(Provisional translation)

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

1. Date and Time: November 15, 2017 (Wednesday) 9:30-11:30

2. Venue: 13F, Central Government Building No. 7, Meeting Room No. 1

[Ikeo, Chairman]

It's already past the scheduled opening time. Although some members are not here yet, I'd like to open the twelfth 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.

Today, I'll first ask a representative from the Financial Services Agency (FSA) to explain "Strategic Directions and Priorities 2017-2018", which was released last Friday, November 10, as well as points at issue toward deepening the corporate governance reform by summarizing discussions at the previous meeting. Then, today's guest speaker Mr. Satoshi Ando, Director of Omron Corporation, will make a presentation about their initiatives to provide us actual corporate efforts related to such points at issue.

Now I'd like to hand it over to the FSA representative.

[Tahara, Director of the Corporate Accounting and Disclosure Division, FSA]

Good morning. Thank you for your participation.

First, I'll explain Material 1 "Strategic Directions and Priorities 2017-2018".

As Chairman Ikeo mentioned earlier, the FSA released "Strategic Directions and Priorities 2017-2018" last Friday, November 10. With regard to the corporate governance reform, we included the following six issues based on suggestions from the Follow-up Council:

(1) the necessity to ensure that the management is aware of capital cost and makes decisive decisions in response to changing business environment;

(2) the necessity for effective use of cash on hand for various investments for growth, while many companies have accumulated cash and deposits as internal reserves;

(3) the development of CEO candidates, appointment/dismissal of CEO and effective function of outside directors;

(4) problem with "held company" which makes certain companies hold their shares as cross-shareholdings;

(5) effective dialogue between companies and investors; and

(6) necessary measures in response to the situation where few corporate pension funds, among other asset owners, have signed up for the Stewardship Code.

The Follow-up Council has publicly expressed its views on these areas of concern in the form of Opinion Statement, etc. Now, for the purpose of enhancing the effectiveness of each Code, we are considering the publication of the Guidance. We'd like to request the Follow-up Council to develop such Guidance, and already included such a plan in the recently published "Strategic Directions and Priorities 2017-2018".

In the last paragraph, we specifically referred to the issue about asset owners, because we believe it is important for promoting the said initiatives.

Accordingly, we'd like the members of the Follow-up Council to focus the formulation of the Guidance and have discussions.

Now, I'll explain Material 2, which sorts out and summarizes the preceding discussions at the last Council. Concerning six issues which I just explained, we organizes your opinions expressed during the previous meeting.

The first point is about management decisions in response to changing business environment. As written in the first bullet point, it is pointed out that Japanese companies have such issues as low awareness of capital efficiency and earnings power. This is of much interest to global investors. Measuring indicators of operational efficiency solely by ROE is unreliable, but the low levels of ROA and ROS are issues facing the companies as well. Furthermore, it is also pointed out that providing incentives to the senior management for their decisive decision-making decisions is important.

The second point is about investments and internal reserves in the form of cash and deposits, which mentions that Japanese companies should use cash on hand to accelerate their investments in facilities/equipment, human resources, R & D, etc. to enhance their competitiveness in the global market, and this has been one of the issues since the drafting phase of the Corporate Governance Code. Furthermore, in discussing this topic, some members indicate the importance of having dialogue in light of specific circumstances of individual companies.

The third point is about CEO and the Board. As for this topic, the Council had extensive discussions last year and published the Opinion Statement. As a way of amplifying its content, suggestions were provided as we summarized here. The Board, especially outside directors, should actively and voluntarily engage in appointment of a CEO successor, and selection and development of CEO candidates. Active use of the nomination committee is recommended for appointing a successor to CEO. Sufficient discussions is important on qualifications of outside directors and diversity of boards, and outside directors are expected to have capabilities to effectively oversee the management. Furthermore, it is pointed out that *kansayaku* or audit committee members should be appointed from those who have appropriate expertise.

The fourth point is about cross-shareholdings. The Council discussed this issue two years ago, and it is pointed out that cross-shareholdings have various disadvantages, and therefore, companies should reduce such cross-shareholdings. Similar comments were made this time. Some also referred to the necessity to thoroughly consider problems with “held companies” which make certain companies hold their shares as cross-shareholdings. Furthermore, while companies hold such shares for various reasons, they need to thoroughly think about explanation/disclosure of rationales of such cross-shareholdings.

The fifth point is concerning asset owners. For the recent revision of the Stewardship Code, the Council had considerable discussion regarding the importance of asset owners for the proper functioning of the investment chain. Among asset owners, corporate pension funds are slow to sign up for the Stewardship Code for various reasons. Right now, the number of corporate pension funds of non financial corporations, which accepted the Code, is just one. Looking at the entire spectrum of corporate pension funds, the number of funds which signed up for the Code is only seven. This number is extremely small, given that there are approx. 700 defined benefit corporate pension funds. It had been already discussed that it is important that corporate pension funds as asset owners conduct stewardship activities, and we’d like you to further discuss what initiatives they conduct first, while there are various issues.

The sixth point summarized other issues. It comments that dialogue with investors plays a significant role, and we’d like to develop the Guidance that provides direction with regard to what should be addressed in such dialogue. As shown in the last bullet point, it was noted that such efforts are essential for stable asset accumulation of the general public, and are directly connected to our daily life. We’d like you to discuss the issue, keeping it in mind.

That’s all about explanations from the secretariat. Thank you.

[Ikeo, Chairman]

Thank you very much.

Next, in connection with those points explained by the secretariat, Mr. Ando from Omron Corporation will provide us a presentation about the company's management by using ROIC, enhancement of its governance structures related to the appointment of CEO, and efforts for unwinding cross-shareholdings. You have Material 3 prepared by Mr. Ando.

Now I'd like hand it over to you.

[Mr. Ando]

I'm Ando, director of Omron. I'm honored to have this opportunity.

I'd like to explain the practice of integrated management at Omron according to the reference material. The reason for choosing the title "Practice of Integrated Management" is that Omron secures both offensive [i.e. growth-oriented] and defensive governance, in order to demonstrate corporate management which achieves both sustainable business growth and capital efficiency; and actively discloses information and work on increasing its corporate value through dialogue/engagement with stakeholders. The title reflects such a view.

I am allowed 15 minutes for presentation. Due to the time limitation, I summarized key messages, which I'd like to share with you, in the presentation material.

Please turn to page 7. First of all, at Omron, when we consider what corporate governance responsibilities are, we consider them on the premise of stakeholders' expectations. What all stakeholders expect from a company is integrity in management practice. Based on that, what especially shareholders/investors expect is to demonstrate sustainable earning power. In other words, we understand that a company is expected to secure both the integrity and the sustainable growth.

However, when I talked with senior executives of other companies, I sometimes felt that they do not fully understand the importance of management information disclosure and IR activities. On page 8, I listed five points [as the significance of disclosure/IR]. An emphasis is placed on disclosure of management information, which is a requisite for fulfilling corporate governance responsibilities, as well as the need for recognizing that securing human/financial resources for dialogue with stakeholders should be recognized as investments.

Next, I summarized features of Omron's management in three layers from page 10: "(1) basic stance of management"; "(2) foundation to support primary corporate values of Omron";

and then “(3) drivers for creating long-term corporate value”. As for (3), I listed up 15 drivers on page 11. I believe that these items would serve as a useful reference for institutional investors to have dialogue with companies. Mr. Tahara earlier proposed the formulation of the Guidance. These factors would be useful for companies to improve the quality of their corporate governance to sustainably increase their corporate value.

Now I’ll explain the features of our corporate governance. Our company made public “Omron Corporate Governance Policies” in line with the Code. On page 16, I summarized the characteristics into ten bullet points. For example, as shown in the fourth bullet point, we declared that “we will not adopt any anti-takeover measures.” Bullet point 7 clarifies our numerical criteria for the board composition.

Page 17 is about the organizational form of our governance. We adopted “Company with Kansayaku Board (board of corporate auditors)”, but have three advisory committees and one committee on a voluntary basis. These committees, especially outside directors, have extremely heavy job responsibilities. Among these four, many Companies with Kansayaku Board also have Personnel Advisory Committee and Compensation Advisory Committee, so I’d like to introduce functions of CEO Selection Advisory Committee and Corporate Governance Committee.

Please turn to page 20. CEO Selection Advisory Committee consists of five members: three outside directors and two inside directors, and is chaired by an outside director. Highly transparent consultation is made at this committee, in terms of member composition, as well as the fact that the chairman, who is an outside director, has a casting vote. CEO Selection Advisory Committee does not only select a successor to a retiring CEO as the name shows, but also makes an annual evaluation of CEO’s performance to determine whether he/she should remain in the CEO position. It means that, depending on the evaluation result, CEO may stay in the position for a long time, or may be replaced in a year in an extreme case. Needless to say, such a decision has nothing to do with CEO’s own will. Because it is really difficult to select a successor, we provide CEO candidates with an opportunity to periodically make presentations at board meetings, and answer questions. In turn, outside directors judge their personalities and degrees of competence.

Now I’d like to explain Corporate Governance Committee on page 22. As I mentioned earlier when I talked about “Omron Corporate Governance Policies”, we declared that we will not adopt any anti-takeover measures. In the event another company proposes an acquisition, the committee, consisting solely of outside members, will judge whether to accept the proposal or to maintain the current management team, from the perspective of a third party, and then consult with the Board. Even though it is a voluntary committee, by establishing a structure where governance works well, we give the advisory committees and the committee strong authority in effect.

Earlier, I referred to the issue of incentive compensation for directors and other executives. Page 24 shows our policy concerning directors' compensation. Page 25 specifically shows a relation among short-term compensation, short-term performance-linked compensation, and long-term performance-linked compensation. I assume that our "Integrated Report 2017" is distributed to all of you. In this report, we disclosed the same details. We introduced the mid- to long-term performance-linked compensation three years ago. From this fiscal year, stock compensation is approved, so our mid- to long-term performance-linked compensation is provided in stocks.

The next topic is ROIC-oriented management. The essence is shown on page 31 to page 32. There is no doubt that ROE and ROIC are important operational indicators, but looking from the standpoint of ordinary employees, such indicators are rather irrelevant to their day-to-day operations. Therefore, in order to ensure that every single employee is aware of the importance and effectiveness of ROIC management, and incorporate the MBO (Management by Objectives) method into performance appraisal for each employee, as shown on page 31, we provided the breakdown of ROIC elements, clarified important KPIs, and articulated our philosophy that when all the employees contribute to achieving these KPIs, ROIC will improve. Therefore, in our company, ROIC is the indicator which not only the management is interested in, but also individual employees can utilize.

Similarly, we use the concept of ROIC as the hurdle rate for business portfolio management. Please turn to page 32. Our company emphasizes ROIC, because it is an indicator allowing us to evaluate businesses in a fair manner. Generally, within companies, business segments with large sales revenue or profits tend to draw attention, but if they can continuously generate ROIC that exceeds capital cost, regardless of the level of sales revenue and operating income, they can feel that they are increasing corporate value of the entire group. Therefore, we believe that ROIC is the optimal indicator that can be commonly used by both executives and individual employees. However, in case of our company, net cash is currently positive and ROIC and ROE are almost equal. Personally, I believe that the management should be evaluated based on ROE.

Recently, in the investment community, ESG (environment, social and corporate governance) investment has drawn attention, so we are aware that companies have already entered into the phase of evolving sustainability management or ESG management and ESG integration. Our view on it is written on page 47 and thereafter. Due to the time constraint, please refer to the summary on page 55. At the bottom of the page, you can see where in the Integrated Report the corresponding information was disclosed, so I'd appreciate it if you read those parts.

Finally, although I have not prepared any reference material, I'd like to tell you about our efforts for unwinding cross-shareholdings. In "Omron Corporate Governance Policies", we clearly show our policy that we will reduce low-return assets. As for the question whether returns from listed shares are always low, such returns vary depending on circumstances. Our company holds some [listed shares] for strategic business alliance purposes, and we do not believe holding listed shares is always wrong. However, since the implementation of the Corporate Governance Code, we have steadily reduced our holdings of listed shares: we have unwound some of cross-held shares, and transferred some to the employee pension trust so that such shares do not appear on our balance sheet. Many companies have been working on the reduction. In general, the more companies focus on capital efficiency, the more they reduce the number of low-return and highly volatile listed shares they hold.

Before closing my presentation, I'd like to share my personal view. From this fiscal year, institutional investors have started disclosures of their proxy voting records for each investee company. In order to enhance the quality of two Codes, I'm watching how it impacts investors and companies. Companies got an impression that current voting standards of institutional investors seem like a box-checking exercise, and they do not look at the overall governance of the companies. One of institutional investors disclosed its proxy voting standards, announcing that it will vote against the management (i.e. representative director/representative executive officer) who is unwilling to conduct IR activities. I believe that a further emphasis on such overall judgment should be the proper way of fulfilling stewardship responsibilities.

This is the end of my presentation. Thank you very much.

[Ikeo, Chairman]

Thank you very much. I'm sorry that we could not allocate sufficient time for the presentation. Now I'd like to move on to the discussion session. As the secretariat explained earlier, we are strongly expected to develop the Guidance, so I'd like to you to express your opinions focusing on six large points at issue presented in Material 1 or Material 2.

Before opening a general discussion, if you have any questions or comments directly related to Mr. Ando's presentation, please express them first.

In this connection, two members, who are absent today, presented their opinion statements. Mr. Toyama's opinion statement is related to Omron Corporation's initiatives, so I'd like to ask the secretariat to introduce his opinions.

[Tahara, Director of the Corporate Accounting and Disclosure Division, FSA]

We distributed Mr. Toyama's opinion statement to you. Mr. Toyama wrote that Omron's case, which was just explained, is very insightful from the perspective of appointing CEO. Mr. Toyama comments that reforming the method of appointing CEO should be the core of the governance reform, and it is essential to spend a significant amount of time and energy on it, as discussed last year. Omron has been actually working on it, and Mr. Toyama had taken part in such initiatives in the capacity of outside director. Therefore, he suggested that Omron's case should be shared by a large number of listed companies as one of model cases.

[Ikeo, Chairman]

Now if you have any questions or comments directly related to Mr. Ando's presentation, please express them. Mr. Tsukuda, please go ahead.

[Tsukuda, member]

Mr. Ando, thank you for your great presentation.

I'm impressed that your company has established such an excellent governance system. I'd like to know what motivated your company to move toward such governance. For example, on page 20, it says that CEO Selection Advisory Committee monitors the performance of President. This is easy to say, but it should be very difficult to incorporate such a mechanism. I'd appreciate it, if you could explain how it became possible to do so.

[Ikeo, Chairman]

Could you?

[Mr. Ando]

On page 14 of the material, I summarized the history of our corporate governance. This is the evidence of our efforts for making the corporate governance reform for more than 20 years. We have exerted them, not necessarily because they were required by law or stipulated in soft laws. Instead, we voluntarily identified what was missing to become a global visionary company, and filled the gap. When discussing corporate governance in our company, we recognize that the autonomy is the most important thing. However, with attaining autonomy alone, there is a concern about falling into the inward-looking management where a priority is given to an internal logic. Therefore, according to the philosophy that taking a balance between autonomy and heteronomy is extremely necessary, we have steadily deepened our initiatives over the years.

It has been 84 years since our company was founded. Originally, it was a family business. Although the current company name is “Omron Corporation”, we had used the name “Tateishi Electric Co.”, which includes the family name of the founder, until 1990. While the company expanded its business globally and the number of employees increased globally, the founder intended to enhance unifying force of the entire group through three pillars. The first one is “principle-based management” where Omron Principles are put into practice. The second one is “highly transparent corporate governance”. And the third one is an emphasis on “stakeholder engagement”, where we have sincere dialogue with all stakeholders, and analyze our strengths and gaps. In order to ensure the effectiveness of these three pillars, we place considerable weight on suggestions from external experts, especially outside directors/officers with broad experience in corporate management.

Therefore other companies will be able to adopt a similar system, but I feel that whether or not they put their whole soul into it significantly matters.

[Ikeo, Chairman]

Mr. Sampei, please.

[Sampei, member]

Mr. Ando, thank you for the presentation. I have learned Omron’s best practices attributable to its autonomy on a regular basis, so I think I knew various things [about Omron’s governance], but I'd like to briefly ask three questions.

First, how is the chairperson of the Board of Directors appointed? Second, how is the chairperson of each committee appointed? Third, after the retirement of CEO except for the case he is dismissed due to a problem with performance, what roles does he play? Usually, retiring CEOs tend to assume the position of Chairman of the company. I'd like to know these points.

[Mr. Ando]

Regarding your first question, the chairperson of the Board is selected among inside directors by mutual vote. Based on the view that the Board should be chaired by a director who understands the actual condition of business best, we do not ask an outside director to chair the Board.

Next, the chairpersons of three advisory committees and one committee are also elected by mutual vote. Especially, in case of CEO Selection Advisory Committee, in principle, a person, who has served as an outside director the longest and thus understands Omron's corporate management best, is appointed as the chairperson.

With regard to the treatment of a retiring CEO, we have only one case, so it is difficult to give you a general idea. The former CEO, who retired seven years ago, no longer stays in our company. After a certain transition period where he had served as Chairman of the company, he participated in the management of another company, with which our company does not have any capital relationship.

[Sampei, member]

Thank you.

[Ikeo, Chairman]

Mr. Kawamura, please.

[Kawamura, member]

I have a question about CEO Selection Advisory Committee on page 20. When the Committee conducts an annual performance evaluation of President/CEO, have you experienced a case where, for example, there was a conflict of opinion and an evaluation decision was made by a majority vote or some other methods? In case of such a conflict, do the members actually go for a majority vote, or continue discussion until they reach a consensus? This is my first question.

Next, I took a glance at your Integrated Report and found it great. It seems that overseas business accounts for a larger share and the majority of employees are working overseas. Judging from the composition of the committee members, I got an impression that it would be difficult to incorporate opinions from overseas. How do you reflect opinions of overseas employees or those outside Japan in these committees? This is my second question.

My third question is about the organizational form. Your company adopted Company with *Kansayaku* Board (Audit & Supervisory Board) and is doing great in this form. I think it is excellent. However, personally, I feel that, if you change the form to Company with Three Committees, the organization will be streamlined, and decision-making will be faster and clearer. What do you think about that?

I'd like to ask these three questions.

[Mr. Ando]

Actually, the current CEO is the first President/CEO selected through procedures of the current CEO Selection Advisory Committee. He has been in the CEO's position for seven years, and in fact, the members have unanimously approved to keep him in office so far. Hypothetically speaking, if opinions split, it certainly will be possible to use majority vote, and the final judgment by an outside director in the capacity of the chairperson will matter.

As for your second question about challenges facing Omron, personally, I perceive the diversity as a challenge, as you mentioned. Currently, we have directors including outside directors. All of them are Japanese, and one of them is female. And among more than 20 executive officers, we have only two non-Japanese members. Although we've been making efforts, we need time to achieve the same level as Hitachi, Ltd. However, we fully recognize this issue, and would like to steadily improve the situation around the diversity.

As for the third question about whether we need to be a Company with *Kansayaku* Board, actually we occasionally receive similar questions from foreign investors. In "Omron Corporate Governance Policies", we declared that we will maintain the organizational form of Company with *Kansayaku* Board for the time being. When we developed the Policies, we had considerable discussions on whether we should change the organizational form to Company with Three Committees, or we should continue to be a Company with *Kansayaku* Board. In conclusion, we identified some key points: while the company operates its business globally in 117 countries, consolidated revenue is a little more than 800 billion yen, and characteristics of business segments do not significantly vary. Based on the core technology of “Sensing & Control + Think”, Omron competes on B2B and B2C applications. Accordingly, given the current business portfolio, it does not make sense to newly adopt the form of Company with Three Committees. Rather, it is more effective for our governance to design a hybrid organizational form – adding voluntary advisory committees and voluntary committees to Company with *Kansayaku* Board. That was our conclusion. However, while the majority of Boards of Companies with *Kansayaku* Board tend to be like Management Board, we’d like to make our Board less close to Management Board by delegating the authority to CEO and placing the monitoring function at the center of the Board. However, at present, regarding matters which may have a significant impact on the corporate value, including such investments as M&A and establishment of subsidiaries, such matters require a resolution of the Board. We believe that Omron can secure more effective governance with the hybrid organizational form based on Company with *Kansayaku* Board, rather than Company with Three Committees.

[Ikeo, Chairman]

Thank you.

Mr. Tanaka, please.

[Tanaka, member]

Actually, Mr. Kawamura already asked a similar question to what I am about to ask. First of all, what made me wonder the most is why your company does not adopt the form of Company with Three Committees, when you have made governance efforts that far. Based on your answer, I’d like to ask a further question on this point. In case of adopting Company with Three Committees, the characteristics of the Board will change from Management Board to Monitoring Board. Then, as your company is a Company with *Kansayaku* Board at the moment, under the Companies Act, all business execution-related matters, including large debts, must be decided by the Board. As a result, in the substantial majority of companies, board meetings are held roughly once a month. In Omron, how many times does the Board meet in a year, and what is the percentage of discussions that are related to monitoring? This is my first question. Just a rough idea would be fine.

The second point is related to the description on page 8, stating “reduce capital cost”. The Council also discussed the issue of capital cost last time. In the first place, how much is the current capital cost of Omron in your perception? What formula do you use to calculate the capital cost? Specifically what measures do you take for reducing the capital cost? Specifically, formulas to calculate ROIC and capital cost should be different. How do you link these two? To calculate capital cost, CAPM or beta is more popular. The formula should be different from ROIC formula. How do you blend or balance these two, and how do you reduce your capital cost? This is my second question.

Finally, although this may be a delicate subject, CEO Selection Advisory Committee and Personnel Advisory Committee are chaired by Mr. Kobayashi, an outstanding person. Yet he is the incumbent Chairman of Itochu Corporation. With regard to the situation where a person who has an official position in another company plays such a role in your company, does or did your company consider any problems involved?

I’d appreciate it, if you answered these three questions.

[Mr. Ando]

As for your first question about the possible shift into Company with Three Committees, we believe that the Board of Company with Three Committees and the Board of Company with *Kansayaku* Board, in effect, have different functions. We operate our business in 117 countries, and face various risks. Therefore, to enable the Board to function closely to the frontline, we decided to maintain the form of Company with *Kansayaku* Board. If the Board focuses solely on monitoring, we feel that governance will not work sufficiently in both offensive [growth-oriented] and defensive manners. As for the proportion of monitoring and management, until last year, it was around 70% vs. 30% respectively. This year, we changed the policy, so I got an impression that the proportion is roughly 50-50 so far.

As for your second question about capital cost, as we adopted the ROIC management, the cost is calculated as WACC. Although we do not disclose WACC of the entire Omron group, we actively disclose the management information, and reduce the capital cost by reducing the beta through business portfolio management. With such self-help efforts in mind, we aim at maintaining it around 6%. However, we have some highly volatile businesses due to their nature. For such cases, we set a higher hurdle rate. CEO has communicated to employees that we aim at achieving the entire group's ROIC of more than 10%.

As for your third question about the selection of outside directors, to tell the conclusion first, we make judgements based on their personality and competence. However, if we find any conflicts of interest during the preliminary screening, such people are eliminated from the candidate list. The fact that we put the importance on the incumbent corporate manager as you said, is for the purpose of obtaining his frank suggestions and criticism about Omron's governance in terms of both offence and defense, based on his experience in his company. In our company, ordinary board meetings are held on a monthly basis – 12 times in a year – and extraordinary meetings are held roughly twice in a year. In total, they meet 14 times or so. However, compared to other companies, the time spent for board meetings is relatively long. A monthly board meeting is half day long. Furthermore, meeting minutes are prepared in detail, recording who pointed out what, who asked what questions, and what executives answered. Usually, the volume of meeting minutes is at least 5 pages of A4 size paper in regular font size.

[Ikeo, Chairman]

Next, I'd like to hand it over to Ms. Takayama. Now I'd like you to discuss the whole range of today's topics, not limited to those directly related to Mr. Ando's presentation.

Ms. Takayama, please.

[Takayama, member]

Mr. Ando, thank you very much for your informative presentation.

Although you did not directly mention it, as it is related to the development of the Guidance for dialogue between investors and companies as one of the objectives of this meeting of the Follow-up Council, I'd like to ask you this question. On page 7 of your presentation material, it is written "make efforts to select shareholders" as ideal stance of the corporate management. As discussed during the previous meeting, the quality of dialogue varies from investor to investor. There are various investors. Investors select companies to invest in. Similarly, I believe that companies may select investors. In fact, IR practices of companies in Europe and the U.S. show that they are active and positive to select shareholders by stating "We run the company this way, so we'd like to have this kind of shareholders." On the other hand, Japanese companies take a passive stance in that area. Under such a circumstance, your company states that is will “make efforts to select shareholders”, and it sounds new to me. Could you please provide more details about that?

[Mr. Ando]

I have worked for Omron for more than ten years. For the first four years, I assumed such a unique role as full-time outside corporate auditor (audit & supervisory board member), then served as executive officer, and was appointed to Chief Investor Relations (IR) Officer six years ago. The policy we set at that time was “departure from passive IR activities”. In those days, dialogue between investors and the company used to be like a Q&A session: investors asked questions, and the company answered the questions. We found that investors did not ask questions, not because they understood our company, but because they did not understand our company at all. Therefore, companies need to actively provide management information, especially mid- to long-term type information, and explain the details face to face. In the presentation material, I used such an expression as “select shareholders” to convey the key message clearly. I do believe that [companies and investors] should have dialogue on an equal footing. It should not be mere Q&A. Instead, it should be Q&A&Q. I mean, after we answered questions from an investor, both parties need to share common perceptions of how the investor evaluated our answers and what challenges we have in their opinion. Otherwise, it is not really dialogue or engagement.

Similarly, there are many corporate managers who are not much interested in share prices. In my opinion, long-term trends and level of share prices are one of indicators to recognize corporate value. Meanwhile, among corporate managers I talked with, some mentioned that their share price has not yet run up to the expected level, and has always been undervalued. So I asked them, “How much do you estimate the fair value of your company is?” They could not always answer this question. I did not understand why they can judge that their shares are undervalued without knowing the fair value. It certainly is ideal that the primary corporate value matches with the share price. Although it may be difficult in reality, companies should face investors on an equal footing. That’s the underlying message from my statement.

[Ikeo, Chairman]

Mr. Iwama, please go ahead.

[Iwama, member]

I'm sorry I'm late. Private railway services were halted due to a train accident, and I could not manage to arrive on time.

I have two questions, although you may have already discussed them before I arrived. First, on page 10, it mentions that your company implements "hybrid management where advantages of Japanese management practices and the U.S./European management style are combined". I'm aware that this concept is reflected on the entire presentation material, and it is very convincing. I'd like to know specifically what the advantages of Japanese management practices are, from the viewpoint of Omron. This is my first question. The next question is about CEO Selection Advisory Committee on page 20, as discussed earlier. When CEO Selection Advisory Committee presents the result of its candidate selection [to the board], does it narrow it down to one candidate, or present multiple candidates for further discussion? I'd like to ask these two questions.

[Mr. Ando]

As for your first question about the advantages of Japanese management practices, I understand that they are the "*Sampo-yoshi*" principle of the Omi merchants (Win-Win business for everyone – not only sellers and buyers, but also the society), as well as stakeholder-oriented management from the long-term perspective. Traditionally, during the post-bubble period until a few years ago, although we saw the deterioration of the external environment in various ways, including the strong yen and deflation, it seemed Japanese companies were not really conscious of taking voluntary initiatives to improve their management systems and increase returns. In contract, the strength of the U.S./European management style would be a high level of awareness of returns and capital efficiency. The term "hybrid" is often used for various things, but considering the growth of ESG investments, I feel that global corporations are increasingly required to adopt "hybrid management" in the sense of what I just explained. Consequently, moving away from the stereotypical view that Japanese management is from the long-term perspective, and the U.S./European management is from the short-term perspective, I understand that Japanese companies are expected by not only shareholders and investors, but also all stakeholders, to "get the best of both worlds".

With regard to the second question, the current CEO was appointed in 2011. In those days, Integrated Report was not yet introduced, and we used to publish Annual Report. In our

Annual Report 2011, we disclosed the process of appointing the new President/CEO in the form of talk between the then-CEO and Mr. Kazuhiko Toyama, an outside director, on the subject of “How the new President/CEO was appointed”. Therein, we officially provided such information as the background and reasons for appointing the current CEO. Finally, although it is a rather delicate question, I’ll give you a straightforward answer. CEO Selection Advisory Committee narrowed down to multiple candidates, and the CEO was appointed from those multiple candidates.

[Iwama, member]

Thank you.

[Ikeo, Chairman]

Now I’d like to open a general discussion. Before that, as we have another opinion statement from Dr. Ueda who is absent today, I’d like to ask the secretariat to introduce this opinion statement as well.

[Tahara, Director of the Corporate Accounting and Disclosure Division, FSA]

I’ll briefly explain Dr. Ueda’s opinion statement.

She expressed her views on four topics. Six issues presented by secretariat are important and she suggested that we need to keep in mind that we should offer practical solutions to set the Guidance in place in the future. In that sense, it is preferable not to expand the discussion to cover a broader range of issues.

Regarding specific issues, she first expressed her view related to CEO and the Board. In the UK, companies are required to divide responsibilities of CEO and Chairman of the Board, or execution and oversight. Meanwhile, she pointed out that in Japan, the term “Chairman” is commonly used to refer to either Chairman of the Company or Chairman of the Board, thus creating confusion. She suggested that we should clarify the definition of the terms, and discuss issues, with due consideration of the division of roles between President/CEO and the Board Chairman.

Her second point is related to cross-shareholdings. She commented that cross-shareholdings impede dialogue, and are problematic in terms of efficient use of capital. While many people see that cross-shareholdings are rooted in business practice in Japan, and a sharp change may take time, she emphasized the great significance of increasing transparency in the first place, and suggested that companies should work on appropriate and sufficient disclosures.

Lastly, she expressed her opinion about asset owners. As I also explained earlier, Dr. Ueda also shares the same perception that corporate pension funds are on the slow road to stewardship activities. Monitoring asset managers is considered to be required as a part of asset owners' fiduciary duties. And when investment performance is improved through such monitoring, it will lead to a favorable situation for their sponsoring companies. In the UK, various organizations support corporate pension funds to conduct stewardship activities. She suggested that we should consider the establishment of such a system.

That's all.

[Ikeo, Chairman]

Mr. Tanaka, now you can continue.

[Tanaka, member]

As I was absent from the previous meeting, I'd like to make a comment on general issues. I have read the last meeting minutes, too.

The first point is about the term "capital cost". Mr. Ando just mentioned that Omron uses WACC to calculate its capital cost, but WACC's formula includes both capital and liabilities. On the other hand, capital cost as in, for example, the Ito Report focuses only on capital by applying the CAPM-based calculation method. Although the term "capital cost" is commonly used, I believe that its definition should be clarified. One possible way of clarification would be disclosures by companies on their definition and formula of capital cost. It would be also necessary to disclose what measures companies would take regarding such capital cost. Currently, definitions of capital cost significantly vary among companies, and some even confuse capital cost with dividend rate. Therefore, I suggest, as a possible way, that companies should make disclosures to clarify what they perceive as capital cost and how they calculate and judge risk factors.

Next, I'd like to talk about the issue of internal reserves. I totally agree with what Mr. Uchida mentioned during the previous meeting. The term "use of internal reserves" is very confusing. Internal reserves are a part of capital, regardless of whether they are maintained as cash or used for investments, especially in these days when large companies have actively pursued acquisitions of foreign companies as long-term investments. We should look at how companies use them, as the issue on the asset side or P/L side, and I believe that outside directors should play a significant role in this area.

My third point is about outside directors. There may be an issue regarding who virtually selects outside directors. I assume that, in many companies, CEO or Chairman usually brings his/her acquaintances from various places. However, in other countries where companies have many outside directors, there are many cases where such outside directors select candidates for new outside directors. The current situation in Japan is close to that in the U.S. in the late ’80s, and there seems to be a strong tendency that the management team brings their friends as outside directors.

Another thing to be considered in this regard would be the tenure of outside directors. I may have told you before, but in the U.S, it is often said that the retirement at the age of 72 is the best practice. This was supported by the result of a survey by a law firm. When I asked someone why it should be 72 years old, he answered, “In one’s life, one should not make a bogey, so it should be 72.” I did not get it, but it was his answer. In any case, it would be necessary to consider the tenure from the perspective of the independence of outside directors.

As for the discussion on Chairman, I understand that, at the previous meeting, Ms. Takayama provided a detailed explanation, and Mr. Kawamura also made comments. However, situations are very different between the UK and the U.S. In the UK, they ensure the division of Chairman of the Board and CEO. Furthermore, Chairman is appointed among independent directors. That’s an ordinary practice, as Ms. Ueda also wrote in her opinion statement this time. On the contrary, in the U.S., there are many cases where CEOs concurrently assume the role of Chairman. For example, in the industry I used to belong to, Mr. Jamie Dimon of J. P. Morgan is also Chairman and CEO. Many people concurrently assume the roles of Chairman and CEO. Instead, the U.S. companies have an overwhelming number of outside directors, and make use of lead director, who is the head of outside directors. I understand they have such a framework. I do not think it is always necessary to adopt either model, but I always think we can separate the roles of Chairman of the Board who heads the oversight function, and Japanese-style Chairman [of the Company] who performs business-focused function. This is because the title “Chairman” is very useful when conducting sales and other external activities. Besides, in the U.S. and Europe, there are many people using the title of Vice Chairman who are involved in only sales activities but not corporate management. Accordingly, I personally believe that companies can separate three positions of Chairman of the Board, Chairman who is in charge of business promotion, and CEO who is the top executive.

Finally, I'd like to talk about cross-shareholdings. For example, an overwhelming majority of banks say their client companies do not allow them to sell cross-held shares. Meanwhile, an overwhelming majority of client companies say their banks do not allow them to sell cross-held shares. What is the truth? I personally believe that cross-shareholdings are beneficial to both sides for securing the management positions, rather than ensuring stable business management. However, as for cross-shareholdings by financial institutions, they may bring about significant problems with the financial stability of the financial institutions. Therefore, I have already told the secretariat that, as other countries instituted the restriction on banks' shareholdings, it is time for Japan to refer to such examples and consider the possibility of instituting such a measure. For example, I think it is time to require them to reduce cross-shareholdings this much over five years. Otherwise, as I mentioned earlier, the situation where each side says "Our cross-shareholding partner asked us not to sell their shares" will never change.

That's all.

[Ikeo, Chairman]

Thank you.

Professor Kawakita, please.

[Kawakita, member]

Listening to various opinions so far, I believe the roles of outside directors are very important for corporate governance. This is my conclusion of today's discussion. In this regard, concerning how companies invest in their businesses, or what they should do with cash on hand or internal reserves (although definitions vary), it would be necessary for outside directors to thoroughly discuss earnings power of their businesses, dividend policy or internal reserve policy, as well as capital composition and WACC or capital cost for discussing such capital composition, and thereby companies could determine their future direction. Otherwise, it is impossible to address specific circumstances of individual companies. This is my first point.

Next, in connection with cross-shareholdings, the term "pure investment" was used somewhere. That’s out of the question. Nobody expects business corporations to hold shares for the pure investment purpose. That’s nonsense. Furthermore, when we get to the core of shareholdings by business corporations, it leads to the issue of parent-subsidiary listing. This may not be the topic for this time, but we should have discussion in light of measures against parent-subsidiary listing. Then, discussion can be extended to the issue of government-affiliated companies, and that should be carefully examined.

Then, some companies hold shares purely for their operating strategies. There would be various cases for such shareholdings. So outside directors should be able to properly discuss whether such shareholdings are justified, especially at board meetings. As a result of such discussion, if they decide to hold the shares for certain reasons, they should explain the reasons in their Securities Reports. Currently, in so many cases, they explain the reasons only in a few words, but I’d like them to provide more detailed explanations however lengthy they may need to be, even up to several lines. That will be useful for checking purposes.

Corporate pension plan is becoming of growing importance in corporate management, so it is wrong not to discuss it at board meetings. Furthermore, although I’m not sure what to call the top management of a corporate pension fund, when companies appoint the top management of their pension funds, many companies send someone as a part of personnel rotation or as a reward for their services. However, considering the big influence on corporate management, they should have proper discussion to appoint the top management. And considering the impact of corporate pension funds, they should write about it in the Integrated Report or somewhere. We’d like to know how they appointed the top management based on what discussion.

Consequently, when we discuss outside directors, although I think discussion about the number is important, we should also discuss the quality to ensure they are qualified. Many companies have described reasons for appointing each outside director in their Securities Reports, but such descriptions tend to be too general. I believe that they should write results of their discussion on why they needed each outside director. By doing so, it will serve as a check system, or a clue for dialogue with institutional investors.

Finally, I’d like to make a comment on institutional investors. Speaking of professional investors, especially asset management companies, too many of them belong to *keiretsu* groups. There certainly are independent asset management companies, which are capable of making a point from a uniquely different angle. Asset owners should choose and use such independent asset managers. I believe that asset owners need to make efforts for using such independent asset managers to have effective dialogue with companies.

That's all.

[Ikeo, Chairman]

Mr. Uchida, please go ahead.

[Uchida, member]

Thank you very much. At the beginning of today's meeting, we heard that the outcome of our discussion will be the establishment of the Guidance, and I understand that those issues described in Material 2 will be incorporated in the Guidance. I think that those issues are the matters which are thought not fully incorporated in the existing version of the Corporate Governance Code, or not sufficiently addressed by companies. On the other hand, what is essential for business management and corporate governance is business principles or corporate philosophy as well as code of business conduct. And as Mr. Ando of Omron also mentioned, how companies think about their stakeholders, and what they want to realize for such stakeholders, are critical points, and investors and companies must sufficiently discuss such matters. These points are stipulated in the current Corporate Governance Code, specifically in Principle 2.1 "business principles as the foundation of corporate value creation over the mid- to long-term" and Principle 2.2 "code of conduct". Have such dialogues been made to a sufficient extent? In my experience, such dialogues have not been sufficiently made. Therefore, it should be important to discuss these points before going into specific issues. Similarly, in the context of the idea of "companies select shareholders" which was discussed earlier, it would be very important for companies to sufficiently explain such matters [business principles and code of business conduct], and reach a consensus or develop common perceptions between companies and institutional investors, as the premise of discussion on specifics.

Next, with regard to issues presented in Material 2, I think that circumstances significantly vary depending on industry, business category, and whether they are newly established or well-established companies with long history. Accordingly, it is not desirable that the Guidance suggests any structure or framework in a single uniform way. Instead, I'd like to suggest that the Guidance should provide direction toward the approach where individual companies and investors develop common perceptions on these points at issue.

As for cross-shareholdings among those issues, it was discussed at the previous meeting that Principle 1.4 concerning cross-shareholdings may not be working properly. Hearing these remarks, I conducted hearings with major companies which belong to *Keidanren* (Japan Business Federation). Speaking the conclusion first, the companies replied that they have taken necessary actions in accordance with Principle 1.4. Specifically, they conduct a periodic review of their cross-shareholding policies, and verify the mid- to long-term economic rationale and future outlook of major cross-shareholdings at board meetings with outside directors, with consideration of associated risks and returns based on the consideration of the significance of such cross-shareholdings as well as performance, financial health, and other factors of cross-shareholding partners. Furthermore, they replied that they have provided investors with explanations of cross-shareholdings.

However, in such hearings, the number of target companies is rather small. In order to verify the situation by using more data, I picked up 204 companies that are business corporations among Nikkei 225 companies, and compared the number of companies whose stocks they hold for the purposes other than pure financial investments as of end-2013 with end-2016. As a result, roughly 80% or 160 companies reduced the number of companies whose shares they hold. The speed of reduction significantly varies from company to company, but they reduced the number by roughly 13% on average. 78 companies, or almost half of those 160 companies, achieved the reduction by more than 10%. There even were companies which reduced more than a half. Next, from a different angle, I examined changes in shareholder composition among Nikkei 225 companies. Annual Securities Reports prepared by listed companies under the Financial Instruments and Exchange Act include information on “shareholder composition”, and there is a shareholder category named “other corporations”, which represent domestic companies other than financial institutions, securities and insurance companies, in other words, mostly business corporations. We analyzed the percentage of shares held by “other corporations”. Compared to three years ago, 144 companies, or more than 70% of 204 target companies, recorded a decrease in the percentage of shares held by “other corporations”.

According to this data as well, although it is limited to Nikkei 225 companies, business corporations have taken actions based on the intent of the Code, so we should consider that Principle 1.4 is functioning to a certain extent. Therefore, as I mentioned in the previous meeting, it is also true that cross-shareholding practices vary from company to company, so I believe it is important to use the opportunity for dialogue between companies and investors to discuss what verification they implement at the Board, confirm the rationale of such shareholdings, and examine the ideal state.

Let me make one last comment about asset owners, specifically corporate pension funds. In Material 2, it is stated “when corporate pension funds conduct stewardship activities, what challenges do they face?” The size varies across corporate pension funds. Frankly speaking, I assume that many of them have a spending limit. Even corporate pension funds of a certain size may have certain limitations in spending for securing human resources with relevant expertise, and allocating sufficient man-hours. As for this issue, cost-effectiveness should be analyzed before seeking the ideal state and realistic solutions or measures based on the actual situation.

That’s all.

[Ikeo, Chairman]

Thank you very much.

Mr. Oguchi, please.

[Oguchi, member]

Thank you. I’d like to make comments on two issues from today’s agenda, namely cross-shareholdings and asset owners.

With respect to cross-shareholdings, as Mr. Ando also introduced, basically the autonomy is important in terms of corporate governance, and as a matter of fact, Omron has autonomously reduced them. And as Mr. Uchida mentioned earlier, cross-shareholdings have actually been decreasing. However, it may be difficult to go further from here. Companies are increasingly facing a barrier, so creative thinking would be required for considering how they can further reduce cross-shareholdings, or how they maintain truly rational cross-shareholdings instead of merely reducing all of them. The Strategic Directions and Priorities 2017-2018 and Material 2 refer to “incentives for ‘held companies [i.e. issuing company]”. Probably, when they make efforts for further reduction, they may find that such incentives are much stronger there. What to do with that would be a challenge.

We are expected to develop guidelines. Although I won’t say that there is no rationality of cross-shareholdings, the guidelines should require companies to explain whether their shareholdings are really rational with a background of the last paragraph of Material 2. Let me tell you more frankly, with no fear of misunderstanding: the guidelines should be articulated in a way where the companies are hard put to provide convincing explanations. While cross-shareholdings with convincing reasons will be maintained, those without convincing reasons will decrease. The guidelines should facilitate such a change. Ultimately, as Mr. Tanaka mentioned earlier, the ban may be an option. Putting aside whether we go that far, in order to achieve further reduction, unless the guidelines thoroughly discuss the importance of rationality for such shareholdings, I think it will be difficult to reduce them in reality.

Next, I'd like to make comments on asset owners. The Follow-up Council issued the Opinion Statement No. 3 on November 30, 2016, and therein, stated "In the investment chain, asset owners are positioned closer to ultimate beneficiaries and have a direct responsibility to secure the interests of the ultimate beneficiaries. Taking this position into account, asset owners need to pay careful attention to ensure that asset managers' stewardship activities become more effective." Furthermore, today, Mr. Kawakita mentioned the significance of corporate pension funds for corporate management. I believe that corporate pension funds certainly are important. We are working in the investment chain; and from our viewpoint, asset owners have a right to select and appoint asset managers, and thus have a power to influence asset managers. In that sense, not to mention their influence on corporate management, when we discuss the revitalization of the investment chain, it is of great significance to establish the environment to enable asset owners to appropriately conduct stewardship activities, and I think we cannot avoid this discussion.

From that perspective, as suggested in Strategic Directions and Priorities 2017-2018, it is reasonable for expecting parent companies to address qualitative and quantitative shortage of human resources for asset management, although they cannot give what they don't have – due to cost constraints as discussed earlier. However, there is a slight concern that increased intervention by parent companies may cause conflicts of interest with ultimate beneficiaries. We discussed a similar issue facing asset managers. Furthermore, in case we encourage them to enhance the quality and quantity of human resources for asset management, it is critical to discuss how to oversee powerful asset management executives – similarly to the discussion on appointment and removal of CEO in a company – and how to avoid conflicts of interest.

Asset managers have indirect responsibilities to ultimate beneficiaries through asset owners.

The revised Stewardship Code went into such issues as asset managers' governance and conflicts of interest. Specifically, under Principle 2 concerning conflicts of interest, Guidance 2-2 stipulates that [institutional investors] should set out and disclose specific policies, thus ensuring the transparency. Guidance 2-3 stipulates that [asset managers] should establish governance structures, including an independent board of directors or third party committees for decision-making or oversight of proxy voting, in order to avoid conflicts of interest. These were added to the revised Code.

In order to increase stewardship activities by corporate pension funds, only to address problems of human resources and cost is not sufficient. We should also consider such issues as transparency and independence in governance which are required of asset managers – in other words, structures that will not harm the interests of ultimate beneficiaries. On further reflection, asset owners are positioned closer to ultimate beneficiaries than asset managers are. And considering their significant influence on the investment chain, they need more transparency and independent governance structure than asset managers, so I naturally agree with promoting asset owners' stewardship activities. However, if the guidelines include such issues facing asset owners, I suggest that we should discuss appropriate management of conflicts of interest, and include it in the guidelines as well.

That's all.

[Ikeo, Chairman]

Mr. Tsukuda, please.

[Tsukuda, member]

Thank you. I'd like to discuss two points concerning (3) CEO and the Board on page 2 of Material 2 prepared by the secretariat.

The first point is about independent directors. The second bullet point refers to the desirable situation where the majority of those who nominate a successor to CEO are independent directors. Furthermore, in the fourth bullet point, it is stated that some outside directors do not seem to be fully aware of their roles. "Nomination Committee where the majority of the members are independent directors" means that, in case of a committee consisting of five members, three of them should be independent directors. Omron's case is a good example of this situation. On the other hand, the vast majority of Japanese companies currently have only two independent directors, and that would create a bottleneck. When some outside directors are not fully aware of their roles, and when there are only two outside directors, I assume it is rather difficult to strengthen Nomination Committee. The fundamental problem is that there are only two independent directors. In the Corporate Governance Code, Principle 4.8 stipulates that, if a company in its own judgment believes it needs to appoint at least one-third of directors as independent directors based on a broad consideration of factors such as industry, company size, and circumstances surrounding the company, it should voluntarily do so. The principle further states that such a company should disclose its policy for doing so. However, how many Japanese companies are doing so, in accordance with this principle? We should discuss this issue once again.

In that sense, as for the discussion that at least one-third of the members should be independent directors, while Ms. Takayama pointed it out during the previous meeting, and Principle 4.8 refers to that, I believe that we should have in-depth discussion to clarify in which cases it is desirable to have at least one-third [of independent directors]. This is my first point.

My second point is, as Mr. Tanaka commented earlier, the situation where President concurrently assumes the role of Chairman of the Board. In Dr. Ueda's opinion statement, it is written that, among all companies listed on TSE First Section, 83.1% of the boards are chaired by President. In a certain sense, there are ultimate conflicts of interest between oversight and execution. Can we neglect this issue? Mr. Tanaka earlier referred to the U.S. situation. In the U.S., in case of a board consisting of ten members for example, eight are outside directors, and the remaining members are Chairman/CEO and CFO. On that premise, CEO chairs the board. In contrast, while most companies have only two independent directors, in 83.1% of companies listed on TSE First Section, President chairs the board. Considering such a situation, can we say that the corporate governance has been deepened compared to before even in terms of Form? Of course, governance has been deepened than before, but to enhance Substance, we need to address this issue.

Accordingly, for example, if the majority of the board members are independent directors, President may chair the board; President should not chair the board if they do not have a certain number of independent directors. I believe we should, at least once, discuss the incorporation of such an approach into the Guidance.

I wanted to share these two points with you.

[Ikeo, Chairman]

Professor Kansaku, please.

[Kansaku, member]

Thank you. I'd also like to make comments on the issue of asset owners.

The number of asset owners, especially corporate pension funds, which signed up for the Stewardship Code is not so large. Rather, we should say the number is extremely small. The big problem lies in the fact that the acceptance of the Stewardship Code by corporate pension funds has not yet fully improved, not to mention Substance. In this meeting today, Mr. Kawakita commented that corporate pension funds are important for corporate management of the company itself. And Mr. Oguchi pointed out that asset owners have fundamental roles in the investment chain. In addition, I'd like to stress that strict norms should be imposed on corporate pension funds, articulating that they should conduct stewardship activities from the perspective of their normative presence for the beneficiaries of the funds. I'd like to add that corporate pension funds should make efforts for accumulating assets for the limited range of their beneficiaries from the mid- to long-term perspectives.

Today, we understand that we are expected to develop the Guidance. For example, it would be difficult for the Guidance to work for institutional investors who have not yet signed up for the Stewardship Code. Then the point here is how to address this issue. In the Stewardship Code revised on May 29, 2017, Guidance 7-2 states that the management of institutional investors should have appropriate capability and experience to effectively fulfill their stewardship responsibilities,; and Guidance 1-3, 1-4 and 1-5 state that asset owners should engage in stewardship activities, or they should instruct that their asset managers be engaged in effective stewardship activities on their behalf when asset owners do not directly engage in stewardship activities.

On the other hand, I understand that the recent revision was based on the recognition that asset owners have various limitations, including company size, to conduct stewardship activities, and upon requiring asset managers to conduct self-evaluations, the revised Code allows asset owners to use such self-evaluations to assess and select their asset managers. What I just mentioned is related to Guidance 7-4 of the Stewardship Code on page 18, which stipulates that asset managers should regularly conduct self-evaluations with respect to the status of their implementation of each principle of the Code, and disclose the results. It says that asset owners can use asset managers' self-evaluations as a reference material or tool for their stewardship activities. In this way, I understand there has been a gradual improvement of the environment where asset owners, especially corporate pension funds, conduct stewardship activities.

In short, corporate pension funds must be managed by those who understand the importance of stewardship activities as I just mentioned. I'd appreciate it, if the Guidance would give consideration to such human resource aspects, encourage them to sign up for the Stewardship Code upon their agreement with its basic concept first, and promote the flexibility for making the best use of 'Comply or Explain" approach, as the Stewardship Code allows for various ways to address the Code.

That's all.

[Ikeo, Chairman]

Thank you.

Mr. Sampei, please.

[Sampei, member]

Thank you. I'd like to talk about several major points concerning an ideal approach for developing the Guidance.

The secretariat summarized points at issue from (1) to (6). Actually, these issues are very much inter-related, and should not be addressed separately. Furthermore, I think the focus should be on common issues for wide-ranged listed companies as well as investors. On the other hand, if the Guidance stipulates that too many issues should be addressed on an individual company basis, I'm afraid that the Guidance will be ineffectual. So, it should clarify what common issues are, and what should be addressed on an individual company basis, and provide a direction regarding how to explore the issues. That's my overall view.

Now I'd like to talk about how (1) to (6) are linked. For instance, as for (1) capital efficiency, we often say the levels of ROA, ROE, and ROS are low. Even if the management is merely criticized for low capital efficiency, they will not gain any awareness. Unless they examine why the capital efficiency is low, based on evidence, the situation will not change. Let's take the asset turnover ratio for example: this ratio calculates net sales divided by assets.

There are various calculation methods: some may use current assets, some may use intangible assets, and others may use tangible fixed assets for the calculation. Depending on what is used, results are different. For instance, the capital efficiency in Japan is lower than that in Europe and the U.S., but we cannot figure out reasons unless we look at the breakdown of calculation and identify how they are linked. We should prepare more convincing evidence, and show what the common issues are. I think that is a starting point.

Point (2) is closely related to (1). If we encourage companies to use their cash on hand when their capital efficiency is low, they will waste money significantly. Therefore, just urging them to use their cash on hand is absolutely out of the question. So, they need to improve the efficiency first, by taking a closer look at the situation. Just going for M&A is not appropriate. They need to consider in which area they should improve the efficiency.

It is (3) the Board that oversees such judgements, and thus plays a very important role. Supplementary Principle 4.11.3 of the Corporate Governance Code refers to an evaluation of the board effectiveness. As mentioned in Omron's presentation, a relevant committee plays a significant role here. Such a committee could be a statutory committee or voluntary committee. In terms of the number, there are more voluntary committees than statutory committees. The Guidance should clarify in what way such voluntary committees are effective. From my experience of hearing about voluntary committees, I found many cases where they have played significant roles. Besides, although they are on a voluntary basis, after I discussed it with them several times, they took necessary actions. For example, when I found percentages of inside and outside members of a certain committee are almost equal, I suggested that it would be better to increase the percentage of outside members to serve for the purposes of the committee. Six months later, they changed the member composition, and told me, "We reviewed the committee composition in response to your suggestion, and reduced the number of inside members to the necessary minimum." Even a voluntary advisory committee does so. Therefore, in order to make it a good topic for dialogue, the Guidance could describe the effectiveness of voluntary committees as well.

As for the issue of (4) cross-shareholdings, it is related to all of (1), (2), and (3). Of course, it is related to the issue of (1) capital efficiency. As for (2) cash and deposits, on balance sheets, cash and deposits are indicated on the upper left side of balance sheet, and cross-shareholdings are indicated on the lower left side of balance sheet – included in long-term assets. However, they can be translated into cash, so we could regard cross-shareholdings as the issue of cash and deposits in a broad sense. So it is the similar issue. Then, in terms of monitoring, it is related to (3).

Actually, (5) is also linked with (4). In Securities Reports, cross-shareholdings are disclosed in a list of “investment securities held for purposes other than pure investment”. In addition, there is another list of “deemed holdings of equity securities.” Deemed holdings refer to shares representing pension assets, etc. which are entrusted, and thus are not included in balance sheets; but the company in question has voting rights on the shares. Actually, in a dialogue with a certain company, I asked its outside corporate auditor how the company manages deemed holdings. He replied that the corporate pension fund has nothing to do with – or has not discussed anything about – deemed holdings. I requested the said outside corporate auditor to examine and discuss the matter. If the corporate pension fund is in charge of such holdings, questions arise: does it hold such shares for rational reasons associated with its fiduciary duty, or did the company have to hold such shares, and, in turn, treat them as pension assets? This should be perceived as the issue of overall corporate governance. So I asked him to investigate such points. In that sense, (1), (2), and (3) are linked with (4), as well as (5).

(6) is about dialogue with investors. The term “vary” is used here. The quality of dialogue varies [by investor] – that is not good. However, if investors’ stances vary, such variation may be interpreted as differentiation or diversity, and that would be acceptable. However, as for the quality, I assume that the problem should be the low quality, not the varied quality. Unfortunately, I have to admit it. Then how can they improve the quality? I believe front-line personnel who actually have dialogue with companies need to improve their skills. Comparing Japan with other countries, for instance, there is such a qualification as security analyst. Japanese examination subjects for security analysts include not only ordinary analytical skills, but also ethics and standards of professional conduct. The same applies to chartered financial analysts (CFAs) in the U.S. They are subject to the Ethical and Professional Standards. In case of investment management certificate (IMC) in the UK, in addition to the said subject, they need to study Regulation and Legal Concepts, which are applicable laws and codes, including legal concepts. I believe this is very important. Front-line personnel may be familiar with related parts of the Financial Instruments and Exchange Act, for instance. However, unless they have knowledge of necessary parts of the Companies Act, the Corporate Governance Code, and the Stewardship Code, as well as their linkage, background and intention, and make use of such knowledge for actual dialogue, it will be impossible to raise awareness of

companies. Therefore, such an aspect should be the point to be discussed in the future. Thank you.

[Ikeo, Chairman]

Thank you.

Mr. Oba, please.

[Oba, member]

As today's topic is how we develop the Guidance, and what we should focus on, I'd like to share my view on that first. Then I'd like to ask questions to Mr. Ando about certain points in his presentation, which would be related to the Guidance.

First, I'd like to talk about what we should focus on concerning the issues to be covered by the Guidance. As Mr. Sampei also mentioned, what is common in these five issues would be the capital efficiency. Accordingly, the capital efficiency should be the must-topic of dialogue, I think.

Mr. Tanaka mentioned earlier that it is very difficult to sort out how to calculate capital cost or how to calculate fair value, but it is desired to ensure that how a company perceives fair value is a must-topic of dialogue. In addition, how a company identifies its corporate value over the mid- to long-term is also important. While companies assert that they made efforts to increase their corporate value, it should be checked why such efforts have not borne fruit. I would say that most listed companies, have diminished their corporate value. Dialogue should also address how companies perceive such a fact.

Now I'd like to ask two questions to Mr. Ando, which may be related to the Guidance. I understand that your company has taken on difficult challenges and made considerable achievements. Your company gives consideration to what it lacks to become a global visionary company. It may not be so easy. After the achievements you have made so far, what is the top priority issue for your company at the moment? This is my first question.

Another question is related to the topic of today's discussion. For the purpose of the shift from Form to Substance, Mr. Ando explained that Omron Corporation places value on soul rather than Form. In case of a small company with a limited number of employees, it would be easy to communicate what the management is thinking. I'd like to ask you what efforts you have made to put soul into a large company.

That's all.

[Mr. Ando]

In response to your first question, when we imagine an ideal state of corporate management from the perspective of complying with the Corporate Governance Code, I believe that Omron's management ability gets a pass mark, although you might think I am an easy marker. Our challenge in terms of governance is the diversity. As for our challenges in terms of earnings power, we need to make further investments in human resources, research & development, and IT, and identify the growth strategy. As a tool for that, we'd like to leverage M&A and business alliance. Furthermore, the company will increase ROE in a meaningful way, along with the business growth. Please note that this is my personal view, not Omron's official view.

As for your second point, every company has its management principles or corporate philosophy. However, the corporate philosophy is not a decoration for the meeting room. How do we put the corporate philosophy into practice? Conversely, we recognize that the corporate philosophy must be actionable. Accordingly, not to mention the process of developing the corporate philosophy, upon establishing the corporate philosophy, it is important to ensure that each employee worldwide is fully aware of its importance and necessity. In other words, awareness raising and resonance formation are essential. In that sense, Omron has devoted considerable resources, so I believe that Omron's global employees fully understand the corporate philosophy, and realize that they need to conduct business faithfully and at the same time continuously demonstrate earning power. Our corporate philosophy and long-term (ten years) vision were established upon having numerous discussions by combining bottom-up and top-down approaches, so when they are finalized, their content was accepted by not only the management but also individual employees. That is a source of power to implement and carry them through.

Although I omitted an explanation as it is not directly related to today's topic, our company just took a new step toward sustainability management this year. Page 55 of the presentation material shows Omron's initiatives toward it, which are advanced corporate governance responsibilities to be fulfilled by companies. As for our sustainability goals, we identified the materiality – what should be done to what extent in the fiscal year 2020 –, and set numeric KPI targets wherever possible. On page 43, you can find our numerical targets as the mid-term business goals. We have six KPIs, namely sales, gross profit margin, operating income, ROIC, ROE, and EPS. We follow and update the progress every year. We need to increase sales, and also run the company in a capital-efficiency-conscious way. When we work on sustainably increasing our corporate value, taking into account both PL and BS, we believe that it is necessary to set and disclose specific goals, and continue to implement PDCA (plan-do-check-act) cycle through dialogue or engagement with stakeholders, instead of merely talking about general goals.

[Ikeo, Chairman]

Thank you.

Mr. Takei, please go ahead.

[Takei, member]

Thank you.

I think that issuance of the Guidance is a very good move. In particular, at the timing when companies will file their Corporate Governance Reports by the end of June 2018 regardless of whether they choose to comply or explain, the Guidance will clarify the intent of the Code and help them respond to the Code upon giving in-depth consideration to the meaning of compliance, instead of just repeating the way they complied with the Code in the past. So I concur with the issuance of the Guidance. Material 2 summarized six key points. These points alone are very important, so we should be careful to expanding our discussion to other points. Most of the current governance issues would be addressed to a certain extent by working on these six points. Focusing on these six points would be more than enough at this moment.

In this connection, Material 2 refers to capital policy in the first and second issues. In the first place, the current Corporate Governance Code already stipulates that companies should explain their basic strategy with respect to their capital policy in Principle 1.3, and companies should present targets for profitability and capital efficiency in Principle 5.2. I think the first and second issues question companies' substantive responses to these principles, so it is very important to provide the Guidance to clarify the intent of these principles externally. Furthermore, the second issue raises a question whether companies are making necessary investments. Here, the key point would be whether companies have selected appropriate KPIs to support organic growth conducive to such investments. I found some very important points in Omron’s presentation today. In the process of Omron’s consideration, Omron selected ROIC for its organic growth to ensure sustainable development. Not because people recommend ROIC, but because Omron considered ROIC is helpful to support its organic growth, Omron picked ROIC. I think this is very useful information. Therefore, with regard to Principle 1.3 and Principle 5.2, it would be useful to provide Guidance to question whether companies have set targets for profitability and capital efficiency in a way to facilitate such investments.

Second, Omron is very advanced, and at a macro level, we need to pay attention to how to deal with many other listed companies which have not reached Omron’s level. Some companies may perceive that Omron is too advanced to follow, but I do not necessarily think so. Omron’s representative also mentioned that Omron has done those things as a natural result of serious reflection on what it should do for its self-sustaining, continued growth. Of course, Omron’s achievements were made over the long term, such as 20 years, not in a short period of time. The fact that Omron has become a leading-edge, advanced company over time would be a very important message for each listed company. In Omron’s presentation, I found several issues which are common to many listed companies, regardless of company size or industry: specifically issues around global expansion, global stakeholders, and a shift from the first generation since the start of business to the second generation. It was a natural consequence of a company’s own consideration. What Omron has achieved is not something only Omron could achieve. I found many useful points for many listed companies to consider with regard to their sustainable growth in terms of governance, so I suggest that the Guidance includes the essence of its experience.

As for the issue of dialogue with stakeholders, I agree with Mr. Uchida and Mr. Oba on the point that companies should present their corporate philosophy first. In this regard as well, Omron’s case includes well-known shared values among many Japanese companies, including “*Sampo-yoshi*”. So, if we communicate the message in the form of Guidance instead of taking a North Wind strategy, I think companies will be convinced. The Guidance should encourage many companies to consider it is directly related to them. In that sense as well, Omron’s presentation was very informative.

The third point. I don’t mean to broaden the discussion, but I’d like to make a comment on the independence criteria with regard to independent directors as the third issue in Material 2. Considering the fact that the diversity is required, I believe that a certain number of independent directors are required for sure. On the other hand, there is a discussion whether there are a sufficient number of human resources qualified for the position of independent directors. This fundamental issue still needs to be addressed at present. The outcome of our discussion this time will be the Guidance that sends certain messages to institutional investors as well – I think this is good. What we see now is that each institutional investor has its own independence criteria, and there is no coordination among those varied criteria, so human resources who satisfy independent criteria are so far limited. Under such a circumstance, Japanese listed companies are facing the issue of how they can find appropriate independent personnel. Aside from the issue of how to address the situation, I don't mean to expand the scope of our discussion, but I do hope that institutional investors will not make judgements on outside candidates for positions of directors/officers merely based on their formal independence criteria. Instead, I hope that they establish criteria that take balance between independence and diversity, and then judge whether candidates are qualified or not. I would like to recommend to send a message in the Guidance that they should make judgement on qualified outside directors, taking balance of independence and diversity. I'd like to propose that the Guidance sends such a message to the extent that does not to broaden discussions too much to allow companies to appoint independent directors with appropriate diversity.

That's all.

[Ikeo, Chairman]

It's almost the scheduled closing time. Professor Kanda, would you like to share your opinions?

Now, although many of you would still like to share opinions, I'd like to close today's discussion here.

The secretariat will sort out and summarize opinions raised today, and will ask the members to continue further discussions in next meetings.

Finally, I'd like to hand it over to the secretariat for housekeeping announcements, if any.

[Tahara, Director of the Corporate Accounting and Disclosure Division, FSA]

At the next meeting of the Follow-up Council, we'd like to ask you to have discussions, giving additional consideration to the content of the Guidance. As for the date, we will fix the date upon consulting with you, and let you know. Thank you in advance for your cooperation.

[Ikeo, Chairman]

Thank you.

Now I'd like to close today's meeting. I declare the meeting adjourned. Thank you very much for your participation.