The Fourth Council of Experts Concerning the Follow-up of

Japan's Stewardship Code and Japan's Corporate Governance Code

December 22, 2015

[Ikeo, Chairman] Although it's a few minutes earlier than the scheduled opening time, as all the prospective attendees are here, I'd like to open the fourth 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.

The secretariat has made efforts to revitalize discussion, and changed the seating plan this time. If you find any inconvenience, please let me know later.

As shown in the meeting agenda, today I'd like you to discuss growth-oriented governance as "Points at issue on the Board (2)". As I mentioned in the previous meeting, I believe we have plenty to say about the board, and we need to have a series of discussions on how the board should be. Exploring the issues raised during the first round and taking them into account, today we will discuss growth-oriented governance. Specifically, I'd like you to focus on measures for securing an independent and objective standpoint of the board, and the appointment and dismissal of CEO.

In relation with today's topic, we invited guests from Kao Corporation - Mr. Sonosuke Kadonaga, Chairman of the Board, and Mr. Tadaaki Sugiyama, Executive Officer, who will provide a presentation later.

First, I'd like to ask a representative of the Financial Services Agency to explain issues to be discussed today.

[Tahara, Director of the Corporate Accounting and Disclosure Division, FSA] Good morning. Now I'd like to explain today's agenda according to the material at your hand. Please take a look at Material 1 titled "Points at issue on the Board (2)". As you see, Material 2 has the similar title, "Points at issue on the Board". Please don't be confused. This one is the summary of opinions expressed in the previous meeting. Please note that it does not constitute a consensus of the Council. Please use it for your reference, where necessary. As we already explained those issues, I will not explain Material 2 today.

Now I'd like to explain Material 1. As Chairman just mentioned, today we'd like you to discuss measures to secure the independence and objectivity of the board, as well as the appointment and dismissal of CEO. First, I’d like to explain points at issue concerning the “independent and objective standpoint” of the board, which is related to Principle 4.3

We summarized the members’ opinions expressed in the previous meeting in 6 bullet points. First, it was pointed out that it is important for independent directors to effectively perform their functions in order for the board to enhance discussion so that the board can enhance discussions on setting strategic direction and carry out oversight from an independent and objective standpoint. While this is linked to the next point about how to provide information to independent directors, what are effective functions to be performed by independent directors? And what qualifications are required for them? What should we think about the selection of and appointment procedures for them? We’d like you to discuss these points.

The second point is that it is necessary to take measures to adequately provide necessary information to independent directors. For example, the Code suggests further use of executive sessions and lead independent director. We’d like to hear your opinions about it.

Third, it was noted that although the board is expected to discuss such matters as business strategies, it tend to spend time on making decisions on day-to-day operations, and thus it is necessary to think of ways to enable the board to spend more time on discussions of business strategies. Some members introduced practical examples of corporate efforts such as narrowing down the number of agenda items, or introducing ‘matters for deliberation’. We’d like you to discuss what you think about these points, and what should be kept in mind when narrowing down the number of agenda items.

The fourth point is specifically relevant to Companies with *Kansayaku* Board and Companies with Supervisory Committee. It was pointed out that it is important to make use of optional advisory committees or the like for nomination, remuneration, etc., and to take measures to make better selection of committee chairs and members. What roles can such optional advisory committees fulfill? What kind of measures can be considered for the selection of committee chairs and members? We’d like to hear your opinions.

Fifth, it was mentioned that an evaluation of the board effectiveness is important to gain the understanding of shareholders with regard to corporate efforts to improve governance. We’d like you to discuss specific methods of such an evaluation, as well as disclosure of evaluation results.

The last point concerning this issue is that, in order for the board to secure an independent and objective standpoint, it is essential to separate business execution and oversight, and companies should move toward the separation of CEO and the board chair. Under what circumstances the separation of execution and oversight, or the separation of CEO and the board chair is desirable? And how should the separation be made? What ways can be used for it? We'd like to hear your opinions on such matters.

Now, I'd like to move on to the second broad topic for today's discussion. In your previous discussion on the appointment and dismissal of CEO, it was pointed out that how to nominate CEO is essential from the perspective of growth-oriented governance. And it is also essential to be able to dismiss the CEO in case of poor company performance, as well as to have procedures to secure the objectivity, timeliness, transparency, etc. in doing so. Concerning the appointment and dismissal of CEO, in order to secure objectivity, timeliness, and transparency, we'd like to hear your opinions on what methods and/or innovative efforts, including the preparation of a succession plan, can be considered.

Furthermore, we have solicited public comments concerning the issues to be discussed today, and received comments from five organizations. Let me introduce those comments. I'm sorry that there is no print-out.

The first comment is from an international organization related to corporate governance. They raised roughly 5 points. They stated that the boards should play more of a strategic oversight role, rather than a managerial, operational one. They also stated that the companies will generally need at least 3 independent directors and a minimum one-third board independence if they are to gain tangible value from their participation. In addition to the number of independent directors, they also stated that institutional shareholders are increasingly looking at the quality of independent directors, not merely the quantity and such directors should also be people with relevant business experience who can promote to the success of a company and contribute to discussion of strategy. Furthermore, with regard to broad diversity, they suggested that diversity should explicitly include the promotion of global talent and not just gender diversity. Additionally, they stated that, to further enhance the effectiveness of independent directors, they support the appointment of a lead independent director.

Furthermore, concerning board evaluation, they stated that companies should be required to disclose their process for undertaking board evaluations and whether it was a self-evaluation or carried out by an independent, specialist consultant. They also stated that one tool for developing an effective board is the "skill-set matrix", which outlines the range of talent and expertise among directors and links this to the company's strategic and operational needs. Finally, they asserted that it is important to form committees for nomination, audit, etc. with adequate independence.

The second comment is from another international organization related to corporate governance. They raised roughly 3 points related to today's topic. They suggested that extra criteria might help to establish an internationally accepted level of qualified independent board members. Although this overlaps with the previous commenter, they also stated that the board should have at least 3 independent directors, and at least one-third of the board members should be independent directors. Furthermore, in order for independent directors to perform their functions, companies should offer extra administrative support and executive assistance to them.

The third comment is from an organization of management executives in Japan. Their general statement is that the separation of business execution and oversight should be further promoted to achieve 'growth-oriented governance'. As specific actions, they require the disclosure of the board composition and policies for selecting directors. They also stated that companies should actively disclose how they select committee chairs and committee members. Furthermore, for such selection, companies should make use of nomination advisory committee. As their feedback on this Council and its administration, they asserted that the Council should discuss/examine the following matters: what qualifications the board should consider when nominating candidates for directors; specifically what ideal procedures for nomination are; what the board and/or advisory committee should consider when appointing and dismissing CEO; transparent nomination process; and/or creation of an environment where companies are encouraged to appoint a non-executive director as the board chair.

The fourth comment is from an organization of experts in finance. They raised roughly 2 points. First, the Council should consider a definition of "the independence of the board". Second, the Code should emphasize that the board has the authority to dismiss CEO, in case the CEO harms the shareholders' value of the company.

The last comment is from an organization consisting of institutional investors. They made a point about the board evaluation. In case a company adopts an external facilitator for the evaluation, the company should disclose whether or not there is any conflict of interests with the external facilitator.

I just made a quick explanation on the points which we'd like you to discuss today, and shared relevant comments from 5 organizations among other public comments. That's all from me.

[Ikeo, Chairman] Thank you very much.

Next, in relation with today's topic, I'd like to ask a representative of the Tokyo Stock Exchange to explain disclosures which were made by companies in their Corporate Governance Reports concerning the scope of delegation from the board to the management as well as the board evaluation.

[Watanabe, Head of Listing Department, the Tokyo Stock Exchange] I'd like to provide an explanation by using Material 3.

First, I'd like to introduce disclosures about the scope of delegation to the management. So far, a large majority of the companies have complied with the principle [Supplementary Principle 4.1.1], and disclosed the scope of delegation. A typical practice among Companies with *Kansayaku* Board is that matters on which laws and the Articles of Incorporation require a board resolution as well as important management matters are discussed and resolved by the board. In addition, Company A disclosed that they set a threshold amount that requires a board resolution.

In case of Company B, which is a Company with Three Committees, they disclosed that the board discusses solely matters on which laws require a board resolution, and delegates other matters to *shikkoyaku* (corporate executive officers). This is a typical practice among Companies with Three Committees.

Some companies clearly specify roles or position of the board in their disclosures. For example, Company C defines that the board formulates important management policies and strategies from an objective and long-term perspective, and supervises business execution, and that the board manages the process for achieving goals.

In case of Company D, the board delegates to *shikkoyaku* a significant range of decision-making on business execution and focuses on oversight of the management.

These are about the scope of delegation to the management. From page 4, disclosures related to the board evaluation are introduced.

In the previous meeting, I reported that the highest number of explanations for non-compliance was provided for this principle [Supplementary Principle 4.11.3]. Since then, the number of the companies which choose to explain further increased: as of the end of August, 54% of all companies which submitted Corporate Governance Reports chose to explain, marking an increase by 30 percentage points. Looking at their explanations, we found that the majority of the companies explained that they plan to conduct the board evaluation in the future, while more than 40% of all companies are still considering whether or not to conduct the evaluation.

From the next page, disclosures by companies which complied with this principle are introduced. In terms of methods of analysis and evaluation, Company E undertakes a full course of the evaluation, so to speak. First, they conducted a survey in the form of a questionnaire for all directors. In addition, they had interviews with some directors. Having obtained self-evaluations in this way, they invited external experts and carried out an analysis, led by the board chair. Based on results of the analysis, the board had a discussion. This is their evaluation process. In some companies, interviews are not conducted, and the board makes the evaluation, taking solely survey results into account. On the contrary, some other companies do not conduct surveys, and make the board evaluation based only on interviews. Some companies involve external experts, and other companies do not. There are numerous variations.

In terms of a main body for conducting such analysis and evaluation, in most companies, the analysis and evaluation are led by the board, similarly to Company F. In some companies like Company G, representative directors evaluate performance of each director, before the board makes an evaluation.

There is another group of companies like Company H, where Nomination Committee, instead of the board, evaluates the effectiveness of each director and the entire board.

Furthermore, in case of Company I, based on self-evaluations of individual directors, an evaluation is carried out by the Outside Director Session which only outside directors attend.

In case of Company H where Nomination Committee evaluates the board, their Nomination Committee consists of five members, four of which are independent directors, and the committee chair is an independent director. Their evaluation is made by such Nomination Committee.

Furthermore, among companies which use external experts, Company J engages an outside law firm to collect questionnaires for directors, etc., and to summarize and analyze the results. Alternatively, other companies including Company K commission a third party organization for the evaluation of the entire board.

In terms of perspectives of analysis and evaluation, as shown in the example of Company L, the most commonly-used angles include the board composition, and the board operations such as time allocated for deliberation, frequency of board meetings, agenda items, and attendance rate. Furthermore, many companies refer to such perspectives as whether reference materials and information provided to directors are sufficient, or whether explanations are provided to outside directors prior to the board meetings.

On the other hand, some companies including Company M specify, in their governance guidelines, expected roles and responsibilities of the board, the chairperson, and each committee, and then conduct board evaluations from the perspective whether such guidelines are complied with.

I'm moving on to the summary of results of analysis and evaluation. As for the evaluation results, all the companies evaluated that the board effectiveness is secured. Company O and others disclosed the progress since the last year, as additional information.

Furthermore, some companies referred to their next steps, based on the evaluation results. For example, Company P recognizes a challenge of increasing the number of outside directors. Meanwhile, Companies Q and R recognize a challenge of spending more time discussing important issues including mid- to long-term business issues and business strategy, or accompanying risks.

Company S and others are aware of the necessity to narrow down the number of agenda items in order to facilitate essential discussions.

That's all for my explanation.

[Ikeo, Chairman] Thank you very much.

Next, I'd like to ask today's guests, Mr. Kadonaga and Mr. Sugiyama from Kao Corporation to make presentations. I assume the presentation is to be made in accordance with Material 4. I'm handing it over to you.

[Mr. Kadonaga, Independent Director, Kao Corporation] Good morning. I'm Sonosuke Kadonaga, Independent Director of Kao Corporation. It's my pleasure to be here.

[Mr. Sugiyama, Executive Officer, Kao Corporation] I'm Sugiyama, Executive Officer of Kao Corporation, and serving as the secretariat to the board. It's my pleasure to be here today.

[Mr. Kadonaga] I'd like to introduce Kao's initiatives. Please take a look at Material 4.

You can see several points on page 1. We listed Kao's initiatives for "securing an independent and objective standpoint of the board" in line with today's points to be discussed, making them as easy to understand as possible. So I'd like to introduce them in this order. I am an outside director, so I believe that I can introduce Kao's initiatives from an outsider's viewpoint. Before talking about the topic, let me briefly introduce Kao.

As shown on page 2, Kao is a long-established company, incorporated 75 years ago and founded almost 130 years ago. Net sales are 1.4 trillion yen on a global consolidated basis. Speaking of the number of employees, more than 6,000 employees are working for Kao on an unconsolidated basis, as shown on the page. Yet, including Kao Group consolidated companies – mostly 100% subsidiaries, more than 32,000 employees are working for the Group worldwide.

Page 3 shows Kao's fields of business. Roughly 80% of products Kao manufactures and sells are for general consumers. You may be familiar with these product lines, such as cosmetics, hair care products, skin care products, diapers, sanitary napkins, laundry detergents, etc. Kao manufactures and sells such household products, accounting for more than 80% of net sales. You may not be so familiar with Kao's chemical business, which is shown on the upper left of the page. This is a B2B business of chemical products based on derivatives of fatty alcohols, which is the main raw material for Kao's household products, and derived chemical products, accounting for a little less than 20% of net sales. More than 60% of this business is carried out overseas. Broadly, Kao has these 2 pillars of the product portfolio. On the right, sales by geographical area are shown. Japan accounts for two-thirds, and the remaining sales are from Asia, the United States and Europe. These products are locally manufactured and sold, not exported from Japan. This is Kao's business structure.

Let me skip page 4, and explain page 5 first. It shows the entire picture of Kao's governance structure. I'd like to draw your attention to the fact that Kao is a Company with an Audit & Supervisory Board (*Kansayaku* Board). As shown in the middle of the page, the Board of Directors currently consists of 3 inside directors and 3 outside directors, and is chaired by me being an independent director. Kao has two committees, namely the Committee for the Examination of the Nominees for the Members of the Board of Directors and the Compensation Advisory Committee for directors and executive officers, both including all outside directors and outside Audit &

Supervisory Board members (*kansayaku).* And both Committees are chaired by an outsider, that is myself. This is the current corporate governance structure of Kao. Now I'd like to look back at the history of Kao's corporate governance. Please go back to page 4.

We summarized the history for the past 15 years. I'd like to draw your attention to the number of outside directors. Outside directors were first appointed in 2002, resulting in the board comprising 11 inside directors and 2 outside directors. This board composition was maintained for nearly 10 years. The next significant change took place in 2011-2012: an additional outside director was appointed, while the number of inside directors was reduced. As a result, the board composition changed to 7 inside directors and 3 outside directors. Two years later, further progress on the reform was made. The number of inside directors was further reduced to be equal to that of outside directors – 3 inside directors vs. 3 outside directors. At the same time, the chairperson was selected from independent directors. I joined the board as an outside director, when Kao added 1 outside director in 2011-2012. Furthermore, in 2013, the Audit & Supervisory Board (*Kansayaku* Board) also increased the number of outside members by one, resulting in the composition of 2 inside members and 3 outside members. This is the journey which Kao has undertaken. I think that significant progress in the past few years would be a distinctive feature of Kao's corporate governance.

We included photographs of the members. Page 6 shows the members of the Board of Directors: 3 inside directors on the left, and 3 outside directors on the right.

The next page shows the members of the Audit & Supervisory Board (*Kansayaku* Board)*:* inside members on the left, and outside members on the right. This is what Kao's governance structure looks like.

Now I go back to page 1, and explain Kao's initiatives in accordance with today's points at issue. I will not be able to cover the details, so please ask me questions later, if any. The first point is effective functions of independent directors. Let me share how Kao sets the selection criteria to realize the situation where independent directors fully perform their functions. In Kao, outside directors are selected in a way to ensure that Kao can benefit from different backgrounds and areas of experience. As you just saw, the board includes 3 outside directors: a director with extensive experience in the management of a manufacturer, another director with extensive experience in the financial industry, and the third one - that is me - is a former management consultant with a broad perspective. Although each of us has different backgrounds, we have something in common – global experience.

As for expected qualifications of inside directors, important points would be whether they can have different viewpoints, whether they can take objective viewpoints, and whether they can participate in discussions from such viewpoints.

Actually, out of 3 outside directors, two are independent directors and one is not independent. Concerning the issue whether all outside directors should be independent, Kao places significance on their qualities as mentioned earlier. We believe that diversity is as important as independence. Therefore, upon selecting directors, Kao has pursued a balance between independence and diversity.

The next point is what measures Kao has taken to promote active and constructive discussions. The first one is information provision. Naturally, explanations are provided prior to board meetings. In addition, the board members visit business facilities or participate in Kao's events for customers and gatherings of distributors, making efforts to gain understanding of our business conditions and market conditions through such opportunities. Furthermore, given that the chairperson is from outside the Company and thus needs more information, the chairperson – that is myself – visits overseas offices as well. Actually, I have visited 7 countries, and made efforts to understand the local situations through discussions with the local management. The chairperson also attends meetings of the Management Committee. By doing so, the chairperson can have a better understanding of the background of agenda items to be presented to the Board of Directors. This is how I felt through my own experience.

In terms of the way of discussions at the board, agenda items are classified into 3 broad categories. The first category is matters of resolution. The second category is monthly reporting on business execution, which comprises monthly reporting from President, and reporting from directors in charge of specific topics. The third category is discussions on important topics, including M&A, company-wide strategies, organizational issues, R&D and supply chain strategies. Presentations on such topics are given first, and then the board members have discussions. We secure time for such discussions, so our board meetings inevitably require a long time. A meeting usually starts at 9 a.m. and lasts until 3 p.m. We spend that much time. I believe we have sufficient discussions.

I referred to discussions on important topics. Such topics are generally proposed by President. Yet outside directors and outside Audit & Supervisory Board members (*kansayaku*) can also request discussions on specific topics, and their requests are incorporated in the agenda.

Outside Audit & Supervisory Board members (*kansayaku*) also participate in such discussions very actively. Concerning matters of resolution, there were such cases where proposals were returned to proposers, and where I felt something was wrong with a proposal, and, in the capacity of the chairperson, asked the Audit & Supervisory Board members to re-organize the issues and modify the proposal, and then the board resolved the matter. Concerning matters of resolution and matters to be reported, many questions are asked. In case an answer is not given on the scene, the person in charge follows up on such a matter in the next meeting without fail.

In the early days, it was rather difficult to appropriately allocate time for each agenda item within the categories of matters of resolution and matters to be reported and we used to use up time just for presentations. Yet we needed time for Q&A and discussions. Now we have grown accustomed to the time allocation. We spend less than half of the time on explanations, and use the remaining time on Q&A and discussions.

In addition, outside directors voluntarily get together for discussion, although it does not take place regularly. Sometimes we meet somewhere else, and we also have a session during intermission of or after a board meeting to have follow-up discussions on a certain topic of the board meeting. It is the chairperson who convenes such sessions. This is Kao's way to conduct board meetings.

The third point is related to the Committee for the Examination of the Nominees for the Members of the Board of Directors and the Compensation Advisory Committee. I'd like to share their functions and roles in Kao. As mentioned earlier, both committees include all outside directors and outside Audit & Supervisory Board members (*kansayaku*). Both committees are chaired by the chairperson of the Board of Directors. Each committee meets 3 times a year. At our Committee for the Examination of the Nominees for the Members of the Board of Directors, President proposes candidates for directors, and the members discuss them. By arranging opportunities for outside members to meet with the candidates, we ensure that the members do not have discussions solely based on documents. Although this committee focuses on discussions on candidates for directors, it receives explanations on candidates for executive officers as well. I am going to tell you the reason for that. In order to judge whether our corporate governance system will work effectively by including such director candidates, we must also look at the business execution structure. Therefore, explanations on executive officer candidates are provided to this committee.

The Compensation Advisory Committee met 3 times, including a preparatory meeting, this year, and made a significant change to the remuneration system. In the first meeting, outside members provided various comments and advice concerning the current system. In response, a proposal was prepared in the company, and discussed in the next meeting. In the third meeting, we reached an agreement after some calibrations. We achieved a significant reform by taking these 3 steps.

The next point is an evaluation of the board effectiveness. We heard detailed analysis results earlier today. In Kao, even from before the Corporate Governance Code was established, once a year, we have had the opportunity for hearing broad-ranged comments from outside directors and outside Audit & Supervisory Board members (*kansayaku*). Such comments are not solely about the board effectiveness. They share their opinions about how they perceive the entire company, the board and themselves, including what needs to be improved. I think such comments are also shared with the executive officers meeting later. Starting from this year, we presented evaluation criteria in line with the Corporate Governance Code, and asked the members to make comments along the criteria. Then we compiled and published such comments. This year, like previous years, evaluations were made mainly made by outside members, and inside directors did not actively make comments. We are planning to ask inside directors and inside Audit & Supervisory Board members (*kansayaku*) to share their opinions about such evaluations from the next time.

The next point is the separation of business execution and oversight. As mentioned earlier, President and chairperson are separated in Kao. Moreover, the board is chaired by an outside director. I assume this is rather rare among Companies with Audit & Supervisory Boards (*Kansayaku* Boards).

Concerning business execution, reporting is provided at board meetings. While it is impossible to report all the details, important points and background are explained in a way that outside members can understand. At first, explanations were not easy to understand. So we repeatedly pointed out which parts were not clearly understood, and I think explanations are improved and easy to understand now. After the explanation, we have discussions. The board delegates details to those who perform execution functions, but expresses concerns, if any, and points out where the focus should be, or requests for clarification at the next meeting.

Concerning oversight, Kao currently has in place an effective internal control system, and Audit & Supervisory Board members (*kansayaku*) are also watching the situation carefully. Therefore, the board mainly discusses the strategic aspect. An emphasis may differ from company to company, depending on which phase a company is currently in. Kao has improved its internal control over the years in response to various suggestions by the board. At the current phase, the emphasis is placed on the strategic aspect. I think that selection criteria for outside directors may also differ to a certain extent, depending on a company's phase.

Finally, I'm aware that the appointment and dismissal of President is also today's topic. Concerning a succession plan, the Committee for the Examination of the Nominees for the Members of the Board of Directors has discussions on it, mainly focusing on candidates from within the company. Then we secure opportunities for outside members to meet with such candidates, so that a decision will not be made solely based on documents. I earlier referred to informal meetings of only outside directors. At such meetings, we discuss an evaluation of the current business execution structure, including President.

As it is difficult to compare with other companies, I cannot evaluate Kao's initiatives in a relative sense, but I have an impression that they are working well in an absolute sense. However, it simply means that the existing system and operations fit with the current circumstances of Kao, and therefore, this model may not necessarily work in other companies. Each company should optimize its efforts by taking into account which phase the company is currently in, and considering its mechanism or structure as well as appointments. Companies should not fall into a trap of pursuing a "one-size-fits-all" solution. That's all from me.

[Ikeo, Chairman]　Thank you very much. We asked Mr. Kadonaga and Mr. Sugiyama to stay and participate in the following discussion. Therefore, please ask them questions, as necessary, during the discussion.

Please note that we distributed an opinion paper from Mr. Toyama, who is absent today, on your table. The secretariat also sent it to the members in advance, so I won't read it out here. Although I assume the members received it late last night, I'm not reading it out. I'd appreciate it if you took his opinion paper into account, where necessary, for the discussion.

Now I'd like you to have free discussions according to Material 1. As the topic covers a broad range of points, although they are related to each other, I suggest that we discuss the first 3 bullet points now, and the remaining points later. Specifically, under the topic of “response for securing the independent and objective standpoint of the board”, I’d like to split the first half and the second half, if possible. So I’d like you to discuss the first 3 bullet points, from the first bullet point to that reading “At board meeting where management strategies should be discussed, decisions on daily operations …” Then we will discuss the remaining 3 points later. Finally, we will discuss the next topic, the ideal state of appointment/dismissal of CEO. I know each point is interrelated, but I’d like to narrow down the focus, if you don’t mind.

Now I’d like to ask you to share your opinions about the first half of the issues for securing the independent and objective standpoint of the board. Ms. Takayama, please go ahead.

[Takayama, member] I think it is great to discuss the points described in Material 1 concerning the board for two reasons. First, Material 1 listed up important issues concerning corporate governance – the effectiveness of the board. Therefore, it is meaningful to discuss these points. In our previous discussion on issues on the board, I got an impression that an emphasis was placed on the board designs, or forms of corporate governance. The issue of governance form is certainly important. However, these essential points on the board effectiveness should be discussed first; and after the sufficient discussion on these points, each company should consider which form of corporate governance, such as a Company with *Kansayaku* Board and a Company with Three Committees, they should adopt. I think this is a proper course.

Second, discussions on these points are easily understood by global audience. Discussions on the form of corporate governance tend to include country-specific matters, and therefore, it is hard for global investors to understand them. On the other hand, many points described in Material 1 are essential matters concerning corporate governance common to global investors and companies. To attract interest in and gain empathy for Japan’s corporate governance or Japanese companies, it would be better to dispatch such information to the world that this Council discussed this kind of significant points.

The secretariat earlier shared public comments from global investors, and the commenters focused on these points, rather than the the form. I’d like to introduce organizations, which have disclosed their public comments on their websites. One is ICGN (International Corporate Governance Network), and another is ACGA (Asian Corporate Governance Association). Both organizations comprise a group of global institutional investors. You can find their specific views on their websites.

My next point is that it is important for each company to sufficiently discuss roles of the board, and its oversight functions, as the foundation for further discussion on various board-related matters. Only after establishing such a foundation, companies can discuss what the board discussions should be, or what roles independent directors should play. Companies, which I worked with, discussed such points first; and after the board members shared the basic views, they discussed specifics. There may be some overlaps with Kao's case, but I'd like to share what those companies discussed as case examples for reference.

With respect to oversight functions of the board, as Mr. Toyama mentioned in his opinion paper, until recently, the boards of Japanese companies mostly adopted the management board model. However, the Corporate Governance Code clearly places an emphasis on the board's oversight functions. Under the Corporate Governance Code, I think many companies are making a shift toward the board which focuses on oversight, or - I'm not sure if this is an appropriate expression - the Monitoring Board. Nonetheless, even though we say "oversight functions" and the basics would be the same across companies, I assume that priorities differ from company to company, depending on their business situation or management stage. Therefore, each company should first discuss what the board's oversight functions are. That would be a starting point of discussions on corporate governance or the board.

Now I'd like to share some discussions made by companies, to which I provided assistance for the board evaluation, in respect of oversight functions and points covered by Material 1.

A certain company appeared to have an excellent corporate governance system in terms of the form, with a high percentage of independent directors and key committees in place. However, the board did not have opportunities to discuss substantive issues such as how directors should behave in the first place, or what oversight functions should be. It was because the board is a body to make so many decisions within limited time. They were aware that substantive discussions are important, but they simply did not have time for such discussions. Then, fortunately, the Corporate Governance Code was established. In response, the chairperson, independent directors, and independent *kansayaku* spent a whole day discussing the ideal state of the board, desirable board composition, and other matters in light of the purpose and spirit of the Code. They could sufficiently discuss such issues.

The next case example is from a company which also satisfies the formal standards of corporate governance. By referring to the Corporate Governance Code, CEO, lead independent director, the secretariat and others discussed what oversight functions the board should perform, and how they should define oversight functions. Then, based on this discussion, the entire board discussed the matters. Concerning the board's oversight functions, there are two important findings from the discussion. One of the findings is that they should consider the functions from the perspective of the mid- to long-term sustainable corporate growth. Another one is that when the environment surrounding the company is rapidly changing, they should take such a change into account.

I'm moving on to the next example. In case of this company, the entire board shared opinions on roles and functions of the board; and from that perspective, they discussed roles, qualities and composition of independent directors. In case there are only 2 independent directors or just one, the composition may not be at issue. But in case there are 3 or more independent directors like in Kao, the composition matters. Considering the company's current business and management stage, they discussed what the best composition of outside directors is, or what the best mix is. In addition, from the perspective of enhancing independent directors' oversight functions, it is necessary to clarify inside directors' roles. And the composition of inside directors would also be an important point. Accordingly, they sufficiently discussed the roles, functions and composition of inside directors as well.

The last example is from a company which examined contents of discussions at board meetings in terms of oversight functions. This is applicable to other companies - when considering agenda items of a board meeting, there are two points to keep in mind. One is that they should focus on important matters by making choices from a mid- to long-term viewpoint, and in light of sustainable growth and risks. On the other hand, they should not drop important matters from the agenda. According to one of the independent directors, no matter how much information is provided outside of board meetings, there is a limitation, which is that independent directors cannot fully understand things other than what is discussed at board meetings. Under such circumstances, independent directors must make decisions. In that sense, the contents of agenda items and the agenda-setting process are critical. Therefore, that company started discussions on them to find what is ideal. They also discussed how independent directors get involved in the agenda-setting process.

When we consider the board's discussions, it is important to give consideration to discussions at a management meeting, which is held prior to a board meeting. Some companies have been discussing how they differentiate discussions at board meetings and those at the management meetings in terms of the quality.

That's all. I introduced these examples for our discussion.

[Ikeo, Chairman]   Thank you very much.

Mr. Kawamura, please go ahead.

[Kawamura, member]   I'd like to ask Kao representatives questions about the separation of oversight and execution. According to page 6 of the material, the current board consists of 3 inside directors and 3 outside directors. Whether it really constitutes the separation of execution and oversight may depend on whether all directors have equal voting rights, or the chairperson has the casting vote in case of 3 vs. 3. This is my first question. Another question is related to the second topic of the day. With respect to the appointment or dismissal of President, if the voting result is in tie, 3 vs. 3, how can the board make a decision? This is a very serious, the most important issue. How do you make a final decision? How can you avoid dominance of internal logic of the company?

[Ikeo, Chairman]   Could you answer the questions?

[Mr. Kadonaga]   In terms of the structure, I think it would be difficult to clear the concern expressed by Mr. Kawamura. Yet, what I feel from my own experience with Kao is that we have a culture of open discussion in the first place. I feel that we will not have a tie result - 3 inside directors vs. 3 outside directors. If just one director votes against any proposal, we will start over the discussion. That is our culture or practice. Therefore, I do not worry about such "3 vs. 3" situation. It does not mean that a director has a veto, but we have a discussion to understand why that director is against the proposal. We have never experienced such a situation when we make an extremely important decision. However, I believe we can overcome such a situation, if it ever arises.

Therefore, while Kao happens to be like that, I think companies need to make a choice, whether they should have a structure or mechanism to address such a situation, or whether they overcome such a situation taking advantage of their culture or human resources.

[Ikeo, Chairman]　Mr. Kawamura.

[Kawamura, member]　Thanks to your explanation, it is now clear to me. Our company has never experienced such a significant instance of decision-making, but it would be possible that after achieving outstanding business results for many years, President becomes tainted or corrupted. We consider that the board needs to be capable of appointing or dismissing President, in such a case. We are working on establishing such a mechanism. There will be a personnel change in the future. The situation may change. There is no guarantee that we can continue to make decisions on various matters in a friendly manner. Also there is a possibility that an inappropriate person maintains his/her seat for a long time. We'd like to have in place a mechanism to respond to such occasions. That is our company's view. We may have taken it too seriously. I wanted to share our view for your reference.

[Mr. Kadonaga]　Thank you very much. I have not yet answered one of your questions. The chairperson does not have the casting vote, but has just one vote equal to other members. However, as far as the appointment and dismissal of President is concerned, all the members of the Committee for the Examination of the Nominees are outside members, and I am the chairperson, so 6 people are serving on the Committee. So I think that structurally, this may work as a brake.

[Kawamura, member]　Do you mean that the Committee actually has power of appointment, not just providing opinions for reference?

[Mr. Sugiyama]　I'll answer the question about the mechanism. The Committee takes the form of an advisory committee, so it is structured in such a way that the Committee just offers opinions to the board. Kadonaga just explained that the Committee has 6 members - 3 outside directors and 3 outside Audit & Supervisory Board members (*kansayaku*), totaling 6 members. In addition to these members, President Sawada, who submits proposals, attends Committee meetings accordingly. Eventually, according to the Companies Act, candidates of the member of the board are nominated by the board and they are later appointed by a resolution at the general shareholders meeting. The Committee works as an advisory committee, which offers opinions. However, in case where a voting result of the board is 3 vs. 3, the advisory committee's opinion works like an invisible vote. And if the board makes a judgment, which is opposed to that of the advisory committee, the board is required to explain the reason to the advisory committee. That's the mechanism we have established.

[Mr. Kadonaga] I'd like to make a supplementary comment. My expression may have caused a misunderstanding. We are not carrying out our duties in a friendly manner, but in a very strict manner. I make points or provide advice, while feeling I may be too strict. We work in such an atmosphere.

[Ikeo, Chairman] Mr. Oguchi, please.

[Oguchi, member] Thank you very much. Our bread-and-butter job is constructive engagement for clients, so I'd like to make 3 points based on our experience. The first point is concerning the board composition. When we talk with a company, we analyze the company in our way in advance and confirm their mid- to long-term corporate strategy, and then have a discussion with them in terms of whether the current state of the board matches with such a strategy or whether there is any mismatch.

The following is not a question to Kao, but a general statement. For instance, when a large percentage of customers are female, or when the company plans to expand their overseas business, we discuss whether the current composition of the board allows for a sufficient discussion on marketing know-hows. I assume that Kao also had such discussions with their investors many times.

On such an occasion, we often ask this question. And a typical answer is like this: "At the level of executive officers, we have promoted diversity, by increasing the number of females and foreigners. Therefore, please give us more time." Whenever I hear such an explanation, I feel that even though the separation of business execution and oversight is now being discussed in Japan, this issue is, in general, not yet clear to the companies. They still have a view that a director is the position which those who execute business are promoted to, and I think that such a view is an obstacle to the reform of directors.

From the viewpoint of investors including us, why are independent directors necessary? One of the reasons is independence - a factor which does not exist in the company. As is the case with Chairman Kadonaga, independent persons do not exist within the company. With independent directors, the board can secure an objective standpoint, which is indispensable for nomination, remuneration and audit as covered in today's topic. I think this is a significant factor. As typically seen in the case of Chairman Kadonaga, independent directors bring in valuable knowledge and experience which are hard to obtain from within the company, and thus the companies, including those which the members of this Council belong to, also take advantage of them, I think.

Concerning the independence, the Independence Criteria was distributed as a reference material today. I think this would be the center of discussion: obviously, new knowledge and experience needed to be brought in vary from company to company. They have different strategies and different board composition. Therefore, they need to identify what is lacking for realizing their strategy and what they should do. Otherwise, they cannot discuss how many independent directors with what attributes they need. In that sense, the companies need to conduct the board evaluation every year to check the board composition and what kind of people they need, and that will lead to the next step of the board.

I'd like to share what I heard from a chairperson of a Company with Three Committees, who is an outside director. It is related to the categorization of agenda items. At the level of PDCA (Plan-Do-Check-Action), the board plays the roles of P (Plan) and C (Check), and executives undertake the parts of D (Do) and A (Action). Listening to today's presentation by Kao, I got an impression that Kao's board functions and execution functions are separated in that way, and it led to the current classification of agenda items.

My second point is concerning roles of independent directors. When we have dialogue with companies, there are some topics which are hard to discuss with inside persons. Such topics include, for instance, the removal of anti-takeover measures, or confidence-building after a corporate scandal. It is hard to discuss such topics with insiders, who are interested parties. So we seek ways to have dialogue with independent directors. For example, the UK's Corporate Governance Code includes Principle A.4.1, which states that a senior, or a lead, independent director should be available to shareholders, if they have concerns which contact through the normal channels of chairman, chief executive or other executive directors has failed to resolve or for which such contact is inappropriate, or for which such contact is inappropriate. We keep it in mind, but in reality, most Japanese companies do not have a practice where shareholders meet directly with independent directors. For example, we don't know how we can see Mr. Kadonaga. Kao may have such a channel, but generally companies don't. So we seek a channel by ourselves, and approach necessary people.

As one of the roles of independent directors, Principle 4.7 (iv) refers to "appropriately representing the views of minority shareholders and other stakeholders in the boardroom from a standpoint independent of the management and controlling shareholders." In terms of gathering information for that purpose, and in terms of solving the above-mentioned problem, I'd appreciate it if a lead independent director, if there is one, could serve as a contact point with shareholders, and play a role in providing feedback of the dialogue with them to the board. If it is achieved, we can expect three benefits from having independent directors: 1) independence, which does not exist inside the company; 2) new knowledge and experience, which are hard to obtain from within the company; and 3) serving as an intermediary between shareholders and the board. In that sense, I consider that independent directors play very important roles for investors.

Finally, I'd like to make a comment on *kansayaku* and Audit Committee. When we talk with companies, we often hear that audits require inside persons who are familiar with business operations. On the other hand, many foreign investors state that almost all members of Audit Committee should be independent, and the Audit Committee should be chaired by an independent director. There is a huge gap between these two views.

I tried to figure out why foreign investors insisted on independent directors. When talking about a corporate scandal, I told them that in case a corporate scandal occurs in Japan, a third party committee comprising only independent members is established and investigates the causes. Then they said that such a committee should be stationed at a company on a permanent basis.

Certainly, if the committee includes insider persons, we can expect information sharing in various ways. Yet, in case a third party committee is established, independent members of the committee carry out a voluntary investigation, and we know that such an investigation worked in the past. Then even if Audit Committee consists of only independent members, if such members work with the internal audit department, such an audit will be more robust, as the Committee has the authority under the Companies Act. I have come to think like that recently. For the prevention of recurrence of corporate scandals, companies could consider how the *Kansayaku* Board and Audit Committee should be from that viewpoint.

In addition, the new form of corporate organization, Company with Supervisory Committee, is not easily understood by foreign investors, and we have hard time providing convincing explanations. To gain trust from foreign institutional investors, it would be worth considering the composition of the committee to be solely independent members. That's all. Thank you for listening.

[Ikeo, Chairman] Thank you very much. As there are many members who want to share their opinions, please make comments as short as possible.

Mr. Uchida, please go ahead.

[Uchida, member] Thank you very much. Unfortunately I couldn't attend the past 3 meetings due to schedule conflicts. Though Chairman suggested that we should discuss the issues by dividing them into two parts, I'd like to share my opinion on the entire scope of issues...

[Ikeo, Chairman] Please forget about the division.

[Uchida, member] It's about how to proceed with this meeting. While listening to points at issue and opinions introduced at the beginning of the meeting, I found many overlaps with the discussions of last year at the Council of Experts Concerning the Corporate Governance Code, specifically, controversial issues on which that Council couldn't build consensus. It may be meaningful to discuss such issues again here. I think, however, that what is important for this Council is to understand the trend of autonomous corporate efforts to respond to the Code and identify possible future effects of such efforts. I believe that this is the original objective of this Council.

Indeed, companies had to respond to 73 principles of the Code. It is my feeling that it took a long time as expected. Depending on a principle, they cannot make decisions without discussing it with outside directors. Therefore, it is difficult to fully discuss and make decisions in a short time, then it took a long time. The draft of the Code was published in December 2014, and I assume that companies started to work on their response in or around January. Nonetheless, it was not until November or December that they managed to file the Corporate Governance Reports. Finally, we will be able to see the entire picture of corporate efforts over the year.

As you know, the Corporate Governance Code was established as a part of initiatives under the last year's Growth Strategy, aiming at increasing the companies' "earning power", or enhancing "growth-oriented governance". Accordingly, this Council's mission should be to verify whether the application of the Corporate Governance Code really have led to increase the companies' earning power.

In contrast, corporate governance rules of OECD as well as Europe and the United State focus on defense measures, such as preventing abuses by management as discussed earlier today, controlling excessive risk-taking, or preventing fraudulent acts.

This spring, the CEO of the FRC (Financial Reporting Council) visited *Keidanren* (Japan Business Federation) to exchange opinions. It was the FRC that formulated the UK's Stewardship Code and Corporate Governance Code. In the UK, as you know, the first version of the UK Corporate Governance Code was produced in 1992, and the principles have been implemented for more than 20 years. The Code was periodically amended over the years. And the CEO of the FRC clearly mentioned that there is not yet any proven correlation between corporate governance and corporate profitability or earning power. In that sense, Japan's Corporate Governance Code was established as a result of discussions from the perspective of increasing earning power, and thus it could be called progressive in a certain sense. Conversely speaking, it may need a lot of trials and errors, and has many difficult aspects. Therefore, it may be extremely difficult to verify whether the earning power has increased as a result of the implementation of the Code, but we need to carry out the verification. If the earning power has not yet increased, we need to identify and follow up on any problem with governance in order to achieve an improvement. The original objective of this Council should be to implement such PDCA cycle.

Therefore, it is necessary to thoroughly analyze the profitability of the companies in terms of ROA (return on assets) at the macro level, after the implementation of the Corporate Governance Code. However, for that purpose, we need a large amount of data, and must consider external factors, so it may not be possible to measure an explicit effect until 5 years later or so. And, at the micro level, it is vital to look at case examples of success or failure of individual companies, such as today's presentation on Kao's case. Yet as Kao's representative mentioned, a certain company's case example is not applicable to all companies. When the total number of cases is small, they are just reference examples. The companies may use such case examples as reference, and adopt some parts which are suitable to them. For that purpose, it would be important to analyze case examples at the micro level. Anyway, we need to identify how corporate management, economy and society change in response to the implementation of the Corporate Governance Code first.

Now I'd like to talk about expected functions of independent directors related to today's topic under Principle 4.3. I think that Principle 4.3 places an emphasis on defense, similarly to the principles of OECD and Europe/the US, in consideration of the monitoring model. In that case, expected qualities would be the capability to share the understanding of the company's business principles, and frankly express opinions to CEO from an independent standpoint and based on a high level of sense of ethics and knowledge. However, today's topic is growth-oriented governance. From that perspective, I believe that item i) of Principle 4.7 is more important. Let me read it out: "provision of advice on business policies and business improvement based on their knowledge and experience with the aim to promote sustainable corporate growth and increase corporate value over the mid- to long-term." Among expected roles and responsibilities of independent directors, this part would be essential for growth-oriented governance.

Independent directors could notice what inside executive officers failed to notice, and offer insights which inside executive officers do not have. In order to enhance earning power of the companies, it is very important to make the use of knowledge, experience and skills of independent directors to fill such gaps, thus contributing to establishing excellent management strategies. This is what the companies should seriously work on. For instance, concerning growth strategies, it would be extremely significant to select independent directors, who can provide adequate advice and express opinions regarding global strategy, open strategy for open innovation, R&D strategy, intellectual property strategy, etc. for growth-oriented governance.

Now I'd like to ask a question to Mr. Kadonaga. As Kao is a Company with *Kansayaku* Board, I understand that the board needs to make decisions on business execution. Mr. Kadonaga frequently visits business sites, including overseas sites, and therefore, can make a judgment by assessing the nature of businesses to a certain extent. However, I don't think that there are many outside directors who can do that much. Therefore, I'd like to ask you how much of your time you spend as Kao's outside director. Furthermore, what do you think about the burden of outside directors that they have responsibilities even if they participate in decision-making on business execution without sufficient knowledge of business operations?

[Mr. Kadonaga] Thank you for your question. I'll answer the first question. Actually, in case of Kao, Management Committee meetings are held almost every week, and we spend a considerable amount of time on it. I also attend the meetings. Besides, I attend board meetings and various committee meetings. So I go there 5 times a month on average. In addition, I visit business facilities as well. Out of 100% of my time, I spend 25% for Kao. In a month with more site visits, I even spend some 30% of my time for Kao. Making use of such opportunities, at the time of deliberation or resolution, I often offer supplementary explanations to the other 2 outside directors. I explain the background, priorities, and what it means in the context of the entire picture in order to assist their decision-making.

[Uchida, member] I see. Thank you very much.

[Ikeo, Chairman] I don't think you can make comments more than once today. So please forget about the earlier-mentioned grouping of the points. Instead, you can make comments on the overall points. Dr. Ueda, please go ahead.

[Ueda, member] Thank you. I'll try to talk briefly about the overall points. First, I'd like to express my impression of Material 1. Until last year, discussions were centered around the formality, such as whether independent directors are really necessary, or what composition of the board is desirable. One year later, substantive discussions are going on, such as how the companies make use of independent directors, or what qualifications are required of independent directors. I think it is a significant progress. Probably, Japanese companies did not know what to do. Then, in response to the establishment of the Code, they entered into the stage where they have to consider and decide what to do.

There is something common in all of today's discussion. As a feature of the culture of business practice in Japan, the board generally adopted the traditional management model. How do they incorporate oversight functions in the board? Do they clarify what oversight functions are? Does the board focus solely on oversight functions, or how do they take a balance? Concerning these points, responses may vary from company to company. In case of Kao, the board focuses on strategies. My impression is that the companies entered into the stage where each company discusses what the board should be, depending on their specific circumstances.

Therefore, it is necessary to first consider what the board should do. This would be the starting point of all discussions of today. What will happen if we do not consider it? For example, a company may bring two people, whose independence is doubtful, as outside directors, and insist that they are independent from the management. The company may assert that they comply with the Code. I'm concerned such a situation may arise.

Then, there is the issue of quality. Essentially, quality is more important than independence, which is the formality. Required qualities should match with the ideal state of each company's board. Kao's presentation offered an easy-to-understand example. Currently, as a desirable composition of outside directors, Kao has outside directors with the backgrounds of finance, manufacturing and overall business management. Furthermore, as the optimum combination, the board consists of 3 inside directors and 3 outside directors. The ideal state of the board is brought about from its historical context. However, in reality, the companies seem to appoint 2 outside directors, just because the Code requires them to do so. Alternatively, when independence is needed, a company may bring in a celebrity, such as an entertainer. Usually, such a person does not have a close interest in the company. He/She is not from its main bank or business partner. The company could assert that he/she is independent. He/She may have expertise in the area of entertainment, but to what extent, can he/she add value to the management? There are some specific examples of such appointments, which investors have doubt about. Considering the story up to here, the fundamental question is what roles the board should play. To consider qualities, that would be the starting point.

Concerning the executive session, in Kao's presentation, we heard that outside directors met for discussion during an intermission of a board meeting, or somewhere else. This is the case where outside directors voluntarily meet, not at a formal executive session. In the UK similarly to Japan, a board has both executive and non-executive directors. Then, naturally, executive directors have more power and more knowledge of overall management. If one enhances the roles of non-executive directors under such circumstances, what will happen? They cannot speak frankly in front of inside directors. Accordingly, another organization, which is called an executive session, was created, so that outside members can have an open discussion without caring about being watched by inside members.

I expect that, while the companies realize the situation where multiple, at least 2 outside directors are appointed, outside directors will voluntarily get together for discussions. Such sessions may be informal, but if the Code backs up such an initiative, by stipulating that they can have an executive session, which is a best practice, outside directors will feel comfortable doing so. Therefore, I consider that, by its nature, the establishment of an executive session is not something to be required or forced, but something to be recommended as a part of creating a necessary environment.

As the chairman said we can make comments on the overall issues, I'd like to talk about the quality as well. One of the examples of the mere formality is the appointment of female directors. I dare to raise this issue as a female. As an example of diversity, people often refer to the appointment of female directors. In this Council, I serve as a female member, which is the minority. Then, are there many females with qualifications to be outside directors? Unfortunately, under the current career structure in Japan, there are not many females with suitable experience and qualities. Consequently, it is just a formal logic that the appointment of female directors meets the quality of the board member. In this connection, I assume that Kao's business target would be mainly females and actually I used to buy a lot of its diapers for my children, but its board consists of male directors, without female directors. Frankly speaking, at first, I felt it is strange. However, after listening to the explanation that Kao's approach was based on its strategy, I am convinced that the current board composition is suitable for its management strategy. Accordingly, the companies should forget about the appointment of females just for the sake of formality, but should discuss qualities in a substantive sense. I'd like to emphasize this point.

[Ueda, member] Next, I'd like to make some comments on the board evaluation. In today's presentation, the TSE representative reported that 54% of the companies provided explanations concerning the board evaluation, and the remaining companies complied with the principle. Honestly, I doubt about the high compliance ratio. On page 5 of the TSE's material, Company G's example was introduced as a disclosure by the company which carried out the board evaluation. I found it striking. In Company G, the representative director, and directors in charge of accounting and general administration/HR evaluate each director. Such evaluations can be seen as an extension of traditional performance reviews. The board evaluation must be carried out with the spirit or for the purpose of assessing the effectiveness of the board. While assessing the effectiveness of the entire board, they should evaluate how each director contributed to such effectiveness.

Unless the companies share a common understanding of that point, they might report that the board received a high evaluation because of the high attendance rate or the mere fact that directors expressed their opinions at the board meetings. That is not what it should be. I repeat what I mentioned at the beginning. They have to return to the starting point: what is the purpose of the board, and what roles the board of directors should play. The board effectiveness must be evaluated from that perspective. In doing so, they can naturally figure out what kind of board composition is appropriate for them, what should be discussed by the board, and what the board should aim at. I believe that the board evaluation should be conducted based on such discussions, and that is the proper course of action. For this reason, I suspect that even though it was reported that 54% of the companies chose to explain and the rest to comply, they just followed the stipulation of the Code superficially, and reported that they completed the board evaluation or checked the attendance rate.

Thus, I have an honest question whether they comprehend the true nature of the board evaluation. As a matter of fact, in the UK, companies did not seriously carry out the board evaluation at an early stage. At first, UK CG Code stated to conduct a self-evaluation. Then, because such a self-evaluation was lukewarm, they were told to implement an external evaluation, a third-party evaluation. Then, the companies engaged third party organizations such as consulting firms, auditing firms or other organizations which were not independent and thus the quality of such evaluations was not very reliable. Then, they were required to disclose the names of the third party organizations to show that there is no conflict of interests. The UK's current system was developed through such steps. Nonetheless, almost a half of Japanese companies have already conducted the board evaluation. Honestly, I wonder if it is true.

This is a very important point to discuss. The board evaluation is the basis of various issues of the board, including the appointment and dismissal of CEO, and nomination and remuneration. Therefore, we need to sufficiently discuss how the board evaluation is carried out in practice, and whether the substance is secured, and continue to watch the progress. Thank you very much.

[Ikeo, Chairman] Mr. Iwama, please.

[Iwama, member] Mr. Kadonaga, thank you for your presentation. It was very interesting. I looked at page 4 which shows the history. You said you were appointed as an outside director in 2012. Then I assume you were involved in the appointment of the current representative director & President. At that time …

[Mr. Kadonaga] I joined the board at the same time as the appointment of President.

[Iwama, member] Is that so? Sorry. That page shows the Committee for the Examination of the Nominees for Chairman/President at the top, and Compensation Advisory Committee below. In the illustration on page 5, the Committee for the Examination of the Nominees for the Members of the Board of Directors is indicated next to the Board of Directors. Is that virtually the same as the Committee for the Examination of the Nominees for Chairman/President?

Then, as Mr. Kawamura pointed out, although it is all right in ordinary times, but when a company faces an extraordinary crisis, or CEO becomes overconfident, I also feel uncertain whether the current situation is right. I have another question about your presentation. You said that agenda items of the board are classified into 3 categories, namely, matters of resolution, reporting on business execution, and important topics. In case of a Company with *Kansayaku* Board, it is stipulated by law that matters of resolution must be resolved by the board. The Management Committee meets every week and as the chairman of the board, you attend every Management Committee meeting, so you fully understand the current situation of business execution. However, I assume that there may be some limitation of the current board composition in terms of narrowing down agenda items. Have you felt any limitation?

Moreover, I found out from the shareholders registry that Kao has so many foreign institutional investors. More than 30% of the shares are held by foreign investors. Among Japanese shareholders, I assume many institutional investors are included. In dialogue with such institutional investors, what kind of comments, both positive and negative ones, do they make concerning the current structure of Kao?

Looking at the history, I got an impression that Kao has steadily advanced the reform ahead of other companies. I also feel that Kao has moved ahead to be closer to the form of Company with Three Committees. What future challenges do you think the board has? I'd like to ask you these 3 questions.

[Mr. Kadonaga] Thank you. As for your first question about the structure of the Committee for the Examination of the Nominees for the Members of the Board of Directors, I'd like to hand it over to Mr. Sugiyama.

[Mr. Sugiyama] I'll first explain the chart at the top of page 4. In 2003, the management at that time considered that the main focus of the appointment should be Chairman and President, and thus established the Committee for the Examination of the Nominees for Chairman and President, which lasted for 10 years. In 2014, it was expanded to be the Committee for the Examination of the Nominees for Members of the Board of Directors and Executive Officers. At that time, Kao experienced the change of President. Unsurprisingly, new President is younger, so the members of the Committee for the Examination asserted that they should examine the "cabinet members" who support the new President. Accordingly, the target of the examination was expanded to some 30 nominees in total. Candidates for executive officers, including myself, are at division head level, and usually outside members do not even know their faces. So there was a swing back. Outside members claimed that they cannot take the responsibility of examining nominees who are total strangers to them. So currently, the Committee examines only nominees for directors. One committee has changed the target of the examination over the years: only Chairman and President at first; then expanded to cover executive officers; and currently, nominees for directors, including President. This is the history of the Committee for the Examination.

[Mr. Kadonaga] Thank you. There were some other questions left. The types of agenda items to be submitted to the board are stipulated by the rule. As for the priorities, all agenda items are submitted to the board as stipulated by the rule. However, in each agenda item, prioritization or identification of which points should be explained and discussed at the board meeting is implemented. Actually, in the past, there was harsh criticism from other outside directors: why does the board deal with such matters? Is this the venue for listening to explanations? For what purposes, do we have board meetings? Having discussed such points, we narrowed down what should be discussed by the board. As I attend the Management Committee meetings, when the Committee decides to submit an agenda to the board, I make a request concerning points of focus, form, etc. there.

Concerning the second question about dialogue with shareholders, as Mr. Oguchi also asked the similar question, Kao does not have a practice where independent directors have dialogue directly with the shareholders. However, in a monthly reporting by President on business execution, concerning IR, each shareholder's comments are reported. In response, outside directors ask questions, like "Did they ask about this or that?" Consequently, we understand how shareholders view Kao, to a certain extent.

In terms of future challenges, currently the board consists of 3 inside directors and 3 outside directors, but we are now discussing a potential increase in the number of inside directors. This is not from the perspective which Mr. Kawamura referred to earlier. The background of this discussion is as follows. We look at professional backgrounds of 3 inside directors. President is from Research & Development field, but it has been 3 years since he left the field site. One director is in charge of business and marketing, and another director is in charge of sales. We considered that it would be better to have a board composition which allows for discussion on every area of the company. So we are considering a change. As a result, the numbers of inside and outside members may not become equal. However, making them equal is not our objective. What is important is to increase the effectiveness, so I understand that maintaining the equal numbers is not necessarily a must.

[Mr. Sugiyama] Let me make a supplementary comment. Mr. Iwama pointed out that companies are increasingly moving toward the adoption of Company with Three Committees. I'd like to comment on it. When you look at Kao's board, I'd like you to see that the board consists of 6 directors and 5 Audit & Supervisory Board members (*kansayaku*), totaling 11 members. Foreign investors often argue what is the use of Audit & Supervisory Board members (*kansayaku)*, when they do not have voting rights. Besides the earlier discussion of independence, personally, I feel that Kao is at the stage where outside directors are pushing the back of inside executives in terms of strategies. Conversely speaking, 5 Audit & Supervisory Board members (*kansayaku)* including 3 outside members complement such efforts, although there may be some mix-up with internal control, auditing and oversight. The board composition is well-balanced. Material 1 is titled "Points at issue on the Board". When we have such a discussion, we always discuss what roles directors and Audit & Supervisory Board members (*kansayaku*) have, and how they work together on the board. That's it.

[Ikeo, Chairman] Thank you very much. We have only 20 minutes left, and 6 more members are in line to express their opinions. I have no intention to finish discussions on all the issues today. Any points which we cannot sufficiently discuss today will be discussed in the future meetings, but not endlessly. I apologize in advance that we may not be able cover everything today, but please note that today is not the last chance.

Professor Kawakita, please.

[Kawakita, member] Due to time limitation, I'd like to make a brief comment based on my experience. The roles of directors, especially independent directors of the board are like brake function and navigation system of a car. As a navigator, they are expected to check processes for achieving the company's mid- to long-term goals. In that sense, business execution is naturally delegated to inside persons. However, concerning the status of business execution, as explained in Kao's presentation as well, directors need to receive monthly reports, and check whether the company is managed in the right direction.

I believe that the independence is necessary, although there is an issue of quality. Without independence, while they play a role of a navigator, there is a potential risk of making distorted decisions or judgments. And concerning information provision, in addition to an executive session shown in Material 1, they can obtain information from discussions with *kansayaku*. There are full-time *kansayaku*, who carry out auditing. Independent directors could have discussions with such people, and obtain supplemental information in doing so. I think it is also important. That's it.

[Ikeo, Chairman] Thank you very much. Mr. Era, please.

[Era, member] Thank you. Basically, I think it is very important to allow companies to have diverse corporate governance or corporate management system. Having listened to Kao's presentation, I agree that role of the board and role of corporate governance, such as the balance between offence (growth-oriented approach) and defense, or the balance between execution and oversight, will change depending on the phase of the company. Similarly, the mechanism or structure of corporate governance should also change.

What was more impressive was the fact that Kao has established the current system step by step over the past 15 years. The speaker referred to the system and also corporate culture. Probably the system has changed as necessary over time, but the important thing is the culture, being embedded in the company. I think Kao adopted EVA earlier than other companies. I believe it is essential that the companies have such culture which would ensure the effectiveness of corporate governance. What do you think is important to spread such a culture towards more companies? Do you think such a culture can easily take root in a company? I'd like to hear your views.

Another point is related to the role of outside director or outside statutory auditor. I think it is also important that they also serve to protect the management and business execution. When we talk about growth-oriented governance, given the complex, uncertain, less predictable business environment, it is not easy to encourage risk-taking. The business environment is also rapidly changing, and under such circumstances, there could also be cases of mismanagement. Therefore, it will be increasingly important for the outside members to play the role of proving that the company has taken measures to minimize the damage from such mismanagement, or such decisions were made after rigorous discussions within the board, and thus securing the soundness and transparency of the management' decision.

Such roles are notably seen in the United States. As you know, so called activist funds have grown in asset size, and now submitting proposals to even extremely large companies. In such a situation, institutional investors, such as ourselves, need to judge, whether to support the management's proposal or the activist's proposal. In order to make such a decision, we will feel more comfortable in supporting the incumbent management, if the outside directors/statutory auditors, from an objective standpoint, provides an evaluation of whether the current management is doing well or not. I think such a function is likely to become important in the future also in Japan. Today we had an opportunity to listen to the presentation by the outside director who chairs the board. It would be great if other companies also promoted this kind of activities.

[Mr. Kadonaga] As for the question about the culture, there are many angles. Simply put, the most important point is that if a company decides to introduce a certain culture, the top management must become the model. Without setting an example from the top, the new culture will never take root. There are companies which established Cultural Reform Committee, hired consultants, and so on. However, it is extremely important that President follows the new culture and becomes the model. Kao also has a corporate philosophy, which is called the “Kao Way”. When the board needed to make very difficult decisions and it reached the level of discussing matters in light of the Kao Way, which happened several times, all the members, regardless of whether they are from inside or outside, reached a consensus. I believe this is very important.

[Ikeo, Chairman] Thank you very much. Mr. Tanaka, please.

[Tanaka, member] Mr. Uchida earlier mentioned that a representative of a European or American organization said no significant direct relation was found between corporate governance and profitability. I had also heard about it. Meanwhile, in Europe and the US, there are further discussions on possible causes. The most frequently identified cause is qualities of independent directors, and I think that is the focus. As a point at issue, today we are expected to discuss what we think about specific qualities of independent directors. I believe that it is a very important point to be discussed by this Council.

I’d like to refer to the terminology to sort out the discussion. The term “*dokuritu shagai* (the Japanese term equivalent to ‘independent outside’)” director is used only in Japan. “Outside” director is the term under the Companies Act, and in my understanding, it is from the perspective of the employment relationship. In contrast, “independent” director is from the perspective of interest relationship between the management and director. These two terms take different perspectives. I think that Professor Kanda offered explanations several times at the TSE Independent Directors/Auditors Seminar and other occasions. Eventually, through the Advisory Group on Improvements to the TSE Listing System, the TSE published a document titled “Expected Role of Independent Directors/Auditors”. In that document, it is stipulated that “independent directors/auditors are expected to take action in light of protecting general shareholder interests, such as raising opinions, etc. so that general shareholder interests are considered in such situations as when business execution decisions are made by the board of directors, etc. of listed companies." Through the past discussions, it was summarized that independent directors/*kansayaku* are expected to take action in consideration of general shareholders. This perspective tends to be forgotten. The management tends to consider the protection of their interests only from their own perspective, so independent persons are expected to play a role in correcting it and considering the situation from the perspective of protecting general shareholders. That is what was figured out over the years.

Next, today's topics include functions of a lead independent director, and the separation of CEO and the board chair. These two are significant themes which are much discussed in the financial industry in Europe and the US. Probably, the lead director system is the US model, and the separation of CEO and the board chair is a European model, especially in the UK. For example, among the UK financial institutions, the separation of CEO and the board chair is perceived as a matter of course. The board chair is a leader of the board, and has major responsibility for the board's independence and its fulfillment of expected functions. In contrast, I assume that CEO is perceived like a management expert who was hired by the board.

Then there was an attempt to adopt the similar system in the United States. The first company which separated CEO and the board chair was Enron. Accordingly, this approach suffered a setback. Nowadays, many CEOs chair the board. As you know, the boards in the US generally have a supermajority of independent directors. It means that, for instance, in case a board consists of 15 members, 13 or 14 members are independent directors. This is a precondition. Therefore, separately from board meetings, gatherings of only independent directors were held, and the system of a lead director, who is the head of such a gathering, was established. And such a gathering has come to be called an executive session. This is a historical fact at least in the financial industry, as far as I know.

In both cases, the board is structured as an effectively independent organ. It is clearly designed to enable the board to act independently from the management in terms of its authority and decision-making. In Japan, as explained in the previous meeting, on average among companies listed on the First Section of the TSE, a board consists of 9 members, and 2 of them are outside directors. Then it would be meaningless to call one of two outside directors a lead independent director. It's merely a formality. Rather, an essential point would be whether the board secures the independence in terms of the board composition and leadership.

In this light, in case of Kao, the fact that the board chair and CEO were separated is very meaningful in the context of the historical fact. I assume that they will discuss whether independence is effectively secured. By the way, I was General Manager of Corporate Banking Division in charge of Kao 10 years ago. Compared to those days, I found that Kao made a significant progress. I'm impressed by its continuous transformation. I consider that it is very important for various players in Japan's industrial circles to move forward by considering various matters step by step. That's all.

[Ikeo, Chairman] Thank you very much. Mr. Takei, please go ahead.

[Takei, member] First, I would like to appreciate that Kao's presentation was very informative. Particularly, Kao's efforts to make use of corporate governance for the company's sustainable growth were well understood. Kao is the long-established company with a history of more than 100 years and has always been working on new management challenges in a serious manner. Many Japanese companies will be able to learn a lot from this Kao case by reading the minutes of this meeting.

Kao's case shows a good example of a growth-oriented approach through making capital investments and human investments with confidence in the future, and has a good influence on the current macro-economic-policy issues.

Moreover, Kao's case also carried important messages in connection with today's topics. For example, concerning diversity, Kao's representative talked about independent directors from the angle of what kinds of people are required. Kao described its growth-oriented governance in connection with management strategies/management plans in its Corporate Governance Report. And outside directors voluntarily hold executive sessions. Upon evaluating the effectiveness of outside directors, they consider what each director should do; instead of conducting a third-party evaluation, directors and other officers consider by themselves how they should contribute to what. Most importantly, risk-taking is adequately managed through providing proper explanations to the board which includes outside members. There is a lot of useful information. While companies continue to address the Corporate Governance Code, Kao's presentation gives them a renewed recognition of responses to the Code.

I have just one question to Kao's representatives. After the implementation of the Corporate

Governance Code, what is the biggest change or benefit for your company? Your company has worked on capital cost-conscious initiatives as well as sustainability, global, and various growth strategies. Furthermore, your company has promoted future-oriented management. What was the biggest benefit from responding to the Corporate Governance Code? For example, the focus of internal discussions on governance became clearer, or a direction of future efforts became clearer. Please share your experience.

[Mr. Sugiyama] Thank you for the questions. While I was in charge [of establishment and further improvement Kao's corporate governance system], I could not link governance stipulated in the Companies Act with corporate growth. Mr. Takei, a member of this council, provided me with various advice and coaching, but I could not figure out the purpose of governance. Nonetheless, while implementing a reform upon discussing the corporate governance reporting and other issues, I finally found a convincing answer: governance is not an objective, but a tool for companies to achieve growth. When we have good infrastructure and facilities in place, and use such a tool properly, it will lead to the growth. I found how they connect with each other. Not only I, but also President and all senior team members were convinced of that point. Although this is a conceptual aspect, we can move forward with this way of thinking. I think that is the biggest benefit.

[Ikeo, Chairman] Thank you. Professor Kansaku, please go ahead.

[Kansaku, member] Thank you. I'd like to make two points. First, in order to improve the governance by enhancing monitoring functions of the board, I believe that it is desirable to narrow down matters of resolution by the board, thereby reducing the burden of the board so that the board members can shift their focus to monitoring functions. Accordingly, to realize a shift from traditional Company with *Kansayaku* Board to a typical Monitoring Model, the said process is important. On the other hand, as Mr. Iwama raised a question, under the Companies Act, the board of Company with *Kansayaku* Board may not delegate important matters to someone else. Due to such a limitation, other forms of corporate organization, namely Company with Three Committees and Company with Supervisory Committee, were created, in order to allow for the delegation.

Under such a circumstance, I found today's presentation very interesting, because Kao is a Company with *Kansayaku* Board, but effectively places an emphasis on monitoring functions of the board. Although there may be some overlaps with Mr. Iwama's question, I'd like to ask a detailed, specific question. The chronological table is shown on page 4 of today's material. I assume that

Kao has narrowed down the scope of matters to be discussed or resolved by the board little by little over the years. At what point on the chronological table did you narrow down the scope of matters of resolution and in what way? Such a review may be conducted frequently or phase by phase. Including such a history, I'd like to know based on what concept, and to what extent, you made the decision on narrowing down and at what point in time. I'm sorry for a rather technical question. This is my first question.

My second question is related to Principle 4.7 of the Corporate Governance Code. Among roles and responsibilities of independent directors, the Principle listed 4 items from (i) to (iv) as especially important roles and responsibilities. Mr. Uchida earlier pointed out that the advisory function as in (i) among others would be important for the companies which have not yet adopted the Monitoring Model, in other words, companies which adopted the Management Board or Hybrid Board models, if I understood correctly. I consider items (i) to (iv) of Principle 4.7 are meant to be of equal importance. Does the Corporate Governance Code stipulate that all outside directors are expected to have these 4 roles and responsibilities? Is this understanding correct? On the other hand, suppose that each company has a sufficient discussion on what the board should be, and defines what roles they expect independent directors to mainly play, for instance, (i) of Principle 4.7. Does this approach follow the concept of the current Code? Would it be accurate to assume that prioritization of these 4 roles still constitutes compliance with Principle 4.7? I'd like to ask these 2 questions.

[Mr. Sugiyama] Our company set the standards for submitting agenda to the board and Management Committee more than a decade ago, and has followed the standards. In general, we reviewed and changed the standards upon revisions of laws such as the Companies Act. Such changes were mainly related to the delegation, and as one of quantitative standards, threshold amounts above which a board resolution is required, have been significantly increased over the years. The standards include requirements of law, requirements in the Articles of Incorporation, and other important qualitative rules of the company, as well as those related to personnel and organization. In the past decade, we made revisions within 6 months to 1 year following significant changes such as the revision of the Companies Act or organizational change which involves change in management and senior officers. In this way, there were certain points in time for reviews, but I could say we changed the scope from time to time.

The next question was complicated. Could you repeat the question? I need to sort out…

[Kansaku, member] This may be a legal issue. I'd appreciate it if anybody could answer my second question. Principle 4.7 listed 4 roles/responsibilities of independent directors, and it can be interpreted that all these 4 items should be complied with. However, for example, as Mr. Uchida or Dr. Ueda mentioned earlier, there may be a company which prioritizes these 4 items and expects independent directors to play specifically the role described in item (i). I'd like to know your interpretation concerning whether such definition of the roles/responsibilities can be regarded as compliance with Principle 4.7.

[Mr. Sugiyama] Thank you. I consider that companies should comply with all the items. However, in reality, some parts of the stipulation do not apply to our company. For example, although it refers to conflicts of interest between the company and controlling shareholders, our company does not have controlling shareholders. Furthermore, the Code stipulates that [independent directors] should appropriately represent the views of minority shareholders and other stakeholders in the boardroom. As Chairman Kadonaga mentioned earlier, President reports on IR meetings to the board. Various views of investors at IR meetings are reported to and discussed at the board. You used the term "prioritization". Certainly, we place major emphasis on some items, but not so much on other items. Nonetheless, we need to take all the items into consideration. In reality, however, considering the situation of our company, an emphasis is place on item (i). Did I answer your question?

[Kansaku, member] Yes, thank you very much.

[Ikeo, Chairman] It's already the scheduled closing time. I'd like to continue the meeting for some more minutes. If any of you have another appointment, please feel free to leave. Now I'd like to hand it over to today's last commenter, Mr. Tsukuda.

[Tsukuda, member] I'm sorry that it's already time to leave. I prepared my comment on the appointment and dismissal of President, but due to time limitation, I'll talk about it in the next meeting, if there is an opportunity. Today we had an opportunity to listen to excellent presentation by Kao, so I'd like to ask a couple of questions.

First, how much time does the nomination committee spend on its duties in a year? I ask this question, because we conducted a survey of the companies and found the following results. Among companies which have the nomination committee or the like, on average, the committee meets 4.4

times a year, and a meeting is 0.8 hours in length. In other words, on average, the nomination committee spends only 3.5 hours per year on the most crucial matters such as succession planning for President and the appointment and dismissal of the management. We were surprised at the result, so I'd like to know the situation of Kao. That is my first question.

My second question is related to the history of your nomination committee. Concerning candidates for executive officers, basically the committee just receives relevant reports and does not examine the candidates. Meanwhile, Supplementary Principle 4.3.1 stipulates that the board should appropriately carry out the appointment and dismissal of the senior management. In light of this Supplementary Principle, what kind of involvement of the nomination committee are you planning in the future? I'd like to know your future policy. These are my two questions.

[Mr. Kadonaga] I'll answer the first question. In Kao, the committee meets 3 times a year. We spend approx. 2 hours each time. We think that a meeting which lasts more than 2 hours is not very productive. Therefore, the length is 2 hours. Actually, in addition to the meetings, we are requested to see candidates on certain occasions. For example, a candidate for outside director is invited to a lecture meeting for Kao's senior management to deliver a talk, and we meet the candidate there. In case of inside candidates, they may be invited to board meetings and participate in discussions. Including those occasions, we probably spend twice as much time on such activities.

[Mr. Sugiyama] I'll answer the question about the appointment procedures. First, as mentioned earlier, the Committee for the Examination of the Nominees for the Members of the Board of Directors currently focuses on directors, including President. The Committee members, consisting of all outside directors and all outside Audit & Supervisory Board members (*kansayaku*), have discussions on the candidates, and submit proposals to the board. However, the board is also responsible for the appointment of executive officers. So the board discusses candidates both for directors' and executive officers' positions. Some of the board members also serve as members of Committee for the Examination of the Nominees for the Members of the Board of Directors. Chairman attends both meetings, and has to discuss the same matter twice. In this way, I believe that the board is appropriately involved in the appointment.

[Tsukuda, member] Thank you very much.

[Ikeo, Chairman] Thank you very much. We had very active discussions today, but could not cover all the topics, and the meeting was extended by 10 minutes. I am sorry about that. I'd like to ask the secretariat to summarize points at issue, reflecting today's discussion, and prepare an opportunity to discuss what we could not cover today.

Now I'd like to hand it over to the secretariat for an administrative announcement.

[Tahara] As for the time and date of the next meeting, we will let you know later. I'm sorry that we have not yet fixed the schedule. Thank you very much for your participation.

[Ikeo, Chairman] Thank you very much. Now I'd like to declare the meeting adjourned.