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

November 24, 2015

[Ikeo, Chairman] Now it is the scheduled opening time. So I'd like to open the third 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.

As written in the meeting agenda, today we will discuss issues around cross-shareholdings. In the previous meeting, we discussed the board. Naturally, it does not mean our discussion on the topic is over. The secretariat will thoroughly sort out issues raised in the previous meeting, and then we will discuss the topic once again, or 2-3 more times. So today's topic is issues around cross-shareholdings.

First, the Financial Services Agency, in the capacity of the secretariat, will explain initiatives of the three major-bank groups. Following that, we will hear two guest presentations. Mr. Masatoshi Matsuzaki, Chairman of the Board of Directors at Konica Minolta, Inc. will talk about corporate initiatives first. Then Mr. Hiroki Sampei, Director of Research atFidelity International and a steering committee member at the Forum of Investors Japan, and Mr. Ryusuke Ohori, Chief Investment Officer of the Japan Research Driven Process Team at JPMorgan Asset Management (Japan) Ltd. and a steering committee member at the Forum of Investors Japan too, will talk about "Opinion on Cross-shareholdings", which was published by the Forum of Investors Japan in September.

Now I'd like to start the proceedings. First, I'd like to ask the Financial Services Agency representative to explain initiatives of the three major-bank groups.

[Ishida, Director of Banks Division I] I'm Ishida from Banks Division I, Supervisory Bureau. It's my pleasure to be here.

We distributed A4-sized material indicated as "Explanatory Material". I'll explain in accordance with this material.

Please open the material to the first page. This is an excerpt from 'Financial Monitoring Report'

published by the Financial Services Agency in July 2015. You can see various charts on it. Compared to G-SIFIs in Europe and the US, the three major-bank groups have a higher rate of shareholdings to equity capital. This means that particular attention needs to be paid to the impact on equity capital due to a decline in the stock price. Later on page 4, we included a chart showing changes in the equities held for business relationship purposes over time. It has been a problem for quite a long time.

Please take a look at the small line chart on the upper right on page 1. The red line represents ratios of shareholdings to equity capital among the three major-bank groups. In calculating the ratio, the denominator is Tier 1 capital, and the numerator is the market value of shareholdings. The line shows an increasing trend. Of course, the recent rise in market value is a significant factor, but even if we rule out such a factor, compared to the ratio of shareholdings to equity capital among G-SIFIs in Europe and the US as shown by the blue line, as I just mentioned, the ratio among the three major-bank groups is much higher. Naturally, in case of a drop in the stock price, this part will be affected in the form of a reduced market value.

The bar chart on the lower right shows the current state of equity capital in terms of Common Equity Tier 1 (CET1) ratio. The bar on the left represents CET1 ratio of the three major-bank groups; and the bar on the right represents the ratio of G-SIFIs in Europe and the US. Looking at these two bars, we get an impression that they are almost comparable. However, the bar in the middle represents the three major-bank groups' CET1 ratio after deducting net unrealized gains on stocks, which is lower than CET1 ratio of G-SIFIs in Europe and the US. So you can see the net unrealized gains on shareholdings contributes to making their CET1 ratio compare well with that of G-SIFIs in Europe and the US.

As you know, in the past, especially in the turmoil of the financial system, economic/market downturns affected financial conditions of financial institutions through a drop in stock price, and restricted sufficient function of financial institutions (so-called occurrence of procyclicality). Partly because of that, in the past, various measures have been taken to reduce shareholdings held by financial institutions.

I'll move on to the fourth bullet point. It is necessary for the three major-bank groups, from the perspective of soundness, to further strengthen their financial bases especially through reducing the risk of stock price fluctuation in order to be able to adequately respond to the growing needs of

business support to enterprises during such hard times. That's what we suggested in the Report.

Please turn to page 2. In this connection, you can find the similar issue in the revised 'Japan Revitalization Strategy', which was decided by the Cabinet on June 30. I'll read out the second sentence: "Especially, the global systemically important financial institutions need to reduce procyclical factors such as the risk of stock price fluctuation, etc. in order to be able to adequately respond to the economic/market changes and business support needs of enterprises during hard times, while taking into consideration the international regulatory changes." The Strategy incorporated the issue in this way.

Please turn to page 3. In June to July, the three major-bank groups issued their Corporate Governance Reports, and disclosed their policies of shareholdings for business relationship purposes therein. The first one is an excerpt from Mizuho Financial Group (MHFG)'s Report released on June 1. Let me read it out. "As a basic policy, unless we consider these holdings to be meaningful, MHFG and our core subsidiaries will not hold the shares of other companies as cross-shareholdings. This reflects factors including the changes in the environment surrounding corporate governance and the potential impact on our financial position associated with the stock market volatility risk.

The next one is from Sumitomo Mitsui Financial Group (SMFG)'s Report, which was released on July 3. I'll read out the main part. "In principle, in order to help maintain SMFG's financial soundness, SMFG does not hold the shares of other listed companies where 'the rationale' to hold those shares cannot be recognized."

Third one is from Mitsubishi UFJ Financial Group (MUFG)'s Report released on July 31. They have "adopted a basic policy that its Group banks, taking into account shareholding risk, capital efficiency and international financial regulations, shall reduce the amount of shares held for the purpose of strategic investment, following sufficient consultation with the relevant corporate business clients."

Such policies were announced by the three major-bank groups last summer.

On page 4, the line chart shows changes in the equities held for business relationship purposes over time, from 2003, approx. 10 years ago. It shows each major-bank group's shareholdings on an acquisition cost basis. As you can see, as of end-March 2003, which is in the leftmost of the chart, MUFG held 6.1 trillion yen, followed by MHFG which held 3.9 trillion yen and SMFG which held

3.2 trillion, in total roughly 13 trillion yen of shareholdings. Then, each group has made effort to reduce such shareholdings at different paces. The most recent data is shown in the rightmost. As of end-March 2015, MUFG holds 2.8 trillion yen, followed by MHFG which holds 2.0 trillion yen, and SMFG which holds 1.8 trillion, totaling some 6.5 trillion yen. Although the shareholdings have been reduced, you can see the pace of reduction has been slowing – the shareholdings remained almost unchanged in the past few years. The pace of reduction has not accelerated. Under such a circumstance, we, the Financial Services Agency, are working further on this issue.

Meanwhile, after disclosing their policy on the equities held for business relationship purposes in the Corporate Governance Report in June/July, each of the three major-bank groups has been considering how they could further address the issue in the future. Then, recently – on November 13, as shown on pages 5, 6 and 7, they disclosed their near-term policies and future actions based on results of their further considerations, when announcing their interim results in November.

The first one is MHFG's policy. Their basic policy shown in the upper left is the same as what I explained earlier. As explained in the lower left, they assessed the meaning of shareholdings. They determine shareholdings as meaningful when a 'ratio of Total Profit to Risk Capital' exceeds the hurdle rate established based on their ROE plan. Actual figures are shown on the right. According to their calculation, they need to reduce shareholdings by approx. 40% to satisfy their profitability criteria. In this pie chart, the total value is 1,962.9 billion yen, representing the total value of their shareholdings. They need to reduce the area enclosed by the thick blue line, approx. 40%. They also announced that they aim at achieving at least approx. 70% of the required reduction by selling such shares by ending in March 2019; and 40 to 50% of the above disposal plan by Mar. 2017 through accelerating dialogue and negotiation with clients.

Page 6 shows the policy of SMFG, which was also released on November 13. Their policy is quoted in the box on top. It reads "We will continuously mitigate the risk from stock price fluctuations in order to have a more stable and robust financial base. Toward achieving an appropriate level of the Ratio of Stocks-to-CET1 capital as one of the G-SIFIs, we aim to have the assurance of reducing the current Ratio by half within approximately 5 years." CET1 stands for Common Equity Tier 1 ratio, as I referred to earlier. The chart below shows such a plan by indicating specific figures.

Page 7 is an excerpt from MUFG's summary of interim results. Their policy to reduce equity

securities held for strategic purposes is shown in the red box at the bottom of the page. It reads “We are aiming to reduce our equity securities holdings for strategic purposes to approximately 10% of our Tier 1 capital on an acquisition cost basis over the next 5 years.”

In their disclosure documents, three groups described their reduction targets with different measures such as CET1 ratio, Tier 1 ratio or 40% of the total value, so it might be difficult to compare the targets with each other. I’ll provide a supplementary explanation. In case of MUFG, the acquisition costs as of March 31, 2015 were approx. 2.8 trillion yen. So it can be restated that they are going to reduce shareholdings by approx. 800 billion yen or approx. 30% in around 5 years. In case of MHFG, the acquisition costs can be rounded to 2 trillion yen. They aim at reducing such shareholdings by approx. 550 billion yen, or approx. 30% in around 3 and a half years. Thirdly, in case of SMFG, while the acquisition costs were 1.8 trillion yen, they aim at reducing such shareholdings by approx. 500 billion yen or 30% in around 5 years.

These are the recent moves of the three major-bank groups. We the Financial Services Agency will closely monitor that each major-bank group continues to reduce its shareholdings for business relationship purposes.

That’s all from me.

[Ikeo, Chairman] Thank you very much.

You know that the Follow-up Council is inviting public comments on issues to be discussed. Now I’d like to ask the secretariat to introduce received comments.

[Tahara, Director of the Corporate Accounting and Disclosure Division, FSA] As Chairman just said, the Follow-up Council is inviting public comments widely, and we have received two opinions related to today’s topic. So I’d like to introduce those opinions.

The first one states that Principle 1.4 of the Corporate Governance Code consists of three parts. The first part is that companies should disclose their policy on cross-shareholdings. The second part is that the board should examine cross-shareholdings on an annual basis, and provide detailed explanation of the objectives and rationale behind it. The third part is that companies should establish and disclose standards with respect to voting rights as to their cross-shareholdings. The first commenter provided his opinion on each of these three parts.

With regard to the first part concerning the disclosure of the policy on cross-shareholdings, many companies tend to provide abstract explanations such as “it is necessary to maintain

collaborative relationships with other companies" or "to increase the corporate value", but do not specifically explain why such shareholdings help them strengthen collaborative relationships, or whether they can gain business benefits from such shareholdings. So the commenter would like companies to provide clear and specific explanations. As for the second part concerning the examination and detailed explanation, the commenter pointed out that no company has disclosed specifically how they analyze return and risk, but that companies should examine such matters by looking at numerical values. With regard to the third part about the establishment and disclosure of standards concerning the exercise of voting rights, the commenter claimed that there is no example of clearly-defined standards concerning the exercise of voting rights. The commenter further stated that in addition to the current principle which requires the establishment of standards concerning voting rights, companies should be required to disclose results of the exercise of voting rights.

Overall, this commenter states on this Principle that listed companies, as a general rule, should be prohibited from owning cross-shareholdings, by naming several reasons. If the objective of cross-shareholdings is to maintain/expand business transactions, there will be a suspicion of giving benefits. If a company holds such shares as a stable stockholder, such shareholdings will be regarded as an anti-takeover measure for the entrenchment of the issuing company's management, and thus inappropriate. He also stated that operating companies should not take the risk of stock price fluctuation.

The second commenter raised a question whether it is possible to consider tax benefits to facilitate the disposal of cross-shareholdings.

These are the two comments we received.

[Ikeo, Chairman] Thank you very much.

Now I'd like to ask today's guest, Mr. Matsuzaki, Chairman of the Board of Konica Minolta, Inc. to make a presentation. We distributed Material 2 "Our Response to Principle 1.4", which he prepared for the presentation. Mr. Matsuzaki, I'm handing it over to you.

[Mr. Matsuzaki, the Board of Chairman, Konica Minolta, Inc.] I'm Matsuzaki, Chairman of the Board of Konica Minolta, Inc. I'll explain in accordance with Material 2. I assume you'll have a Q&A session later, and hope this presentation will facilitate active discussion.

Before going into the main issue, I'd like to briefly explain characteristics of our Company's corporate governance system, because it is connected to specifically how we responded to the Code,

such as General Principle 1.4. Our company was founded in 2003 through the business integration of Konica and Minolta. Since then, we have continued the operation of the corporate governance system, where the execution and supervision of the management are separated.

Let me tell you the background. Before the business integration, Representative Director & Chairman of Konica at the time said, “When I was President, I did not feel that I was checked by third parties. That is not good. It is necessary to have a system in which checking functions work without relying on personal moral values and innate disposition of the management.” With such a problem consciousness, he decided to devote himself to the supervision of the management thereafter, and set about establishing this system. The established system was stipulated as “Corporate Organization Basic Regulations”. During the process of developing the Regulations, Mr. Takei, a member of this Follow-up Council, helped our Company a lot.

Now I’d like to talk about characteristics of our system. We adopted the organizational form of ‘Company with Three Committees’, which was a new option at that time, in order to introduce a perspective of outside directors, and to separate the execution and supervision of management. We stipulated in the Regulations that the highest-ranking executive officer is President & CEO, and that Chairman shall not serve as an executive officer. Meanwhile, to ensure the separation of the execution and supervision, the Regulations stipulated that Chairman of the Board shall be selected from non-executive directors, and all the Chairman of Committees shall be outside directors. Any director who concurrently serves as a representative executive officer shall not serve on Nominating or Compensation Committee. In fact, practically there is no committee member who concurrently serves as a director and executive officer. All the committee members are either outside directors or non-executive inside directors. Chairman of the Board concentrates on the supervision, and plays a role in organizing the Board meetings, while leading and facilitating efforts for enhancing the effectiveness of the corporate governance system.

We also conduct an evaluation of the Board every year, and the results are shared by the Board members. At the first Board meeting after the general shareholder meeting, Chairman of the Board declares the operating policy of the Board for the following year based on the evaluation results. This is what I started when I assumed the role of Chairman of the Board. Then we implement the PDCA cycle. We operate in this way to enhance the effectiveness of corporate governance every year. Therefore, our corporate governance system was designed by the person who decided to

devote himself to the supervision, and is facilitated by Chairman of the Board who concentrates on the supervision. This is a distinctive characteristic of our Company's governance.

Similarly, our response to the Corporate Governance Code was also led by Chairman of the Board: while monitoring the progress of discussions at the Council of Experts, the Board members discussed to what extent our Company had complied with the Code, and what we should do regarding certain principles we had not complied with, thus finding a direction. This is a characteristic of our Company.

Now I'd like to talk about the main issue – our response to Principle 1.4. We consulted the Board members and confirmed that we should 'comply' with this Principle. Such a decision was made because we consider it reasonable to establish and disclose the policy on cross-shareholdings as well as standards of the exercise of voting rights in order to ensure accountability to our investors.

Regarding the second part of the Principle, reports from the execution side concerning "the rationale and future outlook of major cross-shareholdings based on the results of the examination" should be set as an item of supervision of the Board. This is also a matter of course for fulfilling supervisory responsibility, so we decided we should 'comply'.

Then what did we do after deciding what direction to take? The execution side immediately established the policy and standards in question. At the Board meeting in June, the Board received a report and approved it. Then our Company disclosed the policy and standards in the Corporate Governance Report issued on June 30, 2015.

The content is shown in the Material. Earlier today, some public comments were introduced, and there was an opinion that explanations lack specifics. As written on the next page, the Board confirmed that when making a decision on cross-shareholdings or the exercise of voting rights, the point of judgment is based on whether it contributes to increasing the corporate value.

On the other hand, when I reviewed our policy and standards on this occasion, I got an impression that they could be further improved. That's my honest feeling. For example, although we wrote that "proposals that are believed to be contrary to the policy on cross-shareholdings are properly evaluated and decided by exercising voting rights", I'm wondering whether we should restate that part in a more straightforward manner, such as "the Company is against voting rights" or "the Company will vote for or against such proposals based on the criteria for judgment". We

still need to work on it and consider how to address it in the future.

Let me repeat that when the Board approved the report, it was confirmed that the point of judgment is whether cross-shareholdings contribute to increase the corporate value.

The execution side is now reviewing the current shareholdings. The Board receives a regular report from the executive department and executive officers in charge. In the recent report, we were informed that cross-shareholdings with 2 companies were dissolved as of September 30, 2015. So I believe that we are more strictly examining whether shareholdings contribute to increasing the corporate value.

As for our future response, reports from the execution side concerning "the rationale and future outlook of major cross-shareholdings based on the results of examination" which has been set as an item of supervision will be placed on the agenda of the Board every year. I think the timing of receiving the reports would be before exercising voting rights. The Board will supervise the appropriateness of decisions made by the execution side. That is what we consider the role of the supervision.

Let me share our current status of cross-shareholdings. In terms of book value, our company's cross-shareholdings make up 3.25% of net assets, which represents our investors' investments. The percentage is not so high. Accordingly, when I was President, as one of significant roles of President, I pursued active dialogue with our target investors – mid- to long-term investors, especially foreign investors. From the perspective of such investors, we consider that our response to this Principle is probably not a high priority. In fact, we have never been questioned about cross-shareholdings. They have asked questions about the return to shareholders, but not cross-shareholdings. Nonetheless, if we are asked, naturally we will fulfill our duty of accountability. If we cannot provide explanation, we will fix what must be fixed. We'd like to fulfill the role of the supervision, taking such a stance.

That's all from me.

[Ikeo, Chairman] Thank you very much, Mr. Matsuzaki.

Next, I'd like to ask Mr. Sampei and Mr. Ohori from Forum of Investors Japan to make a presentation. We have Material 3 titled "Investors' Evaluations and Expectations on the Companies' Response to the Corporate Governance Code" which was submitted as the presentation material. It's Material 3. Now I'd like to hand it over to Mr. Sampei and Mr. Ohori.

[Mr. Sampei, Director of Research, Fidelity International] Well, I'd like to explain as a steering committee member of the Forum of Investors Japan.

As shown in the title of this material, while equity issuing companies file their Corporate Governance Reports addressing the Corporate Governance Code, we considered that Forum of Investors Japan should thoroughly read such reports first and provide feedback to the companies. Accordingly, we read their reports and had discussions. Issues identified there were summarized in today's handouts "Report on the First/Second Investors Forums" and the supplementary document titled "Opinion on Cross-Shareholdings". These reports were published in September.

Before I talk about the subject, I'd like to briefly introduce Forum of Investors Japan. It is a voluntary organization, which such individuals as practitioners of investment research/analysis, those who are directly involved in investment decisions, and those who are directly involved in the exercise of voting rights have joined in private capacity and of their own accord. Principle 7 of Japan's Stewardship Code stipulates that institutional investors should have skills and resources needed to appropriately engage with investee companies and make proper judgments. In order to acquire such skills and resources, the institutional investors exchange their views, share their wisdom, and develop through friendly competition; and communicate outcomes of the discussions to investee companies: these are the objectives of Forum of Investors Japan. In accordance with such objectives, the Forum published these reports.

Regarding the attributes of registered members, Forum of Investors Japan has roughly 100 persons from 58 buy-side companies, such as asset management companies, pension and other funds, banks, trust banks, life and P/C insurance companies. I believe the Forum has members from all key institutional investors in Japan. In addition, we also have 104 persons from equity issuing companies.

Now I'd like to talk about today's main subject. Please take a look at the content of the Material 3. There are three sections from 1 to 3. Section 1 is the overview of "Report on the First and Second Investors Forums", and Section 2 is issues concerning today's topic "cross-shareholdings". On page 3, you can find the purposes of the Report. As I briefly mentioned earlier, the purpose is to provide institutional investors' views on the response of the companies to the [Corporate Governance] Code, which we identified from reading their Corporate Governance Reports. Specifically, we are seeking good examples of explanations in cases where companies choose to

explain under ‘comply or explain’ approach. This is the first year after the implementation of the Code, so we are trying to identify good examples as best we can, and publish them as good examples. However, we would like to avoid a situation where a certain good practice is regarded as the single “best practice” and other companies simply imitate such model superficially. From this perspective, we took a stance of finding and presenting various good examples as much as possible. In that sense, another important point is that the Code adopted not only ’comply or explain’ approach, but also ‘principle-based’ approach. Therefore, we’d like to encourage the companies to have deep understanding of the principles and then present their unique views [which might be different from the principles].

Our main focus is described on page 4. The Code consists of 73 principles, including five General Principles and the relevant Principles/Supplementary Principles. We, investors, focus mainly on 3 principles; namely Principle 1.4 concerning cross-shareholdings, which is today’s topic, Principle 5.1 concerning policy for constructive dialogue with shareholders, and General Principle 4 concerning responsibilities of the board. We had discussions from these 3 perspectives.

Main points raised during our discussion are listed on the upper half of page 4: from 1 to 5. Here, I’d like to emphasize that we consider Principle 1.4 as very different from other principles, had an in-depth discussion, and even prepared the supplementary document on it. Now I’d like to briefly explain key points of the supplementary document.

Please turn to page 5. First of all, cross-shareholdings are also subject to ‘comply or explain’. However, in case companies choose to comply, how can they comply with the principle? In case they choose to explain, what can they explain? In our discussion, we reached consensus that on the premise that cross-shareholdings will continue, the companies can neither comply nor explain. To tell you the conclusion first, from the investors’ perspective, it would be impossible to explain reasons for continuing cross-shareholdings. Therefore, to raise awareness that Principle 1.4 should be treated differently from other principles, we published the supplementary document, which solely addresses this principle. We believe this would be a good opportunity for the companies to ask themselves such questions as “What was the original purpose of cross-shareholdings?” and “While we now name reasons for cross-shareholdings, aren’t they artificial?”

Key issues are listed at the bottom of page 5. There are roughly 5 issues. The first one is objectives and economic rationale of owning cross-shareholdings, which are questioned in the

Corporate Governance Code, as well as the deviation from original strategic purposes. Second, while the Code requires an explanation from companies that hold shares of other listed companies as cross-shareholdings, we consider that the problem may lie on the side of companies that "let their shares be held by other companies". Third, as far as we looked at explanations of individual companies, there was the confusion between cross-shareholdings and pure investments (portfolio investment). Fourth, objectives of cross-shareholdings conflict with interests of minority shareholders. The fifth one is the procyclicality issue with regard to financial institutions, as explained earlier today.

We summarized one of these key issues, problems with companies that "let their shares be held by other companies" on page 6. To put it simply, it is problems of mutual shareholdings. Why do we deem that there are problems with companies that "let their shares be held by other companies"? It is because we often hear such an explanation that selling their trade partners' shares will be a hindrance to their business. Companies that hold the shares of their trade partners cannot sell the shares at their own discretion, even though they should be able to do so under normal circumstances. This implies that the companies that hold the shares are, in fact, "made to hold shares of other companies", and the companies that "let their shares be held by other companies" interfere in their management decisions.

Specifically, as far as we know, when a company decides to sell shares held as cross-shareholdings, they need to seek consent from the issuer. They need to ask, "May we sell shares of your company?" When they try to obtain such consent, the issuer says, "It has been a long-standing business practice. Why do you have to do so after all these years?" or "In that case, you should expect a change in trade terms." Because the issuer refers to resulting disadvantages, the shareholding company cannot take any further action. This happens in the real world, and we often hear such stories.

In this respect, some banks explain, for example, "We actually want to sell the shares, but are not permitted to do so," or "We'd like to sell the shares, but the trade partner does not allow us to sell them." And they ask us, "So there is no choice. Please understand." We quoted their voices in the supplementary document – the second bullet point in Section II. Statements Concerning Companies that "Let Their Shares Be Held by Other Companies". Many practitioners who participate in the Forum had the similar experiences. That's why we daringly quoted their voices in

our report.

I'm moving on to page 7. On the other hand, we also discussed whether the problems lie only with companies that "let their shares be held by other companies". Companies that "hold/are made to hold shares of other companies" may also have problems. That is the discussion on page 7. Although many companies state "We want to sell the shares, but the issuer denied the sale of the share," it could be just an excuse for not being responsible.

We consider it in this way, based on concrete facts that the companies are also dealing with trade partners, whose shares they do not hold. They are trading with many partners. They do not hold shares of all the trade partners. Therefore, it is not true that they cannot do business with other companies without holding their shares. Furthermore, in the Annual Securities Report, companies disclose lists of specified investment shares in the current and previous fiscal years. By comparing these two lists, we found that a company held another company's shares in the previous year for the purpose of "strengthening the business relationship", but does not hold such shares in the current year. So we asked the company, "Did you lose this trade partner?" They replied, "No. Nothing has changed. There is no problem." It means that although they named "strengthening the business relationship" as the purpose of the shareholdings in question, they did not suffer adverse effects from the sale of the shares. In that sense, although it is hard to find the truth, and we should be aware of the serious problems with the companies that "let their shares be held by other companies", we also need to realize the likelihood that some companies continue cross-shareholdings taking advantage of such problems, even though they are not "made to hold shares of other companies".

We summarized it on page 8. It's a very simple table. The upper two rows of the table show the status of companies that "make their trade partners hold the shares" or "are owned by their trade partners". The lower two rows show the status of companies that "own the shares" or "are made to hold the shares". In case of cross-shareholdings, the first row and the fourth row pair up in terms of being held vs. holding. In case of this pair – the first row and the fourth row, companies that "make their trade partners hold the shares" have a stronger negotiation power over trade terms and conditions. Then, eventually, at the time of exercising voting rights, they implicitly secure votes for supporting the management. On the other hand, in case of another pair – the second and third rows, power relationships are likely to be based on the fact of such shareholdings rather than trade terms, and the companies that hold the shares may make use of their voting rights in order to obtain

favorable trade terms. In either case, it is hard to dissolve the relationships.

Next, I'd like to explain purposes of shareholdings shown on page 9. I already mentioned that it is very hard to conclusively explain economic rationale. This diagram clearly shows it. In the era of global competition, I think companies need to compete on a business model, competitiveness, and quality of goods and services, with transparency. Under such a circumstance, the use of shareholdings or the exercise of voting rights for negotiating trade terms may be still acceptable in Japan, but maybe not in other countries, I presume.

Such complicated mechanisms could be explained by using this tree diagram. First of all, shareholdings are roughly classified into two categories: strategic investments or pure investments. Therefore, when companies hold shares for strategic purposes, it is unreasonable to explain their economic rationale in a fashion as if such shareholdings were for pure investment purposes. To be more specific, it is unreasonable to justify the purposes of strategic shareholdings or cross-shareholding by referring to dividend income or capital gain from the stock price. In case they clearly state that shareholdings are for pure investment purpose, then their ability and qualification to make portfolio investment will be called into question. To get back to strategic purposes, I think strategic alliance could be a reason for shareholdings. In association with the strategic alliance, they have business strategies. In that case, it is likely that they exercise their voting rights from a totally different perspective from that in case of portfolio investment.

Nonetheless, in many cases, the companies name "strengthening business relationship" as an explanation of the purpose of their cross-shareholdings, as shown in the red box in the center of Chart 2. As I mentioned several times, it is like a barter deal involving trade terms and the exercise of voting rights. Trade terms include terms and conditions of supply, pricing, and other advantages. There seems to be such an aspect that the strong place a great deal of pressure on the weak. This tendency sometimes can be found when you look at balance sheets of Japanese companies. Furthermore, the exercise of voting rights ultimately leads to an anti-takeover measure. In return for supporting the current management or status quo through takeover defense, they obtain more favorable trade terms. Such a relation is hard to dissolve, yet it is cause for great concern that it would harm global competitiveness before we know it.

Now I'd like to talk about the current state of the entire market. These days, the data showing a decline in so-called cross-shareholding ratio or ratio of stable shareholders is generally used, but we

have doubts about it. I read the following statement in the handout distributed at a conference: according to the estimation by Dr. Ueda from Japan Investor Relations and Investor Support, who is a member of this Council, the cross-shareholding ratio or the ratio of stable shareholders, has not decreased much. Compared to the ratio of shareholdings by pure investors in a real sense, a significant amount of shares are still held as cross-shareholdings. Then it causes a situation where voices of those who make portfolio investments and exercise their voting rights are not really heard. Accordingly, if the actual cross-shareholding ratio is higher than the generally recognized level as Dr. Ueda estimated, the problem would be even greater.

Please turn to page 10. There is another problem concerning capital productivity. Page 10 shows examples of 2 companies. Chart 3 and Chart 4 are from financial statements of 2 Japanese companies for the fiscal year ending March 2015. The point here is that comparing Chart 3 and Chart 4, their balance sheets look very different; however, in case listed shares, which are convertible into cash, are included, the broader terms of "cash and equivalents" account for roughly 40% of the total assets, almost the same percentages for both companies. It is often argued that Japanese companies tend to have excessive cash. On such an occasion, "cash and cash equivalents" usually consist of (1) cash and deposits; and (2) marketable securities, both of which are under the category of current assets. However, foreign investors often include (3) investment securities, when they make evaluations. Foreign investors consider that even if shares are held for strategic purposes, such shares can be converted into cash upon making such a decision, and thus should be recognized as potential cash equivalents. Under such logic, the ratios of both company A and company B are calculated as approx. 40% of total assets. In that sense, two companies are considered to be similar. Konica Minolta's cross-shareholdings ratio is rather low, and would be close to Chart 3. If the percentage of investment securities was extremely large, it would come into question.

I'd like to raise another point. Holding investment securities means that companies use net assets or shareholders' equity as the risk buffer. A part of the risk buffer, which should be used for businesses, is used for other purposes, not for operating assets. We could call it a waste of capital. Even though 'Japan Revitalization Strategy' advocates a productivity reform, its current state is far from realization. It would make it difficult to attract inward investment.

Page 11 is about conflict of interests with minority shareholders. As I mentioned earlier in relation with trade, if companies whose shares are "held by other companies" offer excessive

benefits to companies that “hold the shares”, it should be a problem. In Germany, during the process of unwinding so-called mutual shareholdings in the past, I remember there still was the similar situation. When I visited German companies in 1999, I found that Deutsche Bank provided a loan to an electric power company with a credit rating of “A” on far more favorable conditions than those for other companies with the same rating. I pointed out that it conflicted with interests of Deutsche Bank’s shareholders, back then. Then Deutsche Bank frankly acknowledged the problem, and said “You are absolutely right. Now we are taking various actions to correct the problem.” Eventually, by making a shift toward an investment bank, Deutsche Bank changed over several years: instead of being pressured for favorable loan conditions by companies that use mutual shareholdings as the lever, Deutsche Bank assumed the role of underwriting corporate bonds. The reform in Germany aimed at making a shift from indirect financing to direct financing. In addition to tax incentives to unwind cross-shareholdings, various aspects underwent a reform, including companies’ move from bank loans to financing in the market by obtaining credit rating for that purpose. I remember that such a holistic nature was a distinctive feature of the reform.

Concerning the issue of conflict of interests with minority shareholders, we need to look at the relation with independent directors. In one case example, we found several inconsistencies within a company. An outside director was designated as an independent director, on the grounds that the trade volume between this company and the company which the independent director belonged to was negligible. However, in the disclosure of specified investment shares, the company holds shares of the independent director’s company as cross-shareholdings, by stating that it is necessary to maintain the business relationship. Isn’t it contradictory? In the Preface of the Corporate Governance Code, there is a description that it is important for companies to operate themselves with the recognition of fiduciary responsibility, but a conflict between ‘independence’ and ‘strategic purposes’ is left unsolved. There is a lack of recognition. Fiduciary responsibility includes duty of accountability, duty of loyalty, and duty of care of a good manager, and it should be looked at in a holistic and consistent manner.

I’m talking too long, but let me wrap it up with conclusion/proposal. It’s on page 12. Our conclusion is that when companies try to provide a thorough explanation on each of these issues, as far as we know, it would be extremely difficult to provide economic rationalistic explanations. If that’s the case, it should be reasonable to dissolve cross-shareholdings.

The biggest problem with continuing cross-shareholdings is that after all, such shareholdings merely help the issuers have/maintain stable shareholders as an anti-takeover measure. We consider it would be the best if the equity issuing companies understand the problems which I just explained, and consequently make autonomous efforts for unwinding cross-shareholdings. Of course, they should explain such reasons as strategic alliance. I hope companies will have dialogue with investors about it to facilitate such efforts.

Finally, on page 13, we presented examples of actions to be taken, although they are not specific enough. One of such actions is to establish and announce the policy to reduce cross-shareholdings. If it takes time to accomplish the announced policy, for such a transit period until the dissolution, they could establish a system to monitor interests of minority shareholders so that they will not be impaired by operating activities through the misuse of the position of a cross-shareholder. The establishment of an audit committee consisting of outside members would also be an option. As explained in the first presentation, banks already expressed their policies to reduce cross-shareholdings. This could be a trigger. I hope that banks would lead the way to dissolve cross-shareholdings.

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

[Ikeo, Chairman] Thank you very much.

Now I'd like to open up a discussion. I'd like you to share your opinions.

Mr. Uchida and Mr. Toyama are absent today, but they submitted their opinion papers. The secretariat distributed them as handouts, and sent them to the members in advance. So I will not read them out here, but please take their opinions into consideration during our discussion.

There is no predetermined order of speakers, so anybody can start. Please feel free to provide your comments. Professor Kawakita, please go ahead.

[Kawakita, member] Various views were expressed. I'd like to make some comments, although there are some similar points.

As you know, cross-shareholdings have been developed or formed during the rapid economic growth period. At that time, stock prices were rising, and thus such shareholdings were reasonable to a certain extent. However, since the bubble burst in the late '80s, a drop in stock prices has become not uncommon, and thus they have lost their economic rationale. In addition, cross-shareholdings served as a factor of depletion of financial institutions' equity capital, which in

turn, contributed partly to the destabilization of the financial system. I believe that these are the matters that need to be reflected on.

Currently, there are certain restrictions on shareholdings in the financial system. However, as pointed out during the first presentation, as for the major-bank groups, the fact that net unrealized gains are included in equity capital calls in question, and therefore, the Financial Services Agency provided guidance, pointing in a direction toward the reduction of such shareholdings, I presume. However, as explained earlier, because there are various obstacles, they set a time frame for reducing cross-shareholdings, typically 5 years. We should seriously consider whether we could wait for such a period. There is no guarantee that stock prices will keep on rising over such a period of time. In this regard, I consider that further regulating strategically important banks would be a possible option, while it would be arguable whether they should be limited to 3 major-bank groups. It is important to note the following case in the past: when a bank sells shares held as cross-shareholdings, the issuing company seeks an alternative counterpart for cross-shareholdings, which is an undesirable tendency. I think it is necessary to control such a matter.

However, I have a doubt about a complete denial of strategic shareholdings or cross-shareholdings. As Mr. Sampei pointed out, in cases where companies form an alliance, or financial institutions support the development of venture companies, I do think such shareholdings should be acceptable, and it would be necessary to consider a framework for securing such initiatives.

That’s my view on cross-shareholdings, but there also is an issue of disclosure. Companies disclose their explanations of the purposes of cross-shareholdings. However, as other speakers mentioned earlier, such explanations are superficial and insufficient. While it is necessary to ensure that the disclosure is to be valuable, it is also necessary that analysts actively engage in dialogue concerning shareholdings. In such dialogue, it is necessary to ask and find out the future responses of the companies which hold shares of other companies for truly strategic reasons. If the companies do not provide convincing explanations during such a process, or if they do not make any change to their shareholdings which seem meaningless after the in-depth dialogue, investors should consider whether they should hold shares of such companies, whether it is right to hold their shares. Such companies are often managed poorly. Then after finding such poor management, is it really right to invest in such companies? It is impossible for outsiders to understand that part. That’s how I feel

about it. .

That's all from me.

[Ikeo, Chairman] Thank you very much.

Mr. Nishiyama, please go ahead.

[Nishiyama, member] Thank you. There may be some overlaps with what I said at the first meeting, but I'd like to share my impression from companies' disclosure concerning the purposes of cross-shareholdings.

First of all, as a result of requiring explanations in this way, each company started to consider the meaning of their cross-shareholdings. I think this is a kind of progress, in terms of an increased level of awareness. However, when I look at the content of such disclosure, as other speakers mentioned, their explanations about the rationale are not necessarily sufficient from the investors' viewpoint. I'd like to share an example. I think a company uses its own judgment whether shares are held for strategic purposes or pure investment purposes. I found some cases where companies categorize a significant part of their shareholdings as pure investments, and as a result, they do not disclose information on such shareholdings. When I was talking with people from operating companies, I was asked, "Then, if we recognize them as pure investments, we don't have to make disclosure concerning these shareholdings, right?" I thought no one would dare to do so, but some did. There is arbitrariness about it. If the shareholdings are really pure investments, a relevant response will be required, including posting mark-to-market gains/losses on P/L statements. If that is not the case, from the outsider's viewpoint, it seems companies classify shareholdings as pure investments in order to avoid disclosure. Mr. Sampei shared the example of conflict between the independence of outside directors and cross-shareholdings. There should be such conflicting cases.

Furthermore, when we consider the examination of cross-shareholdings, although it is about cross-shareholdings, investors are concerned about impacts on the balance sheets. Even though they are not held for purely investment purposes, it is necessary to examine the shareholdings in a similar manner as an examination of portfolio, for example, by explaining that if the stock price drops this much, there will be this much impact on the balance sheets. At the same time, I consider that investors also need to focus on impacts on the balance sheets caused by cross-shareholdings.

On the other hand, frankly, I also feel that there would be limitations on dialogue with investors in the context of providing explanations of cross-shareholdings. Practically, when there are more

than 2,000 companies, it would be extremely difficult for investors to ask questions about cross-shareholdings during their dialogue with such companies. Actually, the companies made disclosures for the first time after the implementation of the Code, after pondering over how to disclose. If investors do not voice their responses, the companies would interpret it as the acceptance of their disclosure in the current way, and thus eventually the disclosure will turn out to be just a formality. On the contrary, as I just said, it would be very difficult for investors to ask all the investee companies questions about their explanations of cross-shareholdings.

Then, for example, should we raise the level of overall requirements and strictly require all the companies to provide explanations of cross-shareholdings? Or should we limit the number of the companies based on certain criteria, and require them to provide detailed explanations? I think approx. 1,900 companies are listed on the TSE First Section. It has been pointed out that it would be difficult to deal with them in a uniform manner; and upon the start of actual disclosures, I feel such concerns are real. So this may be off the track, but when considering the requirement for explanations, it may be necessary in the future to narrow down the scope of the companies.

That's all from me.

[Ikeo, Chairman] Thank you very much.

Ms. Takayama, please.

[Takayama, member] This may be an explanation rather than a comment. I'd like to present the current state of Japanese companies based on my discussions with multiple companies.

Prior to the disclosures, Japanese companies carried out various tasks and made decisions on various matters. I'd like to share some examples of such efforts.

As an overall trend, triggered by the establishment of the Corporate Governance Code, a significant number of companies have reviewed the nature of and reasons for cross-shareholdings. I heard from a company that the most puzzling part for them was how to respond to the requirements concerning cross-shareholdings under the Corporate Governance Code. Even if investors ask them to what extent the cross-shareholdings contribute to earnings, they cannot answer immediately, as they have not yet calculated the contribution. As for the future response, they would like to find out what investors' expectations are through dialogue with them, and respond accordingly.

Another company with a long history holds shares of a significant number of companies as

cross-shareholdings, some of which they do not even know reasons for holding, to be honest. Therefore, the company is now conducting something like cost-benefit analysis for each of the cross-shareholdings.

Furthermore, some companies reviewed their shareholdings in response to the Code, and are planning to reduce the shareholdings gradually. A company in the financial sector has a number of cross-shareholdings, and the dissolution of them requires extreme caution from the marketing perspective. However, if the entire business community in Japan aims at unwinding cross-shareholdings under the Corporate Governance Code, the company does not want to miss the opportunity. That's what I heard from them.

According to a manufacturer, it is not always true that a business relationship will be terminated, if they discontinue cross-shareholdings. Therefore, when investors ask questions about it, the manufacturer has a hard time because it is impossible to answer. They would like to dissolve the cross-shareholdings gradually, starting with those which they do not know reasons for holding.

Another company needs investments for growth. While they tell business partners, "Unfortunately, we have to sell your shares, because of the scrutiny of the regulator and the market," they actively dissolve shareholdings, starting from feasible ones. And they plan to use funds from the sale for building their new production facilities.

On the other hand, some companies reported that even if they hope to dissolve cross-shareholdings, industry-specific circumstances do not permit them to take such an initiative. In a certain industry, as a tradition, vendors form a kind of shareholding association, which contributes to facilitating smooth business relations. From that perspective, they consider that cross-shareholdings are necessary to a certain extent.

Meanwhile, in another sector, as pointed out in the presentation by Forum of Investors Japan, companies that let other companies hold their shares have a stronger power. Consequently, it cannot be denied that the more shares they have, the more favorable trade terms they get, and vice versa. It is extremely difficult for the companies in the sector to voluntary move toward the dissolution. However, they consider that if overall discussions create a situation where cross-shareholdings are considered inappropriate, it will stimulate the move.

These are diverse moves of the companies subject to the disclosure, based on which I heard from them on various occasions. When they make disclosure, they have to prepare formal

documents, which tend to be superficial, or use cautious expressions to avoid any trouble. However, when I asked questions about their actual state, people from many companies told me that they have no choice but to face the question of how they should cope with the issue of cross-shareholdings due to the establishment of the Code. Not only departments in charge, but also senior management and board of directors have to face the issue.

These are the companies' views, corporate logic. However, naturally, how investors look at them is also very important. The situation in Japan was already covered by the presentation by Forum of Investors Japan. So I'll talk about examples with foreign investors. Recently, representatives of a certain company, with a relatively high ratio of cross-shareholdings, met several institutional investors, when they visited Europe and the US, and discussed cross-shareholdings with them. Although they explained the industry-specific circumstances and company-specific circumstances, they hardly gained the investors' understanding. One of the reasons would be that cross-shareholdings are not acceptable in the first place, from investors' standpoint. Another reason would be that they still have a stereotyped view, which was established over long years: Japanese companies are not always shareholder-focused. These factors in combination may be behind their negative view. That's what I heard recently.

Concerning foreign investors, as I mentioned in the previous meeting, they are very much interested in this Follow-Up Council. Multiple investors and organizations are planning to submit their public comments by early December, so we will gain further understanding of their views from such comments.

I hope my input would serve as a useful reference for discussion.

[Ikeo, Chairman] Thank you very much.

Mr. Oguchi, please.

[Oguchi, member] Thank you. Today we had an opportunity to listen to the presentations by various speakers. Concerning Forum of Investors Japan, I understand that members participate in the Forum in private capacity, so I'm not sure who the other members are. Judging from the fact that the source of certain data in today's presentation material is the author, I understand the presentation showed the views of the guest speakers, Mr. Sampei from Fidelity and Mr. Ohori from JPMorgan Asset, who seems to have already left. I have no particular objection to the content.

On the one hand, Mr. Sampei and other people mentioned that cross-shareholdings should be

dissolved. On the other hand, everyone says they are difficult to dissolve, though. While listening to both opinions, paradoxically, I was wondering whether there are cross-shareholdings which investors can show understanding for in the first place. We say cross-shareholdings, but they are still investments. If they can be positively evaluated, investors could show understanding. One of the speakers earlier referred to the waste of capital. In case of investments in businesses, naturally, to earn revenue which exceeds the cost of capital is economically rational. However, cross-shareholdings are investments in listed shares. So when they invest in listed shares with an average dividend yield of approx. 2%, assuming, for example, that cost of capital is in high single digit, there is a significant gap. Accordingly, without revenue other than dividends – capital gains may be included, without earning significant amount of additional revenue, it is impossible to exceed the cost of capital. So the bar is set high for economic rationale.

Suppose that additional revenue is earned, and revenue from the shareholdings exceeds the cost of capital. There seems to be economic rationale. Then the next question is whether such revenue was earned in a legitimate manner. For example, insider information may be involved. There is a question about the legitimacy, including matters which "may raise the suspicion of 'giving benefits' which is punishable as a criminal offence" – This is an expression in the opinion paper of Mr. Toyama, who is absent today. When considering the legitimacy, the problem would be what is called "hollowing out of voting rights". This is the expression used in a report issued by Sectional Committee on Financial System under Financial system Council - I think Professor Ikeo chaired the committee. The expression is rather soft. Frankly, it is about benefits in exchange for affirmative vote. In order to clear the suspicion, at least, the companies have to explain that voting rights do not become hollowed out. In order to explain it, they need to explain that they exercised their voting rights in a fair and transparent manner. Principle 1.4 of the Corporate Governance Code was shown in today's handout. The expression of the Principle was determined after various discussions. The Principle can be separated into two parts. The first half is about the examination and explanation of economic rationale, and the second half is about the exercise of voting rights. Given this perspective, I think the examination and explanation of economic rationale in the first half are only necessary conditions[, and not sufficient ones]. Without them, there is no economic rationale, so such investments cannot be justified. Even if they can provide satisfactory economic rationale, investors need to know whether such gains are legitimate. In that sense, appropriate response to the

exercise of voting rights referred in the second half must be ensured together with the first half in order to obtain investors' understanding. Furthermore, if/when the companies provide convincing explanations both on the first and second parts, cross-shareholdings should not always be denied, in my opinion.

Then I came up with an idea associated with Japan's Stewardship Code. Principle 5 of Japan's Stewardship Code requires [institutional investors] to aggregate and disclose the voting records. Provided that, similarly, cross-shareholdings are investments in listed shares, this principle for institutional investors can be also applied. Then the legitimacy can be demonstrated, I think. As Mr. Nishiyama also mentioned, when the boundary between pure investments and strategic investments is rather blurry, regardless of whether they are for pure investment purposes or strategic purposes, they are equity investment. Therefore, for all listed shares in which the companies invest, the companies could disclose not only the policy concerning the exercise of voting rights, but also voting results, thereby proving that they are innocent in terms of grant of benefits. If they cannot make disclosure, they cannot clear the suspicion.

I'd like to make another point. As explanations of cross-shareholdings, many companies refer to "strengthening a business relationship with the investee company". As other members already mentioned, it is not always true that they cannot strengthen business relationships without cross-shareholdings. If necessary, they can conclude agreements. If they become no longer necessary, they can terminate the agreements. Furthermore, if agreements are concluded between companies for each of businesses, it will be a sufficient alternative. Therefore, such an explanation as "strengthening a business relationship" is not a reasonable explanation for cross-shareholdings, I think.

[Ikeo, Chairman] Thank you.

Mr. Tanaka, please go ahead.

[Tanaka, member] First of all, I would like to clarify that, while I belong to a major-bank, my opinion is my own and does not reflect the views of the banking sector.

I believe that the problem of cross-shareholding may need to be discussed from two separate perspectives - namely, issues specific to financial institutions, and issues affecting the industrial world at large. The report prepared by the secretariat contains excerpts from the Financial Monitoring Report and from the Japan Revitalization Strategy. At the same time, the Strategic

Directions and Priorities announced in September also clearly indicates that "it will be necessary to reduce the risks caused by stock price fluctuations", and further reads: "Engage in in-depth dialogue with financial institutions in order to ensure the steady progress of efforts to reduce cross-shareholdings; in conjunction with this, conduct corporate surveys to verify whether the three major-bank groups take advantage of their dominant bargaining position in engagement to their cross-shareholders." We take this as an unequivocal sign that the financial administration's policy in this respect is to seek the reduction of cross-shareholdings.

Among the various references that have been published, the Forum of Investors Japan has provided an explanation that I have thoroughly read. I have found it to be of great quality, and I believe it sums up investor opinions impeccably.

On the other hand, in 2010 the Japan Association of Corporate Directors wrote a report titled "In re Cross-Shareholdings by Banks", which the Forum of Investors Japan also refers to. This report discusses the history of cross-shareholdings by banks, and states that, as mentioned earlier by Mr. Kawakita, financial institutions actually held about 40% to 50% of all shares on the market in 1988-89 – just before the bubble economy collapsed. This was an extremely large share. Later on, the sale of cross-shareholdings was accelerated by several factors, includeding the collapse of the bubble economy in the 1990s and early 2000s, the subsequent financial crisis, the introduction of fair-value accounting, the global financial crisis of 2008, and the introduction of international accounting standards.

As was explained earlier, the disposal of bad loans, the recovery of healthy balance sheet and, additionally, financial reorganization occurred frequently, and due to the 5% clause of Antitrust Law, I remember that one of the reasons for financial institutions selling their cross-shareholdings lie in the need to sell the portion of shares in excess of 5%. Also, with the introduction of fair-value accounting any excessive fluctuations in profits will cause significant effects, and I believe it is undeniable that this was also a factor.

All those historical experiences lead to avoidance of procyclicality mentioned in the Strategic Directions and Priorities. Ultimately, during the Japanese financial crisis of the 90s and early 2000s, which occurred following the collapse of the bubble economy, as well as during the global financial crisis dubbed the Lehman shock of 2008, the preservation of capital became the top priority for financial institutions, which resulted in criticism of banks' reluctance to lend. These times are

remembered and discussed by various other bodies within the industrial sector. The fact that financial institutions were unable to provide enough liquidity to the industrial sector back then is often mentioned as one of the reasons why major Japanese corporations have hoarded and hold enormous amounts of cash reserves or retained earnings now.

Therefore, in a sense, as stated in the Monitoring Report, financial institutions bear a responsibility to win back trust in their ability to support corporate business during difficult times; this will give companies the confidence to do business in a growth-oriented fashion. Now that we have experienced the two aforementioned major financial crises, frankly speaking I believe that members of top management at the three major-banks today are keenly aware of this issue.

The issue of stockholdings by banks has also become a pressing one in the world of international financial regulations as well. The Basel III Accord, for example, sets shareholding risk weight at 400%, thereby greatly increasing the burden of capital. It is on this basis that all three major-banks have announced that they will reduce their cross-shareholdings. As explained earlier, however, MUFG, for example, will still hold 70% of its cross-shareholdings after a 28.5% reduction over five years. In the case of Mizuho, a 27.5% drop after three and a half years will also leave over 70% of cross-shareholdings intact. For its part, Mitsui Sumitomo has announced that, over five years, it will reduce its cross-shareholdings by 500 billion yen - 27.8% of the 1.8 trillion it currently holds. In other words, the three major-banks plan to reduce the current book value by about 30% over a period of three to five years. As observed earlier by Mr. Kawakita, however, the question of whether we can in fact wait for five years may pose an issue.

I myself have been dealing with investors at MUFG for over three years. I needed to travel around the world once every six months, and I have spoken at length with Japanese investors as well, and I found that expectations and demands toward the reduction of cross-shareholdings are particularly strong in the case of foreign investors. The reduction of cross-shareholdings was a central issue in the IR activities carried out in May after the announcement of annual financial statements. I think the question of how to handle cross-shareholdings has undoubtedly become so important that it was the very first one to come up when we sat down for discussion. With the recent announcement of interim financial statements, IR activities have recently started once again, and I heard that the situation is the same as that of annual financial statements.

When I myself was engaged in dialogue with the investors, many commented that, to begin with,

they had not become the shareholders of financial institutions to have them invest in stock; or that the shares should be sold while there were still unrealized capital gains to be reaped, and should be used as resources to provide returns for shareholders through stock buyback etc.

Many investors also voiced the opinion that cross-shareholdings would distort the ROE calculation. Favorable stock prices lead to greater unrealized capital gains, so that the equity becomes larger and the ROE gets smaller. As the TSE standards state, equity must be calculated by taking into account unrealized capital gains, so that when the stock price is favorable, the ROE gets smaller. Whenever I talk about these issues surrounding cross-shareholdings with people inside my company, and especially those who are in charge of corporate transactions, I am invariably told with great conviction that the sale of cross-shareholdings will either reduce transactions or cause them to contract with other banks. Additionally, the people I speak with are convinced that relationships with business partners will also greatly deteriorate. I myself used to be in the sales force, and was involved in countless sales negotiations, and I realized that negotiations were never harder than in the case of cross-shareholdings. To think of it, the main-bank system is a background factor. It is said to have three major components: the first one lies in the fact that it holds the top lending share; the second lies in the dispatching of company executives; and the third lies in cross-shareholding. The last one is said to function as an umbilical cord of sorts linking the -bank to its business partners. Earlier on, someone has mentioned the exercise of voting rights on cross-shareholdings. From my standpoint as someone who has been directly involved, I can say that this is viewed as a very far-fetched concept.

This is not viewed as a matter that can be explained to customers by a department manager, but is at a level that requires discussion among the members of top management of the two companies involved.

For example, there are certain companies where cross-shareholders decide business shares such as commission, derivatives, and other shares based on the holding ratio of cross-shareholdings. I feel that the policies announced by the three financial groups under the Strategic Directions and Priorities are the result of a desperate attempt to strike the best possible balance between customers and investors. To me, these policies seem to indicate that the financial groups have truly done everything that was in their power.

This appears as a desperate attempt because of the scale of the reductions mentioned earlier on,

as well as the speed at which they are being made. As I have already mentioned, I believe that future dialogue with investors with regard to this reduction plan will focus on its scale and speed. Furthermore, I think that biannual talks with the investors will focus on following up on how far the cross-shareholdings are reduced in the course of each term. Such five-year plans do not necessarily entail a 20% yearly reduction over a five-year period. In some cases, the plan entails an initial reduction of 5%, followed by 7% and finally 50%. Based on my experience of dialogue with investors, I figure that they will be very strict in this regard.

In this sense, the policies that have recently been issued by the three major-banks seem to be quite comprehensive, albeit within feasible limits. Major obstacles will however be faced in actually achieving reduction targets, and everybody working on the front line of the banks' business must be very concerned. Achieving reduction targets will be absolutely impossible without the cooperation of the companies issuing those shares. With regard to this point, as someone mentioned earlier, I believe it will be a key to ensure that people in the industrial world understand that the cross-shareholdings held by financial institutions in the period of the economic recession may lead to the procyclicality issues, reluctance to lend or other problems, and ultimately poses a risk for the industrial world to bear the negative consequences.

As mentioned earlier, presenting a policy package as was done in Germany may also be an option. I myself, however, have been working on this issue at MUFG until last June, and I can't help but feel that Principles 1.4 are one-sided. This is because the Code only concerns the holders of cross-held shares. Its provisions do not cover companies whose shares are being held, or that are making other companies hold their shares. Accordingly, I thought that the Code should contain clauses - for example, a Principle 1.4.2 - that prescribe the course of action to be taken by the company whose shares are held by another public company or which causes another public company to hold its shares as cross-shareholdings. Also, I feel like it will be difficult to make any progress if we address this issue in a one-sided fashion; both sides of the coin should be considered by at least stipulating the disclosure of the aim of such cross-shareholding.

Finally, I would like to make a couple of supplementary points. Earlier on, the explanation of economic efficiency was discussed, and I am in complete agreement with their statements. The monitoring concepts of overall profit [from the relationship] or comprehensive decisions can not be enough explanation. For example, capital costs may amount to 8% at companies with a ROE of

only 3%. When it comes to how the company makes up for that 5% gap, we use the term "overall profit", meaning the company is on the receiving end of business transactions that can make up for that 5%. In this sense, I clearly remember discussing the fact that failure to reach this level of depth would make it difficult to provide a concrete explanation of economic rationale.

Conflicts of interest were also mentioned, making reference to loan interest rates. Foreign investors do in fact say that interest rates in the Japanese loaning market are extremely low, and this is said to be one of the reasons why foreign investors have trouble making forays into Japan's syndication market. Therefore, taking such issues into account, in some cases it may be necessary to look at the broader picture.

One final remark that I would like to make is that, assuming selling cross-shareholdings, the issue remains of who is going to buy the shares. In the past, as you know, different methods have been tried, such as having the Banks' Shareholding Purchase Corporation or the Bank of Japan purchase cross-shareholdings. When considering this issue, it will be necessary to look at the bigger picture, who will buy the cross-shareholdings.

That is all I have to say.

[Ikeo, Chairman] Thank you.

Mr. Iwama, please go ahead.

[Iwama, member] I feel that Mr. Tanaka's words hit close to home. Actually, I also used to be in charge of cross-shareholdings as an executive at an insurance company, and I remember great distress with members of the sales force.

In terms, however, of my own impressions, I do believe it necessary to gradually reduce cross-shareholdings and bring it down to an appropriate level. The insurance companies, too, must consider the stability of business in relation to shareholding, taking into account solvency margin regulation and various other capital cost issues. At the peak of the bubble economy, in particular, unrealized capital gains had grown to enormous proportions, and I have had the displeasure of seeing these disappear day by day after I was put in charge of cross-shareholding. It will be necessary for us to consider an appropriate way to deal with such issues as a form of business risk management.

I currently work for an institutional investor, or at any rate I work in the world of investment management industry, and from this standpoint I can say that for investors. Since the

implementation of the Japan's Stewardship Code preceded that of the Japan's Corporate Governance Code, an investment management institution had the responsibility of thoroughly observing the Stewardship Code in the course of our activities. At that time, I found that the work of our industry alone would not be sufficient to guarantee the economic rationale of cross-shareholding to issuing companies. In this sense, it is revolution that the Corporate Governance Code began by clearly pointing out this issue. Of course, this issue had been taken up much earlier, and had undoubtedly generated a nation-wide, multi-perspective discussion on how to best address it, but I think the fact that such a clear message was sent out was of great significance. As discussed earlier on, this issue is the object of mounting interest on part of foreign investors. I realized, through my occasional exchanges of opinions with foreign investors, that they are cautiously watching to see whether our efforts will truly come to fruition, as I have been clearly made aware of.

Today, I heard many valuable insights from Mr. Matsuzaki, who spoke about dialogue with mid- to long-term investors over the years to come especially dialogue with foreign investors. Our members mainly consist of Japanese institutional investors, and we are proactively encouraging our member companies to engage in dialogue with investors about cross-shareholdings. I would be curious to know whether Mr. Matsuzaki thinks that there have been signs of changes in the way in which Japanese institutional investors work, especially since the Stewardship Code was enforced, and what he expects from them.

[Matsuzaki, the Board of Chairman, Konica Minolta Inc.] Thank you. May I?

[Ikeo, Chairman] By all means.

[Matsuzaki] As a matter of fact, in October we held a small meeting with Japanese institutional investors on the subject of the Corporate Governance Code, which was also attended by Mr. Ohori, who left early to attend to business of his own. The meeting was held upon the investors' request, and in this sense, I feel that Japanese institutional investors are actively trying to create opportunities for dialogue.

[Iwama, member] Thank you. We also intend to encourage such initiatives from now on, and hope that they will be well received.

[Ikeo, Chairman] Mr. Kawamura, please.

[Kawamura, member] As was discussed today, we are in complete agreement that both financial

institutions and operating companies should endeavor to dissolve cross-shareholding as soon as possible. The issue is to whom the shares released by financial institutions will be transferred. One issue that we should address as an operating company lies in the fact that the shares are likely to be transferred to individual shareholders through NISA or foreign shareholders. We have made considerable efforts to increase the holding by shareholders whose interest goes beyond the short term, with a view to boosting corporate value over the mid- to long-term. While this is mainly an area that depends on corporate effort, I feel that a further effort may be necessary to tackle this issue. Since it would be impossible to selectively pick mid- to long-term shareholders only, it will be an important task of ours to consider initiatives for boosting corporate value and economic value over the mid- to long-term.

[Ikeo, Chairman] Mr. Callon, please go ahead.

[Callon, member] Thank you so much. There are four points that I would like to make.

The first point concerns the adverse effects and opportunity losses suffered by companies through cross-shareholdings. I am an investor, but I have also been serving as the chairman of a listed Japanese company for the past eight years. As a business manager, I believe that the practice of cross-shareholding in Japan should be eliminated. The issue of cross-shareholdings hollowing out a company’s own equity during negative market conditions has already been pointed out; not only this, cross-shareholdings are by definition money that is not being put to use for the company's intended business. Companies require working capital and investments to fund growth, a key objective of any manager who wishes to contribute to the revitalization of Japan's economy. In short, putting money into cross-shareholdings instead of using it to fund a company's business is a major opportunity loss. I do understand the context of cross-shareholding in the long history of Japanese corporate management, and that some may view this history an asset and a legacy, but the legacy may be a negative one.

Mr. Kawakita helpfully addressed cross-shareholdings in their historical context earlier in today’s session. When we think about ensuring sustainable growth in the years to come, we need to consider whether cross-shareholdings are truly necessary for Japanese companies, and whether there may be other, more effective ways of using these funds for growth-oriented investments. In the case of cross-shareholding, although the main focus is generally placed on using them to build and reinforce corporate relationships, it is far more important that companies offer customers and

business partners superior, competitively-differentiated products and services. We need to work out if cross-shareholdings are truly necessary, or if the reasons put forward by those in charge of cross-shareholdings are instead just excuses. Many Japanese companies are engaged in international competition, and they will need to develop truly strong products and services in order to be competitive at a global level. While I do understand that Japanese society is based on interconnectedness, I believe it would be inappropriate Japanese corporate behavior to be rooted in cross-shareholdings.

Secondly, as Mr. Sampei suggested earlier on, we need to protect companies that are being forced by cross-shareholding counterparties to hold shares against their well. In this sense, we may need cross-shareholding legislation equivalent to Japanese laws that protect subcontractors from abuse by general contractors. There are Japanese companies that are being forced to hold the shares of other companies against their will due to being the weaker partner in a power relationship. Recently, I spoke about the cross-shareholding issue with representatives of a company that we invest in. They told me that as a result of bank unwinding a cross-shareholding, another company which was a customer of theirs had demanded that they hold the customer’s shares as a condition for doing business together. This is unacceptable and should be treated as a form of harassment and abuse of power. In sum, one of the challenges we face lies in protecting companies that do not want to engage in cross-shareholding from this kind of abuse.

Thirdly, I would like to discuss the exercise of voting rights on cross-shareholdings as addressed earlier by Mr. Oguchi. The single biggest problem with cross-held shares is driven by the presence of voting rights. Please note that for the most part shareholders become shareholders in order to invest in a company's business, not in its cross-shareholdings. If a company is engaged in cross-shareholding, I think this creates a responsibility for it to have a rational policy in place for the exercise of voting rights for the cross-held shares, and to be highly transparent in disclosing the results of the exercise of these voting rights. I think it may be necessary to have such responsibilities stipulated in stock exchange regulations and that company disclosure their shareholder votes would represent a significant improvement and a step forward for Japanese corporate governance. As high-integrity professionals, the managers of both those companies that own cross-held shares and of those whose shares are held should manage their businesses increase corporate value and contribute to Japanese economy. I believe this is at the heart of Japanese-style

management.

Finally, I'd like to suggest the possibility of setting numerical limits on cross-shareholdings. I was one of the drafting members of the Ito Report, and at the Ito Report committee we discussed the possibility of establishing specific ROE targets and measures for improving ROE. At the time, a number of corporate participants expressed the view that it would be preferable to have numerical targets. Consistent with this approach, one suggestion would be in principle to limit cross-held shares to within 10% of shareholder's equity, and ask companies that exceed that limit to gradually reduce their cross-shareholdings. My experience has been that discussions on cross-shareholding unfortunately end up creating a gap between two diametrically opposed camps: namely, those who believe that cross-shareholdings are inexcusable and those who believe that they are commercially necessary. Thus, as a means of seeking common ground, I would suggest that we set numerical targets for reduced cross-shareholdings and have a system in place to reward companies that achieve those targets.

My apologies for the very long comment, and many thanks for the opportunity.

[Ikeo, Chairman] Thank you.

Dr. Ueda, please.

[Ueda, member] Thank you. Today's topic is "cross-shareholdings" - a term that is used in the Code itself - but as mentioned earlier by Mr. Sampei, the issue of stable shareholders is a key one as well from the standpoint of the effective dialogue between companies and institutional investors that the Code aims to achieve. The Code, however, mentions companies holding cross-shareholding, but not the companies being held the cross-shares; this looks a problem that emerged later on, or, rather, that its discussion was postponed at the time of drafting.

Earlier on, it was mentioned that this is the first topic to be discussed in the course of IR with foreign investors, and there is no doubt that the issue of cross-shareholding is a uniquely Japanese one. Speaking of overseas, however, foreign countries also face similar issues. In the U.S. and the U.K. equity markets, free float ratio are over 90%, but other European countries appear to have roughly the same liquidity as Japan. Even so, however, the structure whereby shares are spread among a large number of stable shareholders as opposed to a certain number of major controlling shareholders is unique to Japan. The presence of controlling shareholders would make any problems - such as those posed by dissolution and the protection of minor shareholders - easier to

illustrate. If, however, shares are cross-held in small amounts by a large number of shareholders, or mutually among group companies, dissolution will require considerable time, and I believe it will be necessary to push forward with it gradually.

A foreign country that is in a similar situation to Japan is France. In the 1980s, the Mitterrand government pushed to nationalize major companies, but subsequent left-wing administrations reacted by privatizing them. Consequently, around 30 years ago companies engaged in cross-shareholding to deal with uncertainty concerning incoming investors. Today, this is no longer the case.

Uncertainty over potential investors is a matter of great concern for companies. Looking at the example of a company that was attacked by activists immediately after listing, it appears that they had to devote most business and management resources into tackling with the activist. This is unfortunate for investors. In the midst of the deregulation of global finance, as we gradually relieve companies of such troubles and concerns, the era of stable shareholders, or should I say cross-shareholding, is now gone, and the challenge will be how to ensure balance.

It seems that not only corporations, but also institutional investors, the government and administrative authorities can play an important role in this issue. Firstly, I would like companies to improve the transparency of stable shareholders. Earlier on, Mr. Sampei reported on the results of my survey, where the estimated result shows that a little under 40% of shareholders of Japanese listed companies are stable shareholders. In comparison, institutional investors account for about 25%. Accordingly, however much of an effort institutional investors may make, they can hardly prevail over the 40% foundation of stable shareholders. This is all the more true because the Japanese version of the Stewardship Code does not contain any stipulations on collective engagement.

This is typical in the case of passive investors; so long as the overall foundation does not thin out, any amount of dialogue will hardly produce results. What's more, in the future, even if the Code promotes unwinding of cross-shareholding, it is impossible to grasp how far the result of unwinding of cross-shareholding will exert an impact on the market. For this reason, while I guess that there may be various definitions for estimation, I hope that ways of acquiring data on stable shareholders will be discussed. I think this would allow distinguishing stable shareholders who are strategically necessary from those who are not. So first of all I hope that companies will improve

the transparency of information on stable shareholders.

Secondly, I would like to express my expectations toward mainstream institutional investors. It is only recently that Japanese companies have come to be attacked by activists, and the concern is real. The receiving side of cross-shareholdings has also been mentioned earlier on in the Securities Repots. If we look at the example of the U.S., mainstream institutional investors such as public pension fund and long-term investors have in some cases removed destabilizing short-term investors such as so-called activists by taking the side of corporations. Accordingly, I hope that mainstream long-term institutional investors who are active shareholders will engage in dialogue with investee companies and intensify their presence in order to eliminate the threat of activists. This will eventually become as subject for discussion at a future Follow-up Council.

Finally, there are a few points concerning which I hope for the government and administrative authorities to exert their leadership. Firstly, I would like them to encourage those companies where management intends to sell and dissolve cross-shareholdings through PR activities, creating a movement or at any rate developing the right atmosphere and environment, conveying that it is time to dissolve cross-shareholdings. In other words, the atmosphere that does not allow an implied pressure from the company making its partner hold the shares not to unwind the cross-shareholdings, implying a loss of business after dissolving the cross-shareholdings, may prompt truly necessary selling, and I expect that doing so will leave only cross-shareholdings that have an actual raison d'être.

Also, as seen overseas - for example in Germany - we could include in our measures tax exemptions or reductions on capital gains to create an environment in that facilitates selling. I'd like to suggest that this type of policy package should be considered if our objective is to promote the dissolution of cross-shareholdings across the entire market.

So these are my expectations toward companies, investors and people in the public sector. Thank you.

[Ikeo, Chairman] Thank you.

We hardly have any time left, but I see there are people who have not spoken yet. Mr. Era, would you say a few words in conclusion?

[Era, member] I will be brief. Firstly, as many people - including meetings of the Forum of Investors Japan – have pointed out, I would also like to note that it seems rational and desirable to,

at the very least, reduce cross-shareholdings.

Having said that, I also feel that the issues of the recipients of cross-shareholdings, who will be the new layer of shareholders and the quality of the new shareholder base are perfectly legitimate concerns. In this regard, Mr. Matsuzaki made a very interesting point in his presentation, mentioning "dialogue with the investors targeted by our company". I think this is a very important point for those particularly on the corporate side - that is, the issue of how companies appeal to investors who will take over the stocks after the cross-shareholdings have been unraveled, or, as mentioned earlier on by Dr. Ueda, how to win support from investors who are willing to support the company from short-term-minded investors in the course of implementing long-term strategies. I believe other companies could benefit if they to contemplate and develop a clearer thought and strategy on this topic, and this is why I would like to ask Mr. Matsuzaki for his thoughts on this topic.

[Matsuzaki, the Board of Chairman, Konica Minolta Inc.] Thank you. I will be brief.

Since my appointment as president, when visiting our investors I have found that, much like in business, it is not possible to determine appropriate services and products without first identifying one's customers. I therefore said that we should identify our target so as to be able to develop solid relationships with our investors. I had a list made and then made repeated efforts to that end. Repeatedly going through this process has reinforced our mutual understanding, so that we understand the areas that specific shareholders are interested in. I learned a lot from this experience during my time as president, and I believe that Japan would benefit from implementing such a cycle as well. Of course, as Mr. Kawamura has mentioned, this will not allow us control over the type of investors. There are investors who buy and sell shares based on consensus at the time of each settlement of accounts, and such aspects cannot be controlled. However, it will be necessary to make an effort to determine the type of investors on whose part greater understanding is desired.

[Ikeo, Chairman] Thank you.

We are now past our time limit, and I am going to have to declare today's discussion concluded even though there are still many subjects on which I would like to hear your opinion.

The secretariat will compile a record of today's discussion, which will then be used as the basis for the next session.

In closing, are there any communications from the secretariat?

[Tahara] Thank you for your attendance today.

We will be setting the next date upon taking into account the schedule of all attendees, and will get in touch with you shortly.

That is all I have to say.

[Ikeo, Chairman] Thank you.

I now declare today's session closed. Thank you very much.