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

September 24, 2015

[Tahara, Director of the Corporate Accounting and Disclosure Division, FSA] Good morning. As you can see, camera crews are here only for the opening part of the Council today. Thank you for your understanding.

Now I turn it over to Chairman Ikeo.

[Ikeo, Chairman] Now it's already the scheduled opening time, and all the prospective attendees are here, so I'd like to open the first Council of Experts Concerning the Follow-up of Japan's Stewardship Code and Japan's Corporate Governance Code. Thank you very much for taking the time from your busy schedule.

I'm Ikeo from Keio University, and take charge of Chairman of the Council. It is my pleasure to be working with you.

First, Mr. Ikeda, Director-General of the Planning and Coordination Bureau, the Financial Services Agency, will make an opening remark, representing the Secretariat.

Mr. Ikeda, I'm handing it over to you.

[Ikeda, Director-General of the Planning and Coordination Bureau] I'm Ikeda, Director-General of the Planning and Coordination Bureau, the Financial Services Agency. Thank you very much for attending the Council despite your busy schedule. Today is the first meeting of the Council, and it is my pleasure to deliver the opening address.

As we informed you, the Government and the Financial Services Agency have taken various measures to enhance corporate governance of listed companies. Japan's Stewardship Code was formulated and published in February 2014, and the Corporate Governance Code came into effect in June 2015.

However, the formulation of these two Codes does not mean the end of our efforts for enhanced corporate governance. We consider that the establishment of these Codes was just a starting point of our efforts. The Japan Revitalization Strategy (revised in 2015), which was decided by the

Cabinet in June this year, states that we need to work actively to prevail and promote the adoption of both Codes, as 'the two wheels of a cart' in such a manner that the sustainable growth of companies will be promoted by both sides of investors and companies. We believe that further improvements of corporate governance, for example, making governance function not only formally, but also effectively, continue to be a major agenda. Furthermore, we should not regard such efforts merely as governance issues, but we consider it important to link such efforts to the sustainable corporate growth and the increased corporate value over mid- to long-term, as well as ultimately the establishment of a virtuous economic cycle.

In this respect, for the purpose of following up with the prevalence and adoption of both Codes as well as further improving corporate governance of all listed companies, we decided to set up the Council. We expect the members to have active discussions. Thank you in advance for your cooperation.

[Ikeo, Chairman] Now I'd like to hear a remark from Mr. Shizuka, Managing Director of the Tokyo Stock Exchange, representing the secretariat. Mr. Shizuka, I'm handing it over to you.

[Shizuka, Managing Director/TSE] Thank you. I'm Shizuka, in charge of Listing Department of the Tokyo Stock Exchange (TSE). Thank you very much for attending the Council during the holiday-studded week.

As just introduced, we, the Tokyo Stock Exchange, started the application of the Corporate Governance Code this June. As you know, the Corporate Governance Code stipulates that companies should secure multiple independent directors. Although the application of the Code just started in June, at the completion of this year's general shareholder meetings, among companies listed on the TSE First Section, companies which secure multiple independent directors accounted for 50% or nearly double from the last year. We strongly feel that listed companies are rapidly responding to the Code. On the other hand, we also strongly feel that discussion on governance has entered a new stage.

I think the question used to be whether it is really necessary to have outside directors. Now that the adoption of outside directors has become common, I feel the question now has changed to whether the board of directors, including outside directors, is really useful. I think that the accounting fraud issue, which has been much talked about recently, most clearly embodies such a question. What is required of the board of directors in order not only to formally exist, but also to prevent damage to corporate value or increase corporate value over mid- to long-term? We

established this Council, hoping that the on-going governance reform of listed companies will not be merely formality, but will be substantial, and assume the role of the Secretariat together with the Financial Services Agency.

We look at the actual market every day. I think the members will later discuss various issues, such as strategic shareholding (cross-shareholding), purchases of treasury shares, or class shares issued by listed companies: there still are various issues with certain gaps in perspectives between listed companies and investors/shareholders. We expect discussions here will fill such gaps wherever possible, and facilitate the corporate governance reform with substance.

Please frankly express your opinions and deliberate. Thank you in advance for your cooperation.

[Ikeo, Chairman] Now I'd like to ask the Secretariat to introduce the members and explain the draft Procedures to Run the Council of Experts.

[Tahara] I'm Tahara, Director, Corporate Accounting and Disclosure Division of the Financial Services Agency, and serve on the Secretariat of the Council. It's my pleasure to be working with you.

Before I start the explanation, may I ask the camera crews to leave the room?

First of all, on behalf of the Secretariat, let me introduce the members of the Council according to the seating order. Please take a look at the seating chart at your hand.

Starting from the right, Mr. Yoichiro Iwama.

[Iwama, member] Good morning. I'm Iwana.

[Tahara] Mr. Akitsugu Era.

[Era, member] I'm Era. It is my pleasure to be working with you.

[Tahara] Mr. Toshiaki Oguchi.

[Oguchi, member] Good morning. I'm Oguchi.

[Tahara] Mr. Hidetaka Kawakita.

[Kawakita, member] I'm Kawakita. It is my pleasure to be working with you.

[Tahara] Mr. Takashi Kawamura.

[Kawamura, member] I'm Kawamura. I'm honored to be here.

[Tahara] Ms. Yoshiko Takayama.

[Takayama, member] Good morning. I'm Takayama.

[Tahara] Mr. Kazuhiro Takei.

[Takei, member] I'm Takei. It is my pleasure to be working with you.

[Tahara] Mr. Masaaki Tanaka.

[Tanaka, member] Good morning. I'm Tanaka.

[Tahara] Mr. Kazuhiko Toyama.

[Toyama, member] I'm Toyama. It is my pleasure to be working with you.

[Tahara] Mr. Kengo Nishiyama.

[Nishiyama, member] I'm Nishiyama. I'm honored to be here.

[Tahara] Mr. Hideaki Tsukuda.

[Tsukuda, member] Good morning. I'm Tsukuda.

[Tahara] As shown in Material 1 – List of members, although they are absent today, Ms. Ryoko Ueda, Mr. Akira Uchida, Mr. Hiroyuki Kansaku, Mr. Hideki Kanda, and Mr. Scott Callon are also to participate in the Council.

Next, I'd like to introduce observers.

Mr. Nakahara, Director, Corporate System Division, Ministry of Economy, Trade and Industry.

[Nakahara, Director, Corporate System Division, Ministry of Economy, Trade and Industry] Good morning. I'm Nakahara.

[Tahara] Mr. Takebayashi, Counsellor, Civil Affairs Bureau, Ministry of Justice.

[Takebayashi, Counsellor, Civil Affairs Bureau, Ministry of Justice] I'm Takebayashi. It is my pleasure to be here.

[Tahara] The Financial Services Agency and the Tokyo Stock Exchange assume the role of the joint Secretariat of the Council. Due to the limitation of time, I will not introduce the Secretariat members. Please refer to the seating map at your hand, instead.

Now I'd like to explain the draft Procedures to Run the Council of Experts. Please take a look at Material 2.

The title is "Procedures to Run 'Council of Experts Concerning the Follow-up of Japan's Stewardship Code and Japan's Corporate Governance Code' (draft)". We hope the Procedures are agreed upon today. Let me read them out.

Article 1. The procedures of "Council of Experts Concerning the Follow-up of Japan's Stewardship Code and Japan's Corporate Governance Code" (hereinafter the "Follow-up Council"), as well as other matters related to running those Follow-up Council, shall be governed by the provisions set forth in the procedures.

Article 2.1 Follow-up Council shall be convened by the chairperson.2.2 As soon as a date to be

convened is fixed, such a date of the Follow-up Council shall be announced without delay by whatever method the chairperson deems appropriate.

Article 3. The chairperson shall chair the Follow-up Council and arrange the proceedings.

Article 4. The chairperson may, as necessary, invite academic experts, employees of relevant administrative bodies, and other persons deemed appropriate to participate in Follow-Up Councils in order to hear their opinions.

Article 5.1 Follow-up Councils shall be open to the public. 5.2 Other necessary matters related to public disclosure, in addition to what is provided in the preceding paragraph, shall be decided by the chairperson.

Article 6. Minutes of the Follow-up Council shall be prepared and published after each Follow-up Council.

Article 7. Materials of the Follow-up Council shall also be open to the public.

Article 8. Other necessary matters related to the Follow-up Councils, in addition to what is provided in these running procedures, shall be decided by the chairperson.

That's all from me.

[Ikeo, Chairman] Thank you very much.

Do you agree with the said procedures? Basically, the Council is open to the public and everything will be disclosed. And necessary matters will be flexibly determined as appropriate. What do you think? May I consider that there is no objection?

All right, now the word "draft" is removed from the title, and I declare we all agreed that the Council is to be run according to the Procedures.

Next, the Financial Services Agency will reaffirm the premise of the running of the Council, and then the Tokyo Stock Exchange will explain the implementation status of the Corporate Governance Code based on corporate governance reports which have been submitted by companies so far. After that, we will have a discussion.

Now I'm handing it over to the Financial Services Agency.

[Tahara] I'll explain in accordance with Material 3.

Please turn over a page. It shows the overview of Stewardship Code and the Corporate Governance Code, which all of you may be already familiar with.

Japan's Stewardship Code provides principles of actions for institutional investors, stipulating their responsibilities for ultimate providers of funds. The formulation of Japan's Stewardship

Code was decided in the Japan Revitalization Strategy (revised in 2013), and it was established in February 2014.

The Corporate Governance Code provides principles of actions for companies, stipulating their responsibilities for shareholders and other stakeholders. The formulation of this Code was decided in the Japan Revitalization Strategy (revised in 2014), and the application of the Code started in June 2015. These two Codes are expected to work together like the two wheels of a cart.

Please turn to the next page, which summarizes the Corporate Governance Code. In the Corporate Governance Code, 'corporate governance' means a structure for transparent, fair, timely and decisive decision-making by companies, with due attention to the needs and perspectives of shareholders and also customers, employees and local communities. This Code establishes fundamental principles for effective corporate governance at listed companies in Japan. In addition to 5 General Principles quoted on this page, the Code provides 30 Principles and 38 Supplementary Principles, 73 principles in total. As stated in the upper box on page 2, the prevalence and adoption of this Code is expected to ensure 'growth-oriented governance', increase the corporate value through 'appropriate cooperation with [a wide range of] stakeholders' in addition to shareholders, and enhance 'constructive dialogue' with mid- to long-term shareholders, thus facilitate the sustainable corporate growth and the increased corporate value over mid- to long-term, and ultimately contribute to the development of the Japanese economy as a whole.

Please turn to the next page, which summarizes Japan's Stewardship Code. In this Code, 'stewardship responsibilities' refers to the responsibilities of institutional investors to enhance the mid- to long-term investment return for their clients and beneficiaries by improving and fostering the investee companies' corporate value and sustainable growth through constructive engagement, or purposeful dialogue, based on in-depth knowledge of the companies and their business environment. This Code defines principles considered to be helpful for institutional investors who behave as responsible institutional investors in fulfilling their stewardship responsibilities with due regard both to clients and beneficiaries and to investee companies. It provides 7 Principles shown in the yellow-colored box as well as Guidance for these 7 Principles.

Pease turn to the next page. It is expected that Japan's Stewardship Code and Corporate Governance Code work together like the two wheels of a cart and realize a virtuous economic cycle through constructive dialogue between institutional investors and listed companies, and ultimately lead to the growth of the economy as a whole.

Please turn to the next page. As Mr. Ikeda explained earlier, the said point was also confirmed in the Japan Revitalization Strategy (revised in 2015). As specific new measures to be taken, in order to promote ‘proactive management’ and enhance corporate governance, the Government need to work actively to prevail and promote the adoption of both Codes. The Government needs to actively and globally disseminate the approach of Corporate Governance Code, while ensuring full explanation and publication of the said approach in Japan. It is also stipulated that the Government will assess the overall situation and publish the results in cooperation with the Stock Exchange. In addition, to ensure that institutional investors’ application of Japan’s Stewardship Code is firmly established, the Government will assess and publish institutional investors’ acceptance of the Code, while sending messages to them as necessary.

Please turn to the next page, which shows the Strategic Direction and Priorities, which Japan Financial Services Agency published last week. Based on the Japan Revitalization Strategy as well, the Strategic Direction and Priorities emphasizes improving the reform of corporate governance from ‘forms’ to ‘substances’. We have formulated the Japan’s Stewardship Code and Japan’s Corporate Governance Code. However, it is just a starting point, not a goal. As Mr. Ikeda also mentioned earlier, we need to improve the dimension of the reform from ‘forms’ to ‘substances’. Accordingly, based on discussion of the Council, we need to disseminate information regarding best-practices, and encourage further improvement of corporate governance of all listed companies.

Please turn over 2 pages. It shows items for discussions at the Council. As mentioned earlier, at first, we need to follow up on the status of implementation/entrenchment of both Codes. In this respect, we’d like you to discuss whether the substance of the Codes being implemented, not just the form. We also consider it important whether enhanced governance systems are creating a virtuous economic cycle and whether companies and investors are engaging in dialogue in a constructive manner.

Second, we’d like you to discuss and provide advice on ways to spread adoption and raise awareness of the Codes.

Third, we’d like you to discuss ways to further improve corporate governance and stewardship responsibilities.

We’d like you to have wide ranging discussions, beyond the said items.

For the time being, the Council will be held about once a month. Furthermore, as Chairman Ikeo mentioned earlier, we intend to invite public comments on future discussion/examination items in

the Council and other matters for improving corporate governance, and thereby proceed with discussions in an open manner.

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

[Ikeo, Chairman] Thank you very much.

Now the Tokyo Stock Exchange will provide the explanation.

[Watanabe, Head of Listing Department, the Tokyo Stock Exchange] I'll explain Listed Companies' Response to the Corporate Governance Code by using Material 4.

Please turn to page 2. As written there, the Corporate Governance Code came into effect on June 1, 2015. Starting from companies which hold their annual general shareholder meetings in June, companies are expected to disclose the current status of their responses to the Code promptly after their general meetings. In the first year, the disclosure deadline is extended until December. As of the end of August this year, 111 companies have disclosed their responses to the Code.

The table shows the disclosure status of companies by market division: 66 companies are listed on the First Section, 2 companies on the Second Section, and 8 companies on Mothers, and 35 companies on JASDAQ, 111 companies in total. For today's discussion, we analyzed 68 companies listed on the TSE First and Second Sections, which are required to explain reasons for non-compliance, if any, for 73 principles of the Corporate Governance Code, according to 'Comply or Explain' approach.

Please turn to the next page. Page 3 shows the compliance status with the Code by company. Among 68 companies listed either on the First or Second Section, 41 companies or some 60 percent of them complied with all principles of the Corporate Governance Code. On the other hand, 27 companies or some 40 percent of them provided explanations for non-compliance with certain principles. These 27 companies provided 105 explanations; in other words, explanations for non-compliance were provided for 4 principles per company on average.

The chart at the bottom shows the compliance status by market segment. In the First Section, 62% of the companies reported their compliance with all principles.

Let me give you corresponding figures in other countries for comparison, although they are not shown on the Material. In the UK, the Corporate Governance Code was established more than 10 years ago, and in 2013, 57% of the companies in the FTSE 350 Index reported their compliance with all provisions of the UK code. In France, among 40 key companies – specifically, companies in CAC 40 Index, 36% of them complied with all provisions of the French code. In Germany,

among companies in DAX 30 Index, approx. 7% of them reported full compliance of the German code.

Compared with these countries, the percentage of companies which have already reported their full compliance may be high for the first year of the application: you may feel the percentage of full compliance is slightly more than expected. There may be various reasons for it, but one of the main reasons could be due to the early submission [of Corporate Governance Report] made by companies which had improved their governance systems ahead of others, and are confident with their governance.

In the Second Section, as shown at the bottom of the chart, companies which provided explanations for non-compliance with certain principles accounted for 100%. However, in case of the Second Section, only a few companies have reported their response to the Code so far, so we should pay attention to such a fact.

Please turn to the next page. Page 4 shows the numbers of companies which reported their compliance or provided explanations for each principle. The Corporate Governance Code contains 73 principles in total. Among those 73 principles, 39 principles are complied with by all the companies. On the other hand, there are 34 principles, which some companies chose not to comply with and provided explanations instead. The table illustrates such status. The principles in the yellow-colored rows represent those which all the companies complied with. The principles in the white-colored rows represent those which some companies provided explanations for non-compliance with.

As for these 34 principles, looking at the number of companies which provided explanations for non-compliance for each principle, we found that the maximum number was 16 for a certain principle, and the average number was 3. Furthermore, looking at different layers of the Code, namely General Principles, Principles, and Supplementary Principle, we found that companies were more likely to provide explanations for specifics. That means more companies explain their non-compliance with Principles than General Principles, and more with Supplementary Principles than Principles.

Please turn to page 5. To show principles with higher explanation rate, the table shows such most common principles in descending order of numbers of companies. We selected principles with explanation rate exceeding 5%. The principle with the highest explanation rate, shown at the top of the table, is Supplementary Principle 4.11.3 which requires the board to analyze and evaluate its

effectiveness, and disclose a summary of the result. While 52 out of 68 companies complied with this Supplementary Principle, 16 companies chose to provide explanations for non-compliance, accounting for 23.5%.

The principle with the second highest explanation rate is Principle 4.8 concerning the appointment of multiple independent directors. 14.7% of the companies provided explanations for non-compliance. To put it the other way around, 85.3% of the companies complied with this Principle.

Meanwhile, although I'll explain more later, among all companies listed on the First Section, companies which appointed multiple independent directors accounted for 48% as of July 2015. We assume the difference of these figures indicates the fact that those companies in the First and Second Sections which already disclosed their response to the Code have improved their governance systems ahead of others.

Please turn to the next page. Page 6. We categorized explanations provided by 27 companies according to the content. We consider that the explanations can be grouped roughly into 3 categories.

The most common explanation was that although they do not comply with the Corporate Governance Code at the moment, they intend to comply in the future, accounting for approx. 50% of all the companies. Explanations with clear compliance timelines accounted for approx. 60% of them, or approx. 30% of all the companies, while explanations without clear compliance timelines accounted for approx. 40% of them, or approx. 20% of all the companies. As for specific compliance timelines, many companies stated that they will comply in the next fiscal year or by the submission deadline of the Corporate Governance Report in December. The second common explanation was that they are still considering whether or not they will comply, accounting for approx. 35%. The last explanation is that they have no intention to comply in the future, accounting for approx. 15%.

Specific examples are introduced on the following pages.

Please take a look at page 7. The first category shows examples where the respondent companies plan to comply in the future. Some companies indicate clear compliance timelines similarly to the example of Company A, and others do not similarly to the example of Company B.

The second category shows examples where companies are still reviewing whether or not to comply. We quoted Company D's example as a unique explanation. In the Corporate Governance

Code, the principle in question [Principle 4.8] stipulates that if a company believes it needs to appoint at least one-third of directors as independent directors, it should disclose a roadmap for doing so. In respect of this principle, although Company D appointed a half of directors as independent directors as a matter of form, the Company has not yet reached a conclusion as to whether it needs at least one-third of directors as independent directors. Company D ventured to explain that it is under consideration.

Please turn to page 8, showing examples where companies do not plan to comply with certain principles. There are roughly 2 sub-categories. Company E's example represents the case where companies can fulfill the purpose of certain principles by alternative measures. In the Corporate Governance Code, the principle in question [Supplementary Principle 4.1.2] stipulates that if a company fails to achieve its mid-term business plan, the underlying reasons as well as the company's actions should be explained to shareholders. Company E does not make public its mid-term business plan, and therefore no explanation is given to shareholders in case of failure to achieve the plan, we assume. Instead, its Management Council and the Board responsibly monitor and supervise [mid-term policymaking process]. This is an example of such an explanation.

Another sub-category is the case where companies explain their specific circumstances. Company G's example at the bottom is a typical one. While a principle [Supplementary Principle 4.8.1] of the Corporate Governance Code stipulates that independent directors should endeavor to exchange information and develop a shared awareness among themselves, for example, by holding regular meetings consisting solely of independent directors, so-called executive sessions, Company G frankly explained the composition of its board, and the Company's or its management's view on 'executive session' which is suggested in the Code.

Please turn to page 9. This is not an example of explanations required under 'Comply or Explain' approach. This is an example where a company discloses specifically how it complies with principles, in addition to explaining reasons for non-compliance with certain principles. In this example, Company H referred to Supplementary Principle 4.3.1, and introduced its strategy for compliance with the principle, as shown in the red box. Company H provided explanations for all 73 principles, describing how it complies with the principles.

I'm moving on to page 10. Our analysis on 'Comply or Explain' ended on page 9, and on the following pages, we'd like to briefly explain the disclosure of cross-shareholding, which is drawing more attention lately, and status of appointment of independent directors for your reference.

On page 10, we quoted press stories reporting a new trend where cross-shareholding is being discontinued, just for your reference.

Please turn to Page 11. It shows the status of disclosure of cross-shareholding policies. Please take a look at the second bullet point. As for cross-shareholding policies, some companies declared that they do not have cross-shareholdings in principle, or they will unwind cross-shareholdings. Nonetheless, overall, a majority of companies, however, have policies where they generally make decisions based on economic rationale. As shown in the bottom half of this page, there are cases where companies declare non-holding in the similar manner to the examples of Company I and Company J.

Please turn to page 12. As examples where companies, mainly financial institutions, declare their policies not to have cross-shareholdings or intend to unwind cross-shareholdings, we included the cases of Companies K, M, L, and N. Similarly to the cases of Company L and Company M, some companies explain/disclose in detail their processes for reviewing significance or economic rationale of cross-shareholdings.

Please turn to page 13. These examples are mostly from business companies. They do not show a direction toward non-holding. Instead, they disclose that they make a judgment based on economic rationale.

Please turn to page 14. This is about the disclosure of criteria for exercising voting rights on cross-shareholdings. As shown in the examples of Company R and Company S, a large majority of companies declare that they make decisions based on whether such cross-holdings will contribute to increasing investee companies' corporate value. Meanwhile, as shown in the example of Company T, some companies state that they consider business management policies of investee companies.

Please turn to page 15. On 3 slides from page 15, we included the charts showing the appointment of outside directors and independent directors.

The chart on page 15 shows the appointment of outside directors by companies listed on the First Section. In 2005 or 10 years ago, companies with outside directors accounted for 35%. It was not until 2011 or 4 years ago that a majority of companies appointed outside directors, accounting for 51.4%. After that, companies have increasingly appointed outside directors. In 2015, the appointment ratio reached as high as 94.3%.

Please turn to page 16. This chart shows percentages of listed companies which appointed

independent directors, which means outside directors excluding those from major business counterparties, etc. In 2010 or 5 years ago, the ratio of such companies was 31.5%. Last year, companies with independent directors became the majority for the first time, accounting for 61%. In 2015, the ratio further increased to 87%.

Please take a look at the last page. Page 17. This chart shows percentages of listed companies which appointed multiple independent directors in accordance with Principles 4.8 of the Corporate Governance Code. The ratio of such companies was 12.9% 5 years ago, and 21.5% last year. However, the ratio showed a sharp rise to 48.4% this year.

That's all for my explanation of Material 4.

[Ikeo, Chairman] Thank you very much.

Now I'd like to proceed to free discussion where you share your opinions and ask questions. Taking into account explanations from the Financial Services Agency and the Tokyo Stock Exchange, especially I'd like to hear your opinions or comments on the implementation status of the Corporate Governance Code, which the Tokyo Stock Exchange just explained. As this is the first meeting, I'd also like you to share your opinions on the future discussion/examination items in the Council, as well as your concerns. In addition, please feel free to express your opinions on other matters for improving corporate governance. There is no predetermined order of speakers, so anybody can start. If you have any questions regarding the explanations from the Secretariat, please feel free to ask them. Does anybody want to open the discussion?

Mr. Toyama, would you like to start?

[Toyama, member] I think it would be better to talk first, so I'd like to make some comments.

[Ikeo, Chairman] I thought it would be difficult to speak up first.

[Toyama, member] First of all, I'd like to thank the Secretariat for comprehensive explanations on Materials we received. I have some comments, which may be somehow like questions. Concerning your explanation on page 6 – correct me if my understanding is wrong – I found no major explanations on growth-oriented governance. Rather, most of the explanations were somehow like excuses for non-compliance. Among the companies which do not intend to comply with certain principles in the future, the reasons for choosing non-compliance were not because they could increase their corporate value by non-compliance rather than compliance. Am I correct?

I'm personally disappointed with the result. We adopted 'Comply or Explain' approach, so if companies had discussions [on the Code] in terms of substance, not form, some would argue

“Forget about this Code. Considering the circumstances of our company, it would be better not to comply with such principles.” I think that would be a real substantive discussion. I saw what was written there in that way, and expect you to analyze various explanations which you will receive in the future. If you find such explanations [from the perspective of growth-oriented governance], please let us know. That’s what I felt.

As for outside directors, considering that it was said to be hardly feasible, my honest impression is “you can do it if you try.”

Now I’d like to raise an issue. I presented two articles which I wrote for the column named “*Keizai Kansoku* (economic review)” of the Mainichi Newspapers as reference materials. I wrote what I think relevant to substantive discussions in the context of our current efforts. As I’m not comfortable with not talking straight, I will not hide specific names. I think I should start from the more vivid issue on the second page, namely the recent problem with Toshiba.

If you read this article, it will be self-explanatory. I think that Toshiba’s case embodied something like a focus of disease – a deep-rooted problem with corporate governance of Japanese companies in terms of substance. 10 years ago, we saw a similar incident, Kanebo accounting scandal. Actually it led to a criminal case, so we can call it window-dressing. I clearly remember the case, as I was on the side in charge of investig The schemes of these two cases are remarkably similar. The similar point is that manipulations were performed at various venues within the companies, led by frontline managers who assumed they should do so.

Then why did such incidents take place? Specifically, in such prestigious companies which have many elites, and adopted the structure of Company with Three Committees in the recent case, why did such incidents effectively take place despite having a proper form of corporate governance? I think there are 2 stages in such incidents, and both of them raise a significant question to our follow-up initiatives. The point is that the companies developed a disease, and were left untreated until the disease progressed to a serious stage. There are two questions. First of all, why did you get the disease? And then, why did you fail to find the cancer?

This is a common argument. Specifically, why did you fail to find the improper accounting until it became this much serious? Directly speaking, it is a problem with the reporting line. I also had similar experience with Kanebo. As soon as newspapers reported that Kanebo was placed in rehabilitation under the Industrial Revitalization Corporation of Japan as the top news, I have received a huge number of whistle-blowing reports from the next day. The reports were

well-organized and contained sufficient information for identifying the entire fraud scheme if investigated according to the reports. It implies that whistle-blowing must have been made internally for many years, considering that it is impossible to prepare such reports just in a day. Probably the same thing could be said about the recent case. Various pieces of information must have been provided in various places prior to the detection.

That means this is, after all, the problem of the reporting line. Specifically speaking, despite extensive discussions on internal control, such discussions should generally be made on the premise of the health of the top management. Yet a power structure, like fish, rots from the head down. When the top is rotten, they have to report to the top. In other cases, within the framework of the executive team with certain authority over personnel issues, a controlled person has to report to a controlling person. There is a limitation of reporting. Then, as in the previous discussion, it is basically important to consider how to secure the reporting line to an independent outside party – including *Kansayaku*[1] and Audit Committee. Furthermore, I think we should not fail to consider "before whose authority a reporting person bows" in the discussion. Therefore, I got an impression that the recent incident was predestined to happen.

Let me talk straight. To look at the original cause, I would go back to the appointment of President. In this case, as in the case of Kanebo, after all, money-losing divisions had been practically preserved over a long period of time, and improper accounting was done there. Then why were they preserved for a long time? Or why did the top management, who left them as they were, stay in power for such a long time? More specifically, frontline teams of the top-level manufacturer were told to generate the profit of 12 billion yen in 3 days. From the viewpoint of the frontline teams, it was like a command during a losing battle: they were not allowed to surrender, and told to beat the enemy by whatever means necessary. Frankly, this is almost like the Battle of Okinawa in the last year of the World War II, 70 years ago.

We need to go back to a question "why did the person who gave such instructions maintain the top position for a long time?" I think this is an obvious proof that the appointment and dismissal of top management is very important for corporate governance. Honestly, while I served on the Council for establishing the Corporate Governance Code, I refrained from discussing this issue in

[1] *Kansayaku*:A Company with *Kansayaku* Board is a system unique to Japan in which certain governance functions are assumed by the board, *kansayaku* and the *kansayaku* board. Under this system, *kansayaku* audit the performance of duties by directors and the management and have investigation power by law.

detail. However, I believe we should extensively discuss the appointment or nomination of management – whether the current Japanese practice of nominating top management is appropriate or not.

To tell you straight, the nomination of top management in many listed companies in Japan is insincere. Frankly, they are not earnest. I have read this kind of stories on “My Personal History” [a column on the Nikkei newspaper] several times. Current President consults with Chairman, talks with Senior Advisor, and decides to nominate Mr. A as the next President. Then Mr. A receives a phone call and is asked to accept the position. Usually, the answer is held until the next day. No immediate answer is given. Speaking from the global perspective, it is a shame to nominate in such a way. I would say this is “OB (old boys) governance”. I said OB, not OG (old girls), because there are very few females in senior management positions in Japan.

We need to look at a possible root problem. Discussion on corporate governance should be centered around the power structure of an organization – whether decisions are made in a healthy manner. For companies, the most significant strategic decision-making is the nomination of top management, which takes place once in 5 to 10 years. I believe that they should spend a significant amount of energy and time, go through an appropriate procedure, and make a decision fairly and objectively. This is obvious in democratic politics. Therefore, I’d like to definitely have a discussion on this point.

Now I’d like to go back to the first page. This is written from the standpoint of investors. It is about my own experience, as I don’t think it appropriate to talk about personal experience of other people. At the recent general shareholder meeting, Glass Lewis, a provider of proxy advisory services, recognized that I am unqualified for an outside director of Omron. This is very unique advice, although I say it myself. The basis for the advice is that my company has a trade relationship with Omron. Our sales from Omron account for 0.1%. As Omron is a huge company, their sales from our company account only for 0.001%. With this fact, they judged that I am unqualified according to the formal criteria.

If it is OK to judge whether a person is qualified or unqualified by mechanically applying the formal criteria, such a task can be done by high-school students as a part-time job. Frankly, it is not a job for highly educated people, receiving high compensation. I think this is exactly the problem of the Stewardship Code. Discussions on the Stewardship Code should also be made by focusing on the substance, not the form. Furthermore, the exercise of voting rights is compared to an election in

democratic politics. Do we make voting decisions based merely on formal criteria? Naturally, they should be strictly examined regarding what kind of advice they effectively provide.

Actually, some adverse effects have already been reported. Currently, the Japan Association of Corporate Executives, the Japan Association of Corporate Directors and others are creating various databases. Potential candidates for outside directors register with these organizations, and companies seeking for outside directors can find qualified candidates there. Looking at requests sent to these organizations, most companies request them to exclude those who are from financial institutions. This is ridiculous. The underlying reason is probably because they [those who from financial institutions] are deemed unqualified according to the formal criteria of some advisory bodies.

As the reality of the current Japanese society, especially from my generation or even from the preceding generation, there has been a trend where talented people, mainly with the background in liberal arts, work for financial institutions. Accordingly, the pool of excellent human resources is excluded here. Because of the people who offer advisory services based merely on ridiculous formal criteria, excellent human resources are excluded. To appoint outside directors, they should judge on the basis of personal characteristics, looking at the substance. In that sense, I'm wondering what kind of dialogue takes place under the Stewardship Code, in terms of the substance, not the form.

Actually, in my case, Omron has had dialogue with Glass Lewis. I heard that IR personnel recognized me as qualified, but my contact person just repeated that the judgment was based on the formal criteria. That almost means they do not evaluate the substance at all. If such practices are widespread, corporate governance will be increasingly losing substance. After all, I would say Toshiba's inappropriate accounting is a kind of "cosmetic corporate governance". If institutional investors or advisory service providers keep on acting while focusing on the form, it will facilitate "cosmetic corporate governance". If the form meets the requirements, anything will do. You could pick up any young man walking on the street as a candidate for an outside director. Form over substance would lead to such methods. Therefore, I'd like to request that this issue is discussed at this Council.

That's all. I'm sorry for taking a long time.

[Ikeo, Chairman] Thank you very much.

Today we received 3 reference materials/opinion papers from our members. Please use them as a

reference.

Mr. Kawamura, please go ahead.

[Kawamura, member] I'd like to make comments in connection with Mr. Toyama's comment. I believe that the appointment and dismissal of top management is a very important topic. Therefore, as Mr. Toyama mentioned, we should discuss it a lot on various occasions.

In this respect, page 9 of Material 4 shows the example of Company H concerning appointment and dismissal of the management. I think the company intended to explain that they are doing such things relatively openly. It serves as a good reference. The most important part of corporate governance is the appointment and dismissal of the top management. Also the example provided by Mr. Toyama may serve as a lesson, where the top management had not been dismissed along the way. Considering that whistle-blowing revealed the incident, I assume there had been various things within the company before the whistle-blowing occurred. There must be a lesson for us from why they did not dismiss top management. In that sense, I think the issue of the top management is very important.

Let me share the case of our company, although I'm not sure if it is appropriate. A year ago, our company nominated 3 candidates for President and made the limited disclosure, meaning that the board was informed of who the candidates were. Because our company adopted 'Company with Three Committees' as the corporate structure, we made it clear that these 3 persons were candidates for President within the structure, and also told these 3 persons that they were the candidates. Accordingly, when these candidates attended the board meetings for presentation one after another, the board members, especially outside directors, asked them many questions with much interest. The board members not only asked questions about the presentation, but also checked their personalities and so on. They seemed to have hard time. We interacted with the candidates in such a way for a year, and made a final decision.

Despite such efforts, some outside directors, especially non-Japanese directors, were not satisfied with the procedure. They said that they wanted to be involved in the process for narrowing candidates down to these 3 persons, and that they wanted to include more outsiders with no experience of working for our company. Therefore, while we selected some 30 candidates for the next President from within the company and provided them with necessary education, we are now considering how we make them attend the board meetings.

This is just an example of our company, and not directly related to the earlier comment, but the

appointment and dismissal, especially dismissal, are that much important. The board of directors may dismiss an incumbent President, because their company cannot achieve better performance under the incumbent President. The board cannot make judgment by looking at short-term performance, and thus the top management must be in office for a certain period. If they look at only short-term performance, President will implement only short-term measures. Because companies must certainly implement mid- to long-term measures, the board must also consider such mid- to long-term measures to make judgment. This would be a difficult point, but I believe it is important that the board, which can dismiss President, functions well. In addition, if the board works in that way, the management and executive officers will execute their duties with a sense of tension, and such a tense relation will make various things work. Of course, if the board has a strained atmosphere, that's a different story. Nonetheless, a certain sense of tension is necessary: the notion that someone is looking at my work is very important. It applies not only to the top management, but also to everyone, including ordinary employees. Having the notion that someone is looking at how I work is essential. In this respect, I believe the appointment and dismissal of the top management, as Mr. Toyama mentioned earlier, is a significant topic.

That's all from me.

[Ikeo, Chairman] Thank you very much.

I'll ask all the members in turn, so Mr. Oguchi, please go ahead.

[Oguchi, member] Thank you. As this is the first meeting, I may talk a little about everything. I think everyone has the reference material from me, the copy of the article I wrote for the monthly publication of the Securities Analysts Association of Japan. I won't go into the detail, but let me share my fundamental belief. As often said, there is a view that once the Corporate Governance Code is established, it should be left to the private sector. At the same time, some argue that it is embarrassing that the Code was established by the public sector, not the private sector. In the reference material, I wrote that once the Code is established, listed companies and institutional investors should fulfill their respective responsibilities toward increasing mid- to long-term corporate value, as I believe it is ideal to be self-reliant and self-sufficient, without relying on the bureaucratic control.

Then what should we think about the position of this Council? It takes time until "Comply or Explain" approach really works, and such initiatives are not completed in other countries as well. There is a risk that the Code loses substance due to superficial compliance or boiler-plate

explanations. In fact, such cases were found in other countries. The Corporate Governance Code was just established, but I'm aware that we have to admit such a situation really exists, including the earlier mentioned examples of some companies.

As the Code takes 'comply or explain' approach, some may argue that it should be considered by each company. Yet if everyone overly focuses on the formality, and thus cannot achieve the objective of the Code, specifically "sustainable corporate growth and increased corporate value over mid- to long-term", they will simply mistake the means for the end. We need to reconsider that point.

Honestly, I'm not sure if this is something each company must consider, nor am I confident I should bring it up. Yet looking at Japan as a whole, even though the active participation of women in the workplace is promoted, when there will be a limitation of labor input in the future, to increase the potential growth rate – I think this is the area of expertise of Chairman Ikeo – it is necessary to increase capital injection by improving productivity and return on investment. I hope both of newly-established Codes will be one of the driving forces. In that sense, although some may criticize its public sector-led nature, I believe that the Follow-up Council is of great value, and I'd like to participate in a positive way.

Then what should be done from now on? As explained earlier, the Stewardship Code was formulated in February last year, and the Corporate Governance Code came into effect this June. These two Codes are called "the two wheels of a cart". Although two Codes were formulated one after another, I expect that they will be synchronized given that we call them "the two wheel of a cart". And while relationships between companies and institutional investors would have both 'tense and collaborative' aspects, in order for companies and investors to work together toward achieving sustainable corporate growth and increased corporate value over the mid- to long-term, I think we should discuss both Codes as a combination, not separately.

Speaking of "the two wheels of a cart", in Preamble 8 of the Corporate Governance Code, which was distributed as a reference material, it uses the expression "the two wheels of a cart" in the following context. First, companies are expected to take self-motivated actions in response to the Corporate Governance Code. Then such efforts by companies will make possible further corporate governance improvements, supported by dialogue with institutional investors based on the Stewardship Code. Therefore, I believe that companies are the main actors. In my view, companies decide a direction as the front wheel, and institutional investors support and check such efforts as

the rear wheel: the two wheels would be such front and rear wheels.

In that sense, I was impressed by Company H's initiatives which were introduced earlier today. First, companies take self-motivated actions in response to the Corporate Governance Code. Of course, under 'comply or explain' approach, if companies comply with the Code, they do not have to explain how they comply with the Code. Yet Company H ventured to explain how they comply with the Code. I could sense that their intention is not merely to comply with the rules, but to have dialogue with investors or show its corporate direction through the explanations. I also read the entire report disclosed by Company H. After reading the entire report, I feel I understood what the company is considering.

I can learn a lot of things from their report. For instance, they referred to "Evaluation Committee" throughout the report, so I understand that the committee is important for them.. Any written information can lead to dialogue. It would be OK to simply report that they comply with the Code, but it is not likely to lead to dialogue. In this sense, I think we need to change our awareness that 'comply' is better than 'explain'. I assume 'comply and explain' would be the best approach, superior to 'comply or explain'. I cannot strongly require companies to explain how they comply with the Code as the Code adopts 'comply or explain', but given that explanations facilitate dialogue, we will need to consider how we can appreciate corporate efforts to explain how they comply with the Code, I think. This may be a little too early, but let me tell you anyway. Upon selecting constituent companies of JPX-Nikkei Index 400, there are various requirements, and the requirement items are to be re-examined as necessary. Considering that the requirement for appointing multiple independent directors has been increasingly fulfilled. I think a new item could be included, for example, in a way to positively evaluate companies which actively make disclosure or interact with the market, although the content of the disclosure would be evaluated separately.

Another point is related to Mr. Toyama's comment, and leads to discussion of the two Codes in a combination. Considering that companies are the main actors to increase corporate value, and institutional investors support such efforts, we should assess the implementation status of the Stewardship Code from the perspective to question whether institutional investors really contribute to increased corporate value. Otherwise, there would be a risk of failing to achieve the fundamental purpose of the Stewardship Code.

Let me make one more point. This is the same old request. This Council is open to the public. As I requested at the Council of Experts concerning the Corporate Governance Code as well as at the

Council of Experts Concerning the Japanese Version of the Stewardship Code, please translate documents including minutes and materials into English to the maximum possible extent, so that the same information can be shared with overseas institutional investors, who are very much interested in the progress, although I understand it is a burden to the secretariat. The secretariat earlier referred to public comments. I'd like you to widely solicit opinions not only from within Japan, but also from overseas. I believe it would be beneficial after all.

That's all.

[Ikeo, Chairman] Thank you very much.

Professor Kawakita, please go ahead.

[Kawakita, member] Thank you very much. I think members would express various opinions, so I will make only one point, which nobody else is likely to refer to.

It is related to cross-shareholdings. In a certain sense, a good analogy for cross-shareholdings would be sleeping dogs or lions, in contrast with dogs which keep howling non-stop. If index investors or passive investors are to exercise their voting rights, they can become like such howling dogs or noisy dogs. There would be a possibility of having negative influence on corporate management. I think we should discuss this point.

I believe the exercise of voting rights is active behavior in a certain sense. As Mr. Toyama mentioned earlier, shareholders can make appropriate voting decisions, whether they vote for approval or refusal, only after having dialogue. Then the exercise of voting rights by passive investors or index investors may be contradictory in a certain sense, in my opinion. Of course, I do not deny the exercise of voting rights by passive investors, but there is an option that passive investors do not exercise their voting rights. Conversely, I think we need to consider who bears the costs of the exercise of their voting rights in what way.

Especially, public pension funds tend to deploy a passive investment approach. What are public pension funds thinking about now? What does the largest public pension fund discuss? They focus on reducing fees/costs for fund management. That's one of their goals. They have discussed that they would like to and will get a better evaluation for their behavior by achieving the goal. However, I think we should consider whether it is really good. If we required passive investors or index investors to exercise their voting rights, I think it necessary to examine whether a trustee organization of such passive investment has the structure necessary for the exercise of voting rights, and whether the trust fee is appropriate.

On the other hand, as for a trustee organization of passive investments, it would be necessary to examine how it generates fees for the exercise of voting rights. A possible scenario is that a trustee uses part of the fees collected from the entire business of the trustee in order to hire an analyst(s) or to cover various things. Then it means that the trustee collects fees from active investors and allocates money to passive investment. In a certain sense, it allows passive investors' free-riding. I think such an argument is possible.

Accordingly, both passive investors and their trustees should discuss what is really necessary, what actions are necessary, and whether fees for it are appropriate. By doing so, Japan's Stewardship Code would play the original role.

One more point. Upon exercising voting rights, investors often use proxy advisories. The earlier discussion referred to 2 advisory firms. In such a case, I believe that users of advisory services should examine the adequateness of advice: whether the advisory firms have reliable analysts, what analyzing processes they use, what kind of evaluation they conduct to make a final judgment regarding yes or no for voting rights. Having done so, they should decide whether or not to adopt the advice from the advisory firms.

That's all.

[Ikeo, Chairman] Thank you very much.

Ms. Takayama, please go ahead.

[Takayama, member] First, although there is an overlap with what Mr. Oguchi just mentioned, I'd like to make a comment on external information dissemination.

As stated in the Japan Revitalization Strategy (Revised in 2015) contained in today's Material, I believe it is very important to globally disseminate information on the current situation of Japan. I served on the board member of ICGN, an international organization of global institutional investors, from 2010 to June 2015. During that period, overseas institutional investors' perspective on Japanese companies' governance drastically changed. From 2010 to 2012, a kind of discount factor in terms of governance was applied to Japanese companies, even though being excellent companies, just because they are Japanese companies. That has changed dramatically. The Abe Administration included corporate governance in the growth strategy, and as specific actions, Japan's Stewardship Code was formulated, followed by the establishment of the Corporate Governance Code. This is the reason for the change. In such a flow, their views on Japanese companies have significantly changed.

I informed multiple overseas institutional investors of this Follow-up Council. They told me, “The Council should be useful for further improvement of corporate governance in Japan. We have high expectation for the Council. If necessary, we will present our opinions.” I’d like to ask the secretariat to disclose what is discussed here in the English language to the international community wherever possible, although I know it would be burdensome.

Now I’d like to share my view on the current situation of companies in connection with my own job. Currently, I provide IR consulting services for promoting dialogue between institutional investors and companies based on the Corporate Governance Code, as well as consulting services on corporate governance concerning board evaluations.

In the course of my duty, I had opportunities to talk with many management and board members. I have observed how those companies are responding to the Corporate Governance Code, and gained hands-on knowledge. Speaking from such experience, it could be said that the Corporate Governance Code has a great impact on Japanese companies, and caused Japanese companies to thoroughly consider corporate governance.

Let me share a story told by the chairman of the board of a certain company. That company established its good governance structure, and made efforts to enhance the effectiveness of the board. However, in the board meetings, they rarely had a fundamental discussion on how the board should be in general in the first place, and what they should think about the role and functions of the board. As you know, the board is generally pressed to resolve numerous matters within the limited timeframe. The board members were aware of the necessity of such a discussion, but did not have an opportunity to do so. However, since the Corporate Governance Code was stipulated, the board has discussed their response, including how they are to comply with it. In the course of such discussions, the board had a fundamental discussion on corporate governance. The chairman expressed his opinion that the Code served as a trigger for such discussion. Not a few companies have had this kind of experience.

On the other hand, some companies plan to respond to the Code under the initiative of the division in charge. Yet, as Mr. Shizuka mentioned earlier, even for such companies, fortunately or unfortunately, the Corporate Governance Code contains many significant matters related to the board. Consequently, the board as a whole must work on how they respond to the Code, and consider how the board should be. In that sense, it could be said that the Corporate Governance Code has a significant impact on companies.

In this way, we can see many positive impacts of the Code. On the other hand, from my experience of observing companies, I found two obstacles.

The first one is companies' understanding of each principle of the Corporate Governance Code. In their efforts for responding to the Code, not a few companies merely looked at the text [i.e. surface] of the Code, and consider their response based on it. However, as is obvious from the process of formulating the Corporate Governance Code, the Code did not come out of nowhere. It was created in the context of globally shared best practices of corporate governance, in a way to adapt them to the circumstances of Japan.

This applies to Japan's Corporate Governance Code, as well as OECD Principles and codes adopted in other countries, which were used as references in establishing Japan's code. Over the past several decades, investors and companies have continued dialogue on corporate governance, and through that process, certain empirical rules have been established: for example, by doing this and that, the effectiveness of corporate governance will be enhanced, and as a result, corporate value will increase over mid- to long-term. I believe that the Corporate Governance Code is a compilation of such empirical rules. In that sense, the Corporate Governance Code will serve as very useful guidelines for companies, which hope to increase the effectiveness of the board, and enhance mid- to long-term corporate value. However, not all companies understand the said context or background of the Code or the history of corporate governance. I think it would be desirable to provide in-depth explanations on such matters in the future.

The second problem is, as already pointed out by various members, the fact that not a few companies consider that they must comply with all the principles, or try to comply to the maximum possible extent. Among companies which already submitted their [Corporate Governance] Reports, the compliance ratio was very high. As pointed out earlier it would be partly because companies, which are confident with their governance system, tend to submit their Reports early. However, from my experience of talking with people from companies which will submit the Reports later, I got an impression that not a few companies have this preconceived idea that they must comply with all principles of the Code.

For example, some companies regard the Code as a kind of equivalent of laws and regulations, and consider that they must comply automatically. There are some other companies which are proud of being very much advanced in terms of corporate governance structure, and because of that, they consider that they must show a perfect score externally by complying with all the principles.

However, it is a common misunderstanding. As I mentioned earlier, the Code is a compilation of empirical methods which were established through a long process, and thus very meaningful. I think it is right to take a direction toward the compliance with each principle over time. Nonetheless, this is not something to be done in a short period, and in fact, it cannot be done. As Mr. Watanabe explained earlier, even in the UK, the compliance ratio is approximately 50%. Such a low ratio would make sense if companies intend to work hard on their response to the Code. Looking at each principle, a company may find that considering the circumstance of the company, it would be much more aligned with the spirit, norm, and philosophy of the Corporate Governance Code, if they did not comply.

Taking such situations into account, I hope the Follow-up Council can send the following message, something like "The direction of the Code is great, but please do not try to automatically comply with 100% of the principles. Instead, please thoroughly consider each principle, and use the Code to enhance the effectiveness of corporate governance."

That's all.

[Ikeo, Chairman] Thank you.

And now, Mr. Tanaka, please go ahead.

[Tanaka, member] As this is the first meeting, I would like to comment a bit broadly.

This is a precious opportunity, so I did some research on the events leading up to the organization of this Follow-up Council. In the way that Mr. Kanda organized the facts in this month's issue of "Jurist" - the June 2009 report of the Sectional Committee on Financial System of the Financial System Council which was chaired by Mr. Ikeo, and the reports compiled by the Corporate Governance System Study Group in the Ministry of Economy, Trade and Industry (METI) which was chaired by Mr. Kanda - it is things like this that set the groundwork, leading to the results produced in the "Japan Revitalization Strategy," the Stewardship Code and the Corporate Governance Code. In addition, the Ito Report of METI in August 2014 - I think this has also played an important role.

As explained earlier on, in the Strategic Direction and Priorities that was released last week, in the section on the vision of financial administration and the first item of key measures, the organization of this Council is raised as one of the concrete policies to ensure market fairness and transparency, and to create a vigorous capital market and stable asset formation. As explained earlier on, it has been pointed out that a problem in corporate governance reform is that it remains

at a superficial level, so it is necessary to raise the level from the superficial to the realization of substance. In the briefing materials of the secretariat, as mentioned earlier on, there are certain items that we are asked to discuss in this Follow-up Council, so based on that, I would like to raise 3 points.

First, I have just mentioned the June 2009 report of the Sectional Committee on Financial System of the Financial System Council, the reports of the Corporate Governance System Study Group and the Ito Report, and I think they are all extremely good reports. I think they should be used as references when examining the issue of what is the substance of corporate governance.

For example, in the report of the Financial System Council, with regard to the question of why corporate governance reform is necessary, it says that "we can say that the conventional governance structure centered on the main banks is giving way to market-based discipline." And even at that time, which is 6 years ago, "there appears to be no end to misconduct involving listed companies, and to the implementation of capital policies that severely undermine the interests of minority shareholders." And then, the report goes on to say "it has also been suggested that listed companies are controlled according to the internal logic of those managing the company, and that external accountability remains insufficient; or that no small number of companies tend to remain slow to respond when faced with a demand for change in management." Furthermore, with regard to the corporate governance of listed companies in Japan, it says "given the increasingly global nature of the capital markets, it is necessary for corporate governance to be sufficiently accepted by domestic and foreign investors alike, and to maintain confidence at the international level."

Therefore, from this context, with regard to the point of whether the Corporate Governance Code has substance, and Ms. Takayama also talked about this earlier on, I think perhaps verification from the perspective of whether the code is sufficiently understood by domestic and foreign investors alike is expected.

And then, the fact that 6 years have already passed since 2009. I think the verification of which items in these reports have been realized and which items have remained unchanged will be useful to understanding why certain items concerning corporate governance remain at a superficial level and have not advanced to the level of realization of substance, and where the problems lie.

My second point is in a sense something like the leading figure theory - as to the question of who are the leaders of corporate governance reform, I think the answer is the board of directors who are selected by shareholders. Therefore, it is probably natural to think that the board bears the

responsible for performing duties related to the realization of substance.

If we look at Principle 4-3 of the Corporate Governance Code, it is stated that the board of listed companies - and this is the important part - from an independent and objective standpoint, in other words, the board should "carry out effective oversight of directors and the management from an independent and objective standpoint." Generally speaking, in most of the listed companies in Japan, internal directors make up the majority of the board. For example, if 2 out of a board of 15 directors are outside directors, the remaining 13 are internal. In most cases, the 13 internal directors also assume concurrent *shikkoyaku*[2] positions, and they conduct repeated discussions on matters to be raised at board meetings and a consensus will have already been formed among the 13 directors working under the president at management meetings and so on. In this kind of general case, the question is how the 13 directors are going to discuss the issues again "from an independent and objective standpoint" when they attend the board meeting. And also, can they voice opinions that are different from what was expressed at the management meetings under their superior, the president? Thinking along this line, how each company will handle 'comply or explain' approach with regard to this aspect is something that will be very interesting.

Earlier on, Mr. Toyama and Mr. Kawamura also talked about top executives, and I think there is perhaps also the question of whether it is realistic to expect this kind of board in general to appoint and dismiss top executives in a timely manner and to do it with substance.

Actually, as the Deputy President of Mitsubishi UFJ Financial Group until June this year, I was reviewing our response to the Corporate Governance Code. This is a really difficult issue, and in the end, I had to leave it to my junior fellows. As to the reason why, let's take for example the explanation that "there are 2 outside directors in our company." Even though it serves as a formal explanation in relation to the principle that the board should maintain an independent and objective standpoint, it is extremely clear that such an explanation does not have any substance.

In addition, Principle 4-3 says that the board should "carry out effective oversight of directors and the management from an independent and objective standpoint." This kind of board should "carry out effective oversight of directors and the management...It should evaluate company performance and reflect the evaluation in its assessment of the senior management." In most cases,

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[2] *Shikkoyaku*: According to the Companies Act, Companies with Three Committees (Nomination, Audit and Remuneration) must appoint one or more *shikkoyaku* from directors or non-directors by a resolution of the board and delegate business administration to *shikkoyaku*. Also, authority to make certain kinds of business decisions may be delegated to *shikkoyaku*

personnel matters are handled by the president, but in this kind of board, the president has 12 subordinates under him. With the general board structure I mentioned earlier in which internal directors make up the majority, based on Principle 4-3, what are the expectations with respect to the internal directors working under the president, and what actually does the realization of substance in relation to General Principle 4 refer to? I think it is perhaps necessary to discuss and sort out this point.

Furthermore, when sorting out this issue, I think it might be necessary to get adequate understanding from both domestic and foreign investors. With regard to this, I am in complete agreement with the point made by Mr. Oguchi earlier on.

My third point is related to the reports of the Financial System Council and the Strategic Direction and Priorities mentioned earlier on. There is a point in dispute about the application of the Stewardship Code and the Corporate Governance Code on corporate groups. Both codes do not have special items concerning their application on corporate groups. Since the removal of the ban on holding companies in 1997, I think you can say that there is probably not a single company among the listed companies in Japan that has not adopted some form of holding company, be it an operating holding company or a pure holding company. In particular, there are many financial institutions that have formed corporate groups in the form of pure holding companies, and for Mega-bank groups designated as G-SIFIs like us, there is an increasingly high number of situations where we have to obey group regulations automatically due to international financial regulations.

As a result, for example, on page 12 of the Strategic Direction and Priorities, it is stated that "It is important for financial institutions that have global operations to improve preparations for group-based risk management and business management including overseas operations." And in the Financial System Council report 6 years ago, it is also stated that it is important to improve the so-called corporate group legal system from the viewpoint of thorough implementation of corporate governance in corporate organizations, and that it is hoped that a review of the legal system will be conducted. However, from the viewpoint of business practice, I think there are perhaps still many areas in both the Companies Act and the Banking Act that are very ambiguous with regard to the authority and responsibilities of listed parent companies, the board and the *kansayaku* board in such companies towards their subsidiaries.

As a result, for example, some people think that it is better for the directors of a holding company not to obtain too much information about its subsidiary so that the directors of the holding

company will not be held responsible for the problems of the subsidiary. There is even a trend developing based on this kind of thinking. At this rate, it is obvious that group governance cannot be achieved. To improve the holding company legal system is something that involves the actual scope of application of the Stewardship Code and the Corporate Governance Code, and I think it is necessary to properly identify the issues as they stand now.

As you all may know, the Companies Act has been established with articles to be reviewed 2 years later and it is expected that the issues that are raised at this Follow-up Council will be taken up during that review. Furthermore, I hope that a similar response will be made at the on-going Financial System Council as well.

Finally, the new OECD Principles of Corporate Governance was approved at the G20 Leaders Summit on Sep 5. The OECD Secretary-General, Mr. Angel Gurria, said that in today's highly interrelated world of business and finance, it is not possible to create trust if we do not work together. Similarly, in this Follow-up Council, I hope to share this kind of global perspective and get the opportunity to discuss points at issue that are incorporated in the new code.

That's all I have to say.

[Ikeo, Chairman] Thank you.

And now, Mr. Nishiyama, please go ahead.

[Nishiyama, member] As a strategist on the selling side, I have been studying a few areas in relation to governance, and this time, I would like to introduce only one of them, the area concerning cross-shareholding.

Speaking of cross-shareholding, it is said to be the typical code of Japan, if you look at page 2 of "A Rough Sketch of the Age of the Second Phase Selling of Cross-shareholdings," there is a summary of the ratio of cross-shareholdings in chronological order from the end of World War 2 when the Tokyo Stock Exchange resumed trading up till the present. When we refer to cross-shareholding, it includes not only so-called mutual shareholdings but also strategic shareholdings including non-mutual holdings.

First, as you can see if you look at this graph from a historical viewpoint, the facts show that cross-shareholdings have reached rather low levels. The ratio is shown here in blue, the cross-shareholding ratio that is defined as the cross-shareholdings of banks and business companies as well as the cross-shareholding ratio based on a broad definition with the inclusion of life and non-life insurance are at the lowest levels ever. On the other hand, if you look at the ratio based on

market capitalization, take for example the cross-shareholding ratio, it has exceeded 10%. And if you go by the broad-based definition of cross-shareholding, the ratio is 15%, but you can take either the view that it has already declined to the 10% level or the view that 10% still remains. If you talk with investors about this, I think you will come across both types of views.

Another thing I want to introduce is figure 2 on page 3. A breakdown of cross-shareholdings shows that in the case of financial institutions, banks or insurance companies, with the enforcement of financial regulations, cross-shareholdings have been considerably dissolved, and progress has been made in the selling of strategic shareholdings, but the facts show that not much has changed with regard to policy shareholdings among business companies. In particular - we have a figure showing the situation after 2000 here - the ratio has more or less remained flat.

I have many opportunities to speak with business executives about cross-shareholdings. And in the course of discussing various things, some of them said that they are companies held by them but actually there is no longer any significance for holding them, and that they intend to sell. But they find it difficult to bring up the subject of dissolving cross-shareholding with the other party or they are concerned about who will become the next shareholder if the shares are sold. Or in some cases, they have held the shares for such a long time that they will gain profit from the sell-off, but they are not sure whether it will benefit shareholders to go to the extent of paying tax to dissolve cross-shareholdings.

In any case, with regard to business companies, not much advance has been made in the selling of shareholdings without that kind of regulations in place. But this time, with the implementation of these two codes, when I talk to the people in companies, I think they are showing that they want to put more effort into dissolving cross-shareholdings and reducing strategic shareholdings. Since companies are expected to provide explanations as part of this kind of code, I hear more comments from companies saying that they want to do a mutual review, explain and think about the significance of the holdings, and - this was also mentioned in the newspaper article earlier on - I think business companies have started to do something about dissolving cross-shareholdings.

It’s just that when seen from an overall perspective, as I mentioned earlier, there is this question of whether the cross-shareholding rate of 10% is low or high. But in terms of flow, one can see that the trend is gradual, and especially in the case of business companies, perhaps due to the reasons I just mentioned, I think the companies that have actually taken action to sell are still in the minority even though it is true that the codes have served as a sort of trigger. In the first place, now that

cross-shareholdings have declined to this level, to what extent do they have significance? Are they still important? Or are they not all that important anymore in the context of governance? I think there is perhaps a need to think further along these lines.

And also, there is the issue of the disclosure status of the code. I have seen the governance reports of dozens of companies, and as the first step, you can perhaps say that the reports look very comprehensive, but they contain lots of general explanations and there are few cases that provide in-depth discussion of the details. In the first place, as companies are told to comply-or-explain, the fact of the matter is if they have complied, then they should explain that they have complied, or if they have explained, then they should explain that they have explained, but I think there are still some areas that investors are not clear about.

In that sense, if we think along the line of getting international acceptance as mentioned earlier, I think it is also necessary to consider for example translating the sections concerning governance in corporate governance reports into English, of course this also applies to the translation of the proceedings of this meeting into English. In terms of individual companies, there are some that can do that and there are also some that simply cannot, so I think perhaps such things need to be handled in an integrated manner.

I have gone into quite a bit of detail, but the above are the 2 points that I wanted to bring up.

[Ikeo, Chairman] Thank you.

Mr. Tsukuda, please go ahead.

[Tsukuda, member] Thank you.

In the same way as Ms. Takayama, I work as a consultant on corporate governance involving the evaluation of the effectiveness of board directors. Apart from that, I also provide support for succession planning of management that was discussed earlier, and I formulate succession plans by assessing the management of companies. If suitable candidates for management cannot be found internally, I will help by recruiting applicants from outside the company.

Today, first of all, I would like to bring up and explain 2 points based on my personal understanding of the issues.

My first point involves the Stewardship Code, as Mr. Kawakita also mentioned earlier, for styles of asset management, you have the so-called passive investment and also active investment, and among the different types of active investment, you have asset management companies that focus on growth or those which adopt the deep value investment style by employing strategic consultants

as analysts. And just as I was thinking about how to thoroughly implement the spirit of the Stewardship Code with such a variety of investment styles, the other day I had the chance to talk with an executive of a major company in Japan, which made me realize a few things.

First of all, this person said that when he talked to various institutional investors in overseas IR events, dialogue with high caliber institutional investors would make company executives realize new findings. This gave me quite a hint. I think it is important to promote dialogue, but that should not become the objective in itself. The fact that company executives find new things is a sufficient condition for a dialogue. If so, we need to think about what should be done in order to achieve that.

By the way, this business executive said that, unfortunately, such high caliber institutional investors are only found overseas and there are none in Japan. From the perspective of how to raise the level of the asset management industry in Japan in future, there is perhaps a need to think about what we should do about the Stewardship Code and how to follow up and improve on it in future.
Meanwhile, a number of asset management companies in Japan naturally are subsidiaries of insurance companies, banks and securities companies. There are also many retired executives sent from parent companies in the management of such subsidiaries. I think it is important to think about the career development of fund managers, and also development the top executives, the management in the management industry. This is my first point, which is about the Stewardship Code.

My second point is about the Corporate Governance Code. My first impression is - I think it is true that companies are clearly starting to engage in corporate governance reform due to the implementation of the Corporate Governance Code. In that aspect, I thought all the people who are involved in the establishment of the code have really stepped in and done a wonderful job. And actually there were some company executives – although they are only a small number - who are aware of the problems and are tackling the problems head-on. I think this is really wonderful.
On the other hand, if you say are all companies doing that, well that is not necessarily the case. It might be better to say that the majority of companies have actually not done anything about corporate governance or rather there are many companies that have only just started. This is my personal opinion, but when I read the Corporate Governance Code this time, the more I read the more I find that an extremely difficult, high level is imposed. To respond to the Corporate Governance Code, companies will have to revise the agenda of board meetings for example. However, in revising the agenda of board meetings, will everything run smoothly if only the

supervision side is reformed? That is not the case. In actual fact, management meetings as well as the execution side below that must be included. The point is if the entire decision-making process of management on both the supervision side and the execution side is not reformed, the effectiveness of board meetings will not improve. That is why I think you can say that a response has been made to the Corporate Governance Code only when it is accompanied by a fundamental reform of management.

In that case, to put it in a nutshell, it is necessary to decide which aspects of Japanese style management to retain and which aspects to change. This is a very weighty subject, and if you ask whether it is possible to succeed in corporate governance reform in one year, most probably I don't think it can be done in a year.

In that sense, what I am personally concerned about is the state of implementation and explanation by principles of the code on page 4 of Material 4 that was explained by the Tokyo Stock Exchange just now. Take for example, item 38 - Supplementary principle 4-1-3, which is found in the middle. This is exactly what everybody has pointed out, including Mr. Toyama followed by Mr. Kawamura and Mr. Tanaka. If you read 4-1-3, it says "Based on the company objectives (business principles, etc.) and specific business strategies, the board should engage in the appropriate oversight of succession planning for the CEO and other top executives." This refers to the succession of the president. On the other hand, as Mr. Tanaka also said, out of 15 directors, only 2 or 3 are outside officers while the rest are internal directors, and the candidate for the next president is, of course, found among the internal directors. In this kind of situation, if you ask whether substantial discussion about succession planning can be carried out, I don't think that is possible.

If so, what should be done? The only option is to create a nominating committee. Basically, this nominating committee will be made up of mainly outside people plus the incumbent president, and depending on circumstances, the chairman may also be included. And if discussion at a deep level is not carried out within the committee, then, as Mr. Tanaka said, it will not be possible to have succession planning "from an independent and objective standpoint," in accordance with Principle 4-3. If so, among the 12 division managers, managing and executive directors who serve as the subordinates under the president, the same people are found on both the supervision side and the execution side, and if you ask can they engage in appropriate oversight from an independent and objective standpoint, I don't think they can.

The earlier discussion about CEO succession is about setting the exclusive prerogative of the president concerning personnel matters, which was the usual practice in Japanese companies up till now, as an item to be handled by the board, and I believe that in reality, there are companies that are not suitable for the board to handle the succession planning of the president. There's also the historical background among other things, whether it's the size of sales or whether it's an owner type of business, so it is not my intention to advocate in a fundamentalist approach that the board should handle succession planning in every company. However, if a Japanese company, which has a certain scale and is active globally, really intends to pursue the essence, including institutional design, it will have to make drastic changes. I think if considerable changes are not made to the Japanese style of management, including conventional practices concerning the selection of the next president, it is perhaps not possible to claim that a substantial response to the Corporate Governance Code has been made.

When I talk to many companies, I find that everybody is paying too much attention to how to prepare and submit governance reports. So my concern at this Follow-up Council is the actual state of efforts to carry out corporate governance reform in Japanese companies in a substantial way - in terms of the findings of the survey by the Tokyo Stock Exchange mentioned earlier, 65 out of 68 companies say that they have CEO succession and president succession plans in place - but is this really adequate? I think perhaps this should be verified.

It so happens that we are doing a survey among companies listed on the First Section of the Tokyo Stock Exchange on the state of their efforts in response to the introduction of the Corporate Governance Code on June 1. We have received replies from more than 300 companies, and the collation results will be out soon, so if there is an opportunity, I would like to introduce some of the findings at the next Follow-up Council.

To give a slight introduction here, we find there are major differences in the efforts between companies that have brought in 3 outside directors and companies with 2 or less. My interpretation at this point - my comments may change at the next meeting - but the fact that some companies have taken the initiative to bring in 3 or more outside directors when they are told that 2 is enough shows that such companies have a high level of awareness of the issues. Company executives who have a strong awareness of the problems think seriously about the ideal management style for Japanese companies and corporate governance, and I think perhaps they are naturally taking measures that go beyond the governance code. Based the state of response in this kind of

companies, I hope that we can also discuss how the Corporate Governance Code should be revised in future.

That's all I have to say.

[Ikeo, Chairman] Thank you.

And now, Mr. Iwama, please go ahead.

[Iwama, member] I have got off to a late start and I think it is more difficult to make comments towards the end.

First of all, with regard to the point raised by Mr. Tsukuda, actually I also want to mention a few things including self-questioning as a member of this industry. Having come under a preemptive attack, I have seriously taken to my heart. Coming into this meeting, my biggest concern is how the flow presented on page 4 of the briefing materials prepared by the Secretariat can be achieved, and it's key or starting point is the 2 Codes. This is sort of like an infrastructure, and for infrastructure to function properly, we should think about what should be done going forward, or from my perspective of the asset management industry, it is important how we run the meetings effectively?.

In the first place, for a long time, various things have been said about governance in Japan, and it has been regarded as a limiting factor like some kind of governance discount in the stock market. This is in part due to the Lost Two Decades and also the fact that the market itself had a low evaluation. In addition to them, I think the issue of governance had also cast a shadow.

From 1990, I moved on to asset management industry. Towards the end of the 1990's, my former company also adopted a holdings company structure, and they recruited quite a number of outside directors, and I also became a minor member of the board. As may be expected, there was clearly a difference in the way in which the outside directors see things, and it cannot be denied that even when a very simple and straightforward questions was asked, the board became tensed and seemed to freeze on the spot like it had the bull's eye. Later, I believe [my former company - due perhaps to the considerable advancement of globalization, it also has a *kansayaku* board - made considerable progress in reform in various sense of the word.

That is the situation in my former company, and I am thinking about how we, in the asset management industry, can play a useful role in making the Stewardship Code - which many of you commented on earlier – make it operate effectively and specifically. Basically, this is the very thing that underlies the question of how to improve corporate value in the mid- to long-term, or in other words, how to guarantee the revitalization of the securities market in the mid- to long-term. This is

something that cannot be done by the asset management industry alone, and it is better that the asset owners themselves should bear in mind the fact that they will benefit, and indicate clearly in what way they need to reach out to asset managers. We are working as the agent of asset owners, so taking action in accordance with the intention of our clients is the most important thing. In that sense, I think it is extremely important to make it such that it will lead to all the citizens of Japan receiving benefit, and I hope this viewpoint will also be discussed at this Follow-up Council.

In doing so, I think the question is how we should regard passive investors. A very interesting question for us is how passive investors have changed or is changing their behavior. I have been following this matter closely in the last 2 to 3 years, and I have found that even institutional investors, who consider it appropriate to operate on the basis of complete passive management, in terms of silent shareholdings, have started to take action based on a shift in their thinking that they should actively participate in raising the level of market beta, and that this is one way to contribute to economic growth. Sovereign wealth funds are one of such examples, and the major life insurance companies in Europe and the US that make up one components of institutional investors are another example. In addition, major pension funds have also started moving in that direction.

It includes not only the perspective of governance, but also corporate strategy itself or more broadly ESG perspective, and I think our position is how we can actively work with institutional investors and get them to take action on the questions of how to make everything run smoothly. In that sense I think it is perhaps important for asset owners to make all kinds of requests to asset management companies, as how we should be taken an action. Speaking as our perspective, how should we take action so that the management and board will say that we have said something good and not avoid us, or in other words, we do not get criticized by them for having to take time for boring meetings with us. I think it is very important to clarify what kind of things asset owners want to us to ask them so that we can achieve better engagement than high-caliber European and America institutional investors, as Mr. Tsukuda mentioned just now.

The key factor to corporate governance, as a number of people pointed out earlier, is the extent to which we can make succession planning meaningful. The point is no matter how hard you work at succession planning, there are quite a large number of cases that end up with bad results. I think this is linked to the fact that it is very easy to revise succession plans later if the process is transparent and persuasive. At the root of the corporate governance problem in Japan is the fact that even if the best choice is made, companies still get boring criticism about succession which people

on the outside have no way of understanding, and considering that companies worry about whether they will be criticized, it is important to offer a guarantee in the form of compliance with the Corporate Governance Code, especially when it comes to the selection of the top executives in major companies that have active global operations. As for the other problems, we simply have to explain that this is the Japanese way of doing things.

In that sense, everybody has pointed out core issues at the heart of this matter. In my position as one of the players who share the burden, I hope to participate in this Follow-up Council by accepting all those comments with sincerity.

[Ikeo, Chairman] Thank you.

And now, Mr. Era, please go ahead.

[Era, member] Thank you.

First, I would like to introduce a bit of the actual situation, and I hope you will allow me to say a few things. I think it is an important point that dialogue between companies and investors had been carried out in a substantial way in the midst of changes in the composition of shareholders and increasing interest in such matters, even before the Stewardship Code or the Corporate Governance Code was established. And The Corporate Governance Code and the Stewardship Code were established based on a build-up of such business practice, so I think it was good that things have moved in the direction of further promoting that kind of existing practices. The level of interest in such matters has increased tremendously, even after the two codes were established, I think dialogue with companies and the exchange of opinions among investors have become very much active. Thus, I think we should properly sort out and consider the business practices that have existed in the first place.

With the establishment of the Corporate Governance Code, more companies are keen to explain their initiatives to investors or the progress of their ongoing developments on this kind of initiatives, which have appeared in the course of ‘comply or explain’ approach. There have been many comments about ‘comply or explain’ approach, and - this may be a rather strange way of putting in - I think it requires courage for companies to make disclosures in a way explaining their own unique approach by expressing themselves clearly in their own words. I think what we should do right now is to properly recognize such things and encourage companies on such disclosure.

With regard to the Stewardship Code - this may be partly based on our own reflection - many people have made the point of whether high quality investors are present or not. We do think of

how we can be useful to companies. Basically, we try to have dialogue that will make them become aware of new findings - I think this phrase is a nice way of putting it. Naturally we will keep thinking about how we can become investors who add value. As might be expected, there are many people who are interested about such matters including not only foreign investors but also Japanese investors. Some of them who share the same interest have come together to organize activities such as investor forums, and there are also efforts by the private sector to discuss or sort out various ideas on issues such as what areas investors are interested in or what one needs to do to be acknowledged as a valuable investor by companies. I believe we should also carefully sort out and take into consideration of such activities and efforts.

And also, I would like to say a few words about the infrastructure aspect. I thought the materials compiled by the Tokyo Stock Exchange are excellent. Actually, we have tried to do something similar, however it is surprisingly difficult to gather information about the state of response to the codes. I think it would be great if we can have a proper discussion here on infrastructure development so that investors can access such information easily and spend more time on evaluation.

Finally, please excuse me for going slightly back to the Stewardship Code, investors are reporting the details of their activities under the Stewardship Code in the form of activity reports. While each investors are disclosing or reporting to clients using different unique formats or methods. With regard to the disclosure of the state of response to the Stewardship Code, I would like to request a review for a unified reporting format - may take the form of something like a framework - in order to create an environment in which the people who actually undertake the practical aspects of business can focus more on dialogue. By reporting in a format which allows asset managers to make disclosures in a unified format, which they can provide to all customers, based on agreement from clients, or disclose the nature of their activities to a wider audience with one document, it will lead to reduction of the burden of reporting. I think it will be great if we could also discuss such matters here.

I’m afraid that all the points I have raised tend to lean towards the practical aspect of doing business, but I wanted to bring up these issues, thinking perhaps it’s about time to think about appropriate infrastructure in order to further actively promote this kind of dialogue. Thank you.

[Ikeo, Chairman] Thank you.

And now, Mr. Takei, please go ahead.

[Takei, member] I'm sorry…I think there's only about 5 minutes left, so I will make my comments short.

I think this Follow-up Council is significantly important. In particular, companies are now making various preparations, so there are 4 messages that I think it is better to send out at this timing.

My first point is - as everybody has pointed out - I think a clear message should be sent out that companies need not be afraid of explaining. "Explain" can refer to either comply-and-explain or comply-or-explain, and if anything, everybody tends to feel that the "explain" part of 'comply-or-explain' is more difficult, so we should send out a message that they should not be afraid of this aspect. The Corporate Governance Code is a new attempt at providing non-financial information outside the company based on a mid- to long-term perspective, and it is in fact a self-diagnosis sheet for the sustainable growth of the company. If a company says "I have done my self-diagnosis and my company is healthy" without checking one's own symptoms or examining the issues, no progress will be made, and neither will the report serve as the basis for dialogue with investors, so the first thing is to send out the message: "Need to examine your own company first."

In addition, governance is ultimately an issue about the intention to let one's company grow further, so if only superficial explanations are found, it also implies, in a sense, that one doesn't feel the intention to make one's company grow further. From that perspective, there should be many challenges in future that cannot be done immediately, and there are also things that must be done from now on due to changes with the external environment. I think one of the messages that should be given to companies is: "Please show us that kind of positive attitude and explain without any fear." That is my first point.

My second point is - and this also involves the discussion about explain the issue about whether institutional investors have the caliber to accept explanations as everybody talked earlier,. If they don't have caliber, even if companies work very hard to provide explanations, it is not meaningful from their perspective. Or institutional investors need to understand explanations properly - I think this kind of thing is quite important. From this perspective, I think what Mr. Kawakita said earlier includes a very important point. If institutional investors adopt practices such as merely following the advice of proxy advisory firms in order to fulfill their own duty of diligence, it will mean getting the priorities wrong, so it is necessary to scrutinize them closely so that institutional investors do not merely comply in a superficial way with the Stewardship Code.

As Mr. Iwama has said, it is also important for asset owners to properly understand and pay for the cost that comes with efforts of asset managers to try to understand explanations. I think it is important to get an overall understanding that includes the asset owners at the end of the investment chain. That is my second point.

My third point is, since companies are going to do a self-diagnosis anyway, they should produce corporate governance reports that properly shows a storyline that is rooted in the company's own sustainable growth strategy. In this Corporate Governance Code, Principle 3-1 starts from business principles, business strategies and business issues, and it says "Please explain the governance scheme for achieving that." The flow of this code has a very good structure. I think one of the messages that should be given to companies is: "Please do not forget about this objective while explaining corporate governance in the form of realizing your company's growth strategy." One of the reasons why Japanese corporate governance seems to be undervalued by foreign investors is the way of explanation made by Japanese companies, such as when Japanese companies give explanations about their corporate governance, they mostly give simply legal explanations like "We choose Company with *Kansayaku* Board as our organizational structure under the Companies Act". However, these explanations have no connection whatsoever with the company's growth strategy. A Japanese company needs to make explanations that show link between its growth strategy and its corporate governance system.

In relation to this point, I think that the key strategic nature concerning outside directors is diversity. It is important to explain diversity and strategic nature to the public, such as what a company expects of the people they have appointed as independent officers instead of explaining in a formal way what kind of people they have asked to serve as independent officers.

As discussed earlier about succession planning, I feel that there is still much room for improvement in relation to explanations about the diversity, strategic nature of internal directors as well. In the updated form of the corporate governance report, the first-half covers explanations concerning the Corporate Governance Code while the second-half covers the contents of previous form. As compared to the detailed explanation are made about outside officers in the second-half, the degree of the explanation about internal officers and internal directors in the first half is not sufficiently detailed yet. It is the internal officers that will lead to sustainable corporate growth and the increase of corporate value, so I think it is important, in terms of storyline, to further enhance disclosures concerning internal officers and directors as well.

Finally, for my fourth point, it is often quite difficult to find a department that is in charge of corporate governance among Japanese companies. While corporate planning, finance, legal affairs and IR departments work together to develop their policy for the Corporate Governance Code in most cases, many companies still wonder which department is supposed to continuously develop the policy for corporate governance. If there is no department in the corporation, no staff will be assigned and neither will a budget be allocated in general, which event is not desirable for facilitating good practice under the Corporate Governance Code, given that constant efforts on the code should be made in the future. At least a department that is responsible for developing the policy for corporate governance on a daily basis is required. I think the independency of such department is perhaps a point in dispute, but it might be better for the department, which constantly thinks about corporate governance in the company, to be more visible.

That's the 4 points I wanted to make.

[Ikeo, Chairman] Thank you.

Everybody has made comments. We don't have a rule that each person can only speak once, but we have almost used up our allocated time, so if there's anything that you would like to add taking into consideration all the views that have been expressed, please go ahead. If this is fine with everybody, then I would like to bring today's meeting to a close.

Some of you pointed out the importance of sending out messages, so taking into consideration the views that were expressed today, I would like to send out some kind of message or an opinion statement which summarizes the way in which this Follow-up Council is run in future and the kind of issues that will be taken up in future. We will announce that both internally and externally, and invite public opinions. In line with this, I will get the Secretariat to create a draft of the opinion statement I just mentioned based on everybody's views that were expressed today, and publish the statement after it has been confirmed by everybody. You will get the draft of the statement delivered by email at some time, so I would appreciate it if you could make
sure that you check the content. And I take it that everybody agrees that we should send that kind of message.

Finally, if the Secretariat has anything to inform everybody, please go ahead.

[Mr. Tahara, Director of the Corporate Accounting and Disclosure Division] Thank you for today's discussion.

I would like to bring up 2 matters. The first thing is actually related to what Chairman Ikeo has

just mentioned or the discussion held today. In line with the seeking of a broad range of opinions from people both on the inside and outside that was mentioned at the beginning, before going ahead with the future way of proceeding mentioned just now, if possible, I would like to upload both the Japanese and English versions on the website of the Financial Services Agency and the Tokyo Stock Exchange today, and make a call for the public to provide opinions. And I would also like to upload the future way of proceeding at a later date.

My second point is the schedule of the next Follow-up Council. The Secretariat will let you know at a later date after taking everybody's schedule into consideration Thank you in advance for your cooperation.

That's all I have to say.

[Ikeo, Chairman] Thank you.

We have exceeded the scheduled time by 5 minutes, and now I declare this meeting closed. Thank you very much.

—— End ——