Suppose that A is recorded on the shareholders' register concerning certain share of a company, and A is a trust bank.

Then how should we interpret what is written here [1.2.5]? In my understanding, when B tells the company that B is the beneficial owner and thus wants to attend the general shareholder meeting, it is very challenging to the company that B should be treated as a shareholder under the current legal system. The situation is the same in the US.

So, although this is somehow like the reversal of roles, legally, B could attend the general shareholder meeting as a proxy of A and exercise proxy voting there. This is a practically possible solution.

However, I don't think it is appropriate to discuss it here in too much detail. I'd like to request that this issue be reviewed by practitioners in this area, and then stipulated in an accurate and understandable manner, as the underlying idea of this supplementary principle is fine.

I apologize for taking a long time. That's all.

[Ikeo, chairman] Thank you very much.

Are there any other opinions concerning the first half of the draft?

Then, I'd like to solicit opinions concerning the second half of the draft. You can discuss the first half, if you like.

If you have any opinions or comments on Chapter 3 and thereafter of the current

springboard, please speak up now.

Mr. Ota, please go ahead.

[Ota, member] I'd like to make 5 points.

The first point is about Principle 3.1 on page 10, concerning full disclosure. This may be related to Mr. Uchida's comments. My point is that it should be written more accurately.

Especially, I'm concerned about (iii), (iv) and (v), for instance. Selection of directors and *kansayaku* or determination of remunerations – these are, without doubt, matters for the resolution by the general shareholder meeting. The problem here is a description concerning determination of remunerations for *kansayaku*. As you know, the independence of *kansayaku* is secured by Article 387 [of the Companies Act]. And nomination of *kansayaku* is subject to the consent right under Article 343.

Considering such a structure, even though those matters are decided by the resolution of the general shareholder meeting, the expressions in the springboard give an impression that all of them are decided by the board. Therefore, I think these expressions should be reviewed in order to make them adequate. This is my first point.

The second point is about Principle 3.2. It is concerning external auditors. There may be some overlaps with Mr. Mori's opinion. The Companies Act, which was revised in June this year, stipulates that the authority to decide candidates for external auditors – more accurately, the authority to make such a proposal – is transferred to the *kansayaku* board. Accordingly, I'm not comfortable with the expression in the draft, which states that board, which is not responsible for the matter, appropriately selects a candidate for the external auditor and establishes the criteria for evaluation.

What is important or required here is that in order for the *kansayaku* board to properly exercise its decision-making authority, executives including the board should provide information to and appropriately cooperate with the *kansayaku* board. I think such a description better suits the intention of the law, and will align with the Ordinance for Enforcement which are being established.

The third point is concerning General Principle 4 on page 13. Page 12 is still pending and general statement. This may be linked with what Mr. Uchida said earlier. It is about coordination between or division of functions of the board and the *kansayaku* board, or how cooperation should be arranged. As Mr. Oguchi mentioned earlier, under the Companies Act, all 3 corporate organization are of equal value. It is inarguable. However, although this is a repetition, 98% of the companies listed on the TSE currently adopt Company with *Kansayaku* Board system. This is the actual situation concerning corporate governance in Japan. I think this should be described accurately. Then I think [General Principle 4] will be described differently.

When we state responsibilities of the Japanese-style board in the pending part on page 12, we should clearly describe that under the corporate governance system in Japan, the Supervisory Board corresponds to the board and *kansayaku* board, and these two boards work together and fulfill the responsibilities of Supervisory Board. Then I think it will be very clear.

I'd like to request you to consider whether these two points should be written on page 12 and thereafter or somewhere else. In case of the latter, probably you could write in

Preamble that corporate governance in Japan takes root in that way.

The fourth point is concerning Supplementary Principle 4.4.1 on page 14. I'd like to thank the secretariat for reflecting what we have discussed here to the draft accurately. However, I do not like the way 4.4.1 is stated. The first 4 lines are okay. I mean the sentence beginning from "the *kansayaku* board" and referring to "organically combine …with high ability to collect information …to increase its effectiveness." The problem is the next 4 lines.

The sentence begins with "outside directors". Although the subject is outside directors, considering this is the supplementary principle concerning the *kansayaku* board, it would better fit on this page if you changed the subject by stating "the *kansayaku* board should cooperate with outside directors, and fulfill its responsibilities as non-*shikkoyaku*"

The fifth and last point is concerning 4.4.2… Although it is pending at the moment, I think 4.4.2 is to be added. It seems like that to me. As Mr. Mori also pointed out, I'd like to request to add another item concerning the establishment of audit environment.

Especially, the issue of having sufficient employees as assistant to auditors would be essential for increasing the effectiveness of day-to-day audit activities. Besides, I'd like to request that the pending part on page 15 includes the necessity of cooperation and information sharing among so-called three parties in audit – accounting auditor or the internal audit department.

These 5 points are what I wanted to say.

[Ikeo, chairman] Thank you very much.

Okay, Mr. Horie, please go ahead.

[Horie, member] I'd like to comment on descriptions of outside directors, relating to Mr. Ota's opinion. I'm aware that there are differences in the roles of outside directors between Company with *Kansayaku* Board which is mainly based on the Managing Board model, and Company with Three Committees based on the monitoring model. And I think we should require the companies to clearly explain the roles of outside directors externally.

Upon explaining the roles of outside directors externally, outside directors, as a matter of course, understand the expected roles and fulfill their duties, so it is essential that the Code clearly stipulates the roles of outside directors. As Mr. Oba also mentioned, speaking from the viewpoint of shareholders, to ensure that outside directors speak for shareholders at the board or the *kansayaku* board based on their opinions, it is necessary to clarify who the contact person is.

While there are various roles of outside directors, one of the important roles is to have dialogue with stakeholders in the capacity of representative of external stakeholders including shareholders. Furthermore, they also have the role to accept requests from shareholders and provide feedback from the shareholders and others to the board, as pointed out by many members of this Council. I'd like to request that the Code somehow stipulates these points.

That's all for now.

[Ikeo, chairman] Professor Kanda.

[Kanda, member] Thank you very much. I'd like to share my findings regarding page 9 and thereafter.

I'm sorry that I have to point out problems with the wording, as I mentioned earlier. Regarding General Principle 3 on page 9, it states "laws, etc." in the second line, and "shareholders, etc." in the fourth line. These expressions are awkward when they are translated into English. I don't think these two parts require "etc." I'd like you to review these parts.

There are the same wording problems on page 10, although I'm not pointing out all of them due to time constraint. In 3.2 titled External Auditors, the wording "shareholders, etc." is used, and we cannot omit what that "etc." refers to. However, when it is translated into English, as we cannot express it by using "such as", probably it will be translated as "shareholders and other investors". I'd like to request to consider whether it should be rephrased as either "shareholders and other investors" or "investors". At any rate, I think it is better to avoid using "etc."

I'm moving on to page 12. The title uses the wording "the Board, etc." [*Translator's note: This is a literal translation of the Japanese title. It is translated as "the Board" in the English draft.*] The English title should not be translated as "The Responsibilities of the Board, etc." Then there would be two options – either "The Responsibilities of the Board and the *Kansayaku* Board" or simply "The Responsibilities of the Board" while the corresponding principles refer to the *kansayaku* board as well.

Next one is General Principle 4. It may be acceptable because this is a soft law, but I'm concerned about it in connection with the current system. (3) of Principle 4 refers to "the management/directors". Yet there are some companies which have *shikkoyaku*. So we should consider whether *shikkoyaku* should be included in this part.

Similarly, in the parenthesis at the bottom of Principle 4, referring to Company with *Kansayaku* Board, it states "a part of their roles/functions is assumed by the *kansayaku* board." This is related to the other part thereafter: there is an issue whether it should be the *kansayaku* board or *kansayaku*. *Kansayaku* system is an independent system, where each *kansayaku* acts on his/her own, although he/she also assumes duties of the *kansayaku* board. So we need to consider how to write this part. It could also be written as "*kansayaku* and the *kansayaku* board". This wording is also used in 4.4, which I'll refer to later.

Now I'm moving to page 13, Principle 4.1 and thereafter. I think the title "functions of the board" is too weak, not appropriate. I think the title should be "responsibilities of …" Although this is just my assumption, the title should be written as "roles" or "responsibilities" of the board. I'm sorry that I cannot think of a good idea for the replacement, but I think the term "functions" is too weak.

As for "business principles, etc." in the first line, this is okay to use "etc." because the phrase "such as" can be used here when translating into English.

As for the statement of Principle 4.1, considering what we have discussed so far, I think it should be written as "in case of making a decision on the execution of important operations" instead of "upon making a decision on the execution of important operations."

Many of Japanese companies make decisions on important operations. So the statement reflects the actual situations. However, this is applicable only to so-called Management Board. If they delegate decision-making on the execution of impotent operations to another organ, it does not apply to them. 4.2 and 4.3 are about monitoring, and thus there is no

problem. Consequently, considering the actual situation, I won't say the expression "upon" is wrong, but "in case of" should be logically better.

Concerning 4.4, I'd like to request to reconsider the wording "*kansayaku* (board)". Although this is okay in the Japanese version, but it is preferable to find a better wording in the Japanese language, which can be smoothly translated into English.

Finally, on page 16, in the third line of General Principle 5, it is written as "dialogue, etc." I don't think "etc." is necessary here.

Furthermore, while 3 terms – "suppliers of capital", "shareholders" and "stakeholders including shareholders" – are used, "suppliers of capital" is not an easy term to understand. In the Notes, it is referred to as "equity holders (suppliers of capital)". If the "suppliers of capital" means equity holders here, I think General Principles 5 could use the term "shareholders" instead of "suppliers of capital". Or if the term broadly means capital suppliers, including bondholders, it should be written accordingly. Yet "shareholders" would be the right word here.

My next point is about Supplementary Principle 5.1.3 on page 17. This is about dialogue with beneficial owners, not the exercise of their voting rights which I've mentioned before. It should be written in a way the readers can understand it. I think this is not so complicated, compared to the exercise of voting rights. I'd like to request that this be written in an easy-to-understand manner.

That's all.

[Ikeo, chairman] Thank you very much.

Mr. Uchida, please go ahead.

[Uchida, member] I received some opinions from several companies, so I'd like to share them with you and make some comments including some minor details.

The first point is about Principle 3.1 concerning full disclosure on page 10. Some companies expressed their comments that it may not be necessary to disclose reasons for individual nomination as written in (v), when they disclose the policies and procedures according to (iv).

Next, in Supplementary Principle 4.1.2 on page 13, it states that a mid- to long-term business plan constitutes a commitment to shareholders. As for a medium-term business plan, many companies disclose the plans, which may constitute their commitments to a certain extent. However, as for a long-term business plan, for example, plan for 10 years, I doubt if the companies can make a commitment. They have strategies, policies, visions or targets. However, if they are required to anticipate changes in the business environment over 10 years and make a commitment to numerical targets, I feel it is too demanding.

There is another point to make concerning 4.1.3 on page 13. It refers to the approval of the succession plan. If the purpose of this statement is to ensure transparency, some companies consider that it would be sufficient to just show their approaches.

Still on page 13, Principle 4.2 states that the board should "recognize that establishing the environment which supports risk-taking (ensuring accountability) as one of its main roles." Some companies pointed out this explanation is difficult to understand. I'd like to request an additional explanation.

The next point is about Principle 4.4 Functions of the *kansayaku* Board on page 14. In

the second paragraph, it states "include 'defensive functions'" and "to fully perform such functions". I got an impression that they are restricted to defensive functions. I think "to fully perform such functions" can be deleted. Or alternatively, it can be rephrased as "to fully perform *kansayaku*'s functions" without emphasizing defensive functions.

As for the shareholders' request for dialogue on page 17, as we discussed at this Council, in case there is a flood of requests for dialogue from various shareholders, the companies will face a problem – to what extent they should fulfill such requests. Their burden is likely to increase. So I think something like a floodgate is required. Mr. Callon presented an excellent suggestion for the wording in his opinion paper. I support his suggestion.

Finally, at the bottom of page 17, 5.1.3 states companies should try to identify beneficial owners. Individual companies are making efforts to identify them by using consulting firms. While the consulting firms are undertaking the investigation probably through receiving information from trust banks or individual funds, the reality is that we are not sure how accurate the figures which they get. In fact, while we engage in IR activities, there were cases where an entity which we did not deem to be our shareholder actually owned the share of our company. Despite all the efforts, we are not sure how accurately we identify the ownership. This is the reality. Therefore, if the companies "should try to identify", institutional investors' cooperation is necessary. I got an impression that it should be stated in a stronger expression than "expected to cooperate to the maximum extent possible."

That's all.

[Ikeo, chairman] Thank you very much.

Mr. Toyama, please go ahead.

[Toyama, member] My opinion is not so different from other members. With regard to Mr. Ota's comment, there are 3 types of corporate organization in Japan in actual practice, and it is true that most companies are Companies with *Kansayaku* Board. All the companies in which I have served as officer, director or *kansayaku* are Companies with *Kansayaku* Board.

However, the important point here is that among Companies with *Kansayaku* Board, the companies which demonstrate good governance are generally making significant efforts. The fact that they have established good practices through Japanese-style kaizen (improvement) efforts is probably an essential point. The point is that good governance prevails regardless of corporate organization.

In the meantime, in Japan, these 3 types of corporate organizations were approved by the Diet, which is the highest organ of state power, meaning that these 3 options are of equal value from the perspective of the state. There is no order of superiority or inferiority.

Accordingly, if the Preamble refers to the corporate organization, they should be treated equally. While there are 3 types of corporate organizations, it can be assumed that each company adopts one of these 3 designs and should do the right thing accordingly. Therefore, picking up only one design is not right, because – let me repeat – all these 3 designs are stipulated in the law approved by the Diet, which is the highest organ of state power. This is my first point. If corporate organizations are stated in the Preamble, all 3

should be stated.

Another point is concerning the last General Principle 5. With regard to 5.1 about dialogue with shareholders, considering this is broadly applicable to more than 3,000 listed companies, I assume from my experience that some top management or IR personnel have not had or are not familiar with dialogue with individual shareholders.

What struck me sometimes during such dialogue is some companies provide information, which may constitute insider information. Because the Japanese people tend to show a spirit of good service, they good-naturedly disclose what they should not disclose. The point is there is a certain kind of over-disclosure risk.

There is no doubt about the importance of dialogue. However, dialogue with individual shareholders is different from communication with general shareholders. Therefore, the companies should pay attention to the principle of equal treatment of shareholders, or insider information provisions. I do support Principle 5.1. However, I think the Code should call attention to these matters at the same time in order to ensure a good balance.

Next, I'd like to make a comment on 5.1.3, which Mr. Uchida referred to earlier. This overlaps with my previous point. At the time of the general shareholder meeting of a certain company, to satisfy the quorum, Mr. Saito, the current president of JPX and I made phone calls to those who we assumed to be the shareholders of this company. We did not ask them whether they actually held the shares, but told them just to exercise their voting rights if they held the shares. We made phone calls to people or entities all over the world.

So, as Mr. Uchida said, there is a heavy burden. Therefore, I think cooperation of institutional investors and trust banks are essential.

I'd like to repeat that this is not about management vs. shareholders. This is also important in terms of protecting the rights of those who are proved to be shareholders and who are going to exercise their voting rights. Shareholders' rights are the rights of common interest. The rights of common interest are not just rights, but also involve obligations for common interest. This is also related to the context of the Stewardship Code in a certain sense, and I believe such responsibilities should be borne by shareholders, institutional investors or relevant trust banks, etc. So I think it should be clearly stipulated in the Code.

That's all.

[Ikeo, chairman] Anybody else? Mr. Takei, please go ahead.

[Takei, member] Thank you. I'd like to make several points.

First, I'd like to make a comment on Chapter 3, not for the purpose of rewriting. I think 3.1 (ii) "Basic views and guidelines on corporate governance" is indeed important. So how companies work on them and how they develop such an approach and policy would draw attention. This is just an impression.

Next, I'd like to discuss several points concerning Chapter 4. The expression "upon making a decision on the execution of important operations" sounds like referring to both Supervisory Board function and Managing Board function. I'm wondering how the board solely performing Supervisory Board function deal with this principle. The current expression may be acceptable as it is, but there would be another option: for example, the part "upon making a decision on the execution of important operations" could be moved to Supplementary Principle, splitting the current sentence into two. However, this is a

wording issue, not a substantive issue.

Next, I'd like to make a couple of comments on 4.2. First, 4.2.1 states "proportion of remuneration linked to mid- to long-term performance". Could you add "proportion of cash remuneration and equity-based remuneration" to this part, if possible? I'd like to request to consider the said addition and refer to both the percentage of the portion linked with mid- to long-term performance, and the proportion of cash remuneration vs. equity-based remuneration.

Actually, this point was also raised by the Council for Industrial Competitiveness. It was written as the second point in the paper summarizing their comments for the last meeting. Equity-based remuneration is certainly an important point now. Concerning officers' remuneration, institutional investors and other stakeholders are more interested in the remuneration mix rather than the amount or level of officers' remuneration as an essential point of consideration. And when we say the remuneration mix, the important mix is not only short-term vs. mid- to long-term, but also cash remuneration vs. equity-based remuneration. Especially, when we say remuneration linked with mid- to long-term performance in the US and Europe, the percentage of equity-based remuneration is much larger. In contrast, in Japan, equity-based remuneration has been rarely discussed. Although it has been some 20 years since the introduction of the stock option system in Japan, no major development has been made. Japan is far behind the US and Europe in this area. Therefore, I hope that the companies at least internally discuss how equity-based and cash remunerations should be. Whether or not to adopt equity-based remuneration is up to each company, but at least I'd like the companies to have internal discussion on it. Therefore, I'd like to request that the Code refers to such mix of cash remuneration and equity-based remuneration.

According to recent research which compared increases in remunerations in Japan and the US when corporate value is increased by the same proportion, the increased amount paid to top management of Japanese listed companies is only 5% of that paid to CEOs in the US. There could be various views on the level of remuneration, but at least in the global competition, can Japanese companies really compete while maintaining the current officer remuneration structure? This is a huge problem. From the perspective that this Code supports mid- to long-term corporate value, in order to facilitate the companies' review concerning whether they should retain the current remuneration structure, merely stating "linked to mid- to long-term results" is not sufficient. So I'd like to request an addition of the percentages of cash remuneration vs. equity-based remuneration. This is my second point.

In this connection, although it's a different issue, in the codes in other countries, for the objective of alignment between interests of senior management/board members and shareholders' interests, or fulfillment of fiduciary responsibility to shareholders, the level (limit) of holding the stocks is stipulated by the codes in some countries. Therefore, for instance, I'd like to ask whether it is possible to add a separate item like 4.2.2 to stipulate that "taking into account fiduciary responsibility to shareholders, to facilitate the corporate growth and increase in mid- to long-term corporate value, the board should consider an appropriate level of the stocks held by senior management and the board members"?

Whether or not they should hold the stocks is of course up to each company. My suggestion is to stipulate that the companies should consider the level of shareholdings as well.

The level of such shareholdings is somewhat related with the mix of cash and equity-based remuneration. So if the level of shareholdings is not established, it is what it is. But I'd like the companies at least to consider it. The codes of other countries normally stipulate it, so from the perspective of the alignment with shareholders' interests, I'd like them to consider it.

Yet another point regarding 4.2 is "establishing the environment which supports appropriate risk-taking". As I said previously, and as other members also mentioned, I'd like to request that the Code refers to indemnification: possible statement would be "the board should consider how indemnification of senior management and the board members should be, to prevent excessive risk aversion in managerial judgments, etc."

Even though senior management appropriately made a managerial judgment, believing it serves the company's interest, a third party may file an action. Then they must bear a significant cost and liability: even if they do not lose the case, the cost of response to the action incurs. Accordingly, they could be inclined to make excessively risk-averse managerial judgments. As far as I understand, the US and Europe have the indemnification in place, but in Japan, little progress has been seen in the discussion on the indemnification. This Code will lead to a significant increase in the number of independent directors. To secure those who are capable and can responsibly take managerial risks, this indemnification means a lot. Japan is far behind in this area, to facilitate the change, so I'd like to request that the Code writes with a slight inclination that they should consider how the indemnification of the management and the board members should be, to prevent excessively aversive managerial judgments. That's my comment on 4.2.

Therefore, concerning the environment to support risk-taking, equity-based remuneration and indemnification should be mentioned in 4.2.2 and 4.2.3.

As for 4.4 the *kansayaku* board, I think this part is quite well articulated, well considered.

Now I'd like to talk about Chapter 5. My point is related to other members' opinions. When we say dialogue with shareholders, with which shareholders should companies have dialogue? Concerning how to narrow down the scope, Mr. Callon presented a convincing idea. I agree with Mr. Callon.

The title "Dialogue with Shareholders" is simple and clear. However, if possible, it would be better to include the purpose of the dialogue either in the title of Chapter 5 or Principle 5.1, such as "Dialogue with Shareholders for Increasing Mid- to Long-Term Corporate Value." I think it will be easier to understand. By stipulating "Dialogue with Shareholders for Increasing Mid to Long-Term Corporate Value", it will be clear that the Code is not suggesting dialogue with everyone, or extortionist-like shareholders. For the objective of ensuring dialogue with shareholders to be meaningful, I think this kind of limitation would be necessary.

Finally, I'd like to refer to 5.1.2. Professor Kanda mentioned that companies should be careful about having excessive dialogue in the previous meeting. 5.1.2 listed up items to be

included in the company policies from (i) to (iv). I think it would be better to stipulate as (v) that they should have an internal policy for not disclosing insider information or corporate secret/confidential information. It would work as a measure to prevent insider information or over-disclosure, which Mr. Toyama mentioned earlier, and thus, should be added as (v) or elsewhere.

I apologize for taking a long time. That's all.

[Ikeo, chairman] Thank you very much.

Now I'd like to hand it over to Mr. Oguchi.

[Oguchi, member] Thank you very much. I'd like to make two points.

The first point is related to what Mr. Uchida mentioned regarding Principle 3.1 Full Disclosure on page 10. He raised a question whether both (iv) and (v) are necessary. When I looked at the draft, I thought basically we need both. In response to his comment, I reconsidered these items.

I think probably (iv) and (v) have different meanings. (iv) is about the selection/ nomination policy and procedures, so I think this is necessary in the sense that the companies should explain the transparency of the procedures, according to which they make a selection and nomination based on a certain approach. As for (v), when shareholders vote for or against candidates for directors and *kansayaku* at the general shareholder meeting, I believe that reasons for nomination are necessary to know who they are and judge whether they are adequate or not.

If reasons for nomination are not provided – typically just showing the names and professional background of the candidates – we do not understand why they were nominated. There are some companies which provide reasons for nomination on the convocation notice. In this case, shareholders can constructively exercise their voting rights. In that sense, I believe that disclosure of reasons for nomination is necessary. Certainly, when (iv) and (v) are written in parallel, it is rather difficult to understand the intent. In that sense, I think the Code should write about them in a way the readers understand both are necessary.

In Chapter 5, I think Principle 5.2 articulates a very good point. If the companies set their targets concerning earning power and capital efficiency, and explain how they allocate their management resources to achieve them, they will be able to have constructive dialogue with shareholders based on such information, so I think it is very good.

When the secretariat drafts Principle 1.4 concerning cross-shareholdings, which is pending at the moment, what I expect is that the companies should provide quantitative explanations – not qualitative explanations – regarding how such cross-shareholdings contribute to achieving the targets concerning profitability and capital efficiency written in Principle 5.2, which may seem least related, and thereby shareholders can understand what they are and it leads to dialogue. For instance, shareholders understand that the companies make capital investment to increase their profitability and capital efficiency, but what is the most difficult for the shareholders being outsiders to understand is cross-shareholding. Therefore, I'd like you to explain them in connection with Principle 5.2.

Cross-shareholdings pose another issue over voting rights. I wanted to explain… state that investors look at this issue including capital efficiency from exactly the same

viewpoint as what is written in Principle 5.2.

Thank you very much.

[Ikeo, chairman] Thank you very much.

Does anybody else have an opinion or anything to add? Ms. Nakamura, please go ahead.

[Nakamura, member] As Mr. Oguchi just pointed out, I also would like to make a comment on Principle 3.1 (v) on page 10 "reasons for selecting/nominating individuals when the board selects senior management and nominates candidates for directors and *kansayaku*". I do not negate the intention of this principle that such information is necessary for shareholders to exercise their voting rights, but speaking from the standpoint of a person in charge of preparing the convening notice and related documents, it is difficult to figure out what kind of information is necessary in addition to certain information, including professional background, which we currently provide and based on which we consider candidates are appropriate.

As for the selection of senior management, which media do you have in mind when we talk about releasing relevant information? For instance, upon selecting the top management, are you assuming disclosure via press release?

[Yufu, Director, Corporate Accounting and Disclosure Division] This is not only about 3.1. The Code includes various principles related to corporate disclosures. After the final proposal of the Code is prepared, TSE will consider whether the Corporate Governance Report is to be utilized, or timely disclosure is to be applied for these principles. Alternatively, depending on the nature of information, probably posting on the website or including in the IR materials of the company in question may be sufficient. Such classification will be ultimately considered by the TSE after the proposal of the Code is finalized. This is what we are planning right now.

With that being said, as for the selection of senior management you mentioned, I think it could be disclosed either way – specifically, it could be timely disclosure or written in a certain report after a certain period from the actual selection. We are assuming the combination of these two methods may be appropriate, but we do not intend to limit the methods.

[Ikeo, chairman] Please go ahead.

[Takei, member] Excuse me; I failed to add one more point concerning 4.3. In the text after "appropriately evaluate the company's performance, etc.," it reads "based on the evaluation, if necessary, should remove senior management and select his/her successor." This is not incorrect. However, I got an impression that the current 4.3 describes only the case of poor performance. I think this should work positively in case of good performance. Accordingly, I think it would be better to state something like "should reflect the evaluation in terms of positions and remunerations of senior management."

If the Code must stipulate such removal/selection, I think it would be better to specifically write in Supplementary Principle. Therefore, this principle should just state "should reflect the evaluation in terms of positions and remunerations of senior management."

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

[Kanda, member] Thank you. Let me tell you something I skipped earlier due to time constraint.

This is supplementary to what Mr. Takei mentioned. Because Principle 4.4 is marked as "pending", I thought I don't have to talk about it today, but it is related to what Mr. Toyama mentioned about 3 corporate organization. What is said here is about the audit function, isn't it? And it talks about the roles of *kansayaku*, and the *kansayaku* board. If that is the case, in companies without *kansayaku* and the *kansayaku* board, who assumes such roles? In this case, I think it would be the Audit Committee and its members, or the Supervisory Committee and its members.

I think it does not have to be written in Principle 4.4, but should be written in Supplementary Principle or somewhere else. Otherwise, I'm afraid it is misleading for readers. I assume the secretariat will consider it when preparing the springboard of the pending part, but I wanted to remind you of it.

That's all.

[Ikeo, chairman] Anything else? I assume the next meeting will be long. So may I close this meeting 15 minutes earlier than the scheduled closing time, and add the extra time to the next meeting?

We had valuable…

[Ota, member] May I?

[Ikeo, chairman] Okay.

[Ota, member] It won't take long. Let me make some overall comments on the springboard, considering the earlier discussion.

The first point is concerning the expression using "*bekidearu*" or "*subekidearu*" [*Translator's note: the Japanese words equivalent to the English word "should"*] which are used from the beginning. These expressions are very decisive. Considering the relationship between laws and codes or voluntary discipline, for instance, I'd like to suggest that we should consider other expressions such as "*nozomashii*" [*Translator's note: the Japanese word equivalent to "desirable"*] in the next meetings.

The second point. We are now in the final stage of our discussions on this Code. We have discussed the applicable scope and companies subject to the Code. I think fundamentally all listed companies should be subject to the Code. Yet it was pointed out earlier that it is desirable that the Code is drafted in a way where the large majority of companies can comply. There is a separate argument whether exceptions should be made depending on the company size, business operations, etc., or whether to use such an expression as "desirable". Anyway, due to various circumstances, companies cannot comply. I'd like to request that we will discuss the classification of companies subject to the Code – for instance, small and medium-sized listed companies, or non-global companies in the next meetings.

The third point. I think this would be written in Preamble. I'd like to request that it is stipulated in the part of basic philosophy that this Code is constantly reviewed and improved: continuous improvement is a fundamental feature of the Code.

The fourth point is the use of too many foreign words written in *katakana*. All the members of this Council understand what these words mean. For instance, such an

expression as “support risk-taking” is not used in ordinary Japanese conversation. I think we should use more natural Japanese expressions. In short, the springboard uses too many English words written in *katakana*.

For example, the term “sustainability” is used based on different definitions in Principle 2.3 and Principle 2.2. I think we should reconsider these expressions. Especially, although the term “diversity” has been increasing taking root in Japan, we can simply express it by the equivalent Japanese word. The last point may sound like a complaint, but I’d like you to reconsider the wording.

That’s all.

[Yufu, Director, Corporate Accounting and Disclosure Division] Thank you for your convincing comments. However, as for the expression “*bekidearu*” [*Translator’s note: the Japanese word equivalent to the English word “should”.*] in your first point, we are fully aware that there may be such an adverse effect in terms of interpretation, but consider that expressions other than “*bekidearu*” would be difficult to use.

One of the reasons is the fact that all the codes in other countries – if you look at the English versions – use the word “should”. Some countries not only use “should”, but also “shall” which is closer to “must”. Although the Code is characterized as a soft law, the Code should function as a norm or discipline, which requires a higher level than “*nozomashii*” [*Translator’s note: Japanese word equivalent to the English word “desirable”.*]. Therefore in the Japanese language, we cannot think of any other word but “*subekidearu*” [*Translator’s note: the same as “bekidearu”.*].

Actually, when we drafted the Stewardship Code, there was exactly the same discussion. In the Stewardship Code, the code for shareholders - specifically institutional investors -, we decided to use the expression “*subekidearu*” throughout the code. Considering the Stewardship Code and this Code are two wheels of a cart, I feel there is no other expression but “*subekidearu*” in the Japanese language.

[Ikeo, chairman] No other comments?

We had a very valuable discussion today. Based on it, the springboard is to be revised. And by the next meeting, the secretariat will prepare the springboard for the pending parts concerning the board structure in Chapter 4 “The Responsibilities of the Board”. We will discuss the remaining parts, such as corporate organization, and procedures next time.

Thank you very much for your active discussion and valuable opinions. If you have any additional opinions or requests, please send them by e-mail or other means to the secretariat, as usual. Your comments are always welcome.

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

[Yufu, Director, Corporate Accounting and Disclosure Division] The next Council is tentatively scheduled to begin at 16:30 on Tuesday, November 25, although the secretariat is still coordinating the schedule. We will inform you of the details later.

That’s all for the announcement.

[Ikeo, chairman] Thank you. Now I declare today’s Council closed. Thank you very much for your cooperation.

End