(Provisional translation)

28th Meeting of the Council of Experts Concerning the Follow-up of Japan's Stewardship Code and Japan's Corporate Governance Code

1. Date and Time: April 19, 2023 (Wednesday) 9:30 - 12:00
2. Venue: This meeting was organized virtually.

[Kanda, Chair]

Good morning. It appears we are on schedule, so let us commence. We will now begin the 28th meeting of the Council of Experts Concerning the Follow-up of Japan's Stewardship Code and Japan's Corporate Governance Code. Thank you all for taking the time out of your busy schedules to attend this meeting.

Today's meeting will be conducted in a hybrid format, combining an online conference with an in-person gathering. It has been quite some time since we had such a significant number of participants in our meeting room, and it has been approximately four years since we last held this meeting in person.

Please note that today's meeting is being broadcast live on the web. As usual, the minutes of the meeting will be prepared and made available on the FSA website at a later date.

To start off, the secretariat would like to introduce two new members who will be joining us for this Follow-up Council meeting.

[Hirokawa, Director, Corporate Accounting and Disclosure Division, FSA]

Good morning. I am Hirokawa, the Director of the Corporate Accounting and Disclosure Division at the Financial Services Agency. I will be serving as the secretariat for this meeting. I am excited about the opportunity to collaborate with all of you.

We are delighted to introduce two new members who will be participating in the Follow-up Council meeting.

In accordance with the list of members provided in the material, we have Mr. Kohara Shigeaki, who will be participating online.

[Kohara, member]

I am Kohara from the Japanese Trade Union Confederation. I look forward to collaborating with all of you.

[Hirokawa, Director, Corporate Accounting and Disclosure Division, FSA]

Thank you very much, Mr. Kohara.

Next, we have Mr. Matsumoto Masayoshi, who will be attending the meeting in person.

[Matsumoto, member]

Good morning, ladies and gentlemen. My name is Matsumoto, and I serve as the Chairman of the Kansai Economic Federation. I am eager to work with all of you.

May I make an additional statement?

[Hirokawa, Director, Corporate Accounting and Disclosure Division, FSA]

Certainly. If you have any comments, please feel free to share them now. We will also provide an opportunity to hear your comments later in the meeting.

[Matsumoto, member]

Now, as this is a valuable opportunity, I would like to take a moment to share a few personal remarks as a form of greeting.

Throughout my over 50 years of tenure at Sumitomo Electric Industries, I have consistently upheld the three pillars of Sumitomo's business spirit, namely: "*Place importance on integrity and sound management*"; "*Do not act rashly or carelessly in pursuit of immoral business*"; and "*Do your sincere best in not only business but also every aspect of your life*." The roots of this ethos can be traced back to the teachings of the Sumitomo family's first generation, spanning over 450 years of tradition.

Throughout my career in the corporate world, I have witnessed firsthand how this mindset is deeply ingrained in the decision-making processes of senior presidents who came before me, as well as in the guidance provided to employees at various levels within the organization. Even after assuming a top management position, I have consistently upheld and cherished this business spirit. Six years ago, when I was nominated as the chairman of the Kansai Economic Federation, I took the opportunity to share these fundamental principles with the Federation's members, emphasizing their significance and relevance.

I firmly believe that this philosophy aligns closely with the concept of *sampo-yoshi*, which emphasizes the well-being of all three parties involved: the seller, the buyer, and society as a whole. It embodies the principles of multi-stakeholder engagement, where the interests of all stakeholders are taken into account for sustainable and responsible business practices. I am confident that this sense of shared values is not limited to the Sumitomo Group and companies in the Kansai region, but is embraced by numerous other companies across Japan as well.

Historically, Japanese companies have held the belief that they are public institutions of society and have traditionally embraced a management approach that emphasizes a medium- to long-term perspective. However, notable scandals in both the United States and Japan have served as catalysts for reinforcing and enhancing corporate governance practices.

I myself have no objection to the idea of emphasizing dialogue with investors and delivering returns to them. However, I am concerned that the management has recently become excessively focused on shareholders, potentially leading to short-sightedness. Nevertheless, I personally believe that managers themselves are the bearers of a capitalist society, and their sense of management holds great significance.

I believe that many shareholders and investors are also seeking medium- to long-term growth and value enhancement in a company. In such cases, I think that highlighting the strengths of Japanese companies from the past, such as strategic management with a medium- to long-term perspective and well-balanced contributions to various stakeholders, can result in mutually beneficial outcomes.

Since assuming the position of Chairman of the Kansai Economic Federation six years ago, I have strived to center my activities around the idea of emphasizing a medium- to long-term perspective and adopting a multi-stakeholder approach from the perspective of the business community. For instance, in terms of corporate governance, I have advocated for the elimination of mandatory quarterly disclosure and promoted a corporate governance system that prioritizes substance over formality. Additionally, I have strongly urged companies, from a public interest standpoint, to contribute to measures against the new coronavirus, increase wages, and participate in the Declaration of Partnership Building.

Based on the aforementioned ideas and experiences, I aim to make meaningful contributions to this Council. Despite being a newcomer, I am eagerly looking forward to collaborating with all of you.

[Hirokawa, Director, Corporate Accounting and Disclosure Division, FSA]

Thank you, Chairman Matsumoto.

I have circulated a list of the other members and observers who will be present in the meeting, and I kindly request you to make reference to it. Additionally, there has been a change in the secretariat, but considering the limited time available, I propose substituting the introductions with a seating chart.

That concludes my update.

[Kanda, Chair]

Thank you very much.

Now, let's proceed to today's agenda. The secretariats for this council, namely the FSA and the Tokyo Stock Exchange, will provide explanations on the materials prepared. Following the presentations, we will have a question-and-answer session and open the floor for discussion.

Let's commence with an explanation from the FSA.

[Hirokawa, Director, Corporate Accounting and Disclosure Division, FSA]

Thank you very much. I am Hirokawa, Director of the Corporate Accounting and Disclosure Division.

To begin, I will provide an overview based on the material 2 that is currently available at your hand. Firstly, I will review the proceedings of the 27th Follow-up Council meeting held last year and outline the actions that have been taken since then.

The second page of material 2 provides a review from about a year ago. This page summarizes the materials presented by the FSA at the last Follow-up Council meeting. As part of the interim review following the re-revision of Japan's Corporate Governance Code, empirical analysis and interviews with companies were conducted, and discussions were held based on the results.

For example, some studies suggest that reform efforts are effective and that the establishment of nomination and remuneration committees improves ROA (Return on Assets). However, other studies conducted after the implementation of corporate governance reforms find no significant relationship between outside directors and corporate value. While many studies have been conducted, they do not necessarily provide an evaluation of the reforms.

We also reported on the results of our interviews with companies from last year, which indicated that the direction and effectiveness of the reforms were widely supported by the companies. However, one of the challenges is that some were concerned that the reforms would become mere formalities if they required companies to delve into the details of their management. For instance, we received comments from companies regarding the formal exercise of voting rights, advice from institutional investors and proxy advisors, the lack of opportunities for dialogue, and difficulties in understanding real shareholders, particularly among medium or smaller-sized companies.

I have summarized the previous meeting's discussions on a single sheet of paper.

In terms of evaluating corporate governance reforms, the general consensus is that progress has been made in terms of formalities, and many companies share the view that enhancing the supervisory function of the board of directors is crucial for increasing corporate value. Moreover, the dialogue between companies and institutional investors has been gradually progressing toward the major goal of making the investment chain function effectively.

For instance, to avoid duplication, it is important to recognize that compliance and clear explanations hold equal value. In the realm of management issues, companies need to establish an awareness of the cost of capital and link personnel expenses and R&D expenses to corporate value, clarifying their purposes. Engaging in dialogue with investors to visualize the value is also necessary. Furthermore, regarding the improvement of the quality of directors, there has been a suggestion that the biggest obstacle to substantive governance reform lies in the quality of those who bear the responsibility for it. Some have pointed out the need to enhance the effectiveness of Japan's Stewardship Code in facilitating dialogue between companies and investors. Additionally, in terms of the legal system, the definitions of "joint holder" and "act of making important suggestions" in the large shareholding reporting system should be clarified.

Moving on to page 5 of material 2, Prime Minister Kishida mentioned corporate governance in his speech at the New York Stock Exchange on September 22 of last year. He emphasized the efforts made over the past year since the last Follow-up Council meeting and conveyed the message of accelerating and further strengthening corporate governance reform in Japan. As the meeting took place in New York, he also expressed his intention to listen to the opinions of a wide range of people, including investors from around the world. In response to this message, we established the Japan Corporate Governance Forum, a platform to gather opinions from various stakeholders, including overseas investors.

So far, we have engaged in discussions with overseas investors and governance organizations such as ACGA, ICGN, and investors domiciled in New York. They have highlighted various issues, such as management-related concerns, the promotion of profitability and growth based on the cost of capital, sustainability initiatives including human capital, and the effective functioning of independent outside directors. Dialogue between companies and investors has also been a subject of discussion.

Furthermore, I would like to introduce some of the efforts being made by the FSA amidst these various issues.

Turning to page 7 of material 2, the Disclosure Working Group (WG) of the Financial System Council has been studying the inclusion of matters in annual securities reports during this period. In particular, based on the WG's report in June 2022, the Cabinet Office Ordinance was amended at the end of January this year, introducing a new section for sustainability information in the annual securities report. Efforts are underway to require companies with fiscal years ending in March or later to include sustainability information in their annual securities reports. Additionally, there will be a new requirement for the disclosure of information on the activities of the board of directors, etc., relating to corporate governance.

As reference information on page 8 of material 2, the Disclosure WG of the Financial System Council has been studying sustainability-related issues. In December last year, it presented a roadmap for future efforts in this area. The roadmap includes the efforts of the Sustainability Standards Committee, the standard-setting body for sustainability disclosure in Japan, within the legal framework, along with considerations for third-party assurance of the disclosed content.

As you will see on page 9 of material 2, the disclosure of information serves as the foundation for dialogue. To promote such dialogue, the FSA has been working on the "Collection of Good Practices for Disclosure of Descriptive Information" for several years. This collection is regularly published and updated. In response to the aforementioned revision of the Cabinet Office Ordinance, the FSA has published a collection of good practices for disclosing descriptive information, including information on corporate governance, to enhance the content of disclosures related to sustainability information.

As shown on page 10 of material 2, we commissioned Mizuho Research & Technologies to conduct a survey on institutional investors' stewardship activities. The survey was conducted from January to March this year and included a questionnaire survey of 136 institutional investors, as well as interviews with 16 asset management institutions and asset owners.

The survey results reveal four major issues. Firstly, the survey participants themselves recognized a lack of resources for engagement. It also indicated a shortage of human resources with the necessary skills and abilities to carry out effective stewardship activities.

Secondly, as mentioned in the material, the insufficient behavioral change and attitude in portfolio companies imply that engagement and voting by asset management institutions may not be convincing to companies. These activities are seen as mere formalities and may not lead to behavioral change.

Regarding the PDCA cycle for process development and stewardship activities, some comments suggest that certain asset management companies lack sufficient evaluation and monitoring systems. Similarly, some asset owners may also lack such systems.

Furthermore, some respondents expressed concerns about the lack of incentive to allocate costs and budgets to stewardship activities. They believe that the stewardship activities of asset management institutions are not adequately reflected in the selection of asset management institutions or the setting of their compensation.

Turning to page 11 of material 2, the survey results on stewardship activities provide recommendations for addressing these issues. The first recommendation is to encourage collaborative efforts among asset management institutions. It suggests that asset management institutions should collaborate widely and exchange opinions on solutions to various issues and the effectiveness of their initiatives.

The second recommendation focuses on efforts between asset owners and asset management institutions. It includes the requirement for asset owners to evaluate and appropriately monitor asset management institutions.

The third recommendation emphasizes collaboration among a wide range of asset owners. Recognizing that asset owners may vary in size and face challenges in securing sufficient knowledge and management systems individually, it suggests collaboration with other asset owners who possess the necessary expertise and systems.

The fourth recommendation emphasizes the importance of administrative authorities properly following up on the effectiveness of stewardship activities and addressing issues related to the lack of clarity in the large shareholding reporting system.

Now, let's move on to page 12 of material 2. In connection with the previous point, the Financial System Council conducted a general meeting on March 2 this year, during which the Council was requested to consider the ideal structure of the tender offer system and the large shareholding reporting system. The objective was to ensure market transparency and fairness and promote constructive dialogue between companies and investors, recognizing it as a significant institutional challenge.

Concerning the tender offer system, some issues have been identified, including the scope of tender offer regulations, measures to eliminate or reduce coercion, and the need for increased flexibility in various tender offer regulations. Regarding the large shareholding reporting system, there is a specific request to clarify the requirements for applying special reporting regulations to institutional investors and define the scope of joint holders. Additionally, as mentioned earlier in the corporate interview, there is a suggestion to consider measures to enhance transparency regarding beneficial shareholders.

This concludes the brief but comprehensive explanation of our efforts over the past year. Thank you very much.

[Kanda, Chair]

Thank you very much.

Now, please proceed with the presentation from Tokyo Stock Exchange. Mr. Ao, we appreciate your time.

[Ao, Director, Senior Executive Officer, TSE]

I am Ao from Tokyo Stock Exchange, Inc.

First of all, please refer to the table of contents on page 1 of material 3. Today, under the title "TSE's Recent Initiatives on Corporate Governance," I would like to briefly explain the following four points: 1) Action to implement management that is conscious of cost of capital and stock price; 2) better dialogue with shareholders and related disclosure; 3) using "explain" to contribute to constructive dialogue; and 4) consideration of information disclosure and governance regarding quasi-controlled listed companies. We notified the listed companies about initiatives 1 through 3 on the 31st of last month. In particular, I would like to focus on the first point today, as we feel that there are some nuanced differences in the way it has been reported in the press.

Please turn to page 2 of material 3. This page provides background information on the request for management that is conscious of the cost of capital and stock price. The first point highlights that Japan's Corporate Governance Code has long emphasized the importance of allocating management resources with a clear understanding of the cost of capital and return on capital, in the context of sustainable growth and mid- to long-term enhancement of corporate value. On the other hand, as indicated in the second point, approximately half of the listed companies in the Prime Market and around 60% in the Standard Market still have ROE below 8% and P/B ratios below 1x. The "Council of Experts Concerning the Follow-up of Market Restructuring" held by the TSE has proposed the need for management to change their mindset regarding the cost of capital and stock prices in order to improve corporate value.

On the third page, an international comparison of P/B ratios and ROE is presented. Among the top 500 Japanese companies, approximately 43% have P/B ratios below 1x, and 40% have ROE below 8%. In this regard, we acknowledge that the current situation is significantly inferior to that of major listed companies in Europe and the United States. While P/B ratio and ROE are not absolute benchmarks, they are important indicators, and it is crucial to comprehend them appropriately.

Please proceed to page 4 of material 3. As mentioned in the second point, the purpose of this request is to achieve proper allocation of management resources by having management take the lead in promoting activities such as R&D investment for intellectual property and intangible assets, investment in human capital, capital investment, and reviewing the business portfolio, all with the aim of realizing sustainable growth while being fully mindful of the cost of capital and return on capital.

Some media outlets have reported this initiative as a means to encourage or expect share buybacks or dividend increases. However, as indicated by the asterisk on this slide, we do not expect companies to solely rely on these measures or address issues with a one-off response. Instead, we believe that the best approach is for each company to initially consider making sufficient meaningful investments to achieve a return on capital exceeding the cost of capital, and then identify fundamental initiatives for sustainable growth, subsequently allocating management resources to those initiatives.

Moving on to page 5, as depicted in the figure in the middle, we request companies to first properly understand their cost of capital and return on capital from the perspective of implementing management that is conscious of the cost of capital and stock price. Subsequently, we encourage them to formulate and disclose improvement plans based on analysis and evaluation, along with market assessments during board of directors' meetings. Following this, we recommend that companies continue to take a series of actions, such as updating their initiatives through dialogue with investors.

Page 6 introduces additional initiatives. This section emphasizes the significance of a well-functioning investment chain, where dialogue plays a crucial role in achieving success. Regarding the promotion and disclosure of dialogue with shareholders, while this is closely related to the previously mentioned initiatives, we urge companies engaging in shareholder dialogue and to disclose the status of such dialogues, taking into account the concept of the Prime Market and aiming to foster constructive dialogue with shareholders.

The third item pertains to the points and examples of "explanation" that contribute to constructive dialogue. We have provided these points and examples as materials for listed companies to conduct a self-review of their utilization of "explanation." Therefore, while we request either compliance or explain, rather than simply complying with the principles, we encourage companies to carefully consider these guidelines and either comply with them or provide enriched explanations.

The fourth item focuses on the study of an ideal governance and disclosure system to appropriately protect minority shareholders in quasi-controlled listed companies. Discussions resumed in January of this year at a study group held by the TSE. We will continue to delve into how to structure the disclosure points for listed companies with parent-subsidiary relationships, or broaden the scope of disclosure to a wider range of listed companies. Additionally, we will address how the governance structure of such companies should be established.

Due to time constraints, I have provided only a brief overview today. For more specific information on the initiatives mentioned on this page, please refer to the following pages as needed. Thank you very much.

[Kanda, Chair]

Thank you very much.

The FSA will now proceed to explain the topics we would like you to discuss today.

[Hirokawa, Director, Corporate Accounting and Disclosure Division, FSA]

Thank you very much. I am Hirokawa, Director of the Corporate Accounting and Disclosure Division, once again.

I would like to explain the items for discussion on page 14 of material 2.

First, we have identified the following three issues that have been pointed out as current challenges in substantiating corporate governance reforms, all of which are coming from the previous conference, the Japan Corporate Governance Forum and in the surveys of institutional investors.: (1) management issues, such as promoting profitability and growth based on the cost of capital and implementing sustainability initiatives, including investment in human capital; (2) issues related to the functions of independent outside directors, such as enhancing the effectiveness of the board of directors and the nomination and remuneration committees, as well as improving the quality of independent outside directors; and (3) issues related to the dialogue between the company and investors, such as enhancing information disclosure and addressing legal system and market environment issues.

What are your thoughts on working towards resolving each of the above issues simultaneously in the future? Additionally, are there any other important issues that should be discussed?

The second topic for discussion is the concept and specific actions for future efforts. How should we approach the solutions to the aforementioned issues and other unmentioned but considered issues, taking into consideration that further detailed elaboration of the Code may distort the reforms? Also, what are your thoughts on the timing of future revisions of the Code? What specific measures should be implemented to resolve each of the above issues?

The third topic we would like you to discuss is what do you think about summarizing the above ideas and measures into an action program and then assessing the implementation status of each measure at Follow-up Council meetings, as needed.

On page 16 and subsequent pages of material 2, we have presented a draft of the concept and contents of future initiatives as a basis for discussion. While I will mainly explain these based on material 2, we have also provided a detailed "Draft Action Program for Accelerating Corporate Governance: From Form to Substance" in material 4.

On page 16 of material 2, you can find a list of issues identified as challenges for corporate governance reform. To achieve sustainable growth and medium- to long-term improvement of corporate value through corporate governance reform, it is crucial for management, the board of directors, investors, and various stakeholders to collaborate effectively. With this idea in mind, we have further categorized and organized the various issues. The issues on the left side of the page are related to Japan's Corporate Governance Code, while those on the right side are related to Japan's Stewardship Code.

Specifically, on the corporate side, we emphasize that the board of directors must fulfill its functions in promoting profitability and growth based on the cost of capital, as well as addressing sustainability issues, including human capital. Additionally, independent outside directors must play an active role in promoting these initiatives.

In regard to constructive dialogue from a medium- to long-term perspective, enhancement of information disclosure, facilitation of dialogue with global investors, aforementioned issues in the legal system and substantiation of stewardship activities by asset managers, asset owners, and other investors form the foundation of effective dialogue. The following two pages of the report present draft initiatives proposed based on the classification of these issues and the concept of the intended initiatives.

Firstly, on page 17 of material 2, we have drafted two ideas on how to proceed with the following initiatives based on the provided concepts in order to address the aforementioned issues."

In order to further develop substantive measures in line with the objectives of corporate governance reform, the focus should be on promoting constructive dialogue between companies and investors and fostering autonomous awareness among both parties, rather than solely relying on the development of a formal system. Instead of adhering strictly to the previous three-year review cycle for revising each Code, the timing of revisions will be assessed in a timely manner based on the progress of corporate governance reforms, with the aim of substantiating these reforms. What are your thoughts on this approach?

Next, specific action plans have been presented for each of the previously mentioned issues:

1. Page 17, Section A of material 2 addresses the importance of management properly assessing the cost of capital and being mindful of profitability and growth. This includes reviewing the business portfolio, allocating management resources based on appropriate risk-taking, and making investments in human capital, intellectual property, and capital projects.
2. Section B on page 17 focuses on sustainability-conscious management. Efforts will be made to

address sustainability issues by compiling a collection of good practices in sustainability disclosure and considering additional measures to enhance board diversity and core human resources, such as increasing the ratio of female executives (with a target of 30% or more by 2030), based on individual company efforts.

3. Section C on page 17 concerns the exercise of functions by independent outside directors. The aim is to promote the effective exercise of their functions through surveys, publishing the actual activities of the board of directors, nomination and remuneration committees, and providing educational activities for independent outside directors.

Moving to page 18 of material 2, let's explore the issues on the right side:

1. Section A, titled "Substantiation of Stewardship Activities," highlights efforts to address issues in stewardship activities by investment management institutions, asset owners, and other stakeholders. This includes addressing resource allocation, incentives, and the organizational structures of asset owners.
2. Section B, labeled "Enhancement of Information Disclosure as a Basis for Dialogue," focuses on disclosing dialogue status, providing clear examples of effective and insufficient explanations, and ensuring timely information disclosure by companies to facilitate dialogue with investors. Efforts will be made to provide information required by investors before general shareholders meetings.
3. Section C, titled "Promotion of Dialogue with Global Investors," aims to promote dialogue with global investors through the visualization of corporate groups that proactively respond to global investors' expectations and further enhance English-language disclosure.
4. Section D, "Resolution of Legal System Issues," addresses topics such as the large shareholding reporting system, transparency of beneficial shareholders, and the protection of minority shareholders in partial tender offers. Discussions will be held regarding the "act of making important suggestions" and "joint holders" under the reporting system.
5. Section E, "Resolving Issues in the Market Environment," includes studying proper disclosure and governance related to quasi-controlled listed companies, monitoring the progress of reducing cross-shareholdings, and conducting further studies as necessary.

These are the proposed draft initiatives.

That concludes my presentation.

[Kanda, Chair]

Thank you very much.

Before we proceed with the discussion, the secretariat will provide a brief summary of the written comments submitted by absent Members Waring and Matsuoka.

[Hirokawa, Director, Corporate Accounting and Disclosure Division, FSA]

Thank you once again.

First, I would like to share the comments we have received from Kerry Waring, one of our members. We have received detailed comments on each item, so please bear with us as this might be a bit lengthy. Please refer to the document with the ICGN logo at the top.

First and foremost, before addressing the individual items, the comment letter begins by emphasizing the importance of corporate governance, as described on page 2. It is widely acknowledged that corporate governance directly contributes to corporate performance and, consequently, the long-term value preservation and enhancement.

Building upon this recognition, in the section "2. Issues for seeking sustainable corporate growth and increased corporate value over the mid-long term," the letter follows the same order as on page 17 of the previous material 2. Under the first item "A) Awareness of corporate profitability and growth," Kerry Waring supports the objective of promoting "profitability improvement based on a precise understanding of cost of capital." Additionally, considering the board of directors' crucial role in monitoring a company's capital allocation policy, the recommendations received include clear disclosure of the capital allocation policy, annual board reviews of the policy and business portfolio, transparent justification for holding non-strategic assets, and clear rationale for shareholder returns.

Moving on to the next item "B) Awareness of sustainability," Kerry expresses support for the efforts of the Sustainability Standards Board of Japan (SSBJ) in developing standards. In relation to diversity, she welcomes the increased corporate disclosure in Japan and recommends that companies explicitly state their goals and action plans regarding diversity on their boards of directors.

Regarding item "C) Improving the effectiveness of independent directors," Kerry welcomes the positive trend of having more independent outside directors. Furthermore, she suggests improving the disclosure of procedures and rationale for appointing individual directors, utilizing a skills matrix to clarify each director's attributes and alignment with the company's objectives and long-term strategy, and conducting periodic evaluations of the board by external reviewers.

The subsequent section is "3. Issues related to dialogue between companies and investors."

Under the first item "Substantiating stewardship activities," Kerry references the Global Stewardship Principles published by ICGN and emphasizes the importance of robust governance systems for investors, overseen by independent and unbiased boards of directors or other governance structures. Additionally, she mentions the need for asset owners to effectively supervise and monitor the stewardship activities of asset managers.

In item "(B) Enhanced disclosure as a basis for dialogue," Kerry discusses the principles of "comply or explain" and applauds the efforts to strengthen dialogue between companies and investors by better understanding how this principle works in practice. The letter emphasizes the significance of dialogue facilitated through "comply or explain" and highlights the importance of providing meaningful explanations with sufficient reasoning. At the same time, investors are urged to consider individual companies' circumstances. Regarding disclosure, the letter states that corporate governance disclosures should be consolidated in the annual securities report, which should be available in English, published at least 30 days prior to the annual shareholders' meeting, enabling investors to access the necessary information for voting decisions.

Under item "(C) Promoting dialogue with global investors," Kerry expresses support for any initiatives aimed at fostering dialogue between Japanese companies and investors worldwide.

Concerning item "D) Resolving legal issues: obstacles to collective engagement," as mentioned earlier regarding legal systems, comments have been received welcoming efforts to further clarify joint holders, for example.

Finally, in item "E) Resolving market environment issues: cross-shareholdings," Kerry addresses cross-shareholdings, noting that although information disclosure about such holdings has improved, the rationale and purpose behind ownership remain insufficient in some cases.

That summarizes the comments we received from Kerry.

I would like to continue with Member Matsuoka's comments.

Member Matsuoka, who is also the chairman of the Sub-Committee on Capital Markets of the Committee on Financial and Capital Markets of Japan Business Federation, mentions the Federation in her comments.

First and foremost, she states that corporate governance reform should focus on effectiveness rather than making the Code more detailed. The goal is to encourage management that contributes to medium- and long-term profitability and growth, which is the current need. In this regard, she agrees with the secretariat's proposal to substantiate the reforms in the draft action program. Furthermore, she emphasizes the importance of respecting the principle-based approach and the comply-or-explain principle.

Specifically, in item "1. Encouraging management with an awareness of profit-making and growth," it is suggested that measures be developed, especially on the corporate side, to encourage investment that contributes to sustainable growth, such as research and development and human resources investment for solving social issues. However, it is necessary to ensure that these measures do not lead to short-sighted efforts by companies. Companies should avoid capital policies that overly focus on P/B ratios and are heavily weighted toward actions like share buybacks. Additionally, there has been a growing need for the use of stock-based remuneration in recent years to motivate management and employees to improve corporate value over the medium to long term. Therefore, it is recommended to implement necessary institutional measures to expand the use of such remuneration systems.

In item "2. Encouraging management with an awareness of sustainability issues," it is stated that examples of good practices are welcome, and it is important to allow for flexible responses based on the actual conditions of companies. Additionally, in the realm of international sustainability disclosure standards, the letter notes the importance of actively communicating the views of Japanese companies and suggests that Japan should actively express its opinions on sustainability assurance standards.

In item "3. Improving the effectiveness of independent directors," the importance of analyzing and addressing the current shortage of independent outside directors who can contribute to corporate management is mentioned. The letter expresses hope that awareness-raising activities for independent outside directors will be effective in deepening their understanding of corporate realities and fostering dialogue with executive officers, employees, and shareholders.

Regarding item "4. Effective implementation of stewardship activities," it is pointed out that while stewardship activities depend on the institutional investor, some institutional investors only have formal or insufficient staffing in place for such activities. Therefore, it is recommended to provide policy support to build an ecosystem where sufficient resources can be allocated. The letter also suggests considering measures to cover the cost of stewardship activities by asset owners and establishing an award system for institutional investors who conduct excellent stewardship activities. Furthermore, concerning proxy advisors, many companies have expressed dissatisfaction with the quality of dialogue and concerns about biased evaluations resulting from a lack of dialogue. The letter emphasizes the importance of proxy advisors making reasonable recommendations based on appropriate dialogue with companies. To facilitate this, it argues that the FSA should play a proactive role as an intermediary in dialogues between proxy advisors and companies. At the very least, the FSA should set up a consultation service for companies and request that proxy advisors carefully respond to dialogues with companies.

In item "5. Resolving legal issues to facilitate dialogue with investors," it argues for the prompt establishment of a system that contributes to transparency on the shareholder side, such as a system that allows us to understand who the beneficial shareholders are.

Regarding item "6. Enhancement of information disclosure," it is necessary to carefully analyze and strike a balance between improving the usefulness of information through enhanced disclosure measures and considering the burden it may impose on all parties involved. Specifically, the submission of annual securities reports prior to the annual general meeting will require a significant review of corporate practices and the restructuring of business processes, which could impose a substantial practical burden. We have received feedback suggesting that corporate information useful to investors is already being provided in various forms, not limited to annual securities reports.

Regarding item "7. Promoting dialogues with global investors," it is worth considering a way to visually represent companies with excellent corporate governance that meet the expectations of global investors. However, it should be noted that expanding English-language disclosure needs to be approached with consideration for the unique circumstances of individual companies.

The item "8. Resolving market environment issues" emphasizes the need for stock exchanges to proactively communicate with listed companies in advance when establishing market rules or making requests to improve the market environment. Specifically, stock exchanges should consider practical measures for information disclosure and governance to protect minority shareholders in quasi-controlled listed companies, taking into account the insights and opinions of those responsible for corporate affairs.

I apologize for the length of the explanation. That concludes my remarks.

[Kanda, Chair]

Thank you very much.

Now, based on the explanations and introductions provided earlier, I would like to open the floor for questions and comments for the remainder of the meeting.

As explained by the Director of the Corporate Accounting and Disclosure Division, the issues to be discussed today are summarized on page 14 of material 2, along with the previously mentioned diagram and material 4 for your reference.

As time is limited, I have allocated a maximum of five minutes for each participant to share their comments.

For those who wish to speak, please place your nameplate on the table if you are participating in person. If you are joining online, please use the chat function as usual and type your name along with your request to speak.

Now, I am open to questions, comments, or any other points from anyone. It has been a while, but I would like to hear your thoughts.

Mr. Toyama, please proceed.

[Toyama, member]

It has indeed been a long time.

Firstly, I generally agree with the direction of avoiding excessive detailed rules. I have been expressing this opinion for some time, and I continue to support it because an increasing number of rules will lead to a more formalistic approach, which is not desirable.

On the other hand, I believe the discussion on Price-to-Book Ratio (PBR) at the TSE's Council of Experts Concerning the Follow-up of Market Restructuring, as mentioned earlier, is highly important. I am pleased with this development.

However, as pointed out, it would be unwise to take the easy path of promoting share buybacks. The fundamental issue lies in business profitability, not just the P/B ratio. It is clear. The overwhelming assets are attached to the business. I myself am the head of a company that employs about 7,500 people, and I am also an outside director of a large company in Osaka, so I am deeply aware of the fact that the low level of business profitability poses a threat to investment resources needed to maintain competitiveness and growth. This is particularly true in industries such as electronics, where, as you know, there is real expert in the seat next to me, substantial investments with inherent risks are necessary. Additionally, investments in intangible assets must be made. Therefore, relying on debt for such investments is not ideal. Ideally, such investments should be covered by operating cash flow, which necessitates improving profitability. Therefore, the fundamental problem lies in addressing the crisis of sustainability faced by many underperforming companies in terms of P/B ratios. Engagement is closely related to this issue, and it would be beneficial to shift the focus of the discussion towards it. Speaking of engagement, as someone who actively participates in investor relations (IR) activities and contemplates the matter, I find the current level of engagement to be inadequate. The average level is far from satisfactory. Unfortunately, IR discussions in New York or London surpass those in Japan in terms of content. Ultimately, the discussions should not revolve around share buybacks or similar topics. Instead, we should engage in strategic discussions concerning business earnings, business models, functions, and portfolio. Without opening up the "black box" and addressing these topics, meaningful dialogue cannot take place.

In any case, the quality of individuals coming from domestic institutions is insufficient. Therefore, unless we address this issue seriously, the overall standard will not improve. In this context, I believe that engagement has actually deteriorated, especially at present. As mentioned, passive investment still dominates, which ironically leads everyone to seek a free ride. While some institutions are engaging responsibly, the trend towards free-riding has become unavoidable.

Furthermore, as a member of the Council of New Form of Capitalism Realization, I must mention that the government is currently making significant efforts to increase individual asset income through initiatives like NISA. However, this promotion is resulting in a rise in passive investments, which is concerning. The situation is taking an increasingly peculiar direction.

Therefore, it is crucial not to oversimplify the engagement issue. It will continue to drift into formalities and lose its effectiveness. The underlying trend raises the question of how we should address this problem and deal with the issue of free-riding. To be honest, I wonder if it would be beneficial to focus on the top 100 companies in terms of market capitalization on the TSE and implement comprehensive changes in their practices. Such an endeavor would require the expertise of around 200 professionals who can effectively navigate both financial and business matters.

Without gathering a substantial number of qualified professionals, it would be futile. We certainly should not have numerous individuals who lack comprehension asking irrelevant questions in various ways. That is my perspective on the matter.

Another critical issue pertains to the quality of directors. As the Chairman of the Japan Association of Corporate Directors, I have witnessed numerous instances that shed light on this matter. Regrettably, the formal increase in the number of board members has led to a rise in individuals who join boards solely for small monetary gain. Many companies prefer such board members. Consequently, I receive frequent consultations from individuals who approach me, saying, "*I have been asked to serve on the board of directors of XX company, but I have been instructed by the secretariat not to voice unnecessary opinions.*" They seek my advice on whether to accept the offer, and I advise them not to accept. Alternatively, I suggest that they accept the offer and then betray the secretariat's expectations by actively raising concerns, constantly complaining, or advocating for management changes. This is undoubtedly a serious problem, and the role of outside directors is extremely challenging. To put it succinctly, in the words of Matsushita Konosuke, it is a matter of "entrust, but keep an eye on it." In a sense, the role of an outside director, based on this perspective, entails a greater commitment to the long-term growth of the company than the individuals within the organization. However, this task is far from easy and demands the highest level of sophistication. A familiar practice of expecting a "broad perspective" from an outside director is nonsense. If that is the intention, we can establish an advisory board. In that sense, the board of directors holds one vote and, in some cases, has the authority to propose the dismissal of the president. I believe that the current reforms fall short in terms of creating individuals with the necessary ability and preparedness to assume these responsibilities.

So, the issue of the quality of board members is also depends on the individuals who occupy those positions. After all, we operate within a system of capital democracy. The governance structure of a company is based on capital democracy, and the engagement issue I mentioned earlier is connected to the cultural standards concerning shareholders with voting rights. If this standard is low, democracy will falter.

Furthermore, the directors serve as representatives entrusted by the people, as they are elected to their positions in parliament. If the quality of parliamentarians declines, democracy will not function properly. Hence, both the issue of engagement and directors remain somewhat precarious at present. I urge you to delve deeper into these matters and take decisive action.

That concludes my remarks.

[Kanda, Chair]

Thank you very much.

Now, let's proceed in the order of Mr. Tsukuda, Mr. Sampei, Chairman Matsumoto, Professor Kansaku, and Ms. Okina from online.

Mr. Tsukuda, you may begin.

[Tsukuda, member]

Thank you very much.

Mr. Toyama has already covered most of the points I wanted to make, but I would like to provide a slightly different perspective.

First of all, I find no discrepancies between the issues listed on page 14 of material 2 and the initiatives proposed on pages 17 and 18. The direction outlined in these documents seems appropriate, and I believe we should proceed accordingly.

With respect to the question on page 14, when to revise the Codes in the future, I think it would be wise to make revisions as necessary.

There has been criticism that detailed rules becoming more complex as corporate governance evolves. In the future, it may be worth considering a return to more broadly defined guidelines to avoid excessive complexity.

Regarding the follow-up to the action program, the suggestion to verify it periodically at the meetings of the Follow-up Council, as mentioned at the bottom of page 14, seems reasonable to me.

I would like to address two additional points, which partly overlap with Mr. Toyama's comments, but also drawing on my personal experience of interacting with business people.

Firstly, I want to emphasize the significance of the discussion on the P/B ratio. Based on my interactions with corporate executives, the P/B ratio has become a highly relevant topic among business executives. The TSE's approach with its emphasis on this issue is highly commendable, and it accurately captures the essence. Corporate executives must strive to maintain a P/B ratio above 1x, which aligns with the first arrow mentioned on page 14 of material 2. This emphasis on profitability and growth potential, considering the cost of capital, is an appropriate recognition of the issue. I fully support this direction.

Furthermore, the P/B ratio can be expanded as P/B ratio = ROE x PER. As Mr. Toyama mentioned earlier, due to the TSE's announcement, we can expect a realistic increase in the number of Japanese companies engaging in share buybacks as a prompt response. While the adjustment of the balance sheet itself cannot be disregarded, the discussion on the P/B ratio essentially revolves around improving the PER component of ROE x PER. In other words, it involves shifting focus from existing businesses to growth-oriented businesses, raising growth expectations, and increasing the multiple. This transition will take time, but it is crucial to recognize that this is the most significant aspect.

Taking a broader perspective on this shift towards growth businesses and increasing PER, I believe that improving the P/B ratio requires a transformation of the Japan's industrial structure. This transformation will usher in an era of significant employment changes from declining industries to growth industries.

It is therefore essential for Japanese companies to proactively reform their business portfolios and models. That, to me, is the essence of the P/B ratio discussion. We must be cautious not to merely take advantage of short-term gains without addressing the underlying issues.

Now, moving on to my second point, let me discuss shareholders and institutional investors. While the primary responsibility of management is to enhance corporate value, which I think is the main principle, the role of institutional investors is also of great importance.

I have two points to make. Firstly, on page 10 of material 2, there is a mention of the "lack of personnel with the necessary skills and abilities" as a result of a survey. The detailed data can be found in material 5, and the figures are quite concerning. Nearly 80% of the surveyed institutional investors reported a shortage of human resources. Under such circumstances, it is questionable whether engagement is truly effective. The shortage of skilled personnel is a severe issue that requires our attention.

In fact, the discussion revolves around maximizing human resources and skills required by management styles, such as index investment, as well as the skills needed for engagement activities, which are essentially an intrinsic source of alpha. However, when I raised this issue before, I was told that engagement activities are meant to raise beta, not alpha. After seven or eight years, what has actually happened? It is impossible to solve this skill problem through the efforts of an individual investment management company alone. Therefore, I believe it is crucial to try to solve skills mismatch~~es~~ across the industry through collective efforts. Please allow me to emphasize this point first.

The second point concerns the substantiation of voting rights. The material 2 page10 mentions companies not being convinced. As an independent director, I had opportunities to engage with several asset management institutions. I have gained valuable experience and obtained investor understanding. However, corporate executives of other companies have expressed that the exercise of voting rights at shareholder meetings has become overly formalized. For instance, when an institutional investor or proxy advisor recommends against the re-election of a CEO, the company often complains about lack of opportunities to engage with institutional investors or proxy advisors to secure the reappointment of the CEO.

From the companies' perspective, they are requesting a thorough evaluation. Despite the critical nature of the decision to appoint a CEO, institutional investors or proxy advisors are not spending enough time and resource. I understand that it is challenging for institutional investors or proxy advisors to spend enough time and allocate enough resources to evaluate whether to vote for or vote against the reappointment of the CEO. The large number of companies where voting rights are exercised around the same time of year is also one of the hardships for institutional investors and proxy advisors to secure time for an individual company. However, as Mr. Toyama mentioned earlier, immediate action should be taken to substantiate the exercise of voting rights, particularly concerning the top 100 or 200 companies representing Japan.

That concludes my remarks.

[Kanda, Chair]

Thank you very much.

Now, next, Mr. Sampei, please go ahead.

[Sampei, member]

I am Sampei. I would like to share my remarks based on my experience as an institutional investor involved in engagement for many years and as a supporter of stewardship activities at present.

Regarding page 14 of material 2, I would like to highlight three points related to "Are there any other important issues other than the above?" and "What specific initiatives should be promoted to solve each issue?", particularly concerning stewardship activities and the engagement between corporates and investors.

Firstly, I agree with the overall direction of the action program.

The first point relates to the summary of the stewardship activities survey we received. It is a valuable document compiled through questionnaires and interviews. However, it is unfortunate that we only had a short time to review it before this meeting. I kindly request a separate opportunity to discuss the survey's findings and the necessary follow-up actions. It is important to make the various interpretations and issues more visible and concrete.

Secondly, I believe it is crucial to establish a clearer definition of corporate and investor engagement. This need becomes apparent when examining the survey results. I perceive two types of engagement: one that serves as a source of alpha, and another focused on ESG issues. An engagement that generates alpha involves carefully selecting target companies with the goal of enhancing corporate value through individualized agendas. The incentives here are the potential for excess returns, and if competent individuals are involved, the engagement can be conducted self-sustainingly and proactively.

In contrast, engagement on ESG issues involves selecting and prioritizing themes that apply to multiple companies. The aim is to address ESG issues and promote necessary actions and disclosure. However, the incentives for this type of engagement need to be clarified.

Those are two very different characterizations that are currently mixed together. However, it is important to note that both types of engagement are necessary within the same investment management institution, and also in passive and active investing. This is particularly true for active investing. Additionally, even within the same target company, the two types of engagement are necessary. Therefore, it is crucial for us to provide more clarity on our activities. Without doing so, the focus of the solution may become blurred.

As Mr. Toyama mentioned earlier, the decline in quality is concerning. The survey shows that disclosure as a goal is relatively achievable. However, if our objective is to enhance corporate value, mere disclosure is insufficient. We must take this into consideration as well.

Importantly, engagement as a source of alpha is even more challenging than achieving excess returns in active investing. You may understand it is difficult to earn excess returns in active investing. But much more difficult than that. It is difficult for many managers to achieve positive results in this area. Recognizing this difficulty is vital, and it explains why the survey highlights the shortage of skilled personnel.

This lack of competence is not limited to Japan; it has also been recognized internationally. In the UK, for example, the FRC has started assessing the implementation of the Stewardship Code from 2021, rather than solely relying on acceptance statements. Only 125 out of 189 institutions that declared acceptance of the Code were assessed as successful.

Furthermore, an international certification program called the Certified Stewardship Professional (CSP) was introduced last year. I am involved in developing the curriculum for this program, which aims to equip professionals with the skills and knowledge necessary for effective engagement and fulfilling stewardship responsibilities.

Thirdly, I would like to propose an effective measure for the current situation in Japan. I am eager to ask you to consider it: the reform of TOPIX. At the end of March, the TSE has requested companies with P/B ratios below 1x to disclose their improvement measures, which aims to raise the bottom. In contrast, I believe TOPIX reform would encourage competition at the top. Since achieving results in improving corporate value through engagement is not easy, it is necessary to introduce incentives for companies to initiate change themselves.

There are four key points to consider:

1) Set a ceiling on the number of companies included in the index.
2) Take liquidity into account while emphasizing growth potential and the quality of capital return, rather than focusing solely on market capitalization.
3) Limit the number of companies included in TOPIX itself to around 400 or 500. Please note that this is different from the current TOPIX500.
4) Reform TOPIX itself instead of introducing a new index. This is crucial.

By capping the number of companies in the index, it will foster competition, replacing the absolute standard with a relative standard that has a minimum requirement. This dynamic will last forever. Consequently, companies cannot rest on their laurels and maintain their position in the index solely based on meeting absolute standards. They will be evaluated and replaced based on relative performance. This means that natural selection and company emergence will continue to occur. By applying a relative evaluation perspective that considers growth potential and return on capital, companies must constantly compete to increase their corporate value. Conducting business activities with social sustainability in mind is essential for widespread acceptance by society and future growth. Therefore, efforts toward sustainability are a necessity.

Finally, I would like the GPIF, which heavily utilizes passive TOPIX investment, to take these discussions seriously. As those responsible for actual operations fall into the psychological bias that tends to maintain the status quo, it is crucial for management to engage in discussions and consider the reforms from their perspective.

That concludes my remarks.

[Kanda, Chair]

Thank you very much.

Now, Chairman Matsumoto, please proceed.

[Matsumoto, member]

Thank you very much. Regarding the first perspective, the pursuit of governance with substance, I would like to provide my comments based on two perspectives in relation to the "Draft Action Program for Accelerating Corporate Governance Reform: From Form to Substance" in material 4.

Firstly, I would like to emphasize the importance of pursuing corporate governance with substance. At the Kansai Economic Federation, we have advocated for governance that goes beyond mere formality and focuses on substance. We recognize that constructive dialogue between companies and investors, as well as information disclosure, are crucial elements in achieving governance with substance, as outlined in the action program. Therefore, we generally support the action program's goal of promoting constructive dialogue between companies and investors, along with appropriate information disclosure.

However, we have concerns that companies, in their efforts to comply with increasingly stringent formal rules, may have overlooked the essence of true governance. We have expressed this concern to the public on occasions. We believe that governance should be pursued through flexible dialogue between companies and investors, tailored to each company's industry, business category, size, growth stage, and environment. Hence, we propose a system that prioritizes corporate autonomy and independence, rather than a rigid and standardized approach.

Additionally, there is a worry among management that compliance with Japan's Governance Code has become an end in itself. Often, we see examples of easy going, or other cases where managers are always compliant, such cases are often observed at shareholders' meetings. Personally, I am not well-liked because I always make it a point to explain my decisions. However, I believe that providing explanations during general shareholders' meetings engages in essential debates on the principles of management and expresses our management philosophy.

Hence, it is insufficient for management to merely comply with the Governance Code. It is crucial to proactively and thoroughly explain the company's management strategy and thinking to investors, aligning with its management philosophy while considering the purpose of the Governance Code. Such sincere efforts will foster constructive dialogue between companies and investors, leading to sustainable enhancement of corporate value.

I also do a lot of explaining at shareholder meetings, and afterwards, many shareholders say they understand the situation very well. Based on my experience as a president for over a decade, I often find that shareholders do not really trust managers who are mere compliant. The action program recognizes the importance of voluntary explanations in numerous instances, and I am in agreement with the overall direction of the program.

However, I would like to address two specific areas of concern.

Firstly, on page 3 of the draft action program in material 4, the third black circle in section B, "Encouraging management with an awareness of sustainability issues," states, "Consider whether additional measures are needed to improve diversity [...], depending on the evaluation of the achievement."

Secondly, on page 4, under section B, "Enhancing the quality of disclosure as a basis for dialogue," the first black circle suggests, "Request companies [...], disclose the status of dialogues with their investors and the content of such dialogues."

While I agree with the need for sustainability-conscious management and the importance of information disclosure as a foundation for investor dialogue, I urge caution against imposing excessive disclosure burdens on companies through new uniform and formal obligations. Instead, companies should be allowed to respond flexibly based on their specific circumstances. This is a general request, but I believe it is a fundamental point to consider.

Now let me continue with the second major perspective, which focuses on management from a medium- to long-term standpoint and emphasizes diverse stakeholders, including shareholders. This approach is symbolized by Sampo-yoshi *(good for all three parties: seller, buyer, and society)*.

These multi-stakeholder principles highlight the significance of co-creation with various stakeholders such as customers, employees, business partners, local communities, and non-shareholders. It underscores the commitment to stakeholders and the importance of distributing profits appropriately. This emphasis on multi-stakeholder principles is not limited to Japan; it is gaining traction in other countries as well. I greatly appreciate that the proposed action program includes references to the medium- and long-term enhancement of corporate value in several instances. Furthermore, I acknowledge the inclusion of perspectives on human investment, sustainability, and diversity in the action program, as they hold significant importance.

Our concern is that companies may lose sight of the medium- to long-term perspective under pressure from investors who emphasize short-term profit, such as mandatory quarterly disclosure, and neglect R&D, investment in human resources, and contributions to various stakeholders, which are inherently expected. In my personal opinion, it is crucial for management to have a clear management philosophy and a strong sense of ethics. It is very important to develop managers who understand that they have a choice in explaining their decisions. Unlike employee training, reeducating managers is not solely a technical issue, but also involves instilling a sense of ethics and a management philosophy. I believe it is essential to educate management in a specific direction with regards to philosophy. In corporate management, we believe that a balanced distribution of value should be made to various stakeholders, including customers, employees, business partners, local communities, and shareholders, in accordance with their respective contributions.

This is a matter of great importance, and while it is well understood qualitatively, it raises the question of how to address it quantitatively. For instance, while we can present the dividend rate to shareholders as a specific percentage (e.g., 40% or 30%), other stakeholders such as employees could have wages set at the inflation rate plus an additional amount. Regarding social contributions, management should publicly announce a commitment to contribute 2% of net income to society, clearly explaining this policy at the general shareholders' meeting. By issuing such statements in various forms, stakeholders will perceive an increase in the company's value, which in turn will raise the value of the company's shares.

If the extremely imbalanced distribution of value continues, there will be no medium- to long-term improvement in corporate value. As we have seen in the U.S. and other countries, this could undermine social stability. At the Kansai Economic Federation, we believe that such a situation could lead to the rise of populism and the erosion of social stability. We hope that you will emphasize this point in your future corporate governance policy.

I believe that investors and asset management companies should take actions aimed at enhancing the sustainable medium- to long-term value of portfolio companies through substantive dialogue, considering the objectives of Japan's Stewardship Code, rather than simply exercising their voting rights in a uniform and formal manner based solely on the wording of the Corporate Governance Code. In this sense, it is important to solidify the principles of the Stewardship Code and introduce a certain level of discipline for proxy advisors.

Personally, I wonder what kind of responsibility proxy advisors have in influencing the decision to dismiss a president. This is a sentiment shared by the American business community, which believes it is not right, and therefore, I believe that some form of regulation might be necessary.

Concerning future revisions of the Governance Code, I am worried that the various measures that have been taken in relation to the strengthened Corporate Governance Code may have resulted in a mindset where the protection of shareholder rights takes precedence over the interests of all other stakeholders. The Corporate Governance Code has a significant impact on overall company management. While most Japanese managers are dedicated and always mindful of the soft law named corporate governance, we are concerned that we might fall into a short-term management style due to the current Corporate Governance Code. The Kansai Economic Federation is currently preparing a more fundamental version related to this matter, which we would like to present to the public.

The Corporate Governance Code, as I mentioned earlier, have a significant impact on the overall management of a company. If companies are supposed to prioritize not only shareholders but also other stakeholders, the Corporate Governance Code will be more effective and meaningful. It should emphasize and reflect this aspect throughout its entirety. I believe that incorporating this addition into the Corporate Governance Code would be highly effective and significant.

We kindly request that you take into account the points I have just mentioned when revising the Corporate Governance Code in the future.

That concludes my remarks.

[Kanda, Chair]

Thank you very much.

Next, Professor Kansaku, please proceed.

[Kansaku, member]

I am Kansaku. Thank you for giving me the opportunity to speak. I agree with the three issues listed on page 14 of material 2, as they are all highly important. I would like to comment on each of them individually.

Regarding the first issue, it is crucial that we understand the cost of capital and P/B ratios. Based on this analysis, we should manage the company with a focus on profitability and growth potential. Additionally, it is essential to disclose this information. As mentioned by other members in their previous comments, one of the challenges faced by Japanese companies is the review of their business portfolios. If I were to identify one reason why they have been unable to do so with a sufficient sense of urgency, it would be the complex connection to human capital, which poses difficulties in handling.

This year's revision of the Cabinet Office Order on Disclosure of Corporate Affairs, as of January 31, made it mandatory to disclose, for instance, policies related to human resource development in the context of sustainability. We hope that the board of directors will consider and determine how to manage the company, such as reviewing the business portfolio in conjunction with investing in human capital, and appropriately disclose this information.

Regarding the second point, the effective functioning of independent outside directors is also of utmost importance. There are still formal matters that need to be resolved and taken into consideration. Specifically, it is not desirable, neither in form nor substance, to involve business executives in the selection process of outside director candidates. When a statutory nomination committee or any other voluntary nomination committee is deciding on outside director candidates, it is crucial to have a separate meeting or committee consisting solely of outside directors who are non-executive officers to consider the function of independent outside directors. If it is questioned whether further elaboration of the Code should be considered in the future, I believe it should be, as there are still aspects that need to be considered in terms of form. The process of appointing independent outside directors, which is the second point, is closely connected to the substance of the Code but also relates to its formal aspects.

Lastly, regarding the third point of enhancing information disclosure, it is crucial to disclose the annual securities report before the Annual General Meeting, as requested by investors. However, as mentioned in Ms. Matsuoka’s opinion shared earlier, there are practical challenges to overcome. I would like to pose a question on this matter. At the time of the revision of the Companies Act in 2019, in addition to the introduction of electronic filing of relevant documents for general shareholders' meetings, the EDINET exemption was also introduced into the Companies Act simultaneously.

According to the provisions, the EDINET exemption can be utilized when the annual securities reports are disclosed before the annual general meeting. If the exemption applies, the annual securities report will be disclosed prior to the general meeting. Considering Ms. Matsuoka's previous comment, it seems that there has been limited practical utilization of this exemption. Nevertheless, I would appreciate it if you could provide information on how the EDINET exemption is being utilized. If it is practically difficult to disclose the annual securities reports based on the current schedule using the EDINET exemption, we would highly appreciate your efforts to disclose the securities reports before the AGM, including potential changes to the AGM schedule. As I mentioned earlier, the annual securities report contains critical non-financial information, such as sustainability concepts and initiatives. Therefore, although this aspect may be related to the format, it is important to promote the disclosure of the annual securities report prior to the AGM.

That concludes my remarks.

[Kanda, Chair]

Thank you very much.

I understand you had a question. Can the Secretariat provide an answer to this question?

[Hirokawa, Director, Corporate Accounting and Disclosure Division, FSA]

I will provide more details if I can confirm them during the meeting. However, based on my current understanding, there doesn't seem to be much progress. As mentioned by Ms. Matsuoka in her written opinion, simply converting the data to electronic format may not be sufficient. Apart from the points raised in her letter, it would be preferable to conduct the audit under both the Companies Act and the FIEA simultaneously. However, I am aware that there are various other factors to consider, such as the practical implications and potential negative impact of conducting both audits within a short timeframe from April to June. Therefore, at present, it does not appear to be a widespread practice. If possible, I will provide additional information during the meeting.

[Kansaku, member]

Thank you very much.

[Kanda, Chair]

With respect to the implementation of the revised Companies Act of 2019 regarding the electronic provision of materials for general shareholders' meetings, it applies to companies utilizing the book-entry transfer system and applies to general shareholders' meetings held in March of this year or later. Therefore, it has just recently started, hasn't it? I believe this is a matter of considering what will happen in the future.

Additionally, there is the option of expediting the submission of the annual securities report, but we can also discuss the possibility of delaying the date of the general shareholders' meeting. We can revisit this topic when the opportunity arises.

Thank you very much.

Next, I would like to invite Ms. Okina and then Mr. Oba, who are participating online, to speak. Ms. Okina, please proceed.

[Okina, member]

I am Okina. I agree with the general direction proposed by the secretariat, and I believe we should focus on transitioning from form to substance. I also think it's appropriate to make revisions as necessary without delving too deep into the details. Regular reviews may not be necessary.

I would like to highlight two or three points. Firstly, I believe it is crucial for listed companies to achieve a minimum long-term P/B ratio of 1x. This is an essential condition for listed companies.

As mentioned by the TSE and other members today, achieving this cannot be a one-time response. That is not sustainable. It requires continuous improvement in the relationship between the cost of capital and return on capital. I believe that investing in human capital and intangible assets plays a significant role in this regard. If the market fails to properly evaluate these investments and growth potential, it is not solely due to a lack of investment but also a lack of adequate explanation and disclosure. I hope that the new approach will encourage companies to increase their P/B ratios to 1 or higher.

Furthermore, as I mentioned earlier, sustainability encompasses investments in human capital and GX investment. Innovation is crucial, and it is important to ensure proper disclosure of intellectual property and related matters. Japanese companies still face numerous challenges in this area. Despite the difficulties, it is essential to elevate the level of disclosure and dialogue. We need to carefully consider how to substantiate engagement activities, as mentioned by Mr. Toyama and Mr. Tsukuda at the beginning.

While the TSE has taken steps to promote dialogue and information disclosure from companies, improving investor awareness of these issues remains a significant challenge. In particular, asset owners, such as corporate pension funds, need to raise their awareness as investors.

I have learned that less than 5% of corporate pension funds have committed to Japan's Stewardship Code, and only three corporate pension funds have committed to the UN PRI with a focus on sustainability. Considering these facts, it is crucial to change the mindset of asset owners. The Financial Services Agency has been discussing a customer-oriented approach, including corporate pension funds, to understand the intentions of fund providers within the investment chain. I would like the FSA to enhance investors' awareness of this issue and take actions to enforce and reform the mindset of asset owners.

Lastly, I believe that elevating the level of outside directors is an incredibly important initiative. I encourage continued efforts to promote understanding of the expected role of outside directors and conduct educational activities.

That concludes my remarks.

[Kanda, Chair]

Thank you very much.

Now, Mr. Oba, who is joining us online, please proceed.

[Oba, member]

Thank you very much. Considering our limited time, I would like to briefly summarize three points, as directed by the chair.

Firstly, I would like to address the timing of the Code's revision. As many of you have mentioned, I believe we should reconsider the idea of further detailing the Code while returning to the principle of comply-or-explain. Rather than focusing on regular revisions, we should prioritize sustainable improvement of corporate value. This is my first point.

The second point concerns the improvement of the market environment. P/B ratios remain below 1x, and ROE levels are comparably low among developed countries. I believe this is because companies view listing on the stock exchange as their ultimate goal, rather than striving for continuous growth of their corporate value. To enhance the market environment, we need to encourage new listings and simultaneously adopt stricter measures for exit mechanisms.

The third point involves reviewing corporate initiatives in light of the actual situation of investors. Two major sources of investor funds should be considered: the trend toward passive investment and the outflow of investment funds from Japan to foreign countries.

To elaborate further, if we observe the flow of mutual funds' investments during the past year, we can see that the top 10 mutual funds have not invested in Japanese stocks at all. Instead, all the funds have been directed overseas. According to a survey conducted by Japan's Pension Funds Association, the weighting of Japanese stocks has decreased from less than 40% in the past to less than 10% today. This outflow of capital suggests diminishing expectations for future growth among Japanese companies. Therefore, it becomes crucial for companies to disclose information on how they plan to enhance capital and labor productivity in order to reassess their corporate management.

These are the three key points I wanted to highlight.

[Kanda, Chair]

Thank you very much.

Now, let us return to the venue, and in the order of speaking, Chairman Higashihara, followed by Ms. Takayama, Ms. Ueda, Mr. Obata, then Mr. Kawakita online, and finally back to the venue with Mr. Iwama.

Chairman Higashihara, please proceed.

[Higashihara, member]

I am Higashihara from Hitachi, Ltd. First and foremost, I largely agree with the opinion expressed by Ms. Matsuoka of the Japan Business Federation. I would like to share my personal thoughts on four points.

Firstly, as Mr. Oba mentioned earlier, I had the opportunity to speak at the Asset Management Business Forum held on February 3, where I discussed the relationship between the board of directors and the executive officers. While I believe that the missions of directors and executive officers are being strictly separated in terms of governance and execution, I have observed a tendency for directors to delve into micro-level matters and hold board meetings primarily to demonstrate their presence. With my 46 years of experience at Hitachi, including 6 years as CEO until March 2022, I am currently focused on maintaining a balance in this regard. I consider it my major mission as a chairman to strike that balance by saying that this is too micro, or this is too much because you guys have the power to remove the CEO, or this is too much because you are trying to make this the full responsibility of the president/CEO.

Even without specific rules for the disclosure of human capital, it is beneficial to showcase the presence of such capital during IR meetings and general shareholders' meetings, with the executive group taking the lead. I firmly believe that the executive team forms the core of the company.

Furthermore, regarding the objectivity of outside directors, it is important to recognize that there are limitations to the number of outside directors, and it is unlikely to find outside directors who are flawless. Hence, it is unwise to be swayed solely by the one-sided opinions of outside directors, unless someone like myself, with over 40 years of experience and having served as president, closely monitors the situation.

Secondly, in terms of diversity, equity, and inclusion, we are actively searching for female board members with CEO experience worldwide. However, finding the right candidates, who have a view of the whole picture particularly in a conglomerate like Hitachi, is challenging. Therefore, I believe that establishing an effective talent pool mechanism within Japan would greatly contribute to overall corporate governance. I encourage you to consider this aspect.

Thirdly, we do not need additional detailed rules. Instead, please continue providing us with examples of good practices and inform us when they are on the right track. Based on my own experience, during the COVID-19 pandemic in 2020, we made significant disclosures that resulted in our share price increasing approximately 2.5 times. This experience has convinced me that by disclosing information and having the president and CEO take responsibility for explaining the situation, the share price will rise. Despite the P/B ratio concerns, I am confident that it will improve. I request your support in this regard.

Lastly, I believe that the ethics of development will become increasingly important. Taking the AI field as an example, though I do not mean to quote Chat GPT, there will come a time when people will inquire about the nature of a company's developments and the ethical considerations behind them. This is something that we, including the board of directors, need to disclose with a strong sense of responsibility. Therefore, my final remark is that the board of directors, in line with the discussion on human capital and GX, should clearly demonstrate its long-term thinking and ethical values, showing that the company is managed with such ethics in mind.

That concludes my comments.

[Kanda, Chair]

Thank you very much.

Okay, next, Ms. Takayama, please proceed.

[Takayama, member]

I would like to begin my comments by discussing the contents of page 14 of material 2. You have listed three current issues, and I believe they are all accurate and relevant.

Regarding the section on "Ideas for Future Initiatives," I am opposed to the inclusion of detailed rules in the Code. The Governance Code is intended to present basic concepts, so I do not think it is necessary to provide detailed descriptions.

In terms of the timing for revising the Code, I believe it is better to consider the revision timing based on the stage of board of directors and management of Japanese companies at that time, rather than setting a fixed interval of once every three years. The most recent revision of the Governance Code was in 2021, focusing on the requirement of at least one-third independent directors in the Prime Market and the board's responsibility for sustainability issues.

While it is true that substance is more important than form when discussing the issue of form and substance, I believe that there should be some formalities or standards that ensure substance. In this sense, I consider the ratio of independent directors and the board's commitment to sustainability as important criteria defining substance. Therefore, I believe the revisions made to the Governance Code in 2021 were quite appropriate.

Currently, Japanese companies are still working on improving the substance and effectiveness of their efforts based on this policy. I believe this stage will likely continue, so instead of mechanically revising the Code next year just because three years have passed, it would be beneficial to give Japanese companies a little more time to make these efforts.

Regarding future efforts, I agree with the policy of compiling and verifying the results through an action program. I support this approach. Regarding the specific actions to be included in the action program, I think page 17 of material 2 provides appropriate suggestions.

Among the three issues listed, I would like to focus on the role of independent directors. In the Prime Market, more than one-third of boards of directors now consist of independent directors, and although it is not common to have a majority of independent directors, having around 40% is becoming more prevalent. In such a situation, it is extremely important for independent directors to demonstrate their competence. In this item, measures on the committees and individual independent directors are described. I believe it is beneficial for the Council to investigate the situation and make recommendations based on that investigation. Based on this, I would like to express my opinion on the current situation, the issues involved, and the actions that should be taken based on these issues.

Firstly, regarding the nomination committee, my understanding is that considerable progress has been made in discussing the CEO succession plan, as strongly desired in the Governance Code. However, there are still many areas where a succession plan for independent directors is just beginning to be developed. While the nomination of independent directors is ultimately approved by the nomination committee, as mentioned by member Kansaku earlier, the initiative in this regard is often taken by the executive side, and the nomination committee appears to assume a rather passive position in many companies. From the basic idea of the Governance Code, I believe that the independent nomination committee, led by independent directors, should play a more active role in the succession planning and nomination of independent directors. Therefore, I consider this to be a current issue that needs to be addressed.

Next, I would like to address the topic of individual independent directors. While it is crucial to select the right person for the job, it is equally important to ensure that once they assume the position, they can fully demonstrate their abilities. In this regard, I believe that evaluating independent directors is a significant issue. As mentioned earlier in the written opinion of our member Kerry Waring from ICGN, her opinion includes the idea of conducting individual evaluations of independent directors within the framework of board evaluation and reflecting the results in the appointment and reappointment of independent directors. This practice is also being implemented in other countries. For instance, while the evaluation of the board of directors only encompasses the assessment of the board as a collective entity in Japan, in the UK, the Corporate Governance Code requires the evaluation of the board, its committees, and individuals. Consequently, individual evaluations of independent directors are conducted, and based on these evaluations, the nomination committee decides on the appointment or reappointment of independent directors. It may be challenging to make a direct comparison between Japan and other countries due to contextual differences. In the UK, independent directors comprise the majority of the board, whereas in Japan, the percentage of independent directors is approximately 40% in companies listed on the Prime Market. However, I firmly believe that evaluating individual independent directors will become an inevitable aspect of Japanese corporate governance in the future.

Therefore, when conducting surveys, analyses, and making recommendations regarding the committees and individual independent directors, I kindly request that you consider these two points: firstly, how succession plans for independent directors should be developed, and secondly, how the evaluation of independent directors should be conducted.

That concludes my remarks.

[Kanda, Chair]

Thank you very much.

Okay, next, Ms. Ueda, please proceed.

[Ueda, member]

Thank you for your explanation and thorough research. Before delving into the main topic, I would like to express my appreciation for the Japan Corporate Governance Forum, as mentioned by the secretariat. I believe it is an excellent initiative, and I encourage its promotion in the future. It would be beneficial to engage in a dialogue with the Follow-up Council or share information with them.

The reason I mention this is that while dialogue between companies and investors, particularly foreign investors, is increasing, individual investors often hold diverse opinions on specific projects. This poses a challenge for companies to determine which opinions should be incorporated for the overall benefit of the company. In this regard, having a forum where useful opinions can be gathered for the market as a whole is highly valuable. It presents an opportunity to understand external expectations and enhance the Japanese market.

With that in mind, let me address the main point. Over the past decade, we have made significant efforts to reform corporate governance through the establishment of Codes, among other measures. However, the current challenge lies in reaping the fruits of these efforts.

The objective is not merely to increase the number of outside directors or focus on formal aspects of governance, such as raising PBR or ROE. The most crucial aspect is the growth of companies, which in turn contributes to the growth of the Japanese economy and market. Therefore, I would appreciate it if the action program could emphasize this essence and clearly state the purpose of the reform. While it is easy for businesses and investors to get caught up in detailed explanations, understanding the original intent can encourage companies to make different choices aligned with broader objectives, even if their approaches differ from the prescribed Code.

With that in mind, I would like to comment on the matters discussed on page 14 of material 2 and the subsequent pages. Firstly, I agree with the major directions presented. Regarding the timing of Code revisions, I understand that detailed rules can lead to formalization, which might occur in corporate practices. If that is the case, we should ensure the existence of a flexible framework that can adapt as needed and appropriate.

However, I believe it is necessary to provide appropriate follow-up. We need a mechanism to incorporate ongoing developments and insights from dialogues with foreign investors, as mentioned earlier. Regular follow-up processes should be established to gather and disseminate opinions effectively.

Regarding efforts beyond mere changes to the Code, based on stakeholder dialogue, it is crucial to establish a robust follow-up process to identify gaps, areas that require emphasis, and accomplishments. In this regard, it would be beneficial for the secretariat, relevant authorities, and members of the Follow-up Council to have opportunities for such discussions.

Speaking of stakeholders, I understand that dialogue is already ongoing with investors, corporate management, and the executive side of companies. However, I would suggest expanding the scope of stakeholders to include outside directors and promoting diversity, such as the inclusion of women and individuals from other countries. Additionally, considering the importance of monitoring functions, dialogue between corporate auditors should be encouraged. While there may be outstanding issues to address in this area, I believe it is essential to incorporate these aspects. Furthermore, we should not forget about the workers. With a diverse range of employees, from senior workers to younger generations, it is important to ensure that the principles of governance reform are well understood by all. I would appreciate it if we could explore opportunities to engage various stakeholders in these areas, even though it may increase the workload.

Regarding the action program outlined on page 17 of material 2, I reiterate the importance of emphasizing the purpose of governance reform at this stage. It should be emphasized that governance reform is a means to an end, and not an end in itself. The ultimate objective of governance reform is not focused solely on aspects such as outside directors, PBR, or ROE, but rather on promoting the profitability and sustainable growth of companies.

In particular, human capital and sustainability, which are also significant issues, require a long-term investment period and a lengthy payback period. Therefore, from the perspective of investors, monitoring by outside directors, as well as executives, it is easier to focus on short-term returns and implement strategies. However, in comparison, a long-term perspective is necessary, and it is crucial for all stakeholders involved to learn, gain experience, and accumulate knowledge.

From this standpoint, while the effectiveness of dialogue on the investor side has been mentioned in the Corporate Governance and Stewardship Codes, your survey has made me ponder the governance of the investors themselves.

For instance, what about the human capital of investors? Do they have adequate resources for human resource development, or is there a need for a framework that can support small-scale investors with limited financial resources, such as small and medium-sized corporate pension funds? It would be worthwhile to carefully consider this area, allowing investors themselves to afford it and gain valuable experience without excessive burden.

In this context, as mentioned by some other members, there is a need to improve the substance of dialogue. Initially, it is not feasible to engage in dialogue with all companies in the Prime Market, and therefore, there is a need to enhance investors' capabilities in this regard. It is disheartening that small and medium-sized companies, which are striving to gain access to investors, find it challenging. Conversely, the dialogue tends to be overly focused on a few global companies, and it raises questions regarding the issues that need to be addressed. For instance, how can we identify companies suitable for the Prime Market in terms of formality and substance, even if their market capitalization is not substantial? Or how can we distinguish companies whose primary objective is to enter the Prime Market and those that aim to remain there? It is essential to address those issues for participants, investors, companies, and outside directors for assessing the performance of their companies, and we hope that measures will be taken to address these concerns.

Lastly, I would like to mention that I have recently and non-verbally become quite interested in ethics, as Chairman Matsumoto and Chairman Higashihara have just suggested, partly because I am teaching at the business school on governance and ethics. I believe that ethics is the last resort.

While there are various measures to consider, I firmly believe that governance and sustainability ultimately come down to ethics. This is not only vital for corporate management but also for investors. I am optimistic that reforms are underway to advance in this direction.

Thank you for your attention. It has been a lengthy discussion.

[Kanda, Chair]

Thank you very much.

Next, Mr. Obata, please proceed.

[Obata, member]

Thank you for giving me the opportunity to speak. Firstly, I'd like to acknowledge the formulation and subsequent revision of Japan's Corporate Governance Code and Stewardship Code. I believe that these efforts have established a common language between companies and investors, which has been highly meaningful. However, it is evident that the formal aspects have been largely addressed, as mentioned multiple times. It is high time that, each company must consciously consider how to establish a governance structure, making it a management-level issue.

From this perspective, I don't think it's necessary to make the Codes more detailed. I fully support the secretariat's proposal to use an action program to track progress. It is also appropriate to review and revise the Codes as needed.

On the other hand, I would like to highlight four items in the action program from a practical standpoint, to avoid duplicating previous comments.

Firstly, regarding outside directors, as all of you mentioned, the scarcity of qualified candidates is notable. While there are numerous individuals, the number of truly suitable outside directors is quite limited, and many of them already have been serving on other companies' boards. Consequently, it is increasingly challenging for companies to attract them. Discussions have arisen suggesting the need to search for candidates one or two years in advance, considering the difficulties in this area. I believe it is time to consider evaluating outside directors and expanding the pool of candidates.

The second point concerns the substantiation of stewardship activities. While domestic institutional investors and asset owners' efforts have been discussed today, I am also concerned about engaging in dialogue with global investors, investment management institutions, and asset owners. I have heard that overseas investors are losing interest in Japanese equities. Previously, there were dedicated professionals responsible for Japanese equities who closely monitored and analyzed the Japanese market and sector conditions. However, their numbers have gradually decreased, resulting in a decline in interest in Japanese stocks. To promote dialogue, we need to make efforts to regain their interest in Japanese equities.

Regarding the third point about disclosure, I understand that companies are required to disclose their annual securities reports as early as possible. However, my company's annual general meeting takes place in June, and we are currently focused on preparing our business reports. Once we complete them in early May, we will promptly begin working on our annual securities report.

In that regard, I would like to request a reassessment of what information is genuinely necessary for exercising voting rights. While I acknowledge the complexities introduced by the Companies Act and the Financial Instruments and Exchange Act, I believe it would be beneficial to include essential information for voting rights in business reports by amending the Companies Act. Addressing investors' needs partially in this manner could be a step toward satisfying their requirements. As Ms. Matsuoka mentioned earlier, submitting an annual securities report before the AGM is challenging in practice. Therefore, it would be helpful to explore alternatives that allow us to meet investors' needs effectively.

Lastly, I'd like to discuss the transparency of beneficial shareholders, a topic that hasn't been mentioned today. Currently, research firms are typically employed to identify the real shareholders. However, I've learned that certain countries, particularly in the U.S. and Europe, have legislated American and European-style systems that promote transparency in beneficial ownership. While the choice of method can be debated, I would appreciate the swift introduction of a system for transparent beneficial shareholders in Japan. Such a system would facilitate further dialogues with shareholders.

That concludes my remarks

[Kanda, Chair]

Thank you very much.

Now, Professor Kawakita, who is joining us online, please proceed.

[Kawakita, member]

I am Kawakita, and I would like to briefly share three points from an investor's perspective.

Regarding the substantiation of the Codes, I largely agree or am in favor of the content presented on page 14 of material 2.

Firstly, concerning requests to companies, I urge them to enhance productivity and increase their profit margins. This is not only beneficial for individual companies but also for the overall Japanese economy. Higher productivity and profitability ultimately lead to higher wages, contributing to economic growth. As explained by the TSE, investors evaluate whether a company's activities meet its cost of capital based on whether its P/B ratio exceeds or falls below 1x. While the ROE perspective is also relevant, it is less straightforward than the P/B ratio, as determining the appropriate level of ROE for each company requires calculation.

Regarding P/B ratios, the discussion extends beyond whether investors believe the cost of capital is being met. In terms of exercising voting rights, with respect to dividends, if a company hasn't been able to achieve a P/B ratio greater than 1x, the dividend payout ratio should be 100%. Conversely, if there are numerous business opportunities that meet the cost of capital, there may be no need to pay a dividend.

Secondly, I would like to address the exchange of opinions with companies. As an investor, it is realistically challenging to engage in dialogue with more than a few hundred companies, perhaps around 200 to 300 at most, no matter how capable or well-staffed one is. However, in the index field, there are over 2,000 companies, primarily based on TOPIX. Requesting an exchange of opinions with all these companies is completely unrealistic. Moreover, exercising voting rights for over 2,000 companies would become a mere formality, given the large number.

Therefore, managing index-based investments by focusing on companies that represent Japan is both practical and effective for engaging in meaningful discussions with investors. Additionally, this approach encourages companies to become more autonomous, thereby elevating Japanese companies as a whole. It's important not to limit ourselves to the current TOPIX index and consider the possibility of devising new indexes, such as TOPIX 100 or TOPIX 500.

In this regard, while it is essential to reform the mindset of corporations as a whole, it is equally important to reform the mindset of public pension funds and professional investors regarding the number of investment targets and the cost of dialogue. I particularly urge the Government Pension Investment Fund (GPIF), representing public pension funds, to recognize the true significance of dialogue and encourage professional investors to engage in passive investment, thereby raising the overall standard of Japanese companies. I am unsure if this topic falls within the scope of our discussion, but I believe it is worth mentioning.

The third point is a minor one. Before enhancing descriptive information, there is a need to improve numerical information as well. It is a significant issue that fiscal year-end market capitalization and P/B ratio figures are absent, despite emphasizing the importance of the P/B ratio in the key financial data section of the annual securities report. Regarding human capital, it is also concerning that the annual securities report does not provide a comprehensive overview, including personnel expenses, welfare-related expenses, and training expenses borne by the company. For instance, labor costs or personnel costs are not included in the cost of goods sold. Requesting investors to discuss only descriptive information without such figures would be quite challenging. I request you to consider this point.

That concludes my remarks.

[Kanda, Chair]

Thank you very much.

Next, Mr. Iwama, who is present in the hall, please proceed.

[Iwama, member]

Thank you very much. I would like to share my perspective from the asset management side.

It has been 10 years since I was invited by the FSA to participate in the development of Japan's Stewardship Code, and I believe we have made significant progress during that time. I am in full agreement with the current issues at hand.

However, I believe the purpose of this project is to revitalize the securities market. With the ongoing expansion of NISA and the shift in objectives from DB to DC, the investment results of individuals themselves will become increasingly crucial. In this context, I see the greatest challenge for the asset management industry as addressing the medium- to long-term increase in corporate value.

The key for addressing that challenge, in my opinion, lies in achieving effective dialogue and engagement. I have long advocated for the effectiveness of collaborative dialogue or what I call collaborative engagement from a medium- to long-term perspective. Through the collective opinions of all investors, this approach can encourage improvements in corporate management. I have high expectations that this can be more easily accomplished than the current situation.

The UK's Stewardship Code, which comprises 12 principles, explicitly mentions this as one of them. It even includes a provision that calls for further escalation if effectiveness is not achieved. In practice, this approach has proven to be effective. I believe we should focus on increasing corporate value through collaboration rather than engaging in hostile dialogue. There are some important points to consider in this regard, and I kindly request your cooperation.

I also believe that market reform is of utmost importance to achieve this goal. The reform of TOPIX, as highlighted by Mr. Sampei, precisely aims at this objective. If such a symbolic reform is realized, it will undoubtedly stimulate various movements in other small and medium-sized markets. Remarkable reforms in core areas attract the attention of foreign and global investors. I believe Japan currently has a great opportunity. Despite the declining weighting of the Japanese securities market, my discussions with foreign investors have revealed an increasing expectation for the Japanese securities market. I believe the timing is right.

That concludes my opinion. Thank you very much.

[Kanda, Chair]

Thank you very much.

Now, I would like to proceed in the following order: Mr. Oguchi, followed by Mr. Kohara, and Mr. Takei, all of whom are participating online.

Mr. Oguchi, please proceed.

[Oguchi, member]

I am Oguchi. Thank you very much for the opportunity.

First of all, I agree with the direction proposed by the secretariat. I have heard many valuable opinions today, and I would like to avoid repeating them as much as possible. However, I would like to once again emphasize the expansion and continuity of NISA, which will begin next year, as mentioned earlier.

One aspect that wasn't mentioned earlier is that NISA has an annual cap, which tends to result in time-distributed investments. In this context, despite some expressed concerns, I believe the main focus will be on low-cost indexes. In this case, the choice of the market in which to invest will be made by individuals rather than the companies in which to invest. Therefore, the Japanese market's competitors are overseas markets. While it was explained that the impact of governance reforms on corporate performance has not yet been evaluated, I believe the expansion and continuity of NISA will provide a clearer indication of whether the Japanese market has become the preferred market for individual investors.

In such a situation, as mentioned earlier, about half of the listed companies have P/B ratios of less than 1x, indicating that their cost of capital management, if I may say so, is inferior to overseas markets. I am greatly encouraged by the TSE's strong request for companies to take measures to improve this situation. First and foremost, I hope that companies will make autonomous efforts to improve their situation. However, as has been mentioned, in order for the Japanese market to attract retail money and foreign money, it is essential for companies and institutional investors, who play a dual role in the market, to work together.

Nevertheless, as discussed in the last Follow-up Council meeting, formal and uniform engagement will not fulfill the role of institutional investors, as some comments made today. Although I may not have heard it clearly today, I believe a member pointed out that there are two types of engagement, and I agree with the idea of dividing engagement into two categories. In a world where P/B ratios are below 1x, this is an area that requires a deep understanding of each company because issues differ from company to company.

Although not explained today, a voluminous document titled "Survey on Stewardship Activities" was distributed. Looking at it, the results of the questionnaire survey for companies showed that approximately 70% of companies reflect suggestions and recommendations from asset management institutions in their management decisions less than once a year, which is somewhat disappointing. I believe this may be due to a gap between the investor dialogue that companies expect and the investor stewardship activities they are actually engaged in.

Therefore, I believe we need to substantiate our stewardship activities. As mentioned earlier, the fact that companies have different issues is a prerequisite for encouraging dialogue among investors. Similarly, institutional investors have different governance structures and management styles, so it is natural that they will respond differently to engagement. This point hasn't been extensively discussed until now, but I think we need to be aware of it, even if it overlaps with the two types of engagement mentioned earlier.

Another concerning point is that the survey highlighted the possibility that the asset management institution's own evaluation of its stewardship activities may not align with external evaluations. I wonder what this means. It suggests that while they believe they are doing a good job, others may not perceive it that way. This is why I believe we need a mechanism to individually and objectively examine effective solutions to the issues on the part of institutional investors, rather than addressing them collectively. This point may overlap with the need for a more serious consideration of engagement, as we have heard today.

One thing I was wondering, and this may be related to "A) Effective implementation of stewardship activities," the second section on the list of specific initiatives, is whether the action program could consider constructive dialogue between the FSA and institutional investors, focusing on individuality and objectivity. I would like to request that you consider this in the action program. If, as proposed on the last page of material 2, the Follow-up Council meeting becomes a forum to periodically review implementation status and consider the need for additional measures, rather than revising the Codes, I wonder if the secretariat could play the role of facilitating constructive dialogue between the FSA and institutional investors.

Of course, there may be some challenges and limitations, but as some members have pointed out earlier, I also have a strong sense of urgency about the Japanese market. While the autonomous efforts made so far are important, I believe it is necessary to accelerate these efforts. In this sense, I believe new drivers are needed in the investment chain.

That concludes my comments.

[Kanda, Chair]

Thank you, Mr. Kohara, for your input.

[Kohara, member]

Thank you very much. I apologize in advance if I speak too quickly, as we have limited time available.

I will summarize my three opinions and requests based on the purpose of corporate governance reform and recognition of the issues.

Firstly, you emphasize the importance of management with an awareness of profitability and growth potential. While acknowledging the promotion of profitability and growth based on a proper understanding of the cost of capital, I would like to highlight the need for sustainable corporate growth and increasing corporate value over the medium- to long-term. So I specifically mention the importance of active investment in human capital and request cooperation in this regard.

Secondly, in regard to the significance of sustainability-conscious management. I would like to suggest that companies should demonstrate their commitment to respect for human rights, including those in the supply chain, and propose the consideration of adding respect for human rights to the company's sustainability information disclosure standards. Additionally, considering the issue of Japan's declining labor force, I think the acquisition of human resources from other countries is an urgent matter. I believe that if Japan adopts a proactive approach, taking the lead in international discussions to enhance the disclosure of sustainability information with a focus on human capital, including the respect for human rights, it will encourage foreign talent to consider Japan as an attractive place to work.

Finally, I would like to address the timing of revising each Code. As mentioned by other members, I firmly believe that it should be explicitly stated that it is appropriate to review each Code in a timely manner, taking into account the progress made, without being strictly bound by the previous review cycle.

That concludes my remarks.

[Kanda, Chair]

Thank you very much.

Next, I would like to invite Mr. Takei, who is participating online, and then Mr. Tsumuraya in the meeting room.

Dr. Takei, please proceed.

[Takei, member]

I am Takei, and I agree with the draft of the secretariat's proposal that was distributed today. I would like to make three points following that statement.

First of all, TSE has emphasized that the measures taken by a company related to the P/B ratio should not be temporary, but rather a drastic measure to achieve sustainable growth. I consider this point to be of utmost importance. Particularly, in line with the ongoing disclosure of non-financial information, it is crucial that companies approach this matter not just as a formality, but with a substantive understanding of its purpose. The fact that the P/B ratio is currently below 1x indicates that the numerator, representing the future, is low compared to the denominator, representing the past. Fundamentally, there hasn't been sufficient emphasis on the feasibility of future management strategies, including the allocation of human capital, materials, and financial resources. In this context, I believe that enhanced disclosure of non-financial information will naturally come into play, and it is imperative to approach this with authenticity and a strong sense of purpose. While the current revision of the annual securities report partially addresses this issue, I believe it is essential to further deepen and substantiate these efforts voluntarily by a company.

Furthermore, in terms of human capital, when companies decide to implement future management strategies, they naturally consider the availability of human capital, materials, and financial resources. However, there has been limited logical presentation towards the capital market, of visions and plans specifically concerning human capital. At a time when increasing the added value and productivity of human capital is crucial, I strongly believe that Japanese companies need to undertake significant reforms in employee engagement, reskilling, and diversity, equity, and inclusion (DE&I). The mid-term business plans and various financial results announcements have not logically addressed these points. While some companies have made such appeals, many others have not.

Moreover, Japanese companies possess several advantages in terms of human capital when viewed globally. Particularly, compared to Western companies, Japanese companies have a significant advantage in terms of individual loyalty to the company. As a result, there are positive impacts such as a high rate of successor preparation in key positions, fewer individual scandals in global comparison, and a high level of occupational safety. In general, concepts like "purpose" and "culture" are already well embraced in Japanese companies. While I'm not sure if it is relevant to cite baseball's WBC winning during this discussion, I believe that Japanese companies have a considerable advantage in terms of teamwork and other aspects of international competitiveness.

It is regrettable that these existing strengths are often underestimated due to the lack of logical presentation to the outside world including capital markets. It is important for companies to effectively communicate these points in a positive and appropriate manner, describing their future plans during the process of non-financial information disclosure.

Additionally, these matters should not only be limited to integrated reports but should also be emphasized in high-profile financial results announcements and mid-term plan disclosures. Furthermore, sustainability issues require a range of resilient measures. As previously mentioned in the context of ethics, I believe that human capital, as well as individuals from legal and other departments responsible for risk management, should be more involved in mid-term management plans and related matters. It is crucial for companies to address various issues collectively and provide a coherent and logical explanation of their efforts. These are my first points.

Moving on to the second point, I want to highlight the gender gap and the importance of considering the inclusion of female board members in the proposal. The gender gap is a global issue that Japanese companies need to address urgently. With the implementation of human rights due diligence on a global scale, a slow progress in the DE&I area can cast doubts on a company's growth potential. Therefore, it is necessary to drive change in this regard. Moreover, in terms of the gender issue, it is crucial to promote governance substantiation by addressing the so-called "unconscious bias" prevalent in various management fields, rather than merely following a formal approach. These are my second points.

Lastly, regarding the third point concerning the substantiation of Japan's Stewardship Code, it is evident that substantive compliance has been highlighted in the Governance Code. However, the proper monitoring of substantive compliance under the Stewardship Code remains a significant issue in Japan. As mentioned in Ms. Ueda's previous comments on the governance of institutional investors, it is imperative to scrutinize the governance practices of these investors.

In this regard, institutional investors, not only public companies, should undertake human capital reforms in the context of formalizing the exercise of voting rights and addressing other pertinent issues. For instance, if asset owners aim to maximize profits at the lowest possible cost, they may naturally be reluctant to invest in various forms of engagement. Therefore, it is important to assess what can and cannot be achieved. Additionally, as mentioned earlier from an ethical perspective, it is necessary to gain a substantial understanding of how institutional investors are genuinely implementing measures outlined in the dual Codes.

Furthermore, while the Mizuho Research & Technologies survey is helpful, conducting additional interviews from the corporate side would provide valuable insights. Constructive dialogue should be a two-way conversation, but the current situation often leaves companies unheard when they proactively approach institutional investors. I think corporations are best positioned to understand the challenges faced in fostering meaningful dialogue. I believe that hearing from the corporate side as well about their experiences and issues encountered during interactions with investors would provide significant additional information. I would like to encourage to consider this point.

That concludes my remarks. Thank you very much.

[Kanda, Chair]

Thank you very much.

Okay, Professor Tsumuraya, please proceed.

[Tsumuraya, member]

I believe we have already run out of time, so I will quickly make two points.

Regarding A, B, and C on page 17 of material 2, when you asked if companies are implementing A, B, and C, most or all companies would answer affirmatively. However, I think the root of the problem lies in the fact that companies are not actually implementing them. We should demonstrate to companies how they are falling short. While the focus of this discussion is on substantiating the reform, it is also important to substantiate how we communicate with the companies. To achieve this, I believe the FSA, TSE, and our members need to put in extra effort and work harder. The substantiation of the communication method is my first point.

I'll be brief with the second point as well. TSE's white paper on governance shows that approximately 90% of companies have established nomination committees and remuneration committees. However, most of their disclosures are likely insufficient and do not provide details of their activities. Therefore, although I am against detailed rules of the Governance Code, it is necessary to establish specific and detailed rules regarding disclosure. For example, if a company is compliant with the Code, they should disclose information such as "this is what we discussed in the previous year" or "this is what is left to be discussed." However, these requirements would apply only to compliant companies.

That concludes my points. Thank you very much.

[Kanda, Chair]

Thank you very much. I apologize for exceeding the scheduled time, but I would like to conclude our discussion. Thank you all for your diverse, valuable, and positive opinions.

[Hirokawa, Director, Corporate Accounting and Disclosure Division, FSA]

Just one point. Regarding the EDINET exemption that Kansaku asked about, it was applied from the general shareholders meeting in March of this year. However, at this moment, we have not confirmed any cases.

That is all.

[Kanda, Chair]

Thank you very much.

Finally, I have one important point to address, which is the compilation of the Action Program. Today, we discussed the materials presented by the secretariat, including the key points of the Action Program. I understand that everyone generally agrees with the basic direction and has provided valuable suggestions on minor and fundamental aspects.

For the compilation of the Action Program, we will coordinate through email or other means, taking into consideration the suggestions you have given us today. We will then finalize the Action Program and announce it at a later date.

I would greatly appreciate it if you would leave the final scrutiny of the process, including the consistency of expression, to me. Shall we proceed as I explained now? Could I have your approval?

(Sound of people saying “no objection”)

[Kanda, Chair]

Thank you very much.

I hereby declare today's meeting adjourned. Thank you all for your active participation throughout this extended period of time.

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