(Provisional translation)

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

1. Date and Time: October 20, 2020 (Tuesday) 10:00-12:00
2. Venue: 9F, Central Government Building No. 7, Meeting Room

[Kanda, Chairman] Good morning. It's already the scheduled start time, so I'd like to open today's meeting of the Council of Experts Concerning the Follow-up of Japan's Stewardship Code and Japan's Corporate Governance Code. This is the twentieth meeting of the Council. Thank you for taking the time from your busy schedule.

I'm Kanda and I was appointed as Chairman of this Council by Professor Ikeo, the former Chairman. It is my pleasure to serve as Chairman of this Council from this meeting onward.

I'm pleased to mention that Professor Ikeo will continue to participate in this Council as a member.

As for today's meeting, as an anti-COVID-19 measure, the members participate in the meeting online. Furthermore, the meeting is broadcast live on the Internet. As usual, meeting minutes will be prepared and made public on the website of the Financial Services Agency (FSA) at a later date. Thank you for your understanding and cooperation.

Before we start the meeting, I'd like to ask the Secretariat to explain some matters that require attention. Director Shimazaki, I will give you the floor.

[Shimazaki, Director of the Corporate Accounting and Disclosure Division, FSA] I'm Shimazaki, the new Director of the Corporate Accounting and Disclosure Division. I'm honored to work with you.

Today all the members participate in the meeting online. If you would like to express your opinions, please use the in-meeting chat of the online meeting system. Specifically, please input your name as a chat message, and send it to everyone. The chairman will be checking such messages and will name the next speaker.

According to Article 5 of "the Procedures to Run the Council of Experts Concerning the Follow-up of Japan's Stewardship Code and Japan's Corporate Governance Code" which stipulates that meetings of the Follow-up Council shall be open to the public, today's meeting is broadcast live on the Internet.

[Kanda, Chairman] Thank you very much.

On the occasion of this meeting, it is decided that six people join the Follow-up Council as new members. The Secretariat will introduce them.

[Shimazaki, Director of the Corporate Accounting and Disclosure Division, FSA] I'm pleased to introduce new members of the Follow-up Council.

In the order of the member list in Material 1, Mr. Jyoji Okada, Mr. Shinobu Obata, Mr. Shoichi

Tsumuraya, and Mr. Yuichi Haruta.

In addition, Ms. Yuri Okina, and Ms. Naomi Matsuoka also accepted to serve as members, although they are absent today.

As for continuing members and observers, please refer to the list which we distributed to you.

There were changes in personnel of the Secretariat, but due to the time constraint, I won't introduce new staff members. I'd like to ask you to refer to the seating chart, instead. Thank you.

[Kanda, Chairman] Thank you very much.

Today, all the members participate in the meeting online. Before we start the discussion, I'd like to ask you to reach an agreement on a draft revision of the Procedures to run the Follow-up Council, regarding the method of members' participation and appointment of an acting Chairperson. For details, I'd like the Secretariat to provide an explanation. Director Shimazaki, I will give the floor over to you.

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

Please take a look at Material 2 "The Procedures to Run the Council of Experts Concerning the Follow-up of Japan's Stewardship Code and Japan's Corporate Governance Code".

There are two changes. First, while the Procedures stipulate how this Council should be run, the method of the members' participation is not explicitly provided for. This time, as an anti-COVID-19 measure, we decided to hold today's meeting online upon consultation with Chairman Kanda. For the future clarification, we suggest that we should add another paragraph to Article 2 "Convening Follow-up Councils" of the Procedures, stipulating that when it is deemed necessary, Chairperson may decide to hold the meeting by using information and communications equipment, so that it is explicitly allowed to have meetings online.

Second, we are considering a stipulation that the Procedures allow a vice chairperson to arrange the proceedings, if the chairperson cannot attend the Council. Specifically, we suggest that we should add Paragraph 2 to Article 3 "Chairperson" of the Procedures, stipulating that "In the event of any accident involving the chairperson, a member who was appointed in advance shall arrange the proceedings as an acting chairperson".

These two are the specific items to be revised.

[Kanda, Chairman] Thank you very much. Now I'd like to ask the members to raise questions or express opinions, if any, regarding the draft revision of the Procedures to run the Council, which was just explained.

As announced earlier, if you want to speak, please send a chat message first. Then I will name you. Does any of you have any questions or opinions on the draft revision of the Procedures? Nothing in particular?

All right. Then, with respect to the draft revision of the Procedures to run this Council, it was agreed upon that we will follow the revised Procedures as specified in Material 2 from now on. Thank you very much.

Next, in the event I will be unable to attend the Council, I'd like to ask Professor Kansaku to serve as vice Chairperson. Is that all right with you?

Thank you. Professor Kansaku.

[Kansaku, member] My pleasure.

[Kanda, Chairman] Thank you very much.

Now I'd like to move on to today's proceedings. First, the Secretariat will explain the Materials, and then I'd like you to discuss initiatives under the Corporate Governance Code.

OK. I'd like to hand it over to the Secretariat, who will explain the Materials.

[Shimazaki, Director of the Corporate Accounting and Disclosure Division, FSA] Thank you.

I'll explain Material 3 titled "Economic and social changes and challenges in Corporate Governance after COVID-19". We also distributed Material 4 (Reference Document 1) and Material 5 (Reference Document 2) as reference materials, so please refer to them as necessary.

Now I'd like to start going through Material 3. With respect to "Economic and social changes and challenges in Corporate Governance after COVID-19", various issues have been raised at the Follow-up Council. As stated in the "JFSA priorities for July 2020-June 2021" partly in response to the impact of COVID-19, at this 20th Council, we present some food for thought relating to economic and social changes after COVID-19, and we'd like you to discuss later the issues raised. I'll refer to such topics from page 1 onward.

With regard to changes in the social and economic environment after COVID-19, the pandemic has caused new changes in people's lives. As for companies, the pandemic has triggered some changes, and also accelerated other changes that were already under way. We'd like to look at an overview of such changes surrounding people's lives and companies separately.

In terms of changes surrounding people's lives, we classified "(0) Changes in concepts of values and behaviors" into two categories: changes in consumption and demand as shown in the upper half of the diagram, and broader changes in lifestyles in the lower half. You can find narrative descriptions on the next page - page 2, but, as for now, I'll explain the changes using this diagram. Due to the restrictions on mobility, there is increasing demand for non-face-to-face services, or online services, for preventing infection, and there are changes in consumer behaviors. In a broader sense, certain consumer behaviors are changing: for example, it is becoming a common practice to compare services via the Internet; and people are increasingly demanding high-quality social services in response to the impact of COVID-19.

The lower half of the diagram shows changes in lifestyles: mid- to long-term changes in preference for work styles, which, in turn, causes changes in preference for residential areas, as well as changes in family relationships. More specifically, remote working or remote work causes changes in people's preference for residential areas, or changes in family relationships due to the work-family interface. Such changes are underway in the environment surrounding people and companies. In response, companies are experiencing changes numbered (1), (2) and (3). The first one is changes in customers' demand for goods and services. The second one is greater demand for work style reform as well as employment and utilization of human resources in a new way. The third one is increasing uncertainty, including emerging problems in the supply chain. We prepared this Material based on various reference materials and reports.

Please turn to page 2. I just briefed you on changes numbered (0), (1), (2) and (3) in the diagram. On the right-hand side of this page, narrative descriptions of each are provided.

In the category (0), with respect to changes in consumption and demand, we are seeing such changes as increasing demand for non-face-to-face, or online services for preventing infection; changes in the conventional consumption behavior triggered by increased opportunities to compare services; and increasing demand for high-quality medical, nursing, and childcare services.

With regard to changes in lifestyle, we are seeing such changes as reconsidering workstyles including remote work, second jobs, and job changes; changes in lifestyles including family relationships; and changes in preference for residential areas – specifically, higher interest in moving to the countryside and suburbs (remote work).

Now I'm moving on to the categories (1), (2) and (3), as already introduced on the previous page. The category (1) is "changes in customers' demand for goods and services". Due to changes in people's behavior as mentioned in (0), there are changes in goods and services in high demand. Specifically, people increasingly demand the digitalization of medical care, education, food and beverages, and entertainment. This should include demand for goods and services whose provision is newly enabled by the digitalization as well. Another point is that there are changes in demand for goods and services that involve direct contact and face-to-face interactions due to self-restraint on going out. Accordingly, there may be cases where business problems, which existed before COVID-19, continue or become more serious. That could provide opportunities to anticipate changes in people's behaviors and create new demand/businesses. There are various changes, but we believe we can summarize such changes this way.

The next category (2) is "greater demand for work style reforms as well as employment and utilization of human resources in a new way". The bullet points there refer to increasing need for work style reform in response to changes in lifestyles; the possibility of remote work and, in a boarder sense, of employment and human resource utilization by companies; and opportunities to start leveraging human resources in response to the restructuring of business models – this may be an issue that has been pointed out since before COVID-19.

With respect to "(3) increasing uncertainty", we see growing risks associated with global supply chain development; as well as renewed focus on such tail risks as climate change, triggered by growing risks of infectious diseases.

What we described under (0) to (3) are phenomena, and there should be discussions about the purpose and required behaviors of companies as well. First of all, there are growing discussions in the US and Europe on value delivery to various stakeholders, although such discussions may have been under way since before COVID-19. At the same time, in terms of the social aspects, we assume that companies are increasingly expected to solve social issues through businesses (creation of common values).

Let's move on to page 3. On the premise of such changes, the two left-hand columns are the same as those on page 2, but the third column shows expectations for businesses. With respect to changes in customers' demand for goods and services, it is considered that companies are expected to provide goods and services which match customers' needs, while adapting to or foreseeing changes. That would require adequate digital transformation (DX), investments in human resources, as well as prompt management improvement, business revitalization, and business restructuring. Certainly, some of such activities are forward-looking, while others may contribute to solving issues which existed even before COVID-19, as mentioned earlier. If a company goes for business restructuring, it also needs to address such issues as the overall optimization of the entire group, and necessary protection of general shareholders.

Broadly speaking, with respect to the second category "greater demand for work style reforms as well as employment and utilization of human resources in a new way", companies would be expected to improve the internal environment to meet employees' needs through implementation of remote work and other work style reforms. Another point that needs to be discussed would be the development of employment and HR systems consistent with their business strategies, including increasing diversity within a company in terms of gender, international experience, and mid-career hiring.

As for "increasing uncertainty", companies are expected to review their business continuity plans (BCP) and risk management. In this regard, specific points to be discussed include decision-making for strategic supply chain development/restructuring, preparation for tail risks, and efficient and crisis-proof fundraising and cash management, as cash holdings is one of the issues that emerged in response to COVID-19.

In regard to discussions about the purpose and required behaviors of companies, as stipulated in the current Corporate Governance Code, we consider that companies are expected to fulfill fiduciary responsibilities to shareholders and cooperate with various other stakeholders in order to increase mid- to long-term corporate value for shareholders and other stakeholders.

I'm moving on to page 4. I just covered some agendas. This page provides some extracts from the interviews with investors and companies, which we conducted from May to September. You can find more details in the reference material.

We organized the findings into such areas as business strategy, digital transformation, sustainability/diversity, and financial strategy.

As for changes that investors expect companies to make, investors referred to the appointment of directors with necessary skills, and appropriate involvement of independent directors because internal personnel alone can hardly make necessary changes. In the area of DX, they pointed out the need for transformation of the business process itself through DX. In the area of sustainability and diversity, investors mentioned that companies should work on sustainability initiatives substantially, not just formally; and referred to diversity in the backgrounds, not only focusing on gender, but also nationality. In the area of financial strategy, investors expect companies to secure and improve their ability to generate future cash, upon recognizing the importance of cash holdings in emergency situations.

Next, let's look at companies' approach and responses. In light of changes in the demand structure after COVID-19, companies reported that they are examining how to transform their business models and restructure their business portfolios and seeking a future direction for how to use their strength in services that involve direct contact and face-to-face interactions. Some companies are aware of the need to establish a new business model in response to the digitalization, as well as the challenge of preparing the remote management system and IT system which can be utilized in emergency situations. We also heard that some companies are examining how to address social and environment of ESG in the future, and others continue to work on such initiatives. Representatives of some companies commented that they consider it necessary to increase their cash on hand, and utilize cash as a source of funds for growth. We received such voices of companies, and thought their inputs may be useful for discussion of the Council, so we incorporated their inputs in this Material.

Please turn to page 5. This page summarizes the subjects that we'd like you to discuss at the 20th Council. First of all, you can see the overall theme "challenges in corporate governance for corporate reform after COVID-19". I have presented various post COVID-19 challenges and matters to be considered. In order to address such post COVID-19 challenges and grow further, each company is required to recognize challenges and anticipate these changes. Furthermore, they need to share their vision of transformation with their shareholders, customers, employees, and communities, and actively implement the vision by making prompt and decisive decisions.

As I mentioned at the beginning, the Council raised the following corporate governance issues in previous meetings. The first one is business with a recognition of cost of capital. It is about cost-of-capital conscious management, including such topics as cash holdings, as I mentioned earlier, and cross-shareholdings. The next one is board effectiveness, including improvement in quality and quantity of independent directors, diversity, and so forth. There should be other aspect as well, so we included this page in the Material. As for mid- to long-term sustainability, such issues as sustainability, and diversity of managerial positions were raised. With respect to ensuring confidence in audits, the Council discussed the establishment of processes/systems where the internal audit department directly reports to the management and the Board - so-called "direct reporting". Another topic is about group governance, specifically, group management, and protection of general shareholders of listed subsidiaries. These are the corporate governance issues raised at the previous meetings of the Council, including those expressed in the Opinion Statement.

Accordingly, looking ahead to the post-COVID-19 economic society, we'd like to hear your opinions concerning how we should reconsider our focus of discussion. Are there any new issues that we should discuss? Do we need to change priorities of issues to be discussed? We would appreciate your opinions.

As for other things, we'd also like you to suggest what other points regarding corporate governance should be discussed going forward.

Page 6 and onward are for reference purposes only. Page 6 shows an excerpt from JFSA priorities for July 2020-June 2021. It states that we will consider corporate governance that would be adequate for helping companies lead reforms towards building a better post-COVID socio-economic structure. In particular, we will consider ways of constructive dialogue between investors and companies concerning such matters as DX, supply chain, and work style reforms.

On page 7, we quoted an excerpt from Appendix of JFSA priorities for July 2020-June 2021, which touches on the specific topics.

From page 8 to page 9, you can see the final proposal of the Preamble to the Corporate Governance Code, which was drafted at the stage of developing the Code. The Preamble of the first version of the Code already referred to growth-oriented governance, increasing corporate value over the mid- to long-term, and responsibilities to various stakeholders, as stated in the main body of the Code as well. In the Corporate Governance Code published by the Tokyo Stock Exchange, you can find this Preamble following the main body of the Code. These are quoted on page 8. On page 9 is an excerpt related to the principle-based and 'Comply or Explain' approaches.

We also included the reference concerning efforts to deepen corporate governance reform on page 10, and the outline of the Corporate Governance Code on page 11.

That's all for the explanation of the Material prepared by the Secretariat.

[Kanda, Chairman] Thank you for the explanation.

We received opinion statements from Ms. Okina, Ms. Warring, Mr. Toyama, and Mr. Matsuoka, who are absent today, so I'd like to ask the Secretariat to share the summary of their statements.

[Shimazaki, Director of the Corporate Accounting and Disclosure Division, FSA] Yes, I will share their opinion statements with you.

The first opinion statement is from Ms. Okina.

Her first point is about sustainability. The society has been increasingly interested in the importance of diversity, in addition to consideration of SDGs. This may be because the COVID-19 crisis renewed people's awareness of the fact that companies are exposed to many unforeseeable risks, and in order for companies to be resilient, they need to ensure responsiveness to changes and creativity, and therefore, need to embrace diversity. Embracing diversity is an important business strategy, and investors are required to become interested in such a factor.

Second, with respect to an increase in the number of women in managerial positions, companies are questioned whether their work environment is supportive to the employees, regardless of their gender. According to the Interim Report of "Choice for the Future 2.0", there is a problem of the female regular worker ratio: the ratio reaches a peak during the ages of 20s, and then it declines as they get older. To increase the number of women in managerial positions, it is desirable that more women are promoted to such positions within the companies, not only being appointed as external directors from outside.

For that purpose, companies need to create an environment where women can easily balance home life and work; disclose corporate attitudes concerning employment of female regular workers, flexible workstyles of employees, and whether male employees can take childcare leave; and discuss such matters with investors.

Third, while the business environment is significantly changing due to COVID-19, with the acceleration of DX, companies have another option besides selection and concentration, that is to adopt a strategy to focus on synergy among businesses and collaboration. In that case, companies need to be able to provide a clear account on a path to increase corporate value by such specific combination of businesses. Furthermore, at board meetings and in dialogue between companies and investors, discussions on how a strategy concerning short- to mid-term business portfolios will be linked to increasing long-term corporate value in alignment with the SDGs are expected.

To understand the whole, please refer to her opinion statement.

The next opinion statement is from Ms. Waring [from International Corporate Governance Network (ICGN)].

In response to the COVID pandemic, ICGN has advocated an importance of social factors as a key determinant to a company’s long-term financial health and sustainability. ICGN provided a broad list of priorities that companies might consider while dealing with the crisis: ensuring employee safety and welfare while meeting short-term liquidity requirements; pursuing a long-term view on social responsibility, fairness and sustainable value creation, and publicly defining a social purpose; taking a holistic and equitable approach to decisions on capital allocation to stakeholders; and communicating comprehensively with all stakeholders.

As for subjects of corporate governance to be discussed at the Council, in addition to those listed in our Material, ICGN suggested a few more points to be discussed. The first point is the timing of publication of the Securities Report. ICGN suggests that the Securities Report should be published prior to the annual general meeting of shareholders (AGM). Companies listed in TSE (Tokyo Stock Exchange) prime market should prepare English translated Securities Report and Notice of AGM. Furthermore, ICGN recommends that companies should move their record dates to April and hold AGMs in July.

The next point is about AGM. With regard to hybrid or virtual-only AGMs, ICGN encourages regulators to ensure that shareholder rights are not infringed so as not to restrict their ability to hold companies properly to account. ICGN also suggests that companies should consider publishing AGM information at least one month prior to the meeting, use video technology to allow for facial expression to be shown, ensure participants can ask questions or express opinions, as well as record and respond to all questions and promptly disclose such responses.

The final point is disclosure around human capital management. The COVID-19 pandemic has exposed deep social inequalities in terms of income, gender, race, etc. ICGN members are addressing these issues through dialogue with companies, covering such topics as health and safety especially in industries where human interactivity is high; diversity, noting the disproportionate number of female redundancies; anti-discrimination policies and practices; human rights in supply chain; staff training as companies have transitioned their operations to a virtual and socially distanced world; and income inequality in terms of pay and other benefits. ICGN members encourage regulators to require companies to provide more transparency around human capital management by providing relevant information.

The next opinion statement is from Mr. Toyama.

He argues that digital transformation (DX), which was already underway, has been even more accelerated. Consequently, industrial transformation (IX) is occurring in a way that industrial structures and business models significantly change. We are entering an era that puts companies to the harsh test for their abilities to achieve corporate transformation (CX) that fundamentally and uninterruptedly transforms their forms centering on decision-making abilities/systems.

We have frequently seen devastating black swan events on a global scale. Corporate managers are required to ensure resilience, and further promote governance reforms. Companies need to survive a crisis, and even launch restructuring: they need to aggressively take risks to make it a growth opportunity. To do so, a governance system and strong leadership of top management are increasingly becoming critical. Solid operating profitability and a strong financial foundation will lead directly to resilience.

He also proposed 5 points to be discussed at the Council for the revision of the Code. The first point is about enhancing nomination committee and process for selecting top management. He suggests that the establishment of nomination (advisory) committee should be a de facto obligation, and the committee should be mainly composed of management talent who have diverse management experience. The selection process should not be just an approval of a personnel proposal prepared by the executive body, but a generalized process to evaluate candidates and narrow down the list.

The second point is about ensuring diversity at the level of executive officers (*shikkoyakuin*). In order to undergo CX that responds to major changes of the era, it is indispensable to ensure diversity (in terms of gender, age, nationality, education, managerial background, etc.) of candidates for future top management. Diversity of core human resources precisely defines a company's competitiveness and transformation capability. The effectiveness of a succession plan also depends on the quality and diversity of human resources portfolio at the executive officer level who are candidates for future top management. The Code should state this point including numerical targets.

The third point is about the importance of cost of capital and operating cash flow. As pointed out in "Lead and Disrupt", it is important both to narrow existing businesses down to profitable businesses (exploitation), and to make bold investments in exploring new areas (exploration) by utilizing operating cash flow from the adequate use of debt finance. He argues against the traditional view that "If a company focuses only on short-term profit, it will not be able to make long-term investments, and therefore, lose growth potential." Instead, he advocates that abundant operating cash flow is the source of corporate strength.

The fourth point is that strong earnings power also supports ESG/SDG management. An absolute requirement for companies to contribute to social value is strong and sustainable earnings power. In the first place, Japan's Corporate Governance Code does not stand on the shareholder value supremacy. Instead, its basic philosophy is sustainable increase in corporate value for all stakeholders.

The fifth point is about parent-subsidiary listing. When parent and subsidiary companies have a close business relationship, conflict of interest may occur between the parent company and minority shareholders of the subsidiary company, which can lead to a dispute, thus damaging corporate values of both companies. When both parent and subsidiary companies need to undergo drastic CX, there is a risk where conflicts of interest attributable to their relationship occur, which will compromise their strategic freedom and promptness, thus reducing their CX capabilities. He suggests that parent-subsidiary listing should not be allowed except for such transitional cases as one in the course of a spin-off of a growth business, and the Code should state the controlling shareholder's obligations to protect the interest of minority shareholders (fiduciary duty), similar to a principle commonly used in the US and Germany.

The next one is from Ms. Matsuoka. As for the stance for reviewing the Corporate Governance Code, she would like, as representing Keidanren to contribute to future discussions based on actual corporates' experience. She stated that corporate management and stakeholders support the principle-based approach, because each company can adapt its response depending on its specific circumstances.

With respect to diversity of the Board, diversity has always been a source of innovation and new value creation in terms of business management, and an essential element of management strategy. According to a survey by KEIDANREN (Japan Business Federation), majority of companies held that diversity & inclusion is important. She stated that companies will continue to work on promoting diversity, as a priority, from the perspective of the board effectiveness. She also mentions that such corporate efforts will lead to the improvement of the competence of outside directors as well.

Meanwhile, she considers it is valid that the Material refers to "diversity of managerial positions, etc." from the perspective of mid- to long-term sustainability, and it should be discussed in a forward-looking manner, taking more into account the current trend of diversification of workstyles and global discussions. To create a workplace that makes use of diverse human resources, it is not always sufficient to appoint managerial personnel and officers under the so-called "seniority system". Instead, she believes that companies should establish a framework, where each employee is fairly evaluated based on his/her abilities, skills, and performance, and is given positions, authorities, compensation, and opportunities that is best fits his/her duties. She believes it is important to revise the Code under a principles-based approach so as to allow diverse employees to work in diverse ways and pursue diverse career development.

That was my brief summarization of the opinion statements.

[Kanda, Chairman] Thank you very much.

Now I'd like to hear your questions and opinions. Let me repeat that, if you would like to speak, please use the chat function, and send a message with your name to all participants, indicating that you would like to speak.

This is sort of the "first" meeting after the Follow-up Council was on a hiatus, so I'd like you to discuss "Challenges of Corporate Governance for Corporate Reform after COVID-19" shown on page 5 of Material 3, as well as other corporate governance issues to be discussed in the coming meetings. However, it would be also fine if you express broader opinions.

I got a chat message from Mr. Obata. Please go ahead.

[Obata, member] I'm Obata from NEC. Thank you for allowing me to speak. As I'm a business practitioner, I'd like to share my view from such a standpoint.

As mentioned in the earlier briefing and opinions, we are in the era of uncertainty. I understand that one of the primary concerns for companies is risk management. Neglect of it may develop into a problem of the internal control system, so we are tackling this and BCP with a keen interest.

In addition to the points raised during today's presentation, I'd like to add 3 points to be discussed at the Council. The first point is the human rights issue associated with the supply chain. Human rights issues are not limited to those in the supply chain. There are various types of human rights – human rights for customers, human rights within a company, and so forth. I suggest that we should consider such human rights issues.

Second, while digital transformation is going on, the importance of data is increasing. Since various companies start to have data, possible impacts of cyberattacks on companies are becoming greater. Once there is data leakage, it will cause a significant impact on the business management as well as stock prices. So, I'm wondering if we can discuss ways to ensure cyber security.

Finally, this is my third point. The US-China trade dispute has heightened geopolitical risks. I think Japanese companies need some guidance concerning what they should comply with, and how, including US laws and Chinese laws. Japanese companies have seen the growing international impacts, in connection with their respective positions in the world. Therefore, in addition to the issues raised today, I'd like you to consider human rights, cyber issues, and so-called sanctions. That's all.

[Kanda, Chairman] Thank you very much.

Next, Professor Kansaku, please.

[Kansaku, member] Thank you. At the resuming of the Council, I suggest that we should discuss group governance, although this is the issue that already existed before COVID-19. Looking at the reality of managing listed companies, we could say that listed companies are normally managed by the corporate group to which they belong. And investors are actually investing in corporate groups. Unlike the Companies Act which basically governs companies on non-consolidated basis, the Financial Instruments and Exchange Act established a regulatory framework that requires disclosure on a consolidated basis. I believe that we should review the Corporate Governance Code from the perspective of whether the Code sufficiently discerns group governance from such a viewpoint.

Especially when a listed company has a controlling company or controlling shareholder, I'm aware that there recently have been several actual cases of problem for minority shareholders or general shareholders of listed companies - for example, the lack of transparency around business opportunities or coordination/allocation of business areas within a group; or temporary absence of independent directors who represent interests of general shareholders.

On the other hand, looking at the current Corporate Governance Code, it certainly refers to the protection of minority shareholders in general terms, so the principle-based Code has not failed to refer to this issue. For example, General Principle 1 stipulates that adequate consideration should be given to the issues and concerns of minority shareholders over the effective exercise of shareholders' rights and an enabling environment for that. Principle 4.3 also stipulates that the board should appropriately deal with any conflicts of interest that may arise between the company and its related parties, including the management and controlling shareholders. Principle 4.7 stipulates, as a part of roles and responsibilities of independent directors, that independent directors should monitor conflicts of interest between the company and not only the management, but also controlling shareholders. Furthermore, independent directors are expected to appropriately represent the views of minority shareholders and other stakeholders in the boardroom from a standpoint independent of the management and controlling shareholders. In this way, the current Corporate Governance Code already refers to the protection of general shareholders and minority shareholders of listed companies which have controlling shareholders, in consideration of corporate groups.

Nonetheless, I'd like to suggest that we should explore this point more deeply, in particular, around the following 2 points.

First, with respect to group governance, I suggest that we should have further discussion on such matters as determination of group strategy, internal control system including risk management of the entire group, and risk control. We could discuss strategies for the entire group and internal control of the entire group from the perspectives of securing efficient allocation of management resources and allocation method to achieve the overall optimization, business portfolios, and formulation and implementation of the group-level business portfolio strategy.

Second, more simply put, from the perspective of protecting minority shareholders, we could examine high-risk type of conflicts of interest between controlling shareholders and minority shareholders, regarding its ideal decision-making and disclosure. Due to the revision of the Companies Act in 2019, it has become mandatory for companies that are required to submit Annual Securities Report, including listed companies, to have independent directors. Consistent with such hard law, I think the Corporate Governance Code could refer to deeper involvement of independent directors: while maintaining generalization and abstraction of its principles, the Code could clarify key points to be noted for high-risk type of conflicts of interest between controlling shareholders and minority shareholders, focusing on the decision-making process and disclosure. Especially, I suggest that we should review the Code in terms of such decision-making process, in consideration of the involvement of independent directors and minority shareholders in such types of conflicts.

In fact, many initiatives on this issue are underway, including group governance guidelines and other practical guidelines by the Ministry of Economy, Trade and Industry, and discussion in the TSE. I hope this Council will discuss the matter by referring to outcomes of such initiatives.

[Kanda, Chairman] Thank you very much, Professor Kansaku.

Mr. Oguchi will speak next, and then Mr. Okada. Mr. Oguchi, please go ahead.

[Oguchi, member] Thank you. As the Council just resumed, I'd like to share my view by briefly referring to the past. Although the comparison should not be made carelessly, we have experienced the Lehman Shock, the previous global financial crisis. I still remember that, at that time, there were growing calls that the principal cause was the shareholder-centric system in Europe and the US, justifying Japanese governance. However, Japan still could not get out of its economic stagnation, and that is when the governance reform started, in my understanding. Since the Stewardship Code was established in 2014, we have observed the appointment of independent directors and other progress of the governance reforms. I think we should be proud of it, including the role played by the Council.

Nonetheless, what about the profitability which is critical to investors? If it is possible, could you please show page 13 of Reference Document 2 on the screen? It is titled "Cost of capital as a key management consideration (3)". It shows net profit margin since 2014. Even through net profit margin has improved, the level is much lower than that of the US and Europe. As you can see, leverage has declined from 2014 to 2019. Consequently, as for ROE indicated on the top, Japan remains far behind the US and Europe – half or one-third of their level. As if reflecting such a fact, even though Abenomics had generated the cumulative net inflow of more than two trillion yen from overseas investors, the net inflow has already turned negative by now.

When I talk with overseas investors, they often ask for valid reasons, if any, from the long-term perspective, not for making profit in the short-term, for investing in Japan, a country with aging population and a declining birth rate. I used to give them various reasons with a sense of anticipation, when the governance reform started, but currently, it becomes difficult to give convincing reasons to the investors who know the outcomes shown on page 13. In the past, such terms as "Japan passing" or "Japan nothing" were often used. I'm concerned that this can happen again.

Currently, in response to the COVID-19 pandemic, some justify the risk-reducing business management, as in the time of the Lehman Shock in 2008. Although it may be right to a certain extent, if the market positively evaluated such risk-reducing business management, Japanese stocks would have been purchased more. However, except for some investors who intend to make use of low capital efficiency, that is not happening. As mentioned earlier, the net inflow from overseas is negative. What can be done in order to encourage investors to provide risk money to Japanese companies from the long-term perspective? I think we need to readdress this issue by using objective evidence from the viewpoint of overseas investors, instead of the subjective viewpoint from Japan side.

Then what should we do? As stated in the earlier explanation from the Secretariat as well as

Reference Document 1, what will change in the era of coexisting with COVID-19 or the post-COVID-19 era? There are various views, but I think it is undeniable that the socio-economic structure has significantly changed and will continue changing in the future.

In the meantime, as shown in the section titled “Cash and Cash Equivalents” on page 4 of Reference Document 2, Japanese companies have accumulated cash and cash equivalents. Although there is the problem of uncertainty, there is no doubt that changes in the society will create new investment opportunities. Aside from discussion on which direction to take, it is certain that changes will provide new investment opportunities. Looking at Japan from this perspective, we could say that Japan is well-positioned to make proactive investments, expecting the future outcome through investments in intangible assets or human resources investments.

The term “earnings power” was often used in the past. Now companies are put to the test in terms of their abilities to earn and use profits. To achieve positive results, it will become even more important for the board with diversity to promote healthy entrepreneurship, anticipate changes in the socio-economic structure, and discuss their abilities to strategically use profits – although they may vary among companies. Of course, I mean that companies should appropriately exercise their abilities to use profits, not using profits irrationally. Therefore, I’d like to emphasize once again that cost of capital is a critical measure to judge the use of profits.

Finally, I believe it is true that a company is not only for its shareholders. That is the very reason why the Corporate Governance Code has “Section 2: Appropriate Cooperation with Stakeholders Other Than Shareholders”.

Page 21 of Reference Document 1 quoted the opinion of the Council of Institutional Investors (CII), which you could read later. CII pointed out that “if ‘stakeholder governance’ and ‘sustainability’ become hiding places for poor management, or for stalling needed change, the economy more generally will lose out.” I believe this is an important perspective. As I mentioned earlier with respect to ROE, Japanese companies have not sufficiently responded to expectations of investors, compared to the US and European companies – it is like “one lap behind”. Therefore, CII’s comment is especially important to Japan who needs to catch up.

That’s all from me.

[Kanda, Chairman]　Thank you very much, Mr. Oguchi.

Mr. Okada, now it is your turn.

[Okada, member]　Thank you. I used to serve as chairperson of Japan Audit & Supervisory Board Members Association (JASBA), and I am still involved with JASBA. With this background, I’d like to express my opinion on outstanding issues under the subject of “ensuring confidence in audits” stated in the Material. It is mainly about *kansayaku* (audit & supervisory board members).

In reviewing the Corporate Governance Code, I got an impression that, while the US-style governance system has become the mainstream, *kansayaku* system is being left behind.　Nonetheless, among approx. 3,700 listed companies, approx. 2,500 companies still have the form of “Company with *Kansayaku* Board". Accordingly, it is necessary to improve governance of *kansayaku* system. Especially, as we have recently seen cases where *kansayaku* failed to perform their duties, I believe it is necessary to expect more from *kansayaku*, and further put spurs to them.

In the Corporate Governance Code, it is stipulated that it would not be appropriate for *kansayaku* to interpret the scope of their function too narrowly, and that encouraged *kansayaku* a lot, but in order to allow motivated *kansayaku* to fully exercise their capabilities, the Code should be further enhanced, so I'd like to make some suggestions.

The first one is about appointment of *kansayaku.* While Principle 3.1 stipulates that companies should provide explanations concerning the appointment/dismissal and the nomination of *kansayaku,* there is no specific provision about the nomination of *kansayaku.* Although the Companies Act provides a clear stipulation, in practice, the appointment of *kansayaku* is led by the management. Even though the Companies Act provides *kansayaku* with the consent right with respect to the submission of proposals for the appointment of *kansayaku* by directors, it is rare that they do not give the consent. They also have the right to state their opinion at the general shareholders meeting, but they rarely exercise such a right. In that sense, *kansayaku* is not involved in the appointment process.

I suggest that the *kansayaku* board should be responsible for selecting *kansayaku* candidates, and the decision should be made upon consultation between the *kansayaku* board and the nomination committee. I suggest that these should be somehow stipulated in the Code.

Next, I'd like to talk about *kansayaku's* participation in the nomination committee and other optional committees. Not only the management, but also *kansayaku* themselves tend to interpret the scope of *kansayaku*'s duties too narrowly - specifically, limited to their role of auditing of legal adequacy. I think this was the very cause of the corporate scandal of a certain electric power company. To improve the corporate governance system, it is desirable that a *kansayaku* member serves as a member of an optional committee. In the Corporate Governance Code, Supplementary Principle 4.10.1 refers to an optional nomination committee and an optional remuneration committee comprised mainly of independent directors. Furthermore, it stipulates that companies should seek appropriate involvement and advice from independent directors. If this is superficially interpreted, it may be understood that main members of such an optional committee should be outside directors. However, *kansayaku* are more knowledgeable about internal affairs than independent directors are. Therefore, *kansayaku* can make use of their insights into governance, risk management, and internal control at such committee meetings. I believe that the description of Supplementary Principle 4.10.1 should be revised.

The next point is about *kansayaku*'s participation in dialogues with investors. As I mentioned at the Council of Experts on the Stewardship Code (FY2019), I believe that not only independent directors, but also outside *kansayaku* should participate in dialogue with shareholders. Currently, Supplementary Principle 5.1.1 stipulates that the senior management and directors (including outside directors) should have a basic position to engage in dialogue with shareholders. I suggest that outside *kansayaku* should be included there. I believe that their participation in dialogue with investors from the audit viewpoint is also necessary for the companies.

I'm sorry for taking time, but let me make one last remark. It is not about *kansayaku.* It is about a third-party committee. Corporate scandals keep occurring time and again. While the objectives of the Corporate Governance Code are to help companies perform proactive, growth-oriented management, and increase corporate value, I feel the need at the same time for strengthening the monitoring and supervision by independent directors and *kansayaku* from the independent standpoint. There is no legal problem with establishing a third-party committee, but companies tend to do it too often. There are many cases where independent directors or outside *kansayaku* do not take responsibility of monitoring/supervision and do not engage in an investigation, while the executive body selects members of the third-party committee at its own discretion. As a result, I feel an investigation by such a third-party committee is often used as an escapeway. Indepndent directors and outside *kansayaku* should conduct the primary investigation of the fraud, and be involved in the selection of the third-party committee members or check the abilities, independence, and morality of the members in case the management selected the third-party committee members. In addition, they should monitor the adequacy of investigation expenses. It is very difficult to legislate these dialogues so I suggest that they should be included in the Corporate Governance Code as part of the roles of independent directors and outside *kansayaku.*

That's all. Thank you for allowing time to make my points.

[Kanda, Chairman] Thank you very much.

Next, Mr. Haruta, please go ahead.

[Haruta, member] I'm Haruta from Japanese Trade Union Confederation. It's my pleasure to participate in the Council.

I'd like to make two broad points. First, I understand that the COVID-19 pandemic has accelerated digital transformation (DX), and the society has been and is significantly changing. Under such circumstances, companies are under pressure to undergo a shift in the industrial structures. It would be important to consider how to respond to such perspectives as corporate strategies and changes in employment and work styles.

In the midst of DX, corporate decisions and decision-making systems are changing, and that will significantly influence corporate governance. Furthermore, while work styles are changing, for example, by the introduction of remote work, I think we need to discuss the necessity of face-to-face discussions – and we face the same question in the Council meetings - and what it is like to make corporate decisions online, because judgments on such matters will become increasingly important while corporate attitudes and decision-making processes vary.

With respect to DX, it has been pointed out that Japanese society as a whole is behind in terms of digitalization. In the wake of the COVID-19 pandemic, I feel that the delay in the digitalization caused some inefficiency in government service provision. In terms of having a social safety net, how businesses will involve themselves, I think, will be an important point, including the digitalization. From such a perspective, I think it is important to discuss how companies are changing, when we review the Code.

And I also believe that, in connection with the digitalization, it is important for companies to disclose such information as their corporate strategies, and the direction of their activities from the mid- to long-term perspectives.

My second point is about “increasing uncertainty”, which was presented in the Material. During times of natural disasters and the COVID-19 pandemic, risk management, including BCP, is critical. Especially, it is important to have a perspective of sustaining companies in the community in the wake of the COVID-19 pandemic or natural disasters. Among engagement with various stakeholders, especially during the COVID-19 pandemic, I believe the engagement with the community will be the center of focus: in particular, engagement with essential workers, including healthcare and nursing care workers, in local communities. I think we need to have a discussion toward maintaining the functions of the community, including maintaining of such systems and various community-based activities.

I’d like to talk about one more thing in this connection. Green recovery is becoming a global trend. Economic policies are certainly important, but it is also very important to develop a resilient society/economy by focusing on environment and society from the perspective of ESG.

Finally, since the Corporate Governance Code was introduced in 2015, there have been various changes. I think that some sort of evaluation might be needed somewhere. It may also be necessary to discuss in response what should be done going forward. That’s all from me.

[Kanda, Chairman] Thank you very much.

According to the order of chat messages received, the next speakers are Mr. Kobayashi and Ms. Takayama, in that order. I was informed that Mr. Oba will leave early. So, Mr. Oba, please share your opinion with us, if any, after Mr. Kobayashi and Ms. Takayama.

Mr. Kobayashi, please go ahead.

[Kobayashi, member] As I was not attending the meeting for the first 40 minutes, I am not aware of what has been discussed so far, but according to the Material sent by the Secretariat in advance, the issues to be discussed include “managing businesses with a recognition of cost of capital”, “board effectiveness”, and “group governance”. I’d like to suggest some more topics to be discussed during coming meetings of the Council.

First, I believe that companies should have dialogue with shareholders more explicitly and frequently, involving independent directors. Speaking from my experience in serving as an independent director of a company in a crisis stemming from a scandal, when companies have dialogue with shareholders to the greatest extent possible, involving independent directors, it is evident that executives will be motivated to inform themselves a lot, and the shareholders, including institutional investors, will reasonably begin to place trust on the companies. I get an impression that the management of Japanese companies are still reluctant to engage in dialogue.

Looking at the recent COVID-19 situation, I'd like to talk about virtual annual general meetings of shareholders (AGMs). I'm aware that it is not yet possible to have virtual-only AGMs in Japan. However, considering a risk of concentration of AGMs next year and onward, I suggest that we should thoroughly discuss the possibility and significance of the virtual-only AGMs, not only hybrid AGMs (a mix of in-person and virtual).

Another issue is how intangible assets should be perceived. In what way should present values of various intangible assets related to mid- to long-term sustainability and climate change be quantitatively stated – especially, non-conventional intellectual properties, such as digital platformers? Our company participates in the Value Balancing Alliance with such European companies as SAP, BASF, and BOSCH. This is a global initiative where the participants discuss the way to measure and value non-financial information, while there was no such way in the past. Corporate value is divided into two parts: one is capital efficiency, and another is, as I just mentioned, intangible assets, intellectual properties, or such factors related to digital platforming and environment (for example, the degree of contribution to reducing CO2 and plastic debris). Accordingly, corporate value should be calculated as the sum or the square root of these factors. These I think are much more discussed in Europe. I believe we need to discuss corporate values more in that way in the future.

Next, as Mr. Oguchi mentioned earlier and as shown on page 13 of Material 5, I assume that the low net profit margin would be the primary reason why ROE of Japanese companies is significantly behind that of the US and European companies. While industrial portfolios have significantly changed in other countries, Japan still relies on traditional manufacturing industry, and earnings from digital platforming businesses are limited. I think it is necessary to analyze the actual situation in this regard.

The management works on a transformation of the business portfolio, upon comprehensively reviewing various trends, including not only DX, but also an environmental transformation or environmental issues, and development of bio-related business activities including 'health and productivity management'. The Ministry of Economy, Trade and Industry and other government departments have formulated various policies to facilitate M&As and exits associated with portfolio transformation, including tax breaks, but I think it is necessary to re-evaluate and re-establish those initiatives more comprehensively.

Furthermore, while the sports world has been increasingly globalized or become multinational, and skilled athletes make the world their stage. Meanwhile, management teams of most Japanese companies still consist of only Japanese. Very domestic-centric. Is it OK like this? If you look at Swiss companies with a global footprint, you'll find that most of them are not managed by the Swiss. Japanese companies should address this issue as well. Otherwise, they will not only be put at a comparative disadvantage, but will fall further behind. In order to have women and foreigners in the management teams, it takes time to promote someone from within a company. Accordingly, Japanese companies need to secure access to the global executive recruitment market and actual recruitment.

Otherwise, they cannot win, I think.

That's all from me.

[Kanda, Chairman] Thank you very much, Mr. Kobayashi.

Next, Ms. Takayama, it's your turn.

[Takayama, member] Thank you.

First, I'd like to talk about changes caused by COVID-19. As stated in the Material from the Secretariat, COVID-19 has brought about various changes – for example, risk management and the acceleration of DX. I think these have become significant issues for the management/executives.

The Material provides detailed descriptions on such changes. However, we should remember that the Council is expected to discuss corporate governance – decision-making and oversight functions of the board. We should not go into detail about each change, for example, changes in practices of business execution. Instead, it would be better if we had discussions from a broader perspective, focusing mainly on such topics as how the board looks at such issues as a whole and makes decisions on them, and how the board engages in oversight activities.

With respect to risk management, for example, the executives are expected to manage risks appropriately. Instead of going into detail about specific risk management, we should focus on how the board perceives the risk framework of the company as a whole, and how the board, based on such a perception, oversees the risk management by the executive side – in other words, risk oversight. That would be better suited for the objectives of this Council.

Next, I'd like to talk about important issues that should be discussed during next meetings. As I just said, COVID-19 brought about changes, but on the other hand, I consider that important issues of corporate governance have not really changed. Certainly, COVID-19 has accelerated the moves toward the governance reform, but I think key points remain almost unchanged.

Then, specifically what is important? As far as corporate governance is concerned, the board effectiveness is the most important. On page 5 of Material 3, we can see several issues which were raised at the Council in the past. All of them are important, but I believe the most important one is the board effectiveness. And in order for the board to effectively perform an oversight function, there would have to be the improvement of both quality and quantity of independent directors as stated on this page.

Based on such a view, I'd like to talk about points that we should discussed at this Council. As for the quality and quantity of independent directors, the Corporate Governance Code stipulates that "Irrespective of the above, if a company believes it needs to appoint at least one-third of directors as independent directors, it should appoint a sufficient number of independent directors." As for the percentage of independent directors at the moment, according to the data which the Tokyo Stock Exchange published recently, in roughly 60% of companies listed on TSE First Section, at least one-third of the board members are independent directors. Taking such a reality into account, I suggest that we should discuss the wording here – how we think about this going forward and how it should be described in the Code.

The next point is the quality of independent directors. Essentially, it boils down to the strong sense of responsibility and awareness of each independent director. This Council, however, is the venue to have discussions concerning the Corporate Governance Code. Therefore, I think it would be better to discuss specifically how the quality of independent directors can be further improved, taking into account previous discussions at the Council as well as best practices abroad. To achieve it, there are two key points.

One is the succession plan for independent directors. So far, we have extensively discussed the succession plan for CEOs, but not much the succession plan for independent directors. I suggest that we have in-depth discussions on this.

Another is the targets of board evaluations. Currently, the Code stipulates evaluations of the board as a whole. Perhaps, we could discuss additional targets, specifically, evaluations of committees, including the nomination committee which appoints directors, or evaluations of individual directors.

That's all from me.

[Kanda, Chairman] Thank you very much.

It seems the Internet connection with Mr. Oba is not stable, so the Secretariat is checking it. In the meantime, I'd like to ask Mr. Kawakita to speak.

[Kawakita, member] I'm Kawakita. Thank you for the opportunity to speak to you.

I'd like to express my opinions focusing mainly on three points. First of all, dispersion of dates for general shareholder meetings, cash holdings, and dividend policy, were among the things written in the reference material. I believe that dividends should be determined by a board resolution. Then, if they fix a record date for voting rights for a general shareholder meeting on a different date from a record date for dividends, the flexibility of general shareholder meetings will be enhanced. When the board makes a resolution on dividends, the board members will be forced to thoroughly consider cost of capital, as well as the quantity and quality of cash holdings, and growth strategy. Subsequently, companies may disclose their dividend policies, growth strategies – their views on such things. I suggest such a procedure.

Currently, a dividend payout ratio of 30% is the most common percentage among companies. But how do the companies determine the ratio? After all, most of them are doing what others do. By holding directors accountable for a decision on dividend payment, I believe such "me-too" policies can be corrected. Besides, as I mentioned earlier, it will contribute to the flexibility of and the dispersion of dates for general meetings. This is my first point.

The second point is about cross-shareholdings. This is important, and at the same time, we can see obvious drawbacks in parent-subsidiary listings. I think Mr. Toyama also wrote about it in his opinion statement. It is important to get rid of adverse effects of parent-subsidiary listings. Currently, controlling shareholders are causing disadvantages to general shareholders by exercising their option rights to top up or sell their holdings of shares in controlled companies. If a controlling shareholder holds above 40 percent shares through TOB, the controlling shareholder can virtually control the majority of the shares, considering the percentage of voting rights. On the other hand, there are cases where a controlling shareholder sells shares in its subsidiary to obtain cash, but continues holding above 40 percent shares, and then suddenly acquires 100 percent ownership of the controlled company. What for? After all, controlling shareholders exercise their option rights and manipulate controlled companies on their own terms. There seems to be such an aspect. Minority shareholders are swayed by controlling shareholders' strategies. We have seen many such cases.

Accordingly, companies should reorganize parent-subsidiary listings: they should formulate strategies as to whether they should hold 100 percent shares or zero percent, and disclose such strategies to the public. They should get such a process going without making a fuss. I think that's what is expected of the companies.

The third point is associated with COVID-19. Companies should secure diverse and excellent human resources. They are, so to speak, significant intangible assets of companies. In order to do so, aside from ensuring adequate compensations, companies will, for example, need to enhance and improve satellite offices to drive workstyle reforms. Currently, following a trend in the US and Europe, multi-stakeholder idea is being brought into Japan. Unfortunately, Japanese companies are not really generous to their employees. The pay level has significantly declined. Judging from the fact that labor's share has declined and the pay level is low, as Mr. Oguchi mentioned earlier, I suspect Japanese companies are not successful in rewarding not only their shareholders, but also their employees. I think this discussion is also related to "Social" of ESG.

The Material from the Secretariat mentioned ESG, but I won't talk about it now. If there is another opportunity to speak, I'll share my view of ESG.

That's all from me.

[Kanda, Chairman]　Thank you very much.

Mr. Oba, please go ahead.

[Oba, member]　I'd like to make three points.

The first point is about an evaluation of the current situations. As for the evaluation of the current situations, evaluations of the two Codes would fall into two types: one would be such a positive evaluation as "slow but steady progress in creating positive impact", and another would be such a negative evaluation as "frustratingly slow". Reasons for concurrently receiving these two different evaluations are differences in companies' responses to the Codes. Some companies have made steady progress, and other companies have not. Co-existence of such companies may have led to such evaluations. Accordingly, the positioning of listed companies subject to the Corporate Governance Code is a very important topic, and it is also an issue related to the restructuring of TSE markets. This is my first point.

My second point is: let's return to the starting line. On page 5 of Material 3, the issues raised at the Council, etc. are summarized: cost of capital, the board effectiveness, mid- to long-term sustainability, confidence in audits, and group governance. I believe it is essential to have deeper discussions on these issues once again. According to the recent survey conducted by the Securities Analysts Association of Japan in March, cost of capital is regarded as a key management consideration in less than half of the respondent companies. I believe it is important to consider how the Code delivers key messages to practitioners in the companies in an actionable way.

With respect to the board effectiveness, I agree with what Ms. Takayama pointed out. Concerning mid- to long-term sustainability, as several members already mentioned, it would be necessary to have deeper discussions on diversity of people in the managerial positions. As for confidence in audits, I agree with the point raised by Mr. Okada. Recently, we have seen such serious problems as the system failure at the TSE, and improper counting of votes. They reminded me of the importance of confidence in audits as well.

Next, with respect to group governance, I agree with Professor Kansaku's view. To be more specific, I think we should have deeper discussions on the issues summarized in the Material once again.

My third point is about what we should review concerning corporate governance in the coming meetings. This is related to my second point – the necessity for having deeper discussions once again. It has been pointed out that the industrial structure remains unchanged, or companies are making slow progress toward achieving diversity of human resources, but ultimately, I think the underlying issue is the mobility of human resources. Due to the lack of the mobility of human resources, the progress in achieving diversity is slow, and the improvement of the board effectiveness is slow and becomes even more difficult. The issue is not only about the mobility of corporate managers, but also about the mobility of employees. Perhaps a similar situation is observed in universities, among professors and researchers. The mobility of human resources in Japan is characterized by vertical moves. I feel it is important to raise awareness of how lateral moves must be achieved. I believe this is also a very important topic relevant to the shift in the industrial structure in the post-COVID-19 era. As the topic of discussion going forward, I suggest that we discuss the mobility of human resources.

That's all from me.

[Kanda, Chairman] Thank you very much, Mr. Oba.

Next, Mr. Sampei, please go ahead.

[Sampei, member] Thank you.

First, I'd like to respond to the question about additional new issues, changes in priorities, and review of existing issues on page 5 of Material 3.

The keyword related to co-existence with COVID-19 and post-COVID-19 would be "changes". The pandemic revealed changes that had already been underway. Reasons for their huge social and economic impact are as follows: even though companies were aware of ongoing changes, they were resistant to the changes and did not have a sense of urgency to address them. There were ongoing changes on the one hand, and failure to act due to the reluctance to accept the changes on the other hand. The gap had been growing. Then due to COVID-19, the gap was revealed. This is my understanding.

In that sense, now that we are aware of the gap, I believe it is important to promptly put in place necessary structure that helps companies undergo the changes. Therefore, my response to the question is that key issues have not significantly changed before and after COVID-19. However, it is necessary to correct companies' failure to act or procrastination.

More specifically speaking, I have some expectations for corporate management. The first one is decision-making on matters where there is no right answer. The second one is accountability for such decisions. I think this is important. As the Secretariat explained, when companies anticipate changes and decisively take on challenges, they might work on initiatives to which they are likely to find the right answers, or collect evidence until they can see the right answers. By doing so, after all, everyone will do the same things. That is not what we expect. Due to the current circumstances, we fully realized that there are no right answers now. Nonetheless, companies must make decisions. How should they do it? Rationality and transparency are required for it, for instance. Companies must provide clear explanations on the decisions. The third one is the expectation for the results: ensuring to make changes in an effective and speedy manner. As Mr. Oba mentioned earlier, I believe the speed is increasingly becoming very important. These 3 points are minimum expectations for corporate management.

With respect to human resources, companies should respect individuals. Motivation and circumstances are unique to each individual. It is not about providing and enforcing a new format in the name of "work style reforms". Instead, it is necessary to look at unique motivation and circumstances of each individual more closely. In Europe and the US, such efforts have been actively made. On the other hand, it is important that individuals take an initiative, instead of merely following orders or complaining that they are not given orders. I believe that self-initiative and independence is important.

Concerning the resistance to change, currently there is a growing sense of emergency so now is a good opportunity for a change. Then important things here are the full use of diversity & inclusion, as well as restructuring starting with the digital transformation. While the digital transformation is currently a trend, it does not mean mere introduction of IT. The digital transformation involves a change in ways of thinking, in the first place. The phrase "xxx transformation" has been used in various areas.

However, I often feel something is off. Transformation necessarily requires subtraction. Addition of small improvements will not enable transformation to occur, or will be too slow to make transformation happen. Therefore, subtraction is indispensable for transformation.

With respect to "other points regarding corporate governance that should be discussed" at the bottom of page 5, first of all, I'd like to say that the Corporate Governance Code adopts the principle-based approach. We should return to the principle-based approach. Since the introduction of the Code, 'Comply or Explain' has drawn attention, as it was a new style. The focus was placed on practical responses in terms of whether companies comply with principles or provide an explanation for non-compliance. However, regardless of whether they comply or explain, especially in case of providing explanations, they need to have an understanding of the underlying philosophy of principles under the principle-based approach. Therefore, the Preamble of the Code, which is included in the Material, is extremely important.

For example, in Europe and the US, stakeholder primacy is much talked about, as if it were a new concept, but the Preamble of Japan's Code already referred to the significance of such a concept, including the need for a balance. I have also seen the reimport of the concept, and some cases of wrong use of the term – what to say, it is like the abuse of "stakeholder primacy". For example, the term is used in the context where dividends can be reduced when companies place the priority on ensuring job security. Or in the US, the regulator bans share buyback by banks, caps dividends. For instance, among S&P 500 companies excluding financial institutions, 43 companies reduced dividends. Meanwhile, among TOPIX 500 companies excluding financial institutions, 74 companies reduced dividends. Looking at year-on-year changes in dividends, among S&P 500 companies including financial institutions, dividends increased by 5% year-on-year. While some companies reduced dividends or decided not to pay dividends, other companies increased dividends – therefore, the overall change was plus 5%. On the contrary, among TOPIX 500 companies, dividends decreased by 9%. I got an impression that stakeholder primacy somehow influenced decisions on dividends, perhaps placing the priority on job security, or there may have been sort of "me-too" reduction in dividends in line with the trend in Europe and the US. Of course, if the reduction was due to a pressing need for cash, it would have been unavoidable. I think some of the companies reduced dividends according to reasonable judgments.

Another important point related to the principle-based approach is to ensure diversity. I earlier mentioned that the keyword is "changes". To facilitate changes, it is essential to ensure diversity. In order to monitor such aspects as decision-making where there is no right answer, rationality, transparency, no action or procrastination, diversity is highly necessary. This has likely resulted in the rule of board composition of a half or one-third of the board members being independent directors. As for the board composition it is not right to set a numerical target first, since the objective is to ensure diversity.

With respect to responsibilities of the board, whenever something goes wrong, people tend to say that independent directors should handle the matter in question, or to question the responsibility or the quality of independent directors. However, in the first place, the entire board is responsible. Inside directors must understand it. If any inside director cannot understand it, he/she should not be in the position of director, I believe.

In such a context, I'd like to have further discussions on the following topics: the review of business portfolios, which is associated with recently-formulated "Practical Guidelines for Business Transformations"; and group governance, as pointed out by other members. I find the protection of minority shareholders from controlling shareholders is especially an important point.

And now, a few words on the general shareholders meeting. This year, an increasing number of companies held hybrid general shareholders meetings. As a result, it became clear that they typically failed to secure shareholder rights. It is essential to ensure the interactivity and instantaneousness during Q&A sessions as well as live streaming.

Finally, I understand that the revised Corporate Governance Code will be used for setting a bar for listing on the TSE prime market. In that sense, it will be even more important to establish an independent committee that is equivalent to statutory nomination committee or statutory remuneration committee of company with three committees system in terms of independence. And as Ms. Takayama mentioned earlier, I believe it is important to analyze and evaluate the effectiveness of such committees.

That's all.

[Kanda, Chairman] Thank you very much.

Next, Mr. Takei, are you there? Please go ahead.

[Takei, member] Thank you. I'd like to first talk about matters related to sustainability governance. I suggest that some points of the current Principles 2.3 and 2.4 should be revised.

First, the expression "increase employee engagement" has often been used recently. It is important for a company to increase employee commitment in the sense that employees identify themselves with the corporate philosophy and therefore perform their best. Such measures and human capital investments are increasingly becoming critical. I believe that we should add descriptions about this point to the Code to a certain extent. This is my first point.

My second point is, as other members mentioned, ensuring diversity in the management team. In the era of DX, innovation requires diversity in the human resources. Therefore, the Code should refer to not only diversity as stated in Supplementary Principle 4.11.1, but also diversity among executives/management team in Section 2. The current principle refers to women as an illustrative example, but it should touch on other elements of diversity as well. Unless a company has clearly defined its vision and values, it cannot attract and maintain diverse human resources. Therefore, I recommend that Section 2 should be enhanced by covering such points.

The third point is the establishment of sustainability committees as a venue where diverse talents have meaningful discussions. We should probably consider it at this stage. In other countries, the establishment of sustainability committee is becoming a common practice. The European style, where such a committee is established under the oversight body will not be our sole option. The sustainability committee could be established under the executive function in a way that diverse members have discussions. For that purpose, I believe that we should discuss sustainability committee this time, and include it in the Code.

These three points are my suggestions about sustainability governance. The next point is related to DX. Concerning DX, I believe it is important that the Code clearly mentions and describes DX governance. DX governance means having in place a governance-by-design framework, in order to realize corporate philosophy and corporate value through DX, in the era where various actions are required for DX. Specific points to be discussed include cyber security in terms of risk management, as Mr. Obata mentioned earlier, but are not limited to security. For example, when the use of data and AI is accelerated in DX, in order to ensure that such data and AI are adequately used and support corporate philosophy that realizes social value, it is important to devise a governance-by-design framework. As for AI, profiling has recently attracted interest. Not only a violation of human rights, as mentioned earlier, but also a damage to corporate philosophy or social value could happen. Accordingly, instead of leaving such things to IT or technology professionals, it is important to have in place a DX governance system at the management level as a response to DX going forward.

The fifth point is related to the board. I'd like to talk about the appointment and remuneration of directors and other officers. In Japan, there are quite many cases where the tenure of the top management runs routinely for 4 or 6 years. There certainly are some reasonable cases, so it should not be entirely denied. Meanwhile, in order to drive business innovation in the context of DX, there may be a concern that the fixed, pre-determined tenure of 4 to 6 years may not be effective. Imagine a situation where the pre-fixed tenure of a CEO expires in the middle of the seed stage with negative earnings, and then the next CEO benefits from its great results. Under such circumstances, some points out that the management will not be motivated to achieve transformations. This issue is how do the board and nomination committee perceive routine prescription for the tenure of directors/officers. In order to facilitate discussions on the tenure at the board and nomination committee meetings to undertake various transformations in the future, this would be a relevant point to be discussed.

I'd like to make another point related to the board. While some members discussed virtual general shareholders' meetings, I think we could discuss the possibility of virtual board meetings in the first place. Since the board deals with considerably confidential materials, electronification may certainly be difficult in terms of cyber security, etc. On the other hand, the electronification will enable participation of diverse people and more frequent meetings. There are such benefits from digitalization. I think we could include the electronification of board meetings in the agenda as well.

The seventh point is my last point. The Material refers to growing discussions in the US and Europe on value delivery to diverse stakeholders. As other members already mentioned, in Japan's Corporate Governance Code, not only General Principle 1, but also General Principle 2 clearly stipulates it, and certain progress has been made ahead of the rest of the world. However, in the wake of COVID-19 and digitalization, this topic is attracting interest again. Especially, in respect of the digitalization, there certainly is a social concern that DX might steal jobs from people, or expand social disparities. Therefore, I think we should refer to discussions in the US and Europe, and revise the Governance Code by including supplemental descriptions about points to be corrected.

That's all. Thank you.

[Kanda, Chairman]　Thank you very much.

Next, Dr. Ueda, please go ahead.

[Ueda, member]　Thank you for the opportunity to share my views.

Multiple impacts of COVID-19 have been talked about. From there, I'd like to make some suggestions and express my views concerning how the Governance Code should be revised.

Did COVID-19 change anything significantly or not? Concerning the 'subjects to be discussed' on page 5 of the Material, basically, I think there is no major changes due to COVID-19. However, I think it is true that transformations, which had been called for before COVID-19, have accelerated, and pre-existing issues or management risks have been revealed to a great extent. Productivity is one of such examples. As some members pointed out earlier and as shown on page 3 of Reference Document 2, a problem of low margin still exists, even though the number of independent directors increased as an outcome of governance reforms. Then we must consider full-scale review of corporate management, including business models and business portfolios. Especially, in the wake of COVID-19, the socio-economic structure has significantly changed. As the society shifts from face-to-face to non-contact, there is a need to address the shift in terms of not only interactions with customers, but also interactions with the whole supply chain. Under such circumstances, how can companies maintain or increase their productivity?

With respect to DX, for instance, DX will not directly cause an increase in corporate value. Rather companies need to consider how they can take advantage of and embrace DX for increasing the productivity in this changing environment.

Furthermore, I'd like to refer to the issue of cash, including capital efficiency defined in financial strategies. Due to COVID-19, many companies are inclined to hold cash. In such an emergency situation, rich cash reserves held by Japanese companies made a positive contribution. However, such cash holdings should not be justified, because what is needed are adequate and healthy financial strategies. We need to consider cash holdings, including this momentum.

In relation to that, I'd like to talk about the sustainability of companies themselves. Nowadays, when the term "sustainability" is used, it tends to lead to discussions on ESG or environmental issues. Yet, in order for companies to work on such issues, companies themselves have to be sustainable. Therefore, we should focus on the sustainability of companies. In the short run, it is expressed in terms of financial value. As far as disclosure is concerned, an emphasis has recently been placed on disclosure of non-financial information. The objective of such a disclosure is associated with the future value and the sustainability of the companies, if not future cash flow of the companies. Accordingly, I think the Governance Code needs to incorporate measures or considerations to support the sustainability of the companies themselves.

Stakeholders, especially, employees are becoming very important. It is necessary to consider ways of employee engagement in companies over mid- to long-term, rather than ways to protect job security right now. Besides, diversity should be considered from a broader perspective, not limited to women or foreigners. It is necessary to look at their backgrounds, views, or commitments. For instance, companies could consider various work styles of employees, or participation from abroad in case of directors/officers. Such efforts will not lead to near-term financial results, but should be considered from the perspective of mid- to long-term sustainable value. Since “stakeholders” sounds pleasing to ears, some tend to jump on it without realizing the essence. However, the important thing here is to look at corporate value over the mid- to long-term.

Finally, I’d like to talk about the market. The market structure is being reviewed. To revise the Governance Code at this timing, we should ensure that companies are aware that they are participants in the global market. Especially, in case of companies seeking a listing on the prime market or listed on the TSE First Section, being invested in by overseas investors, or running businesses in global competition, they need to reaffirm that their management structures incorporate global perspectives, and that corporate managers have global perspectives. In terms of forms, we have increasingly seen the board composition including outside directors or independent directors, as well as the establishment of a nomination committee or nomination & remuneration committee, for example. In case of Companies with Supervisory Committee, what is required of them is the establishment of only one committee. I do feel this requirement is rather weak, so the Code could urge them to establish something like a nomination & remuneration committee from the perspective of the global market and global competitiveness, or we may need to review the composition of independent directors and their qualities on the board.

I’d like to make another comment on the market. From the perspective that companies are listed on the TSE which global investors participate in, it could be said that the cases of parent-subsidiary listings and cross-shareholdings are abusing the market mechanism in a certain sense. As for parent-subsidiary listings, companies concerned may not be explicitly aware of that partly because of the historical background, but this is one way to look at it. They should reconsider their attitudes toward the market, including such aspects, with a heightened awareness. The current Preamble may touch on it, but we need to review things like parent-subsidiary listings or cross-shareholdings on more concrete levels. I suggest that the revised Code should provide such a broader perspective anew, and then stipulate specifics.

That’s all. Thank you very much.

[Kanda, Chairman] Thank you very much.

Next, Mr. Tsumuraya. Are you there? Please go ahead.

[Tsumuraya, member] Thank you. Due to the time constraint, I’d like to briefly express one point.

Other members already expressed their opinions about what should be done in the post-COVID-19 era, yet I think we also need to have a viewpoint for enhancing outcomes from the existing Code. For example, the Code mentions lead independent directors. According to the survey of the METI, the number of lead independent directors is still small. And even if a company has a lead independent director, the current disclosures do not provide information as to who plays such a role. The Code currently stipulates that the lead independent director serves as an intermediary for communications with inside directors, but I believe that the lead independent director is also important as a contact point of engagement. While more than half of TOPIX companies have at least three independent directors, we could consider the roles of the lead independent director and *kansayaku* in engagement.

Similarly, although the viewpoint is slightly different, the number of companies that established the remuneration committee and/or the nomination committee has significantly increased, according to the TSE's survey. However, while examining their disclosure documents, I found it impossible for outsiders to know what they do in such committees. Their Integrated Reports state that the company has established the committee. The subject is "the company" or "our company" in Japan, while the subject is "we" of the committee members in the US. "We (the external committee members) have discussed xx, and identified such challenges as xx." This kind of information is not found in Japan. Now that Japanese companies have increased the number of independent directors to the current level and established the nomination and remuneration committees, including optional ones, I suggest that they improve their disclosures to be more substantive and informative.

That's all. Thank you very much.

[Kanda, Chairman]　Thank you very much.

Next, Mr. Iwama, please to ahead.

[Iwama, member]　Thank you. Let me briefly share my opinions.

I agree with many points made by other members. Speaking of what has changed due to COVID-19, I agree that basically, there is no major change in governance issues. Yet there is one quite new thing: the discontinuation of traditional ways. I think this discontinuation is facilitating the digital transformation. In that sense, we need to seriously consider the electronification of general shareholders meetings or online general shareholder meetings. Probably, we need to sort out the relevant issues, and the enhancement of electronic disclosure will be also required.

In that sense, taking this opportunity, we could consider the use of ICJ [Investor Communications Japan] for electronic voting. There may be practical issues concerning the use of such an electronic voting platform, but I think this is a good opportunity to discuss it.

Another topic to be discussed under the current circumstances would be engagement, because more in-depth dialogue is required concerning mid- to long-term strategies, risk strategies, and risk allocation strategies of the companies. As Mr. Okada and Mr. Kobayashi pointed out earlier, I believe that the Governance Code needs to be move forward in a way to promote deeper engagement.

In that sense, the current Code adopts the principle-based approach, asking companies either to "comply or explain". However, in other countries, some are moving towards "apply and explain" approach. In order to improve the effectiveness, we could discuss principles themselves toward such a direction, and deepen the principles.

Another point is the issue of succession. This is a major issue. As pointed out earlier today, the nomination committee or the remuneration committee should monitor the succession and evaluation of not only the CEO, but also the entire management team. From such a viewpoint, the role of independent directors/officers is becoming more important than ever.

In this regard, as Mr. Oba pointed out, the mobility of human resources is absolutely necessary. If the supply of human resources remains tight, it will be problematic, so a sort of framework, or a momentum will be necessary to facilitate the mobility. Basically, I agree with Mr. Toyama's opinion statement. I hope this revision of the Governance Code will advance in the right direction.

That's all.

[Kanda, Chairman]　Thank you very much.

Next, Mr. Tanaka, please go ahead.

[Tanaka, member]　Thank you. Due to the time constraint, I'll briefly make comments.

Today we are asked by the Secretariat which issues we are going to review, as stated on page 5 of Material 3. In that context, I'd like to return to the Preamble (excerpt) of the final proposal of Corporate Governance Code on page 8 of Material 3. It states "support sustainable corporate growth and increase corporate value over the mid- to long-term". In addition, this Council is supposed to follow up on both the Stewardship Code and the Corporate Governance Code. On page 18 of Material 5, key points of the second revision of the Stewardship Code are summarized. I think this page is very important. I have learned a lot of things from other members so far. Basically, what you see here is the investment chain. Looking at this investment chain once again, I can see the starting point is a company in the utmost right part, which delivers a return [on investment]. I thought about various things, looking at this diagram. Among ① items that relate to the whole, you see "improve corporate value over the mid- to long-term". In this diagram, company in the utmost right part delivers a return [to asset manager], and constructive dialogue is held for exactly such a return. When you look at actual returns in the world, the market cap of all listed companies in Japan combined is still smaller than that of the four GAFA companies.

I've been thinking that the essential issue is how to make the investment chain work. I happen to currently manage a business corporation, and I feel that the market cap or share price will be an extremely important element. One of the essential duties of corporate managers, especially in case of listed companies, is to create wealth, as I have understood for some time. Looking at the market cap from such a viewpoint, Toyota Motor holds the largest market cap in Japan for 22 trillion yen, which hasn't changed for a long time. The rest seems to fluctuate: some companies keep going down in the ranking while there are newcomers climbing up.

My point is that we need to redefine corporate value in this review. As I have mentioned several times in the previous Council meetings, corporate value could be defined in two ways: financial definition and non-financial definition. As for the financial definition, the following factors can be used: ROE, cost of capital, and share prices which represents EPS x PER – we need to review from such a viewpoint. In the M&A world, it is a common practice to obtain a fairness opinion in valuation of corporate value. In addition, there is a method using EVA and WACC. I think we need to consider how to define corporate value from the financial viewpoint.

Meanwhile, there should be a non-financial definition, considering recent developments. Possible factors for valuation include ESG, SDGs, diversity, and digitalization. After all, unless all of those factors can be properly measured and tracked, I'm afraid that it will not be possible to increase returns based on constructive dialogue.

In Japan, there is a tendency for sales supremacy, rather than looking at margins. Therefore, we need to provide a firm financial definition of the corporate value, allowing for the proper measurement of the corporate value.

Although there are many other points to address, I started thinking about the issue I just mentioned while preparing for the Integrated Report, which was published last week. Due to the time constraint, I won't go into my opinions on other things. If you are interested, please visit our website to find our Integrated Report. I wrote my view on various issues in the Report.

That's all.

[Kanda, Chairman] Thank you very much, Mr. Tanaka.

Time has passed so fast, and it is already the scheduled closing time. Professor Ikeo, if you would like to share your opinions, could you please do so?

[Ikeo, member] No, thank you. I think we had sufficient discussions today, so no thank you.

[Kanda, Chairman] Thank you very much. Please do not hesitate to make comments, if necessary.

Since it is already the scheduled closing time, I'd like to close today's meeting now. Thank you for your participation online for a long period of time. I appreciate your invaluable opinions. Based on today's discussions and comments, we'd like to have further discussions at coming meetings.

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

[Shimazaki, Director of the Corporate Accounting and Disclosure Division, FSA] I'd like to thank all the members for their participation. As for the next meeting of the Council, we will fix the date based on your schedules and will let you know later.

That's all from the Secretariat.

[Kanda, Chairman] Thank you very much. Now I declare the meeting adjourned. Thank you again for your participation.

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