(Provisional translation)

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

1. Date and Time: April 10, 2019 (Wednesday) 13:00-15:00
2. Venue: 13F, Central Government Building No. 7, Meeting Room

[Ikeo, Chairman] It's already the scheduled start time. Although I have been informed that some members would be late, I would like to open the nineteenth 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, and coming despite the bad weather.

Today, I would like you to discuss the draft Opinion Statement of the Follow-up Council based on our discussion so far.

We received opinion papers from Mr. Kobayashi and Ms. Waring concerning the draft Opinion Statement and the supplementary material today, so I would like to ask the representative from the secretariat to explain the draft Opinion Statement and the supplementary material, as well as the opinion papers from the members.

Now I'm handing it over to you.

[Inoue, Director of the Corporate Accounting and Disclosure Division, FSA] I would like to first explain Material 1 titled "Recommended Directions for Further Promotion of Corporate Governance Reform", which we distributed to you as the draft Opinion Statement of the Council.

Please take a look at "Introduction". Following the revision of the Stewardship Code in May 2017, the revision of the Corporate Governance Code in June 2018, and the establishment of the "Guidelines for Investor and Company Engagement", steady progress has been made in the disclosure of voting records for each investee company on an individual agenda basis, as well as the appointment of multiple independent directors. That's what is written in the first paragraph.

In the next paragraph, we referred to the fact that since November 2018, the Follow-up Council has reviewed how both institutional investors and companies addressed the two Codes since their

revisions, in order to enhance the effectiveness of the Reform.

As a part of such process, the Council, having exchanged opinions with foreign institutional investors, gained insight into the importance [for the companies] of having a clear corporate philosophy, of taking responsibility for managing their pension funds, of having dialogue with investors from a long-term perspective, and of being accountable for meeting investors' expectations.

In the meantime, the Council members have pointed out some ongoing issues. Those regarding the companies include: although nomination and/or remuneration committees have been established, they do not seem to have sufficiently fulfilled their function because of imbalances in the composition of committee members, nor have led to the appointment of qualified independent directors from the perspective of increasing corporate value; and there are some corporate pension funds that have an excessively high percentage of cross-shareholdings to total assets under management.

Issues regarding the investors include: their dialogues with companies remain formalistic and do not sufficiently contribute to increasing corporate value over the mid- to long-term; some investors, while demanding the enhancement of disclosure by companies, do not actively fulfill accountability of their own; and due to insufficient understanding of the significance of the 'Comply or Explain' approach, some investors are apt to see companies' compliance with the Code in a formalistic way.

Taking into account such discussions, the Follow-up Council further facilitates increased effectiveness of the Governance Reform, and offers recommended directions on issues to be addressed in preparation for the next revision of the Stewardship Code.

In "Section II. Stewardship", we first mentioned that it was important to enhance the quality of dialogue between investors and companies, and then stated that enhanced disclosures by asset managers would contribute to fulfilling asset managers' accountability to asset owners and promoting constructive dialogue with companies based on deeper mutual understanding.

Furthermore, considering the fact that service providers, such as proxy advisors and investment consultants, may significantly influence asset managers' stewardship activities, it is extremely important to work on promoting increased effectiveness in dialogue between such service providers and companies.

From this perspective, it is necessary to further accelerate the consideration of the issues described below. The issue of collective engagement and the significance of the escalation, which have also been pointed out by the Council members, will continue to be discussed further.

Now, let's move on to specific issues. In the section "1. Asset Managers": disclosures of stewardship activities by the asset managers are increasing, and over 100 asset managers, including almost all large institutional investors, have already started disclosing their voting records for each investee company on an individual agenda basis, as well as their stewardship activity reports. On the other hand, the number of asset managers which disclose reasons for voting decisions is still only 20, and there are big differences in the contents of stewardship activity reports from manager to manager. Accordingly, it is pointed out that asset managers should disclose not only their voting records, but also information on their dialogue with companies prior to making voting decisions.

Furthermore, it is pointed out that strengthening the governance of asset managers themselves, including conflict of interest management, continues to be an important issue.

Then, in order to increase the effectiveness of constructive dialogue through fulfilling asset managers' accountability to asset owners and deepening mutual understanding with companies, it is important to encourage asset managers to disclose reasons for their voting decisions, processes and results of their dialogues with companies, and self-evaluation of their implementation of the Code.

When asset managers have dialogues related to the ESG factors, they are expected to ensure that the dialogues lead to the sustainable growth of companies and increased corporate value over the mid- to long-term.

The next section is "2. Asset Owners, including Corporate Pension Funds".

In order to facilitate the functioning of the investment chain, the roles of asset owners, who stand closest to the ultimate beneficiaries, is extremely important in encouraging and monitoring asset managers who have direct dialogues with companies.

From this perspective, in the revision of the Corporate Governance Code in 2018, a new principle has been incorporated that require companies to take measures to support their pension funds in terms of human resources and operations.

However, the number of corporate pension funds which have signed up for the Stewardship Code remains small. It has been pointed out that the underlying reason would be insufficient understanding of the scope or extent of stewardship activities due to little awareness of benefits and

responsibilities of corporate pension funds.

Therefore, it is important to continue to promote initiatives for supporting stewardship activities of corporate pension funds in collaboration with wide-ranging stakeholders, including the business community.

Next, moving on to section “3. Service Providers” – (1) Service Providers.

Although the revision of the Stewardship Code in 2017 clarified the responsibilities of proxy advisors, it has been pointed out that the procedures for developing voting recommendations still lack transparency, and that proxy advisors may not have sufficient human resources and operational structures necessary for making substantive evaluations of each company’s specific circumstances.

Given that proxy advisors are widely used by asset managers while passive management is increasing, it is important that proxy advisors provide asset managers with recommendations based on correct information on individual companies, so that they can exercise their voting rights in a way to contribute to sustainable growth of the companies.

From this perspective, proxy advisors are expected to secure sufficient and appropriate human resources and organizational structures, specifically disclose the entire processes for developing voting recommendations, and proactively have dialogue with companies in addition to making decisions based on disclosed information.

Furthermore, it is important to encourage asset managers to make more detailed disclosures on the use of proxy advisors, including the names of proxy advisors, processes that asset managers take to check the advice from proxy advisors, and specifically how they use proxy advisors’ recommendations, in order to have constructive dialogue based on deeper mutual understanding with companies.

With respect to “(2) Investment Consultants”, according to data, one-third of Japanese corporate pension funds have concluded advisory agreements with investment consultants for the management of pension assets.

It has been pointed out that some investment consultants use influence to induce their clients to purchase their own investment products while providing consulting services, and that some investment consultants do not appropriately evaluate stewardship activities of the asset managers.

It is therefore important to clarify the fact that investment consultants are one of key players in stewardship activities through their support to corporate pension funds, and thereby encourage

investment consultants to be aware of their roles in the investment chain, secure mechanisms to manage conflicts of interest, and disclose relevant initiatives.

That's all for my explanation about the section concerning stewardship. Now please move on to "Part III. Corporate Governance".

It is stated that the Council will continue to review the measures taken by companies based on the Corporate Governance Code, which had been revised in order to address such issues as business management in consideration of cost of capital, cross-shareholdings, and fulfillment of the board's functions, as well as the following issues in a cross-sectoral manner. Two issues have been presented.

The first issue is "Ensuring Confidence in Audits". We have defined that so-called "defensive governance" is an essential precondition for companies to achieve sustainable growth and increasing value over the mid- to long-term. It has been pointed out that, in most companies, the internal audit department is under the sole control and supervision of CEO or the like, and does not fully perform its functions independently in the event of wrongdoing of senior management.

It is also important to promote the development of mechanisms that allow the supervisory bodies, such as *kansayaku* and the board including independent directors, which are independent from the management, to be reported directly.

The second issue is "Group Governance". With respect to corporate group management in Japan, it has been pointed out that the companies do not have in place the optimal allocation of management resources within the group as a whole, including the restructuring of business portfolios, and the sufficient risk management of subsidiaries. It has also been pointed out that listed companies with a controlling shareholder (so-called "listed subsidiaries") have risks of structural conflicts of interest between the controlling shareholder and general shareholders, and therefore, the independence of the board needs to be strengthened.

In discussions on group governance, including the issue of governance of listed subsidiaries, stricter governance of listed subsidiaries is called for, through enhancing the responsibility of parent companies to explain rationales for holding listed subsidiaries, and increasing the ratio of outside directors who are independent from the controlling shareholder, taking into account the review of the TSE's independence criteria.

Based on these discussions, the Council will continue to discuss the future of group governance

from the perspective of protecting general shareholders.

Finally, “IV. Closing Remarks” concludes as follows. In order to further enhance the effectiveness of the Corporate Governance Reform, and amid expectations of enhanced disclosures on cross-shareholdings, etc. in response to the recent revision of the Cabinet Office Ordinance, it is extremely important that asset managers and service providers have dialogue with companies based on deeper understanding of the companies, and that asset owners proactively engage with and monitor asset managers with respect to stewardship activities. In order to realize increased corporate value over the mid- to long-term through constructive dialogue between investors and companies, the Council expects further deepening of discussions, with a view to the next revision of the Stewardship Code scheduled roughly once in every 3 years.

Moreover, as corporate governance is closely linked with the equity market structure, the Follow-up Council needs to watch the progress in the TSE’s review of its equity market structure, and discuss further promotion of the Corporate Governance Reform, taking into account governance appropriate for each segment of the market as its feature become clarified.

That’s all for my explanation on Material 1 - draft Opinion Statement.

Now please move on to Material 2. We have summarized supplementary information on some topics raised during the previous meeting, as well as results of the FSA’s hearing survey of companies.

The first part is related to the topics raised last time. On page 2 are the key points of the exposure draft of UK’s Stewardship Code revision, which had been brought up by Mr. Oba and other members. Please refer to this page as necessary.

Page 3 shows the overview of the U.S. Stewardship Principles, which had been brought up by Mr. Kansaku. Please also refer to the details as necessary.

From page 4 to page 6, we have summarized the current status of disclosures by proxy advisors, which had been brought up by Mr. Matsuyama. Page 4 shows the current disclosure requirements in Japan, the UK, and the US. On pages 5 and 6 are the excerpts of disclosures by proxy advisors which have signed up for Japan’s Stewardship Code. Please take a look as needed.

On page 7, we have summarized the results of the FSA’s hearing survey of companies. I’ll briefly explain the findings.

Since November 2018, the FSA has conducted hearings from CFOs, etc. of more than 10

companies, concerning their situation in cross-shareholdings and stewardship activities of corporate pension funds, and I'll share the summary of the results. With respect to the reduction of cross-shareholdings, some stated that their finance divisions are taking the initiative, but others reported that their operation or sales divisions were reluctant to sell off cross-shareholdings from the perspective of maintaining business relationships with the counterparties, and therefore, the coordination would require time.

Some indicated that some financial institutions were even more reluctant to reduce cross-shareholdings because of their business practices.

Next, with respect to stewardship activities of corporate pension funds, some stated that they had already, or were ready to, sign up for the Stewardship Code. On the other hand, some expressed their concerns that they were not so sure about how to evaluate asset managers after signing up, although signing up for the Code would not impose any significant burden on them; or that corporate pension funds would be required to exercise their voting rights by themselves or directly engage with investee companies once they signed up for the code. As such, there were cases where the sufficient understanding had not been achieved with regards to the stewardship activities required of corporate pension funds.

It has also been pointed out that, in order to promote stewardship activities of corporate pension funds, it is important to obtain understandings from both "management" and "employees" of the company.

Next, I'll briefly introduce Mr. Kobayashi's opinion statement.

Firstly, he points out that there is a world of difference among investors and among companies [in terms of investment policies and companies' ability to dialogue with investors, respectively], and thus we need to fully understand the actual state of such differences, when we consider collective engagement and escalation.

Secondly, he suggests that we should differentiate between listed subsidiaries that have a role as tentative tool for smooth enterprise integration and those not deemed to have such significance.

Thirdly, while gradual advance in the reform has been made, the Japanese market could be targeted by those investors who try to take advantage of the time lag and make money. He suggests that steady progress should be made while "preserving what should be preserved."

Finally, we have received an opinion statement from Ms. Waring as well. She supports the

issuance of this Opinion Statement, and raises some topics to be discussed in preparation for the next revision of the Stewardship Code.

Firstly, she recommends that the FSA should consider applying the concept of stewardship across all asset classes, including not only listed stocks but also corporate bonds, etc.

She also suggests that the FSA should publish guidance on collective engagement or investor collaboration which are not considered 'joint ownership of shares' or 'acting in concert'.

Furthermore, investors should seek to explain to investee companies the reasons underlying their voting decisions, preferably before the shareholders meeting. When investors use proxy advisors, they should confirm that the exercise of voting rights has been made in accordance with their own voting policies.

She also suggests that investors should disclose their stock lending policy. Currently, the Stewardship Code refers to stock lending only in a footnote, but it should be given more importance and incorporated in Guidance.

Next, asset managers should ensure that their internal structures align with their investment policies and stewardship obligations.

Finally, she suggests that the Code should more clearly refer to the importance of integrating ESG factors into stewardship activities, and establishing policies to address systemic risks.

Ms. Waring has also given some suggestions on corporate governance. The board should maintain close communication with the internal audit department, and the internal audit department should directly report to the board and/or the audit committee. Furthermore, she points out that a listed subsidiary is a separate legal entity independent from the parent company and, as such, directors of the listed subsidiary should serve for the interest of the subsidiary. The parent company should develop a comprehensive governance framework applied throughout the group, manage conflicts of interest, and protect the interest of minority shareholders.

That's all from the secretariat.

[Ikeo, Chairman]　Thank you very much.

Now I would like to hear your opinions and questions.

If you would like to speak, please place your nameplate vertically as usual. Anyone would like to speak first?

Dr. Ueda, please go ahead.

[Ueda, member] Thank you. As I have been absent from the meetings, let me speak first.

First of all, thank you very much for preparing the draft Opinion Statement. I have read the minutes of the meetings, in which I was not able to participate, and I believe that the draft incorporates the essence of the discussions recorded in the minutes.

I support the draft Opinion Statement, but let me make some suggestions to details.

I understand this Statement has been prepared primarily with a view to the revision of the Stewardship Code. Here, let me point out "Asset Managers" on page 2. Currently, asset managers are proactively conducting stewardship activities – typically, engagement with companies.

However, the last paragraph in this section conveys the impression as if dialogue on ESG issues were a goal in itself. Although it may be a different story with passive investors, active investors are essentially expected to ensure the alignment between their investment procedures and their dialogue on the ESG issues as a part of stewardship activities. In reality, it seems some asset managers have dialogue on the ESG issues mainly as a kind of gesture to show their emphasis on the ESG to their client asset owners. There are the cases where the engagement is part of operating cost, and not integrated into their investment procedures.

As a result, I hear that some companies, after having dialogue with the investment team (analysts, fund managers, etc.) of an asset manager, are forced to have same discussion with or explanations to the ESG team of the same asset manager all over again. Such doubly dialogues place heavy burdens on companies.

Perhaps, if asset managers were able to properly incorporate their ESG teams' costs into their investment procedures, they would have an opportunity that long-term value is improved. Unfortunately, they have not been able to fully take advantage of the opportunity.

Now that many asset managers put more focus on ESG issues, I would suggest that the next revision of the Code emphasize the integration of ESG factors into investment process.

One more thing about the term "ESG". Reading the past meeting minutes of the Council, I noticed that considerable discussion had been devoted to whether the primary emphasis should be placed on Environment or Social factors. It varies from investor to investor, as well as from company to company. The term "ESG" just refers to factors as illustrative examples. The term is widely used probably because it is instantly appealing and memorable. Rather, I suggest that the Opinion Statement use such expression as "dialogue from the sustainable perspective, including the

ESG factors” in order to emphasize that we are referring to dialogue on sustainability. When we just state “dialogue on ESG issues”, it tends to focus only on environmental, social and governance issues, for example. Therefore, I would recommend changing the expression here to “…including the ESG factors” instead of specifying “dialogue on the ESG issues”.

That’s all for now. Thank you very much.

[Ikeo, Chairman] Thank you very much.

Mr. Toyama, please go ahead.

[Toyama, member] Thank you. I had been absent, too, so today I’m glad to have this opportunity to express my views.

I also support the overall direction of the draft, in general. As for specifics, this Opinion Statement highlights the issue of the exercise of voting rights. Ultimately, at annual general shareholders meetings (AGMs), the most important agenda for voting would be the election of directors. I don’t mean other agendas are not important, but in terms of governance, other agendas do not matter so much. The election of directors is critical in two aspects.

One is the election of the top management [CEO/President]. At AGMs, shareholders elect directors, knowing which director candidate will likely assume the position of the top management once elected as a director. It is about whether shareholders vote for or against the candidate for the top management; there is a certain company with ongoing trouble, as you may know. Another is the election of independent directors.

With respect to the two aspects, to what extent does the capital market perform its expected function? This is the most critical of the dual issues: stewardship and corporate governance. We should focus on ensuring that the capital market plays its full part, regardless of whether it is included in the Opinion Statement or not. In other words, this is the very point which should not be addressed in a formalistic manner; it should be addressed in a substantive manner.

In this connection, if proxy advisors’ voting recommendations concerning the elections of directors are made in a formalistic way, that will give rise to risks. The biggest problem now is the shortage of qualified candidates for outside directors. This is a real issue.

However, as I mentioned before, if director candidates are elected merely based on the independence criteria, you can just bring someone walking in the neighborhood as a candidate for outside director. Yet, in practice, there are this kind of formalistic voting recommendations.

If that is the way proxy advisors develop their voting recommendations, they should not make recommendations at all. For instance, a proxy advisor reported that they had engagement meetings with approximately 100 companies a year. Then, leave it at 100, I would say. It may sound a little extreme, but proxy advisors should not provide advice on a company with which they have not engaged. That will make proxy advisors' job easier, too. If pressure or discipline is imposed on proxy advisors this way, they would gain more trust, and the quality of their voting recommendations would likely be overwhelmingly improved.

Conversely, say if a candidate had a background in the main financing bank of the company, or whatever, for example. Who's good is good, anyway. Frankly speaking, such an attribute does not matter. I say this because few members in this Committee, including Mr. Tanaka, seem to be lenient at the board meeting simply because they have a background in the main financing bank. The trend has been significantly changing these days.

They [proxy advisors] should make judgements based on personality and competence of candidates. We have been discussing the reform in order to move its focus from Form to Substance, so I believe it is important to enhance the substance in this area as well. This is my first point. I would very much like to have this point clearly focused in the Opinion Statement.

My next point is about corporate governance – Section "2. Group Governance". This is a half-question, half-statement. As implied in Mr. Kobayashi's opinion statement as well, a part of the business community is unreasonably against moving toward stricter group governance with respect to the relationship between parent company and subsidiary, so the discussion tends to focus on the future of the formality of parent company and subsidiary. I would say such a discussion is missing the point: you are hitting a ball into the rough, if not out of bounds.

The essence of this issue is the fiduciary duty of dominant shareholders. The issue is about this doctrine. Because you do not look straight at the nature of the issue, you try to apply various formalistic frameworks. Then it leads to discussion like what is written in the second bullet point of Mr. Kobayashi's

And then you tend to get into formalistic details, asking specifically whether regulations would apply under various conditions. If we talk about the substance, we should take the high road, and return to the discussion on the fiduciary duty of dominant shareholders as in the US and Germany. If we cannot make this point in this Opinion Statement, I request that we should refer to

this point in the next Opinion Statement for sure. We must do it. I'll keep requesting it, until it's done.

The oppositions are classified roughly into two groups. One is the group of people, who refer to possible abuse of the right of petition. Is there fact of such abuse in the U.S. and Germany? If so, please show me the legislative facts. I've never heard of abuse of the right of petition [by minority shareholders].

Another group consists of legal experts, who mention the lack of enforceability. That is a pointless argument. The Companies Act includes many provisions which are not enforceable. As you know, Article 1 of the Civil Code is not enforceable in the first place. How can you enforce the provision of Article 1?

It is stipulated that private rights must be exercised in conformity to the public welfare. The very first article of the Civil Code is unenforceable, so I cannot at all understand the assertions of the legal experts nor some people in the business community. As I assume the position of Lead Vice Chairman of the Japan Association of Corporate Executives (*Doyukai*), one of influential figures in the business community, I'll keep on making this point. We need to go back to the basics.

My concern is that, if you try to address this issue without looking straight at the true nature [fiduciary duty of dominant shareholders], you will end up introducing various formalistic regulations. Things would be more complicated.

Another point. As Mr. Kobayashi pointed out, among activists who engage with companies, there are good activists and malicious activists. Malicious ones purchase a large number of shares in a company in a short period of time, and carry out "greenmailing" to the company's management.

In the US, the threshold of dominant shareholders is probably around 10%. Therefore, it is impossible that those who have a more than 10%-stake buy up the company's shares. Good activists purchase a 5% or 6%-stake at best, and pursue common interests of shareholders from the standpoint of a minority shareholder. This is their style.

However, in Japan, there are many cases where activists have already purchased a 20% to 30%-stake, although I won't name the companies. Frankly speaking, among the capital markets in developed economies, Japan is the only country which allows such acts.

In other words, because Japan does not have the legal rules on it, Japan is exposed to a higher

risk of attracting such malicious activists. In fact, there have been such cases in the past. Therefore, from this perspective, I strongly believe that we can never avoid the discussion on fiduciary duty, so I would like to suggest that we discuss the matter in the next meetings.

[Ikeo, Chairman]　Thank you very much.

Mr. Tsukuda, please go ahead.

[Tsukuda, member]　Thank you.

I also think this draft Opinion Statement is well-written. Especially, I would like to thank you for incorporating the issue of group governance, on which I made comments last time.

Let me make just one remark. With respect to “Ensuring Confidence in Audits” on page 4, there have been media reports on several corporate bankruptcies due to failures in “defensive governance” rather than growth-oriented governance.

I agree that it is important to ensure confidence in audits as stated in section 1. However, taking into account what has been happening, I don’t think the measures specified in the Statement are sufficient. Specifically, even if the internal audit department fully performs its functions, and reports directly to supervisory bodies that are independent from the management, such measures do not cover everything, I’m afraid.

In addition to the recently-reported cases, for example, if the leadership of a company gets out of control, it is necessary that all stakeholders involved in corporate governance, including its auditing firm and law firm serving as a third-party committee, remain in righteousness, without surmising or speculating about the current leadership.

On page 3, in the section on service providers in connection with the Stewardship Code, proxy advisors and investment consultants are named. However, in addition to them, audit firms and law firms are also important. Furthermore, the nomination committee is extremely important.

Mr. Toyama also mentioned earlier that the appointment of independent directors is extremely important. Including that, I consider it is necessary to raise the overall level toward the next stage.

That’s all.

[Ikeo, Chairman]　Thank you very much.

I would like to hear more opinions and questions. Would someone like to speak?

Mr. Matsuyama, please go ahead.

[Matsuyama, member]　I would like to briefly make 3 points.

First of all, with respect to proxy advisors, I appreciate that my suggestions at the previous meeting have been incorporated in the Opinion Statement, including the importance of their dialogue with companies.

Taking this Opinion Statement into account, I expect that constructive dialogue would be further encouraged; discussion toward the revision of the Code would be facilitated; and the follow-up of the Codes would be carried out by concerned parties, including foreign institutional investors operating in Japan.

Secondly, in the middle of page 1, ongoing challenges are listed up, including 2 issues facing companies. The second bullet point reads "There are cases cross-shareholdings in corporate pension accounts being excessively high." I assume it refers to retirement benefit trusts.

What is written here is certainly an issue facing companies, so I don't see any problem with this description. However, as you know, retirement benefit trusts were introduced approximately 20 years ago when the accounting for pensions was introduced in Japan, as a means for the one-time amortization of huge underfunded pension liabilities at initial application. Therefore, retirement benefit trusts are systematically constrained by corporate accounting standards (ASBJ Statement and Guidance) as well as trust contracts at the time of establishment.

Accordingly, when considering how companies should address the issue [of cross-shareholdings], we are going to face a huge challenge. Without reforming the trust system, it would be very difficult to change the current situations.

My third point is about auditing stated on page 4. It is about the description in the last paragraph in the section "Ensuring Confidence in Audits" – the second line from the bottom.

It reads, "such supervisory bodies as the board and *kansayaku*, which are independent from management". The board is certainly a supervisory body, but whether *kansayaku* is a supervisory body would be controversial. So I would like to hear experts' opinions concerning this point.

That's all.

[Ikeo, Chairman] Thank you very much.

Professor Kanda, please.

[Kanda, member] Thank you. I would like to make a few comments on the papers.

First, although the message is good, I'm not comfortable with the expression "promoting effective engagement between service providers and companies". The text itself may be OK.

However, in this Opinion Statement, the term “service providers” specifically refers to proxy advisors and investment consultants, as shown on the next page. I think service providers’ dialogue with companies is different from that of asset managers in terms of incentive structures.

Of course, nothing is wrong with proxy advisors’ engagement with companies, and effective dialogue will be appreciated, as someone mentioned earlier. However, the way they engage with companies is different. Therefore, proxy advisors’ engagement and asset managers’ engagement should be distinguished, although I cannot suggest any appropriate expressions.

Another point. I wonder whether investment consultants are in position to have dialogue with companies. It is good to apply the Stewardship Code to service providers in general. However, as shown in the table of other countries’ status in the reference material, I would suggest using a different expression rather than “engagement between service providers and companies” when considering the future revisions. This is my first point.

My second point is concerning the ESG factors. In the last paragraph of the asset managers’ section on page 2, there are 3 lines referring to the ESG factors. Although the text itself is not wrong, I would like to point out 2 things.

The first one is the fact that the subject of the sentence is “asset managers”. It gives an impression that only asset managers have dialogue on the ESG factors, but considering the tone of the entire Statement, actors that have such dialogues are not limited to asset managers. So I think it would be better to write this message somewhere else in the Opinion Statement. I am, however, aware that, in reality, it is the asset managers that have such dialogue more frequently than anybody else at the moment.

The second one may be related to another member’s comment. It reads, “…expected to promote dialogue that leads to mid- to long-term increase of corporate value.” Nothing is wrong with the message itself, but it can be interpreted that if it does not lead to an increase in corporate value over the mid- to long-term, they should not have dialogue on the ESG factors.

We have discussed this issue over and over again. The basic concept is the growth of companies. For example, what is the point of discussing the ESG factors with companies whose PBR is under 1? To put it simply, companies with ROE of 15% or more are encouraged to work on the ESG issues; but if companies with lower ROE do not achieve the growth under the excuse of their efforts in the ESG issues, is that acceptable? I remember similar points have been raised many times at this

Council. The intent of the sentence here is not wrong, but the expression concerning the relationship between the ESG factors and an increase in corporate value should be changed. This is my second point.

My third point is about auditing on page 4. I'm sorry to make a fuss over details, but I think the title of this section does not match with the statement. While the title is "Ensuring Confidence in Audits" as addressed earlier, the first sentence starts from referring to "defensive governance", and I believe the concept of "defensive governance" is broader [than that of "audit"].

Therefore, for example, when stating "in the event of wrongdoing of senior management" as written in the last sentence of the first paragraph, are we talking about the prevention of such an event or the response to the event? I think "defensive governance" covers both.

The internal audit department mainly conducts accounting audits. Anyway, it has a preventive function, so is no doubt an important part of defensive governance, but does not cover the whole thing. Which one are you trying to describe in this section?

It would be better to discuss "defensive governance" in this section, and state that auditing is also important as an integral part. I believe this is the intent of this section, so the description should be aligned to the intent.

Lastly, as my fourth point, I would like to make a remark concerning what Mr. Toyama mentioned earlier, in the capacity of a legal expert. Certainly, with respect to whether there is legislation defining that a controlling shareholder owe certain obligations under private laws, or fiduciary duty as he said, under the Japanese legal system, the Companies Act does not have such explicit provisions.

However, in terms of legal precedent, although it is not really about controlling shareholder, there is a case of MBO transaction, court decision has been given that directors of a listed company have certain obligations to minority shareholders, for example.

As a legislative approach, some have been strongly asserting for many years that the Companies Act should include a provision to lay controlling shareholders under duty of loyalty to general shareholders.

Perhaps, Mr. Toyama means that incorporating such duty in a law is a matter of course under the legislative approach, and the interpretation approach should work as well. Some in the academic circles also have such opinion under the interpretation approach.

This issue was extensively discussed in 2014 when the Companies Act was revised, but it was concluded that the Act does not include such a provision.

The issue was discussed at the Companies Act Task Force under the Legislative Council of the Ministry of Justice, and the discussion was controversial. The minutes are disclosed to the public, so please visit the website of the Ministry of Justice, if necessary. Today, we have Counselor in charge of the Companies Act here, so you might want to ask questions directly, as necessary. Anyway, that's the current situation.

Therefore, as far as the Companies Act is concerned, the legislative approach – the revision of the Companies Act in a way to incorporate explicit provision as Mr. Toyama mentioned – would be a future agenda. And it is also worth discussing what interpretation is possible under the framework of the current legal system without such provision. I just wanted to share the current situation with you.

That's all.

[Ikeo, Chairman] Professor Kanda, what do you think about the expression "supervisory bodies" including *kansayaku*, which Mr. Matsuyama pointed out earlier?

[Kanda, member] Although I do not really want to discuss the matter in strict accordance with legal terminology, speaking from the viewpoint of the legal system, the concept of supervision and the concept of auditing are different under the Companies Act. Therefore, such wording as "*kansayaku* supervises something" is not correct in legal phraseology.

However, if you use the expression as a general term, I think there is no problem.

[Ikeo, Chairman] Originally, the term "the audit committee" was used. However, the term "audit committee" would not be applicable to Companies with *Kansayaku* Board. So it was sort of an expedient expression, I think. Thank you very much for your explanation.

Mr. Oguchi, please go ahead.

[Oguchi, member] Thank you.

Thank you for preparing this draft Opinion Statement mainly by summarizing our discussions relevant to the next revision of the Stewardship Code. I generally support the draft. On that premise, I'd like to briefly make three comments: two of them are about "Asset Managers", and one is concerning "Ensuring Confidence in Audits".

With respect to asset managers, the draft refers to the enhancement of disclosure. I believe it is

necessary to push the entire investment chain towards further revitalization in a manner consistent with the Corporate Governance Code, which is the inseparable counterpart as the two wheels of a cart. However, the use of the term “enhancement of information disclosure” could bring asset managers’ attention to merely expanding the quantity of non-quality information for form’s sake, and companies likewise. Dr. Ueda has expressed concern about the dialogue on ESG issues becoming a goal in itself. Similarly, I’m afraid such description could result in an increase in sort of self-satisfying information disclosure, which is rather useless for users.

So as always, the third bullet point in the “Introduction” comes in - dialogue with companies remains formalistic and does not sufficiently contribute to the enhancement of mid- to long-term corporate value. I think we are going to hear this remark over and over again.

I fear that the concern might increase, rather than being resolved, if we keep on naively calling for “the enhancement of disclosure”. It could encourage formalistic dialogue.

Then, what should be done? If dialogue with companies is expected to eventually enhance corporate value over the mid- to long-term, I think the statement should be written in a more result-oriented manner. For example, in the second paragraph of the “Asset Managers” section, it states “…encourage asset managers to disclose detailed information.” During the last meeting, in the explanation of the revision of the UK’s Stewardship Code, we talked about “outcome”. The revised UK’s Code requires “Annual Activities and Outcomes Report”. While activities themselves are important, what are the outcomes from the activities? By raising awareness of outcomes – objective results, I believe we can encourage stewardship activities which contribute to enhancing mid- to long-term corporate value. Therefore, I think it would be better to change this part to a more result-oriented statement, which would lead to positive discussion in the future. This is my first point.

My second point is about the ESG factors. Other members have already expressed various views. I understand that interpretations vary depending on standpoint, and Mr. Kanda referred to the influence of corporate performance. With respect to asset managers, looking at the matter from the perspective of fiduciary responsibility is unavoidable.

There should be no objection to its importance from asset managers. In the reference material for the last meeting, interpretations in the US and the UK were introduced. The US Department of Labor issued the guidance, stating that fiduciaries must not too readily treat ESG factors as

economically relevant, and should put first the economic interests of the plan in providing retirement benefits.

In the UK, the revised rules for occupational pension schemes require the schemes to consider financially material ESG factors in their investment processes. This may lead to the ESG integration, which Dr. Ueda has mentioned earlier. I think the release of such an interpretation has significant meaning to asset managers.

Certainly, there are many interpretations of ESG factors from various viewpoints. Seeking to understand from the standpoint of asset managers, I think expressions here are convincing.

Finally, with respect to auditing, other members have expressed their opinions from the perspective of "defensive governance" and Mr. Kanda has given comments on the wording.

Aside from whether it is appropriate to lump a variety of matters together as "defensive governance", I'd like to remind you that we discussed measures for preventing corporate scandals or responding to scandals ex-post facto at the 16th meeting when this Council resumed. It was there suggested that the internal audit department, which is the third line of defense independent from operational and administrative divisions, should report directly to the supervisory body independent from the management.

At that time, I suggested that we should discuss that idea further. Although there may be various ideas about the wording itself, I agree with focusing on and strengthening the third line, and believe it is of significance to write about that in the Opinion Statement. That's my last remark. Thank you.

[Ikeo, Chairman] Ms. Takayama, please.

[Takayama, member] First of all, I agree with the content of the Opinion Statement. On that premise, I would like to make one remark.

It is about the ESG, which some members have just discussed. In the draft Opinion Statement, it reads, "When asset managers have dialogue related to the ESG factors…" The intention of the statement itself is convincing, but I think that the topic comes up a little too sudden, and that it would be better to include the background and context.

There is a consensus among global investors that the ESG factors are closely related to mid- to long-term corporate value. When Mr. Fink, CEO of BlackRock participated in this Council in February, he also referred to ESG. In BlackRock's letter to companies, which was presented to the Council as a reference material, it is stated, "environmental, social, and governance issues will be

increasingly material to corporate valuations."

Furthermore, in the similar context, Kerrie [Ms. Waring] refers to the importance of integrating ESG factors into stewardship activities, in her opinion statement.

With respect to our discussion [on ESG factors] at this Council, my perception is a little different from Professor Kanda's. I don't think we have discussed that high-performing companies were allowed to consider the ESG factors, and other companies should not. Instead, our discussion has been based on the perception that the ESG factors are related to mid- to long-term corporate value, regardless of the current financial performance.

Therefore, I believe it would better to add some more explanations to this part to clarify the background: for example, "Taking into account that environmental, social and governance (ESG) issues – or sustainability issues including ESG factors – are closely related to corporate value or corporate valuation, asset managers should…"

That's all.

[Ikeo, Chairman] Thank you very much.

Mr. Sampei, please go ahead.

[Sampei, member] Thank you.

First, I would like to make a comment on the first paragraph in the stewardship section on page 2 – the sentence which refers to further enhancement of disclosure by asset managers. I have a question about that. For instance, as for "asset managers' accountability to asset owners", asset managers provide detailed explanations directly to asset owners. "Detailed" may not be the right term. The number of questions during dialogue has been increasing year after year. I sometimes wonder what's the point of asking such questions. In other cases, they ask additional questions, but they don't seem to have fully absorbed information even at the final evaluation stage. This is a little problematic.

For instance, with respect to asset managers' engagement with companies, I'm wondering whether asset managers are supposed to make public disclosure to the same extent as they disclose to asset owners on an individual basis. In reality, there are many cases where companies are uncomfortable, because of losing face, with the public disclosure of what they discussed during the dialogue. That's what I've heard from some corporate executives.

Then, does the enhancement of disclosure really lead to deeper mutual understanding with

companies? Not necessarily, to say the least. They do not want asset managers to disclose too much. Therefore, I think expression here would require a bit more careful polish, to ensure 'constructive' dialogue with a positive outcome.

With respect to information disclosure, the disclosing party, whether a company or an asset manager, should do it with responsibility. This is an important thing. It should not be considered from the viewpoint of third parties, who just want to satisfy their curiosity. I have made the same point during the discussion on disclosure by companies. The important point about disclosure is the same for both companies and asset managers.

In the next paragraph, there is a reference to "promoting increased effectiveness in dialogue between service providers and companies". As Mr. Kanda has also mentioned, proxy advisors or ESG rating agencies offer their evaluations on companies or voting recommendations as their final products. In order to do so, I believe it is necessary for them to have appropriate dialogue with the companies.

Therefore, I think the context itself is all right. But what about investment consultants? They may be closely related service providers, but do they share the same standpoint? I think investment consultants are different from proxy advisors and ESG rating agencies.

With respect to collective engagement in the next paragraph, we need to clarify why investors undertake collective engagement – what they expect of collective engagement. A possible case would be like this: because their individual engagement did not generate a desired effect, they decide to work with other investors to produce better results. Another possible case would be that, due to lack of sufficient skills and knowhow individually, they want to work with other investors.

In case of the latter, if investors do not have sufficient skills and knowhow on an individual basis, I wonder whether a group of such investors in a bundle can produce the desired effect.

In case of the former, they decide to work again with other investors, as a result of unsuccessful individual engagement. Did they reflect on why their agenda or intention was not properly understood by the company during the individual engagement? And did they decide to undertake collective engagement based on the reflection? Or do they just want to raise their voice and express the same logic?

Raising their voice implies their intention to force companies to do what they want. So, may I bring up a question: constructive dialogue is supposed to raise the awareness of the companies,

isn't it? Therefore, we should clarify when engagement needs to be escalated. Otherwise, merely ensuring that such collective engagement is not regarded as "acting in concert" is different from what we expect.

Actually, after the last revision of the Stewardship Code, the Forum of Investors Japan had discussion on collective engagement. Expected effects of collective engagement include forming a consensus among investors, and having a bigger voice.

However, the problem is the difficulty in administrating the group. Someone needs to lead the dialogue. Who assumes the leadership role?

We use the term "mid- to long-term" quite often. Dialogue is not a one-time thing. Investors and companies have a series of dialogues, while obtaining better understanding of each other. In some cases, it takes quite a long time. The "group" may include some members who cannot afford to stay engaged for so long. Some may sell their shares in the middle of the collective engagement, others may aggressively try to reach a conclusion, as they cannot afford much time. It seems the participants share the same agenda when a "group" is being formed; but the "group" becomes less useful over time.

Therefore, at the Forum of Investors Japan, we have discussed specifically how collective engagement should be done, and identified some key points. I would like to see the Opinion Statement, taking such matters into account. In the UK, investors may resort to escalation on the basis of a wealth of empirical value that has been accumulated overtime. I think we are yet to reach the same level.

My third point is concerning the "Asset Managers" section. It is written that "it has been pointed out that strengthening the corporate governance of asset managers, including conflict of interest management, continues to be an important issue." This sentence is referred to as an ongoing issue for investors, specifically the third bullet point concerning investors on page 1: these two can be treated as two sides of the same coin.

In response to the requirement for managing conflicts of interest, asset managers, especially those which belong to full service financial institutions, strive to show how well they manage conflicts of interest, and demonstrate that, as asset managers, they exercise their voting rights independently from the parent company's businesses. For that purpose, they establish fairly strict voting standards. As a result, they apt to strictly apply the same logic to everything. Say they have

dialogue with a company. They find through the dialogue that although the standards are not met formalistically, there seem no problem in reality. For instance, as Mr. Toyama mentioned earlier, suppose an outside director of a company has a background in a main financing bank. That person does not satisfy the formal standards, but through dialogue, asset managers may find he/she is an excellent director. Nonetheless, they conclude that he/she is not qualified for an independent director according to the standards. I think this is an example of the formalistic approach mentioned on page 1.

Against the background of such "formalistic" approach, strengthening corporate governance concerning conflicts of interest is closely related. I think we need to take this into account. The issue on page 1 would not be solved just by shouting about "strengthening" corporate governance.

Next, in the "Group Governance" section on the last page, there is reference to the issue of controlling shareholders. During the last meeting, I suggested that it was the issue of dominant shareholders, not only controlling shareholders.

What is important here is not only adopting the formal definition of controlling shareholder, but also looking at the mentality or intention to "dominate" the company. I believe it is essential to raise a broader awareness of situations that require such consideration.

For example, if a parent company has a 50.1% stake in its subsidiary and controls the subsidiary, it is very efficient for the parent company. Even though it does not have a 100% stake, the parent company has control over the subsidiary.

Seeing from another perspective, it is at the expense of someone else that allow the parent company to cheaply and efficiently control the subsidiary. Whose expense? The minority shareholders of the subsidiary. If the subsidiary looks to the best interest of its minority shareholders, not the parent company, then the parent company would find that benefits of holding the subsidiary are significantly decreased. Therefore, it is very difficult to take a balance in the parent-subsidiary relationship. I say it is difficult, not saying it is formally unacceptable.

I'll give you one evidence. On March 19, Credit Suisse issued a report on its survey of all listed companies (except those in the financial industry) with market cap exceeding 10 billion yen. According to the survey, in the case of companies that have no shareholder (companies) which have a 1% stake or more, their average return on investment (on a cash basis) is 6%, and the cost of capital is 5%. On the other hand, in the case of companies with a parent company which holds 50%

or more of voting rights, their average return on investment is 4%, which is significantly below the cost of capital.

I’m saying this is the problem. This is the situation where parent companies sacrifice minority shareholders of the subsidiaries. Incidentally, among such parent companies, average return on investment is 3%. In fact, such parent companies are not really enjoying benefits. It is a very inefficient situation. We need to look at such situation surrounding not only controlling shareholders, but also dominant shareholders.

My fifth point is about the “Closing Remarks” – the sentence stating that asset owners encourage [and monitor] asset managers [with respect to their stewardship activities]. I feel this sentence is very Japanese.

I’ll tell you the reason. Even though people often refer to “the investment chain”, they are looking at the value chain within the investment chain.

You say asset owners encourage asset managers [to conduct stewardship activities]. You say they monitor asset managers. That is as if there is a hierarchical relationship between the two; asset owners preceding asset managers. This is true [in Japan] for business companies as well; hierarchical relationships go unchallenged, where suppliers are expected to do anything customers say. This is one of the reasons for extremely thin profit margins.

In other countries, when you say “value chain”, a player asks the next player in the chain to do something which the former is not capable of, and thus the value of product as well as the value of the former player itself are enhanced by the expert. In other words, the value of the entire chain is enhanced. I appreciate it if such perspective would be taken into the statement.

Finally, in the Closing Remark, it reads, “revision [of the Stewardship Code], which is scheduled to occur about once every 3 years.” This is not new, but the UK’s Stewardship Code, for instance, was established in 2010, and revised in 2012. Although the UK’s Code has been periodically reviewed, revisions have not been made for a long time after the revision in 2012. It will be revised this year – in 2019. So, it is ok to review the Code every 3 years, but do we need to revise every time? That’s my point.

Sir Winston Churchill once said, “To improve is to change; to be perfect is to change often.” In other words, if you pursue perfection, you will need to change it frequently, and it will not be perfect forever.

So, the Code is widely accepted, each player does what it has to do, reflect on what it did, start new initiatives, and get experienced. That will require some time. Therefore, the review of the Code should be done in an appropriate frequency while ensuring necessary corrections are made before it is too late, and change what is necessary to be changed.

That's all.

[Ikeo, Chairman] Thank you very much.

Mr. Tanaka, please go ahead.

[Tanaka, member] Since the beginning of this year, I have been elected as director for two companies at general shareholders' meetings. On these occasions, I asked questions about specifically how shareholders made voting decisions. As for the voting results, I was supported by the majority of the shareholders. However, I have been informed that some of them were kind of forced to checked off a box next to my name on the basis of the formal checklist prepared by their advisors, just for the sake of the fact that I had a background in a financial institution. This should be the case that Mr. Toyama and Mr. Sampei mentioned earlier, I suppose. My case would be an example, which highlights the necessity for looking at what the person actually is, instead of just relying on formal procedure.

So now I am on the board of stock issuers. Looking at the statement from the standpoint, I wonder specifically how it could be implemented. We have already started internal discussion, but I would like to consult with you about a few matters.

Specifically, the section "Ensuring Confidence in Audits" consists of only 7 lines. In the reference material for the last meeting, as shown on the screen earlier, there was reference to three lines of defense: operational management functions as the first line, risk management and compliance functions as the second line, and the internal audit department as the third line. Each line must independently and effectively fulfill its functions.

This is common approach in the US and Europe, and very effective. However, I'm wondering specifically how this approach can be applied to Companies with *Kansayaku* Board. In Japan, an overwhelming majority of companies, including my company, adopted the organization form of "Company with *Kansayaku* Board".

In the case of Companies with *Kansayaku* Board, I wonder if this approach works. Because the primary role of *kansayaku* is, in general, to audit compliance with laws, this question is raised in

our practical discussion: can we adopt three lines of defense in the first place?

Another point. Certainly, what is written here sounds nice, but we need to consider it in connection with the next section "Group Governance". All large Japanese companies have expanded their businesses globally.

Our company has roughly 20,000 employees, and 85% of them are foreign nationals. For ensuring governance of such corporate group, we face practical issues concerning internal audits. How much can we spend for internal audits? How many people are required for audits, and in what way does the group conduct auditing?

While there are such various issues, this section describes audits in just 7 lines. I'm wondering whether we can offer any suggestions. Let me further discuss this point. What is written here is the tripartite auditing system. In the meantime, there are currently 3 forms of governance: Company with *Kansayaku* Board, Company with Supervisory Committee, and Company with Three Committees (Nomination, Audit and Remuneration). I think the nature of audits or auditing methods may differ depending on the governance forms.

Nevertheless, the Statement describes the auditing for all forms of companies in a single way. Is it feasible in practice? Even if we publish this Opinion Statement, a simple generalization by using the term "audits" could make it quite difficult for the readers to facilitate effective incorporation into practice.

I would rather want to have inputs from Chairman Ikeo or Professor Kanda on this point. I think these 7 lines should be edited in a way to provide different explanations for these 3 forms of organization. Could we somehow provide such explanations so that it would become easier for the readers to apply it in practice? This is my first point.

Another point is about the ESG issues. Certainly, I think the ESG issues are very important, but as I have mentioned during the last meeting, working on the ESG issues incurs costs. Accordingly, it usually decreases financial returns to a certain degree.

While we always talk about sustainable growth of corporate value as a goal, as I have mentioned during the last meeting, how can we measure the sustainable growth of corporate value? We must return to this issue.

How can we measure or calculate sustainable growth of corporate value, including the ESG factors? And there should be non-financial aspects, in addition to financial aspects. Unless we find

answers to this question, it will be very difficult to explain what is expected.

I don’t think corporate value merely refers to market cap. Nonetheless, how corporate value should be defined and measured will remain an unanswered question.

That’s all.

[Ikeo, Chairman] Thank you very much.

Mr. Oba, please go ahead.

[Oba, member] I’d like to make one remark.

Mr. Tanaka just referred to the growth of corporate value. It is very difficult to define it. Yet may I remind you that the initial objective of the Follow-up Council is to achieve a sustainable growth in corporate value.

We need to reconfirm this point. Considering that the Follow-up Council is expected to serve to deepen reform, moving its focus from Form to Substance, I believe it is necessary to enhance disclosure from 3 aspects.

The first aspect is the companies. Companies need to disclose specifically what their boards have discussed for enhancing corporate value, and how the boards evaluate such discussions. These are not yet sufficiently done. Some companies have made steady progress, so it may not be appropriate to generalize, but I think it is necessary to enhance disclosure on this matter. Therefore, I suggest that such reference should be made in ongoing issues for companies on page 1.

The second one is the investors. They also need to disclose specifically what stewardship activities they have conducted, and how they evaluate their activities.

The draft says “fulfilling their own accountability”, which would imply what I have just mentioned, but it is necessary to enhance disclosure on investors’ stewardship activities – specific activities and self-evaluation of such activities. This is the second point.

The third one is concerning “Ensuring Confidence in Audits”, which other members also have discussed. This section abruptly mentions “defensive governance”. It is sort of difficult. Currently, it is not clear specifically what activities *kansayaku,* the internal audit department, and the audit firm conduct and what they point out, respectively.

Accordingly, as Director-General Mitsui mentioned in a magazine, - I think I have read his column - it is becoming even more important to increase the transparency of auditing itself.

Audit firms are encouraged to adopt Key Audit Matters (KAM) from the next fiscal year. I

suggest that the visibility of *kansayaku* and internal auditing should be enhanced as well. Therefore, although I'm not sure how to incorporate this point in the simple 7 lines, it is extremely important to encourage the visibility of auditing.

That's all.

[Ikeo, Chairman] Thank you very much.

Mr. Toyama, please.

[Toyama, member] I'll briefly make some remarks. Professor Kanda has referred to the discussion at the Legislative Council of the Ministry of Justice, and Mr. Sampei has spoken on the issue of freaking parent-subsidiary or disadvantages for both parent and subsidiary. In this connection, I would like to express my view. I too think that it would not be easy to incorporate relevant requirements in the Companies Act overnight. The intention of my earlier comment was that we should consider whether such requirement would be included in the Code.

Actually, the difficult part of this issue is like this: the case where a listed company owns a listed subsidiary would rather fall into the Corporate Governance Code, but the case where an engagement fund – in fact, a vulture fund – emerges as a large shareholder of a listed company, would rather be associated with the Stewardship Code, because the fund is an institutional investor.

Therefore, in order to incorporate this issue into the Opinion Statement, we need to find a creative solution. Anyway, this point is within the scope of both Codes. So, I would like to point out that this issue relates to both the Stewardship Code and the Corporate Governance Code, which are like two sides of the same coin.

Now I would like to make a comment on the ESG issues, which many members have already mentioned. Let me share the historical background. For the past 20 years, the business community has been against the issue of strengthening corporate governance, or the Corporate Governance Code, and many of the reasons have been pseudo-ESG-related.

Many corporate managers or business associations argued that Japanese companies placed the greatest importance on the continuity of employees or employment, and emphasized social, long-term growth, and that therefore, it was ok to sacrifice short-term profits.

My concern about such discussions stems from the fact that many Japanese companies still have such genes. If we mislead the direction of discussion, such genes could easily throw back. This is a real risk. Truly. I know it from my experience.

If the throwback occurs now, the next 30 years of Reiwa era would follow the same pattern of the 30 years of Heisei era when sales, profits and employment collapsed. So, I suggest that we should be aware of the issue in reality. The actual state of the business community falls far behind, and has not been evolving much.

Therefore, it would be better to humbly recognize the reality of the current business community.

That's all. Probably I have earned fresh enemies again. It doesn't matter.

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

[Kawamura, member] This Opinion Statement uses the expression "increase in corporate value over the mid- to long-term" many times. So, I also believe that we may need a new theory, which allows for easy calculation of the mid- to long-term corporate value, and is easily understandable.

The figure used for the near future would be the market capitalization of shares, but actually, it is more important to look at a kind of figure that mirrors future ahead. We may have to ask scholars to write a thesis on the subject of quantifying market cap, future potentiality of human resources within a company, the number of seeds of high-growth businesses it holds, and the likelihood of success in each seed. It is very difficult to measure real corporate value.

As Mr. Kobayashi has pointed out, there are many short-term issues in reality, but they do not necessarily fit with the purposes of this Opinion Statement. The most important thing is the increase in mid- to long-term corporate value. In that sense, I would like to request that the next review of the Code covers this topic so that we can have a logical method to determine corporate value other than market cap.

With regard to the ESG factors, reflecting on the past, various legislative measures have paved the way for those companies that became more ESG-focused to achieve significant development, as history illustrates. For example, factory smoke used to be a big public issue. Massive sulfurous acid gas in the smoke had to be urgently eliminated. Then came the companies that produce flue-gas desulfurization equipment. They produced and launched the equipment [successfully], thus resulting in the promotion of environmentally friendly society. The same is true for car exhaust emission. I think companies will address the ESG issues and increase their earnings power in doing so in the future.

The same would be applicable to working practices. So, as for social issues, companies will move forward that way. Companies, which would pay more to those employees who get work done

in less time, will eventually become strong. Other companies which cannot keep up with this trend will drop out. I assume these are the goals of the ESG factors. These are my impressions.

[Ikeo, Chairman] Thank you very much.

Mr. Takei, please.

[Takei, member] Thank you.

I think the Opinion Statement is well-organized, and my comments are not meant for correcting the wording. Many members have expressed their views on the issue of proxy advisors. Especially, as for their mechanical voting decision-making approach, I agree with what Mr. Toyama and Mr. Sampei said, and believe that it is the most important issue which needs to be properly addressed.

With respect to frameworks for considering Substance over Form, Material 2 shows examples of disclosures by proxy advisors from page 5 to page 6 of Material 2, yet their disclosures are still far from sufficient. They need to provide in-depth explanations of their transparent frameworks with emphasis on Substance to the external audience. I believe it is important to revise the Code to require disclosures on the establishment of appropriate framework and the explanation of the established framework.

The EU has been discussing this issue from various angles, and in the US, as stated in the reference material for the last meeting, active discussions on the proposed legislation have been made. In such discussions, the NASDAQ Stock Exchange has expressed its strong concern that the current mechanical manner in exercising the voting rights could cause adverse effects on listed companies.

The points of argument in the US include not only the issue of resolving conflicts of interest, but also a concern about the one-size-fits-all approach to corporate management of listed companies. They criticize such approach where voting decisions are mechanically made in accordance with uniform standards. What is happening here, as mentioned by other members, is not unique to Japan. The one-size-fits-all approach is being criticized in the US, too. The issue must be addressed. Specifically, various measures are being discussed, including how proxy advisors can obtain accurate information from companies, and the establishment of an ombudsman for complaints. We should thoroughly examine such specific points at issue, and revise the Code to ensure the establishment of an appropriate mechanism.

In the US, since it involves a legislative procedure, things may not move forward easily. Yet in

Japan, we can address the issue through the revision of the Stewardship Code, so we should go into depth to ensure the substance.

One more point. Such issues as transparent frameworks with emphasis on Substance, mechanical voting decision-making, and inflexible voting standards/policies, are applicable not only to proxy advisors but also to institutional investors, if they just follow their voting standards mechanically once established. Therefore, the issues with regard to proxy advisors mentioned in this Statement must be applied in the similar manner to the voting standards of institutional investors. It is essential for us to have discussions with a view to ensuring flexible and Substance-based voting decisions.

That’s all.

[Ikeo, Chairman] Thank you very much.

I would like to explain the positioning of this Opinion Statement. In the near future, the review of the Stewardship Code is scheduled with a view to the possible revision, although the review may conclude that there is no need for the revision. In this Statement, the Follow-up Council presents issues to be discussed during such review.

Accordingly, although Mr. Sampei offered inputs concerning collective engagement and escalation described on page 2, I don’t think it is appropriate to include them in this Opinion Statement. Rather, I would like you to discuss precisely such matters in our next meetings.

As for the section “Ensuring Confidence in Audits” on the last page, as Chairman, I have to criticize myself and apologize to you. The Council has not had much opportunity to discuss ‘defensive governance’ intensively so far. Therefore, we were not able to write anything more than the 7 lines as you can see.

As for this, the next review cycle of the Corporate Governance Code will start in due course. At that time, we should intensively discuss ‘defensive governance’. So please understand that what we can present in the Opinion Statement is limited at this stage.

[The definition of] corporate value is certainly difficult. It involves external effects or externalities, which is an economics term. There are both positive and negative externalities. If they are not so large, we can consider corporate value as an aggregate amount of the market cap plus total liabilities. However, the cases where the ESG factors matter are exactly those with significant externalities, so it requires consideration of social factors and social trends. Therefore, if a company

with extremely high ROE is damaging the environment, it will receive a low valuation, I think.

As Mr. Toyama pointed out, [the ESG factors] should not be used as an excuse. It may be better to argue that companies, which have not even secured the diversity on the board, should not talk about the ESG factors to justify the current situation.

Now I'm handing it over to Mr. Iwama.

[Iwama, member] Thank you.

Basically, I understand that the nature of this Opinion Statement is like guidelines for the Council of Experts on the Stewardship Code which considers the need for revision.

I think the draft covers all necessary matters. Both asset owners and asset managers engage in investment management.

We are both urged to be highly qualified sophisticated investment managers.

We should align our interests with that of beneficiaries to secure their trust.

To show ideal suitable governance structure of invest management is also important to get their trust.

Especially, I would like to emphasize that the best governance structure is most important for getting individual retail investors' trust.

I support this Draft Statement.

[Ikeo, Chairman] Dr. Ueda, please.

[Ueda, member] Thank you. I have made some comments on the wording of the Opinion Statement earlier. Now I would like to make some remarks on relevant contents.

First of all, in the supplementary material 2, which has been prepared by the secretariat for today's meeting, there is a reference to the hearing survey on the last page. While not many corporate pension funds have signed up for the Stewardship Code, there should be various issues.

In the last bullet point, it is stated "It is necessary to obtain the understanding from both 'the management' and 'employees'". At the Follow-up Council, we discuss that there are beneficiaries behind asset owners, and benefits of the beneficiaries should be maximized. Frankly speaking, employees are not so aware that they are the beneficiaries. They have not received such literacy education. So, it makes me feel a bit empty to talk about the beneficiaries.

This may not be the topic for this Council, but I think it is necessary to improve literacy of participants in pension plans or pensioners.

Their increased awareness would lead to enhanced quality of DC or DB, for example.

Concerning the issue of escalation in Mr. Kobayashi's statement, as one of the last-resort measures of engagement, institutional investors can participate in a general shareholders' meeting, or exercise their shareholders' rights, including proposal rights, there. However, I have heard that, in practice, it is rather difficult for institutional investors to participate in the general shareholders' meetings.

Then, we should look at the guidelines on attendance at the general shareholders' meetings by institutional investors, which were formulated by Kabukon in response to the discussion at the Study Group concerning Promoting Dialogue between Companies and Investors under the Ministry of Economy, Trade and Industry (METI). This is a border area or a bridge between the Stewardship Code and the Corporate Governance Code, so there may be a question about which Code is appropriate to incorporate the matter, but I would like to have the discussion around here incorporated into somewhere.

As for the proxy voting, today's discussions have focused mainly on the issue involving proxy advisors. However, it is primarily the asset managers that exercise voting rights. Compared to large asset managers in other countries, Japanese asset managers spend too much time and effort on voting. Meanwhile, companies are excessively concerned with percentages of "for" or "against" votes – to the level where the percentage is less than 1 percent.

Furthermore, in Japan, thousands of companies hold general shareholders' meetings within a short period of time, so shareholders – institutional investors – must deal with tens of thousands of proposals. It is impossible to be completely free from making any mistakes. Therefore, in order to increase the efficiency, I would suggest that certain mechanical approaches or formalization would be inevitable. Anyway, exercising all voting rights by themselves without making any mistakes would actually be pretty much the exact opposite of reform of working practices.

On the other hand, since the establishment of the Corporate Governance Code and the Stewardship Code, dialogue or engagement has been increasingly conducted. While it may be necessary to make certain efforts to increase the efficiency, asset managers are expected to make use of outcomes of their dialogue when voting. Nonetheless, as a result of strictly regulating conflicts of interest, as other members have also mentioned, they tend to avoid overriding formalistic decisions based on qualitative data.

When the Stewardship Code is to be revised, even if it stipulates many things, only the rules would become stricter, and the actual situation would not change. Therefore, even if the mechanical approach and efforts for increasing the efficiency are generally unavoidable, promotion of changes in the investors' consciousness may be necessary – telling them "Take it easy" and add qualitative elements to their decision-making for voting.

Specifically, I believe asset managers are allowed to vote in a contrary manner to their voting policies, upon fulfilling their accountability by explaining reasons for the votes based on the results of dialogues. However, they tend to follow formalistic procedures, maybe because it is difficult to provide convincing explanations to asset owners, or they are concerned about possible criticism that they gave preferential treatment to certain companies. It is expected that they will take initiatives to make substantive voting decisions in a series of dialogues, instead of sticking to inflexible administrative procedures.

When shareholders vote against their proposals, there are reasons for such voting decisions, so companies should work on deepening mutual understanding. We need to further discuss this issue in the future. While I support the content of this Opinion Statement, I wanted to share my views with you.

That's all. Thank you very much.

[Ikeo, Chairman] Fortunately, we still have some time left. If you have any additional comments, please feel free to express them.

Please go ahead.

[Callon, member] Thank you.

Unusually for me, I've been quiet today, because as Chairman Ikeo explained, today's Opinion Statement presents the key points at issue in order to determine the direction of future discussions, and I think the Statement is very well done and clarifies important areas for further improvements in Japanese corporate governance and stewardship. It is true that there still remain issues to be addressed and we need to find ways to resolve them through continued discussion, such as we have done today, but I am happy with the Statement.

As we still have some time, I would also like to express support for Mr. Sampei's points. As a matter of practice, it is very difficult for institutional investors to exercise their voting rights in an optimal manner. If an institutional investor establishes strict voting standards carefully designed to

avoid conflicts of interest or other negative outcomes, the investor risks being criticized for being inflexible, not considering the specific circumstances of individual companies, and "mechanically" applying the voting standards. If, in response to criticism, the institutional investor seeks to consider the specific circumstances of companies by exercising discretion in the application of voting standards, the investor can in turn be criticized for "arbitrarily" applying the standards and face demands to strictly follow the standards.

What's key is to grow long-term corporate value and have a shared understanding in Japan of the importance of corporate governance to that end. This is a matter of mindset, not soft law or hard law. At the heart of this mindset is the recognition that value creation is an important social contribution in support of Japan's future.

Apologies for the lengthy comment. In sum, I believe the Statement is very good and would suggest leaving any minor amendments to its language to the discretion of the Chairman. Thank you.

[Ikeo, Chairman] Anybody else?

Please go ahead.

[Oguchi, member] I'd like to make just one remark. We have been discussing the issue of the mechanical exercise of voting rights, as Mr. Callon and Dr. Ueda have mentioned, including override voting based on specific dialogues. As for judgment criteria for this issue facing asset managers, I think it is asset owners' views that matter the most after all.

Mr. Sampei referred to value creation. It is asset owners who select asset managers for value creation, so I think it is necessary to understand asset owners' views for our discussions in the future.

I think that we would need to take their views into account before considering specifically how the effective and deep corporate governance reform would be realized. We have not had many opportunities to get knowledge of the actual viewpoints of asset owners. I would appreciate it if we would be able to have such opportunities during the next meeting.

That's all.

[Ikeo, Chairman] Please look at the bottom of page 3 concerning corporate governance. It says, "the Follow-up Council will continue to review the issues, including but not limited to, the following area in a cross-cutting manner."

As for the second section “Group Governance” on page 4, it reads, “Based on these discussions, the Council will continue to review…” However, the first section “Ensuring Confidence in Audits” does not mention the Council’s review in the future. So, it should be edited by including something like “the Council will review… in the future” to ensure the consistency for the better understanding of the readers.

These 7 lines do not offer any conclusion. Some members have pointed out that the writing here would not be able to be implemented in practice. You are totally right. Based on such standpoints, I will have this part of Statement edited in a gesture of our determination to continue our review in the future, ensuring that the readers would understand our commitment.

Does anyone have additional comments or questions?

Mr. Sampei, please go ahead.

[Sampei, member] This is not an opinion or question. I would like to offer a supplementary explanation – for information sharing.

With respect to the practicality of the exercise of voting rights, which various members have mentioned, I would like to make 2 points based on my actual experience. First, it requires time and efforts. Second, if companies provide reasonable explanations, asset owners understand.

For example, officials from a business corporation visit us to explain a proposal to be presented at the next general shareholders’ meeting. The proposal is on the re-election of an outside director candidate, who does not satisfy the formalistic standards in terms of independence: for example, the candidate has a background in its main financing bank.

However, the officials state that the candidate is of significance to the company, and explain the competence and personality of the candidate. As we cannot be so sure without evidence other than the company’s explanation, we request for an interview with the candidate. We say that we would like to see the candidate in a face-to-face meeting, and confirm his/her views. In order to do so, it is necessary to secure time for the interview prior to making a voting decision. We actually have an interview with the candidate.

To make a judgment, we, consisting of not only those responsible for voting, but also portfolio managers and/or analysts, meet with the candidate. If we find the candidate would certainly meet our expectations, we will override the standards, even if he/she does not satisfy formal standards in our guidelines. For the overriding, we need to clarify reasonable grounds, and undergo internal

checking.

Then, we will visit asset owners to explain which voting decisions are not following our voting standards, guidelines – which ones are overriding voting. At that time, we explain what procedures have been taken, and which points we attach weight on, and inform them that we voted for the candidate because we believed he/she is qualified regardless of formalistic standards. We do this much.

Then no asset owner raises doubts or questions the violation of the guidelines. This is an example of how we obtained asset owners' understanding. However, requiring all asset managers to go through the same procedures for all investee companies is a different story.

The extent of asset managers' activities depends on their circumstances. In reality, there are things they can and cannot do. In that sense, in the future, we should discuss the issue based on the actual situations, not merely relying on imaginary scenario or desk plan.

That's all.

[Ikeo, Chairman] Thank you very much.

I think everybody has made necessary comments. Unless there is an additional comment, I would like to ask the secretariat to revise the draft Opinion Statement, taking into account the members' views expressed today. As a major correction beyond grammar is likely, the secretariat would either send you the revised draft by e-mail, or visit you one after another for your review. There was no objection to basic elements of the draft, so I assume we can prepare the final version this way.

In case the Statement cannot be finalized, we may need to meet again soon. However, I hope we can finalize the Statement through either e-mail communications or visits by the secretariat.

Regardless of whether another meeting is to be held soon, the Follow-up Council will continue to be held in the future. As mentioned earlier, there remain many issues to be discussed. The next meeting will be held probably after the completion of discussions on the review of the Stewardship Code. I would appreciate your continued cooperation.

Finally, I would like to ask the secretariat to make some announcements, if any.

[Inoue, Director of the Corporate Accounting and Disclosure Division, FSA] As Chairman just explained, we would like to prepare the revised draft, consult with Chairman, and then send it to you for your confirmation.

In the event we need to hold another meeting of the Follow-up Council soon, we will arrange a date which is the most convenient, and let you know.

That's all from the secretariat.

[Ikeo, Chairman] Although it is not yet the scheduled closing time, I declare the meeting adjourned. Thank you very much.

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