(Provisional translation)

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

1. Date and Time: February 15, 2018 (Thursday)　10:00-12:00
2. Venue: 13F, Central Government Building No. 7, Meeting Room No. 1

[Ikeo, Chairman] It's already the scheduled opening time. I'd like to open the fourteenth 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 would like the secretariat to clearly summarize the discussions up until now. Two materials have been prepared, one consisting of the Guidelines for Investor and Company Engagement (Draft) and the other consisting of points related to the revision of the Corporate Governance Code accompanying the formulation of the guidelines based on this draft. An explanation will be provided based on these two materials, and then we will hold free discussions as usual.

Now, I would like to ask the secretariat to provide an explanation.

[Tahara, Director of the Corporate Accounting and Disclosure Division, FSA] I would like to provide an explanation on Material 1 and Material 2.

First, please look at Material 1, "Guidelines for Investor and Company Engagement" (Draft). These guidelines have been summarized based on the points regarding investor and company engagement discussed at the previous meeting. First, the preface states what the "Guidelines for Investor and Company Engagement" are. It is extremely important for companies to achieve sustainable growth and increase corporate value over the mid- to long-term in order to achieve the growth of the Japanese economy and the stable asset building of households, and the guidelines summarize the important items for achieving these goals through constructive engagement. On the other hand, while these points are said to be the current issues of companies overall, each company's conditions are different, as it was pointed out before, so the last two lines starting from "Since corporate governance" states that each company's conditions should be taken into consideration.

The concrete details of the preface are based on the discussions at the preceding meetings.

Regarding the first point relating to management decisions in response to changes in the management environment, 1-1 discusses whether specific business strategies and business plans are established and disclosed and whether these business strategies and business plans are consistent with business principles, from the perspective that decisive management decisions are extremely important to achieve sustainable growth and increase corporate value over the mid- to long-term.

1-2 asks whether management identifies the cost of capital of their companies appropriately, and whether the management undertakes their businesses with recognition of their cost of capital by setting targets on profitability and capital efficiency. In addition, it was pointed out that it is important for companies to achieve returns which cover the cost of capital on a mid- to long-term basis. Note that while the word “cover” means “exceed” here, we have decided to use the word “cover” because there were discussions regarding whether simply exceeding would be sufficient.

In regards to 1-3, it was pointed out that when making management decision with appropriate understanding of the management environment and risks based on business strategies and business plans, the management could decide to invest in new businesses or restructure their business portfolio, for example. The effect of this is described. For example, 1-3 also asks whether the policy on reviews of their business portfolio is clearly established, and whether such a review process is effective.

The second point described is investment strategy and financial management policy. 2-1 asks whether specific investment in fixed assets, R&D, and human resources are carried out strategically and systematically in consideration of discussions on the importance of establishing business strategies and business plans consistent with business strategies and business principles, making decisive management decisions, making steady investments, and reviewing the businesses.

2-2 asks whether financial management is conducted appropriately during these activities. Because the approach towards the balance sheet becomes determined naturally along with management strategy and investment strategy, steady balance sheet management and cash flow management is important from the perspective of capital efficiency and procurement as described above. For example, the cash reserves of companies were discussed, and the belief is that if companies carefully implement financial management, the cash reserves of companies will be naturally handled appropriately.

The third point was regarding the appointment/dismissal of CEO and responsibilities of the board, and I believe that an extremely valuable statement was gained through vigorous discussions in the process leading to the statement in February of last year. This point has been summarized with a focus on these contents, and regarding the first point of the appointment, dismissal, and development of CEO, 3-1 first asks whether there is an established policy on CEO qualifications.

3-2 asks whether the CEO is appointed through objective, timely, and transparent procedures deploying sufficient time and resources. It states that the active involvement of an independent nomination committee is important to make these procedures effective.

3-3 asks whether the succession plan is appropriately established and implemented, and whether successor candidates are developed with sufficient time and resources.

3-4 describes it is important for objective, timely and transparent procedures to be established for dismissal procedures in consideration of discussion on this point.

3-5 in the second major point is about determination of management remuneration. It was pointed out that the remuneration system is important for achieving sustainable growth and increasing corporate value over the mid- to long-term and it should function as healthy incentives. It is important for the remuneration system to be designed, for the procedure appropriately deciding on the specific remuneration amount to be established, and for the remuneration amount to be clearly explained from this perspective. It also states that it is important for an independent remuneration committee to be actively involved in order to make these procedures effective, and this point is also incorporated in the guideline draft.

The third point is regarding the constitution of the board of directors, the appointment of independent directors, and their responsibilities, and 3-6 asks whether the diversity of the board of directors is fully ensured. In addition, because it was pointed out that it is necessary to appoint a sufficient number of independent directors though many companies have already appointed at least two independent directors, and it was pointed out regarding the quality of independent directors that knowledge of finance and an understanding of relevant laws and regulations including the Companies Act would be preferable, and these points are also stated.

Because it was pointed out that whether the boards of directors formed in this manner function effectively in terms of whether independent directors recognize their roles and responsibilities and provide advice and monitor management appropriately in response to business issues should be a

specific theme for engagement, these points are described in 3-7.

The fourth point concerns the appointment of Kansayaku, etc., and their responsibilities. The role of Kansayaku has become even more important than before and for this reason it has been incorporated in the Code. It was pointed out that whether Kansayaku have the appropriate knowledge, experience and skills should be in the scope of engagement, as well as whether such members are fulfilling their role effectively, for example, the role of securing proper business audits and accounting audits, and these points are described in 3-8 and 3-9.

The fourth point concerns cross-shareholdings, and extremely vigorous discussions have been held regarding this point up until now.

It was pointed out that it is important to first clearly explain the purpose of cross-shareholding in an understandable manner to their shareholders, and this point is described in 4-1. The importance of making decisions at the level of the board of directors appropriately on whether or not to hold cross-shareholdings considering whether benefits from such holdings cover their cost of capital was also pointed out. This is described as the second point. In addition, because it was pointed out that the changes of held companies are not sufficiently explained, this is described as the third point. In addition, the exercising of voting rights is also incorporated in the Code, and because it was pointed out that whether there are appropriate standards with respect to voting rights, whether they are disclosed in an understandable manner, and whether voting rights are exercised appropriately in accordance with the established standards are issues, these are described as the fourth point.

In addition, various discussions were held regarding the approach towards cross-shareholdings, and it was pointed out that it is important to fully clarify the policies and approaches towards the reduction of cross-shareholdings and whether appropriate actions are being taken in accordance with these policies and approaches, and these points are described in 4-2.

In regards to the second major point, it was pointed out on several occasions regarding relations with cross-shareholders that there are cases in which a party that actually holds shares as cross-shareholdings decides to sell the holdings after reviewing the significance of the holdings, and gets a response from the listed company (the held company) that it will review the business relationship if the shares are sold because they don’t want the shares to be sold. 4-3 asks whether there are cases in which companies hinder the sales of cross-held shares by implying possible reduction of business transactions in this manner.

It was pointed out that it is not acceptable for transactions with cross-shareholders to be continued without carefully examining the underlying economic rationales, and this point was described in 4-4.

In point five regarding asset owners, during the previous council it was explained that the Stewardship Code had only been accepted by one non-financial corporate pension fund. However, the Stewardship Code was recently accepted by Panasonic's corporate pension fund, and I believe this is a big first step. In order to encourage this trend, it was pointed out that it is important to work towards further enhancing the expertise of corporate pension funds, and that it is important for efforts by pension fund sponsors to improve their expertise of their corporate pension funds in investment management to be included as a theme for engagement because the efforts by pension funds sponsors are important, and this point is described in 5-1. In relation to this point, it was pointed out that it is important that the systematic recruitment or placement of qualified persons for investment managements, and 5-1 suggest the hiring or use of outside experts as an example when internal human resources are not sufficient.

This concludes my explanation on the "Guidelines for Investor and Company Engagement" (Draft). I would like you to discuss this draft today.

Next, I would like you to look at Material 2. This summarizes the main points related to the revision of the Corporate Governance Code accompanying the formulation of the engagement guidelines in consideration of the discussions on the engagement guidelines described above.

The contents of the "Guidelines for Investor and Company Engagement" (Draft) that were just presented are stated on the left side of this table. The related principle in the Corporate Governance Code is stated on the right side of this table, and I believe that the Code should be reviewed as necessary based on your suggestions from the perspective whether they are consistent with the contents of the guidelines (draft).

First, in regards to the point of management decisions in response to changes in the management environment that I explained previously in relation to the guidelines draft, currently Principle 5.2 describes the establishment and disclosure of business strategies and business plans, because 1-2 and 1-3 of the guidelines draft state that consideration should be given to the cost of capital when formulating the basic policy towards the earning plans and capital policy, and that reviewing the business portfolio would be included as an example of the allocation of business resources, we

would like you to discuss whether these points should also be incorporated in the Code.

In the same manner in relation to Principle 5.2, decisions on investment in fixed assets, R&D, and human resources are included as an example of the allocation of business resources in consideration of 2-1 and 2-2 of the guidelines draft, and we would like you to discuss whether this point should also be clarified in the Code.

In regards to the appointment/dismissal of CEO, responsibilities of the board, etc., although HR matters for senior management are described in Principle 4.3 and Supplementary Principle 4.3.1, and of course consideration is given to a CEO as a member of senior management, we would like you to discuss whether a new supplementary principle regarding the procedures for the appointment/dismissal of CEO should be created and the contents that were discussed should be incorporated into it.

Supplementary Principle 4.10.1 describes the establishment of optional advisory committees, and we would like you to discuss whether the contents of the Code should be reviewed regarding the involvement of an independent nomination committee for the appointment/dismissal of CEO.

Supplementary Principle 4.1.3 describes appropriate supervision on successor planning by the board of directors, and while it does not directly describe successor planning or the development of successor candidates, we would like you to discuss whether the contents of the Code should be reviewed regarding this point.

In addition, Principle 3.1 describes the disclosure of the various roles of the board of directors, and in consideration of 3-2 and 3-4 in the guidelines draft, we would like you to discuss whether the appointment/dismissal of CEO should be included in the disclosure contents.

Currently, remuneration is described in Supplementary Principle 4.2.1, and we would like you to discuss whether this section should be reviewed in consideration of the discussions for the guidelines draft regarding designing the remuneration system for management and the procedures for deciding on the remuneration amount.

In addition, in regards to Supplementary Principle 4.10.1, I mentioned the independent nomination committee previously, and we would like you to discuss whether the contents of the Code should also be reviewed in the same manner as for the remuneration committee.

In regards to the appointment of audit committee members and their responsibilities, while the current Code states that an audit committee member should have the appropriate knowledge

concerning finance and accounting, it was recently pointed out the knowledge and qualities beyond this may be necessary, and although it may already be possible to read the current Code in this manner, this item has been stated because it may be necessary to clarify this point.

Although cross-shareholdings are described in Principle 1.4, we would like you to discuss whether to review the contents of the Code regarding the verification of whether or not it is appropriate to hold each share as cross-shareholdings and whether policies towards the holding of cross-shareholdings should include the policies and approaches towards the reduction of cross-shareholdings, as indicated in the current guidelines draft.

Because the current Code does not necessarily explicitly describe relationships between cross-shareholders and listed companies, this point is stated because it may be necessary to clarify this point in the Code.

Because corporate pensions are not mentioned in the current Code, we would like you to discuss whether a new principle should be established regarding efforts by pension funds sponsors regarding corporate pension funds in consideration of 5-1 of the guidelines draft.

Regarding these points, it is necessary to summarize a final code revision draft going forward based on your discussions on the “Guidelines for Investor and Company Engagement” (Draft), so I would like to discuss these points today. Thank you for listening.

[Ikeo, Chairman] Thank you.

I would like you to discuss these issues now, and because we have to decide on a guidelines draft, I hope that we can have constructive discussions with this in mind. At the same time, I would also like you to discuss to what extent the Corporate Governance Code should be revised as we discuss these issues, but before doing that, I have received a statement from Mr. Sampei who is in attendance, and it has been distributed here today. A statement has also been submitted from Ms. Waring who is not in attendance today. This statement has also been made available, so I would like to ask for everyone’s opinion while referring to these statements.

Who would like to start? We can start from anyone.

OK, you are free to speak Mr. Toyama.

[Toyama, member] First I would like to discuss the guidelines, but I will be going back and forth. First in regards to the cost of capital that I believe was on page 3, although it seems that there are many people saying that the cost of capital has been exceeded, but I think that they probably don’t

understand the concept of the cost of capital. This goes for most managers in Japan. Probably about 80 or 90% or even more of these people have not studied basic corporate finance at all. I once read in a book that Mr. Kawamura first became aware of the cost of capital when procuring funds through stock. As was previously mentioned by Mr. Tanaka, it may be better to make directors, like a president, manager, take a test, I might be talking something that sounds a bit extreme. For example, whether they can say something regarding the cost of capital instantly are they able to calculate the cost of capital for a company under certain conditions? I would like to say that global managers all generally know this. This is because they basically all have enough knowledge of corporate finance that are taught in an MBA program, but what I mean to say is that Japanese managers probably don't understand this. For example, when it comes to the dividend rates, I think the majority of them think that about 3% would be appropriate. At least, that has been my personal experience. For this reason, I think that this is something that of course should be written in the guidelines and the Corporate Governance Code as well, and because managers should understand what the cost of capital is, this is something that everyone should study once more. This is probably mainly because of the literacy issues, and I believe that it would be better to clarify this issue. For example, when a ROE of 7% or 8% was discussed, many people would think that it would be appropriate for all listed companies to have an ROE of 8%. I can only say that this conclusion is stupid because it changes depending on the volatility of a company's cash flows. What I mean is that it can be lower for a company with stable earnings, and it has to be higher for companies with highly volatile earnings. To speak honestly, I think that they have a really low level of knowledge regarding these matters. To speak frankly, the majority of people serving as independent directors don't know about these things. While the scholars we have sitting at the table today are different, scholars from completely unrelated fields are also serving as independent directors. There are also former diplomats that are serving as independent directors, but I think that all or most of them would fail if they had to take a test. For this reason, because Japanese people are sensitive when it comes to shame, I think having people take tests like I and Mr. Tanaka mentioned before would be an extremely effective method for addressing this issue. Of course, because this is an extremely important point, I do think that it would be better to incorporate the concept of the cost of capital in the Corporate Governance Code. This is what I mean.

Next, I would like to discuss the appointment and dismissal of CEO, which I have been saying is

an extremely important point for a long time, and I think that it is only natural to use an independent nomination committee or nomination consultation committee. As I have said many times, and while there are of course some exceptions in some cases, the capabilities of the top management at Japanese companies are low. They are way too low in comparison with the rest of the world. Considering this, the problem is why top management with such low capabilities were selected and why is it not possible to develop them. The business world should reconsider this seriously. The things written here are only natural to some degree if this point is reconsidered seriously, and I believe that it would be better to use a nomination committee or nomination consultation committee as described in 3-2 and 3-3. What I mean to say is that it is important to carefully watch this process, and the selection timing is getting younger at decent companies at the very least currently. Because methods of selecting management from people in their 40s or their 30s in some cases are being adopted, and these processes are extremely time consuming, people who have management experience at other companies or people who have served as a company president should be used for independent directors because they are available. Because many companies end up paying high salaries, I think it would be better to make fuller use of independent directors. This is something that should definitely be reflected in the Corporate Governance Code. Because this is the most important point, I think these discussions are meaningless if we don't reflect items like 4.10.1 and 4.1.3 in the Corporate Governance Code.

I would now like to skip over to the section on the appointment of audit committee members and their responsibilities, which I think is presenting itself as an issue in some ways, because "the appropriate knowledge, experience and skills" sounds a bit abstract to me. This should be clearly stated as legal and accounting, or perhaps legal, accounting, and finance. At the very least, this should be specified as legal and accounting. It will lead to problems if this is not stated clearly. For example, there are some Japanese companies with audit committee members that don't really understand the differences between IFRS and Japanese accounting standards. I worry about companies like that. For this reason, sometimes at Japanese companies in discussions with directors, when there is no accounting specialist in the company and there is an external accountant, I will ask the external accountant while I am serving as an independent director about accounting, like what kind of impact an event will have on accounting. To speak honestly, this is an unbelievable situation. It should be the people in the company who have the most information, and if internal

personnel cannot give proper and prompt answers to these types of questions, it is difficult for discussions to even begin. For this reason, I think a degree of specificity is required here.

Next, I would like to talk about cross-shareholdings in 4-1. Things are a little similar here, as when it comes to how to describe the appropriate criteria, everyone uses the same format and avoids providing a proper explanation. Companies should be asked to be more specific here. Individual specificity should be required. In other words, when Company OO has shares of Company XX as cross-shareholdings, Company OO should state that they have shares of Company XX for reason A. They should state that they have shares of Company YY for reason B. They should state that they have shares of Company ZZ for reason C. It's not acceptable if the reason is not clearly stated. It is not appropriate to just quickly use a set format. I think that this point should also be incorporated in the Corporate Governance Code. As I am one of the realistic managers, of course I do not believe it will disappear tomorrow. Because it is difficult to define cross-shareholdings even to begin with, and recently there are cases of ambiguous cyclical holdings that are not simple and easy-to understand cross-held shares, this is not something that is easily reduced, and some of the holdings are reasonable. However, to put things conversely, it should be possible to explain the holdings separately and specifically if they are reasonable. The holdings should be explained separately and specifically. Because I believe that companies should be asked to explain separately and specifically why they have shares of Company XX, it will not be effective if this point is not reflected in the Corporate Governance Code. Because it is a difficult issue, we should be sure to include it in the Corporate Governance Code.

Lastly, I would like to talk about asset owners. A corporate pension fund of a company that I am serving as independent director recently accepted the Stewardship Code thanks to everyone's efforts. This made me realize that companies can do it if they try. This is even more true because that company is one of those companies that everyone thinks of as being very traditional and conservative. I think wording that encourages the acceptance of the Stewardship Code should be included in 5-1. To say what I really think in relation to cross-shareholdings previously mentioned, in some cases shares held as cross-shareholdings are being transferred to pension plans. While you can't really call this evasion of the law, to speak honestly, I don't think this is very good. While all would be well if the price of these shares goes up, if the price does not go up, it would be completely unacceptable from the perspective of retirees. In other words, it would be unacceptable

if your important pension fund for retirement were to incur losses due to circumstances related to the company's current business relationships. This is complete conflicts of interest. In a sense, this is malfeasance. For this reason, because it is unacceptable for companies to do this sort of thing, getting corporate pensions to swiftly accept the Stewardship Code and provide strict guidance on investments as well is an important point, at the very least this should be subject to engagement as mentioned above. Because I would like for something to be written regarding the Stewardship Code, this should also probably be incorporated in the Corporate Governance Code in some manner. Although everyone is saying that they can't do anything about this for the time being, this is something that people can do if they try. Companies can do it if they try. Accordingly, the problem is motivation

Lastly, when it comes to changing the Corporate Governance Code, while there will be many companies that will say that it has been difficult to implement the Corporate Governance Code up until now and that they are getting very tired, I am sorry, but I expect them to do at least this level of work. If they are not able to do something like this, I wonder what they are normally doing. What are the people in the related departments doing? They are listed companies, right? If they don't have enough time to manage their companies in order to implement this level of governance, I think they should not be listed companies, to speak honestly. There is an overabundance of listed companies in Japan anyway, so maybe they should stop to be listed. That's why I would like to ask them to at least do this. It's not too much to ask.

One more point I would like to raise is that the compliance rate is too high for the Corporate Governance Code in Japan. If compliance is so hard, it would be perfectly acceptable to explain rather than comply. Do it proudly and openly. Shareholders will look at that and decide whether or not to buy shares. For this reason, I cannot understand at all the argument that compliance is hard, so give us a break. It would be perfectly acceptable to explain in such cases. Because the original rule is to comply and explain, this Corporate Governance Code is being made because companies are all foolishly taking a follow-the-leader approach of feeling that they have to comply because almost everyone else is complying, and companies are not able to make money as a result. In other words, the Corporate Governance Code is being made because Japanese companies ended up this way due to not being able to make clear strategic decisions based on their own will. The same applies for this Corporate Governance Code. Companies with their own unique philosophy, their

own way of thinking, and their own form of governance should just disregard the Corporate Governance Code openly and proudly. It is not as if there is some kind of penalty if you disregard the Code. For this reason, it would be acceptable to just explain everything, there would be no problem with that approach. It's not as if this is the Companies Act. As I have said before, I would buy the shares of a company like this. Companies that conduct management with this level of faith and philosophy are sure to grow. For this reason, I really think companies should stop with the argument that they are tired so please give us a break. These discussions are being held with listed companies, and the managers of listed companies are talented people who are among the ultra-elite in society. These elite people who are extremely talented should look at the Olympics. The people competing in the Olympics are working until they almost die without making any excuses. The people you are competing against are these types of people in the corporate world. In other words, we are c[Toyama, member] First I would like to discuss the guidelines, but I will be going back and forth. First in regards to the cost of capital that has mentioned earlier, it should, I believe, be added on page 3. Although there are many people saying that the cost of capital has been exceeded, but I think that they probably don't understand the concept of the cost of capital. This goes for most managers in Japan. Probably about 80 or 90% or even more of these people have not studied basic corporate finance at all. I once read in a book that Mr. Kawamura first became aware of the cost of capital when procuring funds through stock. As was previously mentioned by Mr. Tanaka, it may be better to make directors, like a president, manager, take a test, I might be talking something that sounds a bit extreme. For example, whether they can articulate their own cost of capital instantly or are they able to calculate the cost of capital for a company under certain conditions? I would like to say that global managers all generally know this. This is because they basically all have enough knowledge of corporate finance that are taught in an MBA program, but what I mean to say is that Japanese managers probably don't understand this. Even today, majority of them merely think of the dividend rates, and that about 3% would be appropriate. At least, that has been my personal experience. For this reason, I think that this is something that of course should be written in the guidelines and the Corporate Governance Code as well, and because managers should understand what the cost of capital is, this is something that everyone should study once more. This is probably mainly because of the literacy issues, and, therefore, I believe that it would be better to clarify this issue. For example, when a ROE of 7% or 8% was discussed, many people would think that it

would be appropriate for all listed companies to have an ROE of 8%. I can only say that this conclusion is stupid because it changes depending on the volatility of a company's cash flows. What I mean is that it can be lower for a company with stable earnings, and it has to be higher for companies with highly volatile earnings. To speak honestly, I think that they have a really low level of knowledge regarding these matters. To speak frankly, the majority of people serving as independent directors don't know about these things. While the scholars we have sitting at the table today are different, scholars from completely unrelated fields are also serving as independent directors. There are also former diplomats that are serving as independent directors, but I think that all or most of them would fail if they had to take a test. For this reason, because Japanese people are sensitive when it comes to shame, I think having people take tests like I and Mr. Tanaka mentioned before would be an extremely effective method for addressing this issue. Of course, because this is an extremely important point, I do think that it would be better to incorporate the concept of the cost of capital in the Corporate Governance Code. This is what I mean.

Next, I would like to discuss the appointment and dismissal of CEO, which I have been saying is an extremely important point for a long time, and I think that it is only natural to use an independent nomination committee or nomination consultation committee. As I have said many times, and while there are of course some exceptions in some cases, the capabilities of the top management at Japanese companies are low. They are way too low in comparison with the rest of the world. Considering this, the problem is why top management with such low capabilities were selected and why is it not possible to develop them. The business world should reconsider this seriously. The things written here are only natural to some degree if this point is reconsidered seriously, and I believe that it would be better to use a nomination committee or nomination consultation committee as described in 3-2 and 3-3. What I mean to say is that it is important to carefully watch this process, and the selection timing is getting younger at decent companies at the very least currently. Because methods of selecting management from people in their 40s or their 30s in some cases are being adopted, and these processes are extremely time consuming, people who have management experience at other companies or people who have served as a company president should be used for independent directors because they are available. Because many companies end up paying high salaries, I think it would be better to make fuller use of independent directors. This is something that should definitely be reflected in the Corporate Governance Code.

Because this is the most important point, I think these discussions are meaningless if we don't reflect items like 4.10.1 and 4.1.3 in the Corporate Governance Code.

I would now like to skip over to the section on the appointment of audit committee members and their responsibilities, which I think is presenting itself as an issue in some ways, because "the appropriate knowledge, experience and skills" sounds a bit abstract to me. This should be clearly stated as legal and accounting, or perhaps legal, accounting, and finance. At the very least, this should be specified as legal and accounting. It will lead to problems if this is not stated clearly. For example, there are some Japanese companies with audit committee members that don't really understand the differences between IFRS and Japanese accounting standards. I worry about companies like that. For this reason, sometimes at Japanese companies in discussions with directors, when there is no accounting specialist in the company and there is an external accountant, I will ask the external accountant while I am serving as an independent director about accounting, like what kind of impact an event will have on accounting. To speak honestly, this is an unbelievable situation. It should be the people in the company who have the most information, and if internal personnel cannot give proper and prompt answers to these types of questions, it is difficult for discussions to even begin. For this reason, I think a degree of specificity is required here.

Next, I would like to talk about cross-shareholdings in 4-1. Things are a little similar here, as when it comes to how to describe the appropriate criteria, everyone uses the same format and avoids providing a proper explanation. Companies should be asked to be more specific here. Individual specificity should be required. In other words, when Company OO has shares of Company XX as cross-shareholdings, Company OO should state that they have shares of Company XX for reason A. They should state that they have shares of Company YY for reason B. They should state that they have shares of Company ZZ for reason C. It's not acceptable if the reason is not clearly stated. It is not appropriate to just quickly use a set format. I think that this point should also be incorporated in the Corporate Governance Code. As I am one of the realistic managers, of course I do not believe it will disappear tomorrow. Because it is difficult to define cross-shareholdings even to begin with, and recently there are cases of ambiguous cyclical holdings that are not simple and easy-to understand cross-held shares, this is not something that is easily reduced, and some of the holdings are reasonable. However, to put things conversely, it should be possible to explain the holdings separately and specifically if they are reasonable. The holdings

should be explained separately and specifically. Because I believe that companies should be asked to explain separately and specifically why they have shares of Company XX, it will not be effective if this point is not reflected in the Corporate Governance Code. Because it is a difficult issue, we should be sure to include it in the Corporate Governance Code.

Lastly, I would like to talk about asset owners. A corporate pension fund of a company that I am serving as independent director recently accepted the Stewardship Code thanks to everyone's efforts. This made me realize that companies can do it if they try. This is even more true because that company is one of those companies that everyone thinks of as being very traditional and conservative. I think wording that encourages the acceptance of the Stewardship Code should be included in 5-1. To say what I really think in relation to cross-shareholdings previously mentioned, in some cases shares held as cross-shareholdings are being transferred to pension plans. While you can't really call this evasion of the law, to speak honestly, I don't think this is very good. While all would be well if the price of these shares goes up, if the price does not go up, it would be completely unacceptable from the perspective of retirees. In other words, it would be unacceptable if your important pension fund for retirement were to incur losses due to circumstances related to the company's current business relationships. This is complete conflicts of interest. In a sense, this is malfeasance. For this reason, because it is unacceptable for companies to do this sort of thing, getting corporate pensions to swiftly accept the Stewardship Code and provide strict guidance on investments as well is an important point, at the very least this should be subject to engagement as mentioned above. Because I would like for something in the guidelines to be written regarding the Stewardship Code, this should also probably be incorporated in the Corporate Governance Code in some manner. Although everyone is saying that they can't do anything about this for the time being, this is something that people can do if they try. Companies can do it if they try. Accordingly, the problem is motivation

Lastly, when it comes to changing the Corporate Governance Code, while there will be many companies that will say that it has been difficult to implement the Corporate Governance Code up until now and that they are getting very tired, I am sorry, but I expect them to do at least this level of work. If they are not able to do something like this, I wonder what they are normally doing. What are the people in the related departments doing? They are listed companies, right? If they don't have enough time to manage their companies in order to implement this level of governance,

I think they should not be listed companies, to speak honestly. There is an overabundance of listed companies in Japan anyway, so maybe they should stop to be listed. That's why I would like to ask them to at least do this. It's not too much to ask.

One more point I would like to raise is that the compliance rate is too high for the Corporate Governance Code in Japan. If compliance is so hard, it would be perfectly acceptable to explain rather than comply. Do it proudly and openly. Shareholders will look at that and decide whether or not to buy shares. For this reason, I cannot understand at all the argument that compliance is hard, so give us a break. It would be perfectly acceptable to explain in such cases. Because the original rule is to comply and explain, this Corporate Governance Code is being made because companies are all foolishly taking a follow-the-leader approach of feeling that they have to comply because almost everyone else is complying, and companies are not able to make money as a result. In other words, the Corporate Governance Code is being made because Japanese companies ended up this way due to not being able to make clear strategic decisions based on their own will. The same applies for this Corporate Governance Code. Companies with their own unique philosophy, their own way of thinking, and their own form of governance should just disregard the Corporate Governance Code openly and proudly. It is not as if there is some kind of penalty if you disregard the Code. For this reason, it would be acceptable to just explain everything, there would be no problem with that approach. It's not as if this is the Companies Act. As I have said before, I would buy the shares of a company like this. Companies that conduct management with this level of faith and philosophy are sure to grow. For this reason, I really think companies should stop with the argument that they are tired so please give us a break. These discussions are being held with listed companies, and the managers of listed companies are talented people who are among the ultra-elite in society. These elite people who are extremely talented should look at the Olympics. The people competing in the Olympics are working until they almost die without making any excuses. The people you are competing against are these types of people in the corporate world. In other words, we are competing in the Olympics in the corporate world. If compliance is something that makes you tired, I really think that retiring would be better. That is my opinion.

Thank you.ompeting in the Olympics in the corporate world. If compliance is something that makes you tired, I really think that retiring would be better. That is my opinion.

Thank you.

[Ikeo, Chairman] Thank you.

OK, you are free to speak Mr. Sampei.

[Sampei, member] Thank you. I apologize for speaking at the same time as submitting the statement, but I would like to provide a simple supplemental explanation because there are some areas that are difficult to communicate with only what is written here.

Please look at the statement. As was partially explained previously by Director Tahara, the purpose is simply to improve corporate value, identify management issues, and identify, share, and conduct engagement regarding the issues of individual companies. The English word “constructive” in the phrase “constructive engagement” differs from the word “friendly”, and it means to produce results rather than harmonious conversation. Accordingly, I think that it is important to always produce results. I think that continued monitoring until results are achieved to this end is a major prerequisite for effective engagement.

The preface already states some important points to note regarding the formulation of the guidelines, and one of these points is that each item of the guidelines should not be uniformly applied to all companies. Then, I would like to address some specific points from item 3, namely management decisions in response to changes in the management environment, and investment strategy and financial management policy, specifically the cost of capital that was just discussed by Mr. Toyama. I also don’t believe that there will be much progress if only the cost of capital is written. In particular for what is written in 2-2, it only consists of one line, and I believe it would be better to expand this a bit to describe what the financial management policy is. I have written a bit regarding this in the underlined area of page 2 of my statement. In order to understand the cost of capital, the balance sheet has both a left and right side. While management often looks at the left side, I don’t think the relationship between the left and right sides is not sufficiently understood. In particular, in relation to the use of shareholders' equity, it can roughly be separated into the portion that supports interest-bearing debt on the right side and the portion that directly supports risk assets on the left side. Although this way of thinking has not really been instilled, even if it is not possible to decide on a percentage for the cost of capital, an explanation should be made with some understanding on what kind of balance should be achieved from the left and right side of the balance sheet. I think that it is necessary for investors to look deeper into these issues as appropriate, and accordingly I would like 2-2 to be expanded a little. Because I believe what phrasing should be

included in the Code as a result of this expansion is a topic for the next discussion on the Code revision, I have just written about reflection in the guidelines here.

Looking at item 4 which Mr. Toyama recently said various things about, although I don't have very much to add, I have to say that what is written in ⑥ is more of an approach. Something that we are extremely uncomfortable about is that it is common for after-the-fact explanations to be provided regarding the career history or good character of candidates when a candidate is presented. However, because there are management issues, it should be asked what kind of skills should be required of candidates to resolve management issues, and what kind of approach will be adopted in response to such issues. Because this will change depending on the phase, this should be the case when looking at the portfolio of skills, balance of skills, and overall skills when there is a change or when considering the approach towards issues. This is written clearly if you look at annual reports and other disclosure materials from overseas. In this sense, there is a gap with disclosures from overseas.

In terms of ⑦ related to the board of *kansayaku* (statutory auditors), because gaining an understanding of the current state of subsidiaries management including subsidiaries overseas is a precarious area, something that I am extremely concerned about is how the support system for *kansayaku* (statutory auditors), internal control system, and coordination with external auditors is actually addressing this situation. I also believe that a degree of disclosure is necessary in order to identify the issues that are discovered in the process and to work towards resolution while clarifying these issues.

The next item is Supplementary Principle 4.11.3 of the Corporate Governance Code, which is one of the items that is most focused on in governance reports, and accordingly effectiveness should be assessed every year. Although the board of directors should examine so-called cross-shareholdings every year in accordance with Principle 1.4 of the Corporate Governance Code, how this examination is conducted is not visible at all. While there is a very small number of companies that are very proactive towards disclosure, in most cases it is not visible at all what companies are doing or not doing. For this reason, under Supplementary Principle 4.11.3 I would like it to be disclosed how the actions under Principle 1.4 are being verified, what results are being confirmed, and what kind of action plans there are. Because I think the Code will have to be reviewed in that sense, I have added an asterisk here.

In terms of item 5 in my statement regarding cross-shareholdings, because cross-shareholdings are often prefaced by “so-called”, they are somewhat ambiguous. However, I would like to clarify that in short, they consist of specific investment shares and deemed cross-shareholdings. If this is done, I think it will link things to the pension assets topic that Mr. Toyama previously mentioned.

Then, looking at ⑩, I am sorry to say, but the current phrasing of Principle 1.4 of the Corporate Governance Code makes me feel very uncomfortable. It states that “the board should examine the mid- to long-term economic rationale and future outlook of major cross-shareholdings on an annual basis”. Does this mean that cross-shareholdings that are not major are not examined? Because it is unclear what cross-shareholdings that are not major even means in the first place, they should be sold off if they are not examined. The next section that is underlined is “taking into consideration both associated risks and returns”. I think it is strange to talk about risks and returns for something that is not a pure investment. Although the intended meaning of risks and returns may be different here, I would normally think of risks and returns on a pure investment when I hear risks and returns. I actually talked with a company the other day regarding this, and the person I talked with told me that to him it means how much dividends are received and how much the transaction amount is gained for an amount invested or for the market value. However, this transaction amount was sales volume. The company said that they were measuring the return on the investment and this was probably based on an examination method introduced based on the Code. Because the Code could be misleading in this sense, I think that the phrasing should be reviewed here. In relation to 2-2 that I mentioned previously, if a company actually has cross-shareholdings, this means holding risk assets on the balance sheet for the shares that are held, and an examination should be conducted on whether it is acceptable to allocate a large portion of shareholders' equity to such holdings. I think that companies should hold business assets, and that they should not be ambiguously holding investment securities that are risk assets. For this reason, I have marked this area with an asterisk because I believe the Code should be revised along with the guidelines.

Number ⑪ also relates to this, and there is of course the issue of “held companies” which make certain companies hold their shares as cross-shareholdings. While this would be sufficiently possible if there is a specific contract such as a capital alliance, I think that disclosure of the cross-shareholding relationship under 1-7 would be possible for clarifying such relationships. In addition, if there really is a capital alliance, this can be understood as something that should be

also listed as an important business contract in the securities report.

Looking at number 6, there is this type of phrasing in 3-1 and Supplementary Principle 3.1.1 of the Corporate Governance Code, although this is something that applies overall. Accordingly, this is something that should be disclosed more pro-actively. I think there are some companies that get by complying with all items on the surface, but that do not have disclosures that are very detailed given that. Although I am not sure if these principles need to be revised, I think that it is necessary to remind companies to emphasize this area a bit more.

Thank you for letting me explain the statement. Cross-shareholdings are somewhat unique, and if they are not reduced all at once, in some sense business transactions could be reduced in a manner in which honest people turn out to be the losers. For this reason, I think that it is very important to impose a disclosure obligation, well maybe not exactly an obligation, but at the very least a principle to encourage to some degree reductions all at once. I stated at the beginning that it is necessary to think of individual issues and overall behavior issues separately for the guidelines overall.

Lastly, something that various people from companies currently conducting engagement and investors like me have mentioned to me is the simultaneous release of the revised Stewardship Code on May 29 of last year and the Guidance for Integrated Corporate Disclosure and Company-Investor Dialogues for Collaborative Value Creation from METI. There are some people who have asked why there are two guidelines because of this, and I would like for us to be careful with how we release the guidelines so that there are no misunderstandings and people don't get the wrong impression of redundancy. Because my understanding is that these guidelines mention specifically various items in the Corporate Governance Code and aim to improve the quality of compliance or explain for areas that have not been up to expectations up until now, I hope that a release is possible that doesn't result in a strange sense of redundancy.

Thank you.

[Ikeo, Chairman] Thank you.

I'm not sure who was first, but let's go with Mr. Tanaka.

[Tanaka, member] Thank you. Although I would like to make a comment based on Material 2, first I would like to clarify the position of the guidelines. As the guidelines will be released, are they subject to the comply and explain rules? What is the position of these guidelines?

[Tahara, Director of the Corporate Accounting and Disclosure Division, FSA] Comply or explain does not apply for the guidelines themselves, and I acknowledge that the guidelines are only central themes for engagement in order to achieve the compliance or explain rules for the Code.

[Tanaka, member] Oh, I see.

[Tahara, Director of the Corporate Accounting and Disclosure Division, FSA] I believe that was the approach pointed out by Mr. Sampei now, but please let me know if that is not the case or if there are any comments regarding this point.

[Tanaka, member] When I listen to what has been explained, it seems like that it could be conversely said that if something is not written in the Corporate Governance Code, it is not subject to the compliance and explain rules.

[Tahara, Director of the Corporate Accounting and Disclosure Division, FSA] I acknowledge that the discussions up until now can basically be understood as you have stated.

[Tanaka, member] OK, I understand. Based on this premise, I would like to make a comment from page 1. First, in relation to the issue of the cost of capital, I think the reason that we are discussing this issue in the first place is based on the long-term low profitability of Japanese companies. For example, in the case of a European or North American company in which the ROE of three of four businesses is 10% and almost no profit is recorded by the remaining business, resulting in an overall ROE of 1%, the business that is recording no profit will of course be disposed of. However, in the case of a Japanese company, due to some sense of responsibility towards supply, there is a tendency to hold on to the business that is not profitable and for the overall ROE to fall as a result. This is a very common situation. In such a case, one approach would be to carve out the low profitability business or use various methods to only keep the remaining three businesses and transform into a business structure that is highly profitable and competitive, and in doing so work to boost the profitability of all companies and industries in Japan. For example, this is something currently being discussed by GE. I think there are several other American companies that are also doing this, and in consideration of this, I think that it is necessary to make sure to include reviews of the business portfolio in the Corporate Governance Code. I feel that this is something that is extremely important when you consider why we are discussing these topics in the first place. Japanese companies are becoming more and more complex, and in a sense, the value as a company becomes discounted the more complex things become, and because the cost of capital becomes

higher the more complex a company is, it becomes necessary to thoroughly review the business portfolio in light of these factors, and I believe that this is what governance is for and the recognition of capital costs is for..

In regards to page 2, and this may relate to what was previously discussed by Mr. Sampei, there will of course be some businesses with no prospects for future profitability or growth as I just stated. In the case of such companies, they of course have surplus funds. I believe this page started from talks on surplus cash, and while I do think that it is of course important to create new business through new capital investment, R&D investment, and HR investment in such cases as stated here, because there will also of course be circumstances when doing so is difficult, for such companies it may be necessary to consider measures such as conducting stock buyback or increasing dividends. In other words, there are both defensive measures and aggressive measures. Because the dividend rates for Japanese companies are said to be extremely low, if it is not possible to find opportunities for aggressive measures in these areas, in other words, investments, I believe it is necessary to consider financial strategy at the same time, for example the stock buyback and using the funds for dividends.

Next, let's look at Principle 4-3 to the upper right on page 3. Something that I've always thought about regarding the board of directors, not the directors, in relation to the section "board of directors from an independent and objective viewpoint", is that it has been reported that there is an average of nine to ten directors for companies listed on the First Section of the Tokyo Stock Exchange, and the number of external directors is two or in some cases three for these companies. If that is the case, it means the remaining seven people are the chairman, president, and their subordinates. I have always doubted whether such a board of directors can really be considered independent and objective in the first place. For this reason, I think it is necessary to think about the issue of independent officers and the independence and objectivity of the board of directors separately. In doing so in relation to the guidelines for engagement on the left side, as an example, 3-2 uses the phrase "independent nomination committee" at the very end. However, it is unclear whether this independent nomination committee refers to a committee composed of only independent officers or outside directors or if it is composed of a majority of independent officers or outside directors. I don't think such a committee can be independent if the members are not all independent officers or outside directors. It is clear that the level of influence would be high if an

internal employee with voting power were to join such a committee and provide explanations on all of the circumstances within the company. While of course there would be no problems with explanations from internal employees or explanations regarding successor candidates, etc., I do feel that generally such committees should be formed of only external parties in order to ensure independence because otherwise independence would not be ensured.

Next, let's look at 3-3 that describes the development of successor candidates. I feel that it is necessary to consider selection from a slightly wider range, not just development. In the case of Europe and North America, and I believe there has been a significant increase in such cases in Japan recently, it is common to select not only internal candidates, but to select external candidates as well. One approach would be to make a short list with both parties, and to select three from each, for example and then, to select from these six people. This kind of selection approach should be considered. And we should think about how to evaluate a case in which a CEO is selected from an outside director who has been actually successful, if we assume people only inside the company understand the company. I think that it is only natural for such external candidates to be considered in such turbulent times. As a practical matter, there are plenty of cases even in Japan of an external party becoming successful as an officer or CEO, and as the industry reorganization proceeds, it will lead to the creation of various new companies as stated previously, so I believe that there will be more cases of external parties becoming managers from the beginning. Taking this into consideration, from a broader sense, one approach for these turbulent times would be to invite candidates from the outside as well as the inside and to select at a nomination committee.

In this sense, to the lower right of Supplementary Principle 4.10.1 it states "establishing optional advisory committees under the board to which independent directors make significant contributions" in nearly the middle regarding the board of directors. I wonder what the meaning of the word "significant" is here. I don't think the word "significant" is needed here.

Going a bit further on page 6, and while I mentioned the previous time, I would like to make a comment on directors and corporate auditors. Looking at 3-6 and 3-7 to the upper left, there is an item on the appointment function of independent directors, and I would like to ask why there is nothing regarding dismissal or resignation. What I am wondering is why only selection is described and nothing is described for dismissal or resignation in relation to independent directors who are involved in the selection or dismissal of the CEO. From my personal experience when I served as

the president of Union Bank, a retirement recommendation was issued to one of eleven independent directors based on discussions by the independent directors. As a practical matter, such a case is occurring in various countries, so not only the appointment but also the dismissal or resignation of independent directors should be clearly described. One approach towards this, that was mentioned before, would be a fixed retirement age, and another approach would be a form of a term limit system. However, I think one of these approaches should be written here.

While 3-9 states "implement the business audit appropriately" in relation to the board of corporate auditors, unfortunately there have been repeated scandals in the industry. All of these companies have been companies with a board of corporate auditors recently. Although I am not sure how these corporate auditors have been held responsible, but they are basically responsible for legality audits. Moreover, if the only thing that is audited is whether the acts of directors fulfill the duty of care as a prudent manager, this can only mean that actual business audits have nothing to do with corporate auditors. If that is the case, I don't think that it will be possible to prevent the occurrence of scandals only by strengthening the function of corporate auditors at companies with a board of corporate auditors. In this sense, I believe that the function of support for corporate auditors is actually more important, and I think this is actually contained in 4-13 of the Corporate Governance Code. 4-13 states that "companies should establish a support structure for directors and kansayaku", and in relation to this point, a mechanism in which the audit department reports to corporate auditors has been discussed recently in various conferences related to governance. In other words, the audit department reports to the board of corporate auditors along with the CEO. And, the board of corporate auditors is able to make full use of human resources of the audit department. With this mechanism, the top of the audit department cannot be single-handedly dismissed or appointed by the CEO, and the approval of the board of corporate auditors is necessary. Although this method is standard in Europe and North America, if such a mechanism is not adopted in Japan, it will not be possible for the board of corporate auditors or auditors to figure out things on their own without management resources or a support structure, and accordingly I feel this is an area that needs to be considered carefully.

Next, I would like to look at the third paragraph in 4-1 on page 7 regarding cross-shareholdings, that states "Are appropriate standards with respect to the voting rights as to cross-shareholdings established and disclosed in an understandable manner?" This section refers to the disclosure of

standards. It also asks, “Are voting rights exercised appropriately in accordance with the established standards?” However, one issue is how shareholders are able to recognize this appropriateness. If I were on the company’s side of this, I would probably just write that we are doing things appropriately and be done with it. Accordingly, I feel that this phrasing will just encourage companies to make sure the format is in order without any effect on actual circumstances. In consideration of this, various ideas were presented recently including the disclosure of voting rights exercised, but I feel that this phrasing will have no effect as it will only encourage the company to respond that everything is in order. For this reason, I think it is important to consider to what extent things should be effective in the guidelines, and not only call for the disclosure of policies.

On page 8, it states “by implying possible reduction of business transactions” in relation to this point, and I think an issue for 4-3 here is how to ensure effectiveness. I feel that the question of how to ensure effectiveness is an extremely important theme because companies often have back-room discussions that are kept private. Furthermore, as was previously mentioned by Mr. Sampei, when somebody is the first to suggest the selling off of cross-shareholdings, people usually get angry with them, and then other people are hesitant to bring up the topic because they don’t want the same thing to happen. One can think of this as like a game of old maid, and I believe that it is necessary to take this reality into consideration.

Finally, in relation to asset owners on page 9, I think that what is written here is extremely important. It states “During the dialogue, investors and companies need to be careful about whether conflicts of interest, which could arise between sponsoring companies and pension fund beneficiaries as a result of the measure, are appropriately managed.” at the lower left to the very bottom where there is a star mark. I think that this sentence has an important meaning. For example, it is my understanding that in many cases secondees from asset managers are dispatched to corporate pensions. It is also my understanding that there are cases in which this is formally a one-way ticket, and in the case of companies with these types of relationship, I feel that it should be made clear that an allocation toward the original organization is not appropriate because this would constitute conflicts of interest.

Thank you.

[Ikeo, Chairman] Thank you.

In regards to the position of the guidelines that was confirmed at the beginning of the statement by Mr. Tanaka, it is described on page 1 of the statement from Ms. Waring. On the first line of the item Status of the Guidelines, it states that I understand that the guidelines are not mandatory, but that they are “within the mechanism of “comply or explain” for companies”. Do you feel this understanding is consistent?

[Tanaka, member] What does “within” mean here?

[Ikeo, Chairman] Exactly, I’m not sure. Perhaps it means within the scope of the mechanism. Mr. Callon, what do you think? Does it mean it is presented within the scope?

[Callon, member] May I speak?

[Ikeo, Chairman] Yes, please. Please speak.

[Callon, member] Thank you. My reading is that what it means is that “I understand that these guidelines are subject to comply or explain.” This means that there is a slight difference from what has been discussed today.

[Tahara, Director of the Corporate Accounting and Disclosure Division, FSA] If that is the case, it seems like he has a slightly different opinion, and this is something that has to be confirmed, so I will confirm this at a later date.

Furthermore, because these guidelines are not subject to the comply or explain rules, it is only natural that there should be discussion on the status of response while discussing issues with the guidelines, and it can of course be expected that there will be requests for explanation on the status of response to issues in relation to this point.

[Ikeo, Chairman] Note that we only have one hour, so please try to be as compact as possible when you speak.

OK, next is Mr. Tsukada.

[Tsukada, member] Thank you. The matters that have been pointed out by everyone now cover much of what I have to say today. I would like to make some very specific comments on about two points.

The first point regards 3-6 and 3-7 in Material 1. It relates to the appointment of outside directors. Mr. Tanaka just mentioned the point of dismissal. While I basically feel that 3-6 and 3-7 are sufficient, I would like to point out that the selection process is an important and necessary point. I understand that these guidelines are being formulated in an effort to move from formality to reality,

and when I think about the reality at Japanese companies, the reality concerning outside directors is that while of course they are selected by the general meeting of shareholders in accordance with the law, the entry point is often the president of a company offering a position as an outside director. This means that the person who is being supervised is selecting the person who supervises him. While I cannot instantly say that this is bad when I take into consideration the current state of governance at Japanese companies, I do feel that more autonomous involvement of the nomination committee, for example, should be advanced in order to move to reality

Accordingly, looking at 3-2, for example, which states “Is the qualified CEO appointed through objective, timely and transparent procedures taking sufficient time and resources?”, I think it is important to require the appointment of not only the CEO but also independent directors through such an appropriate process.

Next, when considering how to respond to these issues with the Corporate Governance Code, and reading the current Corporate Governance Code, it could be item 4-8 or 4-9. One approach would be to mention this issue in some form as a supplementary principle. Looking at the second half of Principle 4.9, it states “The board should endeavor to select independent director candidates who are expected to contribute to frank, active and constructive discussions at board meetings.” However, a practical issue is that such active discussions are not really conducted at the board of directors, so if this second half of Principle 4.9 is not prescribed in a manner that is not formal in consideration of reality, discussions will end with the company saying that it has made an appropriate selection and is in compliance, without any improvement in the real situation. That is all for my first comment.

My second comment is that I believe that independent directors should be more autonomously involved in the appointment and dismissal of the CEO in consideration of this situation. For quite a high percentage of the independent directors that I come in contact with day-to-day, the reality is that many have uncertainties towards who should be appointed as next president. Although the selection of the president is not a matter for the sole discretion of the president, there seems to be many independent directors who make an honest statement that preference should basically be given to whom the current president wants to entrust with the duty next. As to whether this is appropriate, it is my view that this is something that should be changed. Accordingly, I think we should look at Principle 4-7, for example. Although four specific roles and responsibilities of

independent directors are listed, as Mr. Toyama often mentions, if everyone can agree that the appointment of the CEO is an extremely important theme from the perspective of improving corporate value, I think that the autonomous involvement in the selection and dismissal of the CEO should be added as an important role for independent directors as number 5 within Principle 4-7. And I think that it is necessary to clearly state that people who have no confidence in doing that or that don't agree with this idea should resign as an independent director. The reason for this is that if independent directors who feel that the selection of the CEO is not there job were to become members of a nomination committee that is merely a formality and merely go through the motions, we will only be going through the motions, which will actually have the reverse effect from the perspective of improving the "substantiality" of corporate governance in Japan, which is why I think it is important to really make some concrete statements in Principle 4-7.

That is all I have to say.

[Ikeo, Chairman] Thank you.

OK, you are free to speak Mr. Takayama.

[Takayama, member] I would like to state my opinion regarding the composition and diversity of the board of directors. I think this is related to the portfolio of skills and balance of the board of directors overall that was previously mentioned by Mr. Sampei. 3-6 of the engagement guidelines states "Is diversity of the board of directors fully ensured?" However, the word of "diversity" is a bit vague, and I believe it would be better for this section to be a little more specific. Because the Corporate Governance Code uses the phrasing "The board should have a view on the appropriate balance between knowledge, experience and skills of the board as a whole", I think more specific phrasing would be better for the diversity of the board of directors, for example "Is diversity of the board of directors fully ensured in consideration of factors such as knowledge, experience, capabilities, gender, and a global perspective based on the company's management policies and business circumstances".

The corresponding principle in the Corporate Governance Code is Principle 4-11 regarding knowledge, experience, and skills as I have just mentioned. In addition to what is here, I think that gender and a global perspective could be added. While opinions may differ regarding a global perspective depending on the company because there are some companies engaged in extremely domestic-oriented businesses, I believe that gender diversity is important for all companies.

Including this, I would like to make comments with respect to diversity from a global perspective. Because Japanese board of directors were extremely homogeneous and lacking in diversity in the past, overseas investors had major concerns towards whether these factors would have a significant negative impact on the oversight function. They were initially interested in the presence and ratio of independent directors. In response to this, there were a lot of improvements due to efforts by companies on their own before and after the establishment of the Corporate Governance Code. Furthermore, although the global minimum standard of one-third may not have been achieved yet, about 30% of companies listed on the First Section of the Tokyo Stock Exchange have achieved one-third, so improvements in this area has been recognized by overseas investors.

On the other hand, areas of diversity that are viewed to be relatively behind the times are the issues of gender and a global perspective. Gender is an issue that overseas investors are particularly interested in for various reasons. First, looking at trends overseas, for example, there are countries such as those on the European continent where the government sets a target for the percentage of women directors, and there are also cases of companies moving dynamically such as companies in the US and UK that set targets on their own. Investors have been very interested in response to such developments. Even from the viewpoint of the competitive advantages of companies, there is deep relationship between gender diversity and competitive advantages. There is also research on the deep relationship between the strengthening of the pipeline for women and the presence of women directors from the perspective of promoting the active participation of women that Japanese companies are currently making great efforts toward.

Meanwhile, in terms of the figures for the situation in Japan, the ratio of female officers is only a few percent, and I feel that Japan is really behind in terms of these figures compared to overseas. However, when I talk with various companies on the occasion of evaluations of the board of directors, etc., there are many directors who comment regarding the composition and diversity of the board of directors that they feel that gender diversity should be promoted as a med- to long-term issue and that it is necessary to add or increase the number of female directors in the future. In consideration of these developments overseas and the situation in Japan, I think that it would be better to add factors such as gender in addition to knowledge, experience, and skills as part of diversity in the Code.

Thank you.

[Ikeo, Chairman] Thank you.

Next, let's hear from Ms. Ueda.

[Ueda, member] Thank you. Because I was absent the previous two times, I would like to speak to some extent today.

[Ikeo, Chairman] Please do so in consideration of the entire time available.

[Ueda, member] OK, understood. First, I would like to address the overall position of the guidelines that was commented on previously. My understanding is that the guidelines describe things specifically that are not fully described in the Code. As was mentioned previously by other members, as far as I can see, there is a very high rate of compliance with the Code based on self-centered interpretations. I think that the positioning of the Guidelines is to describe things more specifically in order to reduce room for self-centered interpretations, and to promote engagement on which items should be disclosed and which items should try to be improved. If this understanding is incorrect, I would appreciate for the secretariat to explain the position of the Guidelines later.

I would like to make some comments on Material 2 related to the Guidelines and the Corporate Governance Code. My first comment is regarding the awareness of capital cost and reviews of the business portfolio on page 1 and page 2. In fact, I am now based in London and have seen many cases of M&As involving Japanese companies. I often hear the difficulties where Japanese companies manage local companies they purchased. The lack of awareness of capital cost means in turn the lack of recognition of the capital they invest to M&As. The shareholder who provides the capital to the investee company has the right to control. However some Japanese companies fail to control or manage the acquired companies or those managements. While I understand that managers can get annoyed of being told various things about capital costs and awareness of capital, I do believe that it is something that leads to corporate value. Accordingly, I think that this is something that should be clearly stated in the Code from the perspective of strengthening the awareness of capital.

My second point is related to page 3 and page 5 concerning the nomination committee and the remuneration committee. A comment by another member was just made on the definition of independence. When looking at the trends in various countries' code, it is common practice to clarify the composition of committees at the initial stage of governance reform and to encourage

companies to move in that direction. For example, the committee chairman and the majority of members should be independent directors for these nomination committees and remuneration committees. I think that it would be better to state this in the Code because this is also a matter that comply or explain applies for.

Furthermore, I think that it is important to encourage improvement in the Guidelines to promote engagement by enhancing transparency in detail, for example by clarifying who is to propose to the committee CEO candidates. Accordingly, I think it would be better to specifically describe structures related to independence as mentioned earlier in the Code.

I would like to go to page 4 now. This section describes information disclosure specifically, particularly the appointment and dismissal of the CEO. Yet, first I think that it is important to make people recognize once more the high importance of enhancing information disclosure overall. In particular, because it is very difficult to consider who should conduct monitoring on the current conditions regarding the Corporate Governance Code in which the rate of compliance based on self-centered interpretation is high, I think that it is important to enhance disclosure so that this process is visible to a degree. I think that it is necessary to have the intent to make disclosure more specific and make companies conduct disclosure in a manner that clarifies the objectives of the Code. For that reason, I would like to advance discussions with the importance of disclosure through engagement, not necessarily limited to the appointment and dismissal of the CEO, in mind.

In fact, there are currently efforts in the UK to strengthen monitoring through disclosure. I think this is the most essential thing to do. If it is made clear what needs to be disclosed after all, it will be possible to understand what is being required by the Code. Then, investors and shareholders will be able to make judgments if there is information available in response to the Code. Because this would also make it possible for management to make commitments, I think this area should be clarified.

Continuing, something that I am very concerned about is on page 6. I am sorry, but honestly, I did not really understand the contents of 3-6 as I read it. I think that financial knowledge and an understanding of laws and regulation is a form of protective governance, not aggressive governance. As Mr. Toyama previously mentioned, I think this is an extremely important point related to the role of corporate auditors. Actually, what I think should be written here is a more specific clarification of what diversity is. In the case of Japan, what diversity means is gender, specifically

women, as well as internationalism. I think those are the two main points. In particular, gender is extremely difficult, and even in the UK where I am posted now, to some degree not much progress is made unless companies are forced to make a strong commitment. This consists of a process in which diversity is promoted on a government administration level or industry level, a commitment to diversity is first incorporated as a management issue, and diversity is then instilled in the company. It is my understanding that as of late many Japanese companies have had a high awareness of gender, so I would like for these issues to be clearly stated in the Code to further promote this trend. If I were to include it in the Code, I would add it as one of the items under Supplementary Principle 4.11. Furthermore, I propose to delete the item in the Guidelines regarding financial knowledge and an understanding of laws, and instead make a clear statement regarding gender and internationalism.

From my experience as a working woman, there is less role models, for example a working mother who becomes a manager or a woman who achieves a balance between work and family life. There has been much talk of the management pipeline recently in the UK, but if there are no role models available, there will be no expansion in the overall management pipeline leading from staff to management. People at the bottom have no choice but to strive to open things up on their own if there is nobody above. For this reason, I first suggest to include women as independent directors on the board of directors in order to create good role models, and I believe that this would also probably lead to the resolution of issues such as the declining birthrate and labor force issues. If women are included in the board of directors, they will eventually become involved with business execution. It may be a good idea to start off as independent directors. Although it may take a little time, this would be an important first step because senior management may eventually emerge from inside the company.

I apologize, but there are various things I would like to address, so next is cross-shareholdings on page 7. I have been really emphasizing this and am thankful for this being incorporated. In particular, I think it would be better to clarify in the Guidelines the holding purpose and numerical targets including reduction deadline and targets. I think it would be good to clarify to what degree cross-shareholdings will be reduced and when they will be reduced. I think this is a good idea because a commitment will be created in doing so, and cross-shareholdings that are really necessary will lead to increase in corporate value so companies may continue to hold such shares.

For that reason, I would like to stress that companies should first make things visible and they should provide specific explanations on.

Lastly, I would like to look at page 9 concerning asset owners. I think that it would be very desirable for there to be an increase in acceptance by corporate pensions as asset owners in order to revitalize the Stewardship Code from the perspective of the investment chain. On the other hand, while things are not that bad for companies that are large enough to have an investment advisor of their own pension funds, I think the actual burden is quite significant for smaller companies. For this reason, I think consideration is required by society as a whole in order to reduce this burden, perhaps with talks including the Ministry of Health, Labor and Welfare. For example, in terms of the format for the stewardship activities report, there is an increase in the administrative burden when many pensions and asset managers make their own report formats. For this reason, I think that it would be useful if there were a support system, for example, a forum for information provision and discussion with corporate pensions. I think that it would be useful if there was a little social support, for example Japan Investment Advisors Association and different types of pension fund associations, although I am somewhat shy to say this in the presence of the current chairman and former chairman of JIAA. Because the format of proxy voting record prepared by the Japan Investment Advisors Association has actually already used by many asset manages and I think that it would be good to promote the use this format by corporate pensions.

Lastly, I would really like the conflicts of interest between a company and its pension fund to be included in the Code. When I read the guidelines draft now, it states that sponsoring companies shall promote personnel and management efforts. However, to implement the stewardship activity by pension funds, the concept of the Employee Retirement Income Security Act to be adopted here. Without referring to that, there may be a risk of cross-shareholdings being transferred to corporate pensions from the company's asset. Because anything goes if the entity is changed for sponsoring companies and funds, conflicts of interest including the concepts of the Employee Retirement Income Security Act should be clearly described here. In other words, it would be better to write here that company management shall not be involved with stewardship activities by pension fund.

That is all I have to say. Thank you.

[Ikeo, Chairman] Thank you.

OK, you are free to speak Mr. Uchida.

[Uchida, member] Thank you. First, in terms of the revision of the Code, as I stated in the previous council, companies are just now trying to implement effective measures depending on their individual circumstances while pursuing engagement with shareholders and investors in consideration of the current Code. Accordingly, my first opinion is that we should avoid revision to the Code as much as possible by using the guidelines to cover areas such as how to interpret the Code, because if the Code is hastily revised, there are concerns that companies could just respond on the surface level because they are busy with trying to respond to the current Code more effectively.

Moreover, the emphasis when the Code was created was improving med- to long-term corporate value, or to bring back earnings power when put in the language of Abenomics, and recently companies have increasingly adopted portfolio reviews and M&As in their business strategies, and I believe they are in the process of gradually regaining profitability and earnings power. I think that many companies feel uncomfortable with tweaking with the Code without examining these circumstances.

Next, regarding the various points made, it is my understanding that public comments will be accepted regarding the draft of the guidelines and the Code if it is revised, so I would like you to expect the Keidanren will submit the overall opinion consensus in consideration of industry opinions and the opinions of issuing companies. I would now like to state my opinion on points I have noticed today.

First, in regard to “Appointment/Dismissal of CEO and Responsibilities of the Board” (on page 3 of the materials), in Supplementary Principle 4.10.1, it states “seek appropriate involvement and advice from independent directors” regarding the appropriate appointment and dismissal of the CEO, and I think this is the key point. The establishment of a nomination committee is one means of doing this, and I believe that was discussed when the Corporate Governance Code was created. Accordingly, I think that it would actually be better to state appropriate involvement and advice from independent directors in the guidelines. Rather than involvement by the nomination committee, I actually think that this should be mentioned as a point.

In terms of CEO succession planning, I think that confirmation of whether there is appropriate involvement and advice from independent directors as stated in Supplementary Principle 4.10.1 that I just mentioned through engagement could be one guideline.

Looking at the current situation, the percentage of TSE First Section-listed companies that have established statutory or voluntary nomination committees is 31.8% according to some data, and actually only 9% for TSE Second Section-listed companies. In consideration of this situation, if we include a statement like “the involvement of an independent nomination committee” in the Code, in other words if we state that a committee should be established, it is likely that a risk of only a superficial response will arise. Another point is that while 70% of TSE First Section-listed companies are companies with *Kansayaku*, if these companies are told that they should establish a nomination committee in the Code, there are some uncertainties as to how this relates to the Companies Act.

In addition, because the Code started based on the interpretation that the CEO is included in the “senior management” in Supplementary Principle 4.3.1 of the Code, I think the CEO is of course included even if this is not stated explicitly.

Next, in terms of cross-shareholdings on page 7, as I have said many times, there are various purposes for cross-shareholdings that depend on the industry and business, and there are also reasonable holdings such as those related to corporate partnerships or transactions. Accordingly, rather than using a tone that suggests that cross-shareholdings should be reduced uniformly, the focus should be on reducing cross-shareholdings that are not reasonable or that have lost reasons to hold. I think that it is important for the board of directors to examine the reasonableness of holdings, provide explanations through engagement, and dispose of holdings that are held for no reason.

As explained two councils ago related to this point, according to data from securities reports, companies are currently reducing holdings that no longer hold significance in accordance with Principle 1-4, and so I would like this issue to be considered once more in recognition of this circumstance.

Next, on the bottom of page 7, there is a point regarding including assessment of whether or not to hold individual cross-shareholdings into the disclosure of policies towards cross-shareholdings. However, whether or not to hold individual cross-shareholdings is linked with individual businesses in most cases, and in many cases, there would be strategic issues with public disclosure of the details of assessments and examinations for each individual share. Accordingly, because the Code states that the board of directors should examine major cross-shareholdings and provide explanations through engagement, I think that it would be sufficient to ensure that this mechanism

can be faithfully implemented.

Next, I think that all issuers recognize that “major shareholders” in Principle 1.7 of the current Code on page 8 include cross-shareholders. However, I think that it would be difficult in practice for the board to implement Principle 1.7, which said “the board should establish appropriate procedures beforehand in proportion to the importance and characteristics of the transaction. In addition to their use by the board in approving and monitoring such transactions, these procedures should be disclosed”, for all cross-shareholders (including those not included in “major shareholders”). Although there are some cases in which there is a clear understanding of cross-shareholdings such as those for corporate partnerships as mentioned above, conversely, there are also cases in which some shares are held because companies want to have a more timely understanding of the state of business at business partners or they want to have a direct understanding of the state of management at the general meeting of shareholders. In such cases, it is very difficult for the board to approve and monitor all transactions including the latter cases. Accordingly, if Principle 1.7 is applied for transactions with cross-shareholders, I think that it should be limited to those with major cross-shareholders.

Lastly, as to whether corporate pensions that are asset owners should accept the Stewardship Code, as I have said a few times, I think there are a large number of corporate pensions including fund-type and trust-type, and in the many cases the costs of stewardship activities could not be covered due to the scale of the corporate pension or the sponsoring company. In light of this situation, even only monitoring would be considerably difficult, so I don’t think that this is something that should be uniformly applied through incorporation in the Corporate Governance Code without in place a mechanism for practical response such as the preparation of uniform report forms as previously mentioned by Ms. Ueda. I think it is important to develop such frameworks while looking at the situation with the guidelines first.

Thank you.

[Ikeo, Chairman] Thank you.

Next is Mr. Oguchi.

[Oguchi, member] Thank you. I’ll try to make this short because it is a bit off-topic, but just yesterday, I had the opportunity to talk with about 30 people from a major institutional investor in North America. They visited Japan to hear about corporate governance in Japan and enjoyed some

travel in Japan before that, so I was able to experience both inbound tourism and corporate governance, which are currently two of the issues attracting the most attention in Japan. In my discussions with them, when I told them that I was involved in discussions related to financial administrative policies and new economic policy packages that are written as the points of discussion for today, the first specific three things that the investors said that they were interested in were the cost of capital, the use of cash, and the appointment and dismissal of the CEO. They said they would really like these points to be focused on because they are extremely important. These are in a sense the global agendas, and these points are common issues for all institutional investors, so I would like for the related debates to be summarized and written out, although I would not comment on these topics as the various opinions were stated by everyone today.

There are two points that are characteristic of Japan that remain, namely cross-shareholdings and asset owners. Moving forward with the issue of assets owners first, various things have been discussed. Working with the issue is necessary but requires management resources, and I think that a balance is needed here. I feel that measures in response to conflicts of interest as mentioned by Mr. Tanaka and Ms. Ueda are really necessary. I am not sure quite how to say this, but in order to ensure that new forms of cross-holdings do not arise, I think that it is necessary to eliminate conflicts of interest by clearly describing conflicts of interest, not only by calling for an acceleration in involvement by the sponsoring company, but by serving as a break.

While the remaining cross-shareholdings are said to be reduced, various things have been written about these efforts not really going forward and we have reached a bottom in a sense. However, my understanding of the current situations is that we should assume that uniform prohibition is not possible. I am not sure quite how to say this, but regardless of what type of phrasing is used to call for reconsideration, as Mr. Tanaka mentioned earlier, there is a dilemma of companies being able to avoid the situation by just superficially complying based on a set format, and no progress will be made if companies really want to keep cross-shareholdings. In light of this, if one is asked whether further reduction can be expected by some kind of phrasing here, I don’t think there is any one here who really thinks there will be a reduction. Accordingly, I think we have to go a bit deeper here, and if prohibition is difficult, I would like to mention once more the disclosure of the results of the exercise of individual voting rights as was previously mentioned by Mr. Tanaka.

Disclosure of the results of the exercise of individual voting right is something that institutional

investors are already involved with and so it would be possible to regard this as equal footing. Something that has to be considered once more is that whether something is a cross-shareholding or pure investment varies depending on the judgment of management. In light of this, without requesting explanations for reasons why listed companies hold the shares of other listed companies before debating cross-shareholdings, various problems including avoidance as mentioned before will arise, and accordingly I think that a wide net needs to be cast.

In relation to this, Principle 4-5 states that directors, audit & supervisory board members have fiduciary responsibilities and that they "should recognize each of their fiduciary responsibilities towards shareholders and work to ensure appropriate cooperation with stakeholders and the common interests of the company and shareholders", and I think that it will be difficult to move ahead if we don't call for the disclosure of the results of the exercise of individual voting rights in the form of a supplementary principle on accountability that positions the exercise of voting rights as part of fiduciary responsibility with a mechanism that prevents companies making such disclosures first from incurring losses in light of the previous discussions on avoiding a game of old maid.

In relation to the position of the guidance being discussed today that was mentioned in the discussions regarding the Code, because the actual Code is under the comply or explain framework, it would really be acceptable to explain everything rather than comply as Mr. Toyama mentioned earlier. However, there is a tendency in Japan to comply, and I think, under such limitations, there will be a crossroad as to whether to make the guidance a code or guidelines. I feel that the positioning of the guidance is ambiguous as it is ultimately different from a law with binding force. While whether the guidelines are subject to the comply or explain rules was discussed earlier, if guidance is made separately from the Code while it is difficult to draw clear distinctions, I have concerns that what will end up happening will lose their effectiveness and be ignored to some degree because their canonicity is clearly weak compared to the Code.

In addition, as was previously mentioned by Mr. Sampei, it could cause further unnecessary confusion if there is the impression of needless repetition in the guidelines, and accordingly I think that the basic policy of reflection of important matters in the Code would be more simple and clear. However, if this is done, there is the issue of the Code revision not being exhaustive enough and explanation of the Code being needed. The Stewardship Code was also revised, and in this case a

manual for discussions at the review meeting called “Revision of the Stewardship Code” was added in the beginning. In consideration of these factors, I would like to propose inclusion in the Code generally, and summarizing points that cannot really be fully incorporated or that require additional explanation in a manner that is integrated with the Code, because I would like to retain the benefits of this guideline that everyone has put so much effort into discussing up until now.

Thank you.

[Ikeo, Chairman] Thank you.

However, I think that one positioning of the guidelines is the enforcement of the Code.

[Oguchi, member] I think there are various approaches and explanations such as Notes and Background in the current Code, and because they are not in the scope of enforcement now, I think this positioning can be used.

[Ikeo, Chairman] OK, you are free to speak Professor Kawakita.

[Kawakita, member] In terms of the relationship between these guidelines and the Code, Material 2 is very convenient, and it can be seen in contrast with each other. Accordingly, I believe that incorporating the important parts of the engagement guidelines would also eliminate the hassle of comparison with 2 materials. That is my overall impression.

Now, let’s look at Material 2. Various things have been said by various people, so I would like to make a supplementary explanation. The first regards the cost of capital that is described on page 1. As was mentioned by Mr. Toyama regarding the calculation of the cost of capital, because the cost of capital cannot even be calculated if risks are not recognized properly, it is generally insufficient to just write the cost of capital. Because risks are stated in the guidelines, I think that it would be better to include both the cost of capital and risks in the governance code at the same time.

I think a framework is necessary to enable independent directors and corporate auditors, etc. to discuss the cost of capital, including risks. For example, a framework is needed in which internal corporate information on risk is provided to corporate auditors, as was mentioned by Mr. Sampei and Mr. Tanaka, and in which this information can be shared and discussed by independent directors and corporate auditors, etc. I really think this type of framework is required. Because it is not really practical to leave corporate auditors, etc. alone and allow them to freely walk around inside the company, a proper internal support framework should be created. Although the specific support framework that can be created will differ because it is something that will be created by

individual companies, I think that disclosing the framework would make it easier for investors to discuss on this issue.

Next, in relation to this, the skills of corporate auditors are described on page 6. If the words “cost of capital” were added here, it could lead to the selection of people capable of discussing the cost of capital. Because I don’t think the only things expected are merely accounting and legal skills, I would really like the inclusion of cost of capital to be considered.

In addition, although I do not have too much to add because various things have already been discussed regarding cross-shareholdings, what specific results companies are expecting from cross-shareholdings should be considered, as well as what kind of results have been gained in the past. Although it may be difficult to describe the holdings for individual companies, if at the very least disclosure was made on some overall examples, investors would be able to discuss whether cross-shareholdings are appropriate, so this is something I would really like to encourage.

Lastly, I would like to look at page 9 concerning asset owners. I think the problem of costs was mentioned in relation to this issue. However, if proper management is not possible because it costs money, such companies should stop corporate pensions as individual companies. I think that it will be necessary to think of other measures for the welfare of employees. If a company is operating an independent pension plan as an individual company, I think they should really make sure to assign specialists and use consultants if those types of human resources are not available. Although this is something that is not in the current Governance Code, I believe that pensions account for the majority of deemed holdings, and as this is something that relates to the independence of the pension portfolio and conflicts of interest, I would like for there to be disclosures on the appropriate management of the pension portfolio from the perspective of risks and returns in order to demonstrate that the portfolio is being managed fairly and impartially. Responsibility will be incurred if a company declares that they have an appropriate pension portfolio while recklessly including cross-shareholdings as deemed holdings in pensions on the other hand. As a result, I think irresponsible responses could disappear.

Thank you.

[Ikeo, Chairman] Thank you.

There is not much time remaining, so please be brief.

OK, you are free to speak Mr. Iwama.

[Iwama, member] I apologize for always speaking at the end. I feel that basically the discussions regarding the guidelines are heading in a very good direction. However, because I am in the position of an asset owner, I would like to join the discussion from this perspective. Leading types of asset owners include corporate pensions and public pensions, and because asset managers will carefully comply with stewardship if corporate pensions carefully do so, I think the general consensus is that stewardship is not something that does not need to be complied with because it is difficult. Although corporate pensions even in Europe and North America do not move as expected, they does begin to move eventually, and considering this current situation in which so-called stewardship activities are being implemented, I think the expectation of society is for assets owners to appropriately take responsibility on their own and make stronger efforts than those up until now if one considers how to instill stewardship activities in order to improve the level of corporate governance overall.

Of course, there will be many difficulties. If one considers to what extent this will be possible for small companies that have their own pensions, it might come down to abandoning such efforts, using a DC plan, or other various methods. However, rather than abandoning stewardship activities of small companies due to a small scale that makes them impossible, it seems there would be ways of overcoming this if such companies worked together a bit. Although this might not be something that should be addressed in the discussions on these guidelines, one point that I think that we have to consider is making it possible for corporate pensions to work together for the benefit of society as a whole.

Another point, that was briefly mentioned, is the remaining issue of how to handle frameworks for defined contribution pensions when a move is made to defined contribution pensions. There are frameworks properly in place for defined benefit funds. Wen looking at developments in the UK, pension associations are beginning the process of clearly positioning what to do regarding DCs, and I believe that sound social infrastructure makes it possible to advance such pursuits. I believe that we need to understand such efforts as leading to the revitalization of financial capitalism and the continuous growth of corporate value, and I hope that future discussions focus on these matters.

[Ikeo, Chairman] Thank you.

OK, you are free to speak Mr. Kawamura.

[Kawamura, member] I think today we discussed what areas companies should focus more actively

for the purpose of the sustainable improvement of corporate value and the sustainable improvement of the value of the public's assets, and my impression is that making various enhancements to the Corporate Governance Code and encouraging companies to make such improvements is the correct approach. Although I really think that the cost of capital should be properly described, and business portfolios should be properly reviewed, I feel that slightly more drastic measures may be needed to revitalize such efforts in Japan now. That is my impression. For example, although I feel that monetary easing will come to an end in Japan like it has to Europe and North America, I think there will be some rough seas rather than a smooth return. In this process, various zombie businesses will fail. I think that things in Japan will probably get better as these zombie businesses fail. Because large companies also have their own zombie businesses, they will be forced to let go of these zombie businesses when they encounter rough seas. No matter how much companies are told to review portfolios at this stage, it will be difficult for such zombie businesses to be fixed. One of the reasons that it is hard to fix this situation is that Japan is a society with firm vested rights, and it is hard to fix things through governance alone because things are quite set in place, for example rigid major companies, rigid Japan Medical Associations, and rigid Japan Agricultural Cooperatives. For this reason, when finance is in the process of normalization, Japan will probably be subject to rough seas and the advance of companies from China and India that are getting stronger than we think. I really think that managers in Japan will realize that the current situation is unacceptable when they try to counter this advance. Although Mr. Toyama said that managers in Japan don't have enough knowledge and awareness, I think that there are also some people with a degree of awareness. While they do exist, everyone thinks that it is easier to be complacent in a society with rigid vested rights. For this reason, when China really makes an aggressive move, I think things will get a little better naturally as people put forth an effort in resistance that will help withstand the rough seas. For this reason, I think that things will not get better before we face these rough seas. That is my impression. I'm sorry for just talking about my impression.

[Ikeo, Chairman] Thank you.

OK, you are free to speak Mr. Callon.

[Callon, member] Thank you. In terms of whether the Corporate Governance Code should be revised, I am in favor. To keep things short because we do not have much time, we need to decide whether to maintain the status quo or evolve. While recognizing Mr. Uchida's concerns, we need to

continue to publicly affirm the importance of corporate governance and the Code. Three years have passed since the Code was introduced, so I think it makes sense to reflect and incorporate into the Code the changes over the past three years, including the positive governance efforts of Japanese companies. In truth, as one of the authors of the Code three years ago, I struggled with striking an appropriate balance between promoting a governance structure that would be accepted by Japanese companies and working to increase corporate value. While I do not think that a full overhaul of the Code is necessary, I do think that some smaller changes are needed to reflect the current status of implementation of the Code.

As a concrete example, the current Code includes language that calls for the participation of independent directors in dialogue with investors. The specific section is Principle 4-7 (iv), which indicates that independent directors should be "Appropriately representing the views of minority shareholders and other stakeholders in the boardroom from a standpoint independent of the management and controlling shareholders." Engagement between companies and investors has clearly progressed in a positive way, but the focus seems to be on engagement between management and investors. There are extremely few cases of engagement between independent directors and investors. Given that a role of an independent director is providing advice to and monitoring of management, is it possible to fulfill this role without ever meeting with shareholders (to hear their concerns)? In this sense, I think there are opportunities to examine the gaps between the Code and the current reality in terms of the Code's implementation and strengthen the Code. There were many forward-looking proposals today, and I would really like to work with everyone to implement them in a positive way. Thank you very much.

[Ikeo, Chairman] OK, you are free to speak Mr. Oba.

[Oba, member] I will keep it simple because we don't have much time. Although this is difficult for me to say after the wide view of the situation that was provided by Mr. Kawamura, a premise that we should assume is that if we make standards that are too detailed, companies will only answer that they fulfill the standards, which could lead to the original purpose of the guidelines being lost, and this is something that should be avoided. Although Mr. Toyama said that this is something the business world should take seriously, I think it is necessary to understand that this is something that the market warns us of regardless of what Mr. Toyama did or didn't say. What I mean to say is that, for example, the current average PBR for TSE First Section-listed companies is one. You can see

from this number that it would make no difference if managers of these companies conduct management or not. Because we have someone from the TSE here today, I believe they would have more detailed data, but I believe there are about 700 companies with a PBR of under 1. This means that the way one-third of the TSE First Section-listed companies are managed is being severely questioned. Furthermore, there are approximately 100 companies with a PBR of less than 0.5. This is the reality. Presidents resign when there are scandals involving compliance violations. On the hand, management continues managing even if corporate value is not improved. I think a major precondition is to first change this situation.

Accordingly, I think there are three important functions for the Corporate Governance Code in relation to this point. The first is the cost of capital, the second is the appointment and dismissal of the CEO, and the third is cross-shareholdings. Because if specific disclosure regarding these three points does not move forward, it will not be possible to get an understanding of the assessment of directors and they are not covered in engagement, I think that it is extremely important to require specific information disclosure in the guidelines.

That is all for me.

[Ikeo, Chairman] Thank you.

Because we are running out of time, I would like to ask Mr. Takei to keep back his statement for later.

[Mr. Takei] I think the current draft of the guidelines has been done very well. Although such comments have not been come out yet, I think the current one is well-drafted.

[Ikeo, Chairman] Although there are members who have not made a statement yet.

Please speak.

[Sakamoto, Director of the Corporate System Division of the Ministry of Economy, Trade and Industry] I am from the Ministry of Economy, Trade and Industry. I would like to make one comment. I would like to make a proposal on the addition of wording to clarify the purpose related to 2-1 and 2-2 on investment strategy on page 2 of Material 2, in relation to the “effective use of companies’ cash and deposits for investments” as part of the New Economic Policy Package that was decided in December of last year. Although I do believe this intent is included in 2-1 and 2-2 of the guidelines draft, because I think the guidelines will be used very broadly, to ensure there is no confusion regarding the interpretation, I would like to clearly communicate the purpose

of the reform package from the perspective of the effective use of resources by clearly asking “Are levels of highly liquid cash reserves appropriate from the perspective of the appropriate use of shareholders' equity?” Thank you for listening.

[Ikeo, Chairman] Although there are still some members who have not spoken yet, we have run out of time today, so I would like to close the discussion.

The discussions would be continued further based on what has been discussed today, so I hope that we continue discussions on any issues that should be included in the guidelines, despite the burden that it causes on the secretariat.

Lastly, the secretariat has one announcement.

[Tahara, Director of the Corporate Accounting and Disclosure Division, FSA] The schedule for the next time will be decided on based on everyone’s circumstances, so I will provide more information once it has been decided on.

That is all I have to say.

[Ikeo, Chairman] Thank you.

Now I declare the meeting adjourned. Thank you for your participation.

END