Note that this English version of the minutes includes liberal translations and omissions, and is not a complete translation of the minutes in Japanese.

Minutes of the 4th Council of Experts Concerning the Japanese Version of the Stewardship Code

1. Time and date: 9:00–11:00 am, November 27 (Wednesday), 2013
2. Place: Financial Services Agency

[Kansaku, Chairman] I would like to start the 4th meeting of the Council of Experts Concerning the Japanese Version of the Stewardship Code (the "Council").

I would like to note that Mr. Furuichi, a member of the Council, is unable to attend today due to other commitments. As there is no other expert on the use of the stewardship code from the insurance company point of view, we have asked Mr. Mitsugi Iwasaki, General Manager of Equity Investment Department at Nippon Life Insurance Company, to attend the meeting in accordance with the provision under Article 4 of the Council's Administrative Procedure stipulating that "the Council's chairman, as necessary, is permitted to invite individuals with relevant knowledge and experience, staff at related administrative offices, or other relevant individuals to attend the Council's meeting and provide their opinions".

Let me go over today's agenda.

Today, we will hear explanations on matters related to the development of the Japanese version of the stewardship code. Then, we will have an additional discussion on each principle of the Japanese version.

Firstly, Mr. Masaya Sakuma, Director of Economic, Fiscal and Social Structure at the Cabinet Office, is present as a guest speaker to report to us on the discussion results of the Council on Economic and Fiscal Policy (CEFP) Expert Committee on Desirable Market Economy System. We will hear Mr. Sakuma's report, which will be followed by a Q&A session regarding his report.

Next, based on opinions addressed in the previous meetings, the secretariat of the Council will explain the existing legal framework in Japan and issues which have arisen in relation to this framework. We will then have a Q&A session regarding the secretariat's presentation.

Then, Mr. Shirakawa, Counsellor, Japan's Economic Revitalization Bureau at the Cabinet Secretariat, who also acts as one of the Council's managers, will present the results of the discussion by the Panel for Sophisticating the Management of Public/quasi-public Funds, which will be followed by a Q&A session.

Lastly, we will have the opportunity to continue from the last meeting and have free discussion on each principle to be included in the Japanese version of the stewardship code.

Please note that the overviews of the ICGN Statement of Principles for Institutional Investor Responsibilities and the United Nation's Principles for Responsible Investment were prepared by the secretariat and distributed today for reference. There will be no reporting on this today, given the limited time and the fact that these were already delivered to the members of the Council prior to today's meeting.

Additionally, the secretariat has outsourced the research on the state of intervention in investee companies by institutional investors in western countries. There will be no reporting on this today either, given the limited time and the fact that research reports were already delivered to the members of the Council prior to today's meeting. The research report covering Europe was prepared by Japan Investor Relations and Investor Support, Inc. and the report covering the U.S. by Nomura Institute of Capital Markets Research.

Let's start the presentation regarding matters related to the development of the Japanese version of the stewardship code.

Firstly, the discussion results of the CEFP Expert Committee on Desirable Market Economy System (the "CEFP Committee"). The Council requested this in light of the requirement under the June 2013 Japan Revitalization Strategy directing that CEFP's discussions should be taken into account in the process of developing the Japanese version of the stewardship code.

[Mr. Sakuma] I am Sakuma, a Counsellor at the Cabinet Secretariat.

To give an overview of the CEFP Committee, it was established in late April in 2013 under CEFP, and its discussions continued for about six months. In brief, the discussions of the CEFP Committee were centered on a desirable Japanese-style, market-oriented principle that will facilitate the achievement of sustainable growth led by the real economy, where continuous innovation is possible via the promotion of medium to long-term investment, preventing the financial markets from going out of control.

In other words, the desirable market economy system is a sustainable system that is real economy driven, in which value is created continuously without excessively focusing on the so-called "money game". The CEFP Committee had in-depth discussions focusing on issues regarding the development of a desirable market economy system, while exploring Japan's traditional style of business management and building upon Japan's experience.

The traditional style of business management in Japan, although not retained fully, includes corporate financing with medium to long-term investments through the main bank system; the fact that Japanese companies have valued long-term relationships with various stakeholders; the concept of "*sampo yoshi*" (triple-win) which refers to the concept that a good business will benefit the seller, buyer and society; and human resources development based on a long-term employment system. These may provide some clues for establishing a desirable market economy system in Japan. However, this does not mean that we should regress or excessively focus on the money game, seeking short-term profits that will not come with the real economy.

Therefore, the CEFP Committee, through in-depth discussions, sorted out and clarified the related issues as follows. Firstly, the committee made clear that it is necessary to ensure that medium to long- term funds are available for innovation that supports sustainable growth. This is written in Chapter 2 of the CEFP Committee's report. Expanding on this, the committee agreed that in order to secure such funds, it is necessary to achieve corporate governance that will improve overall corporate value and to improve communication between investors and investee companies, including nonfinancial information. To achieve this, it is essential to establish a stable financial system that facilitates the growth of the real economy.

The CEFP Committee identified issues related to the medium to long-term funds for innovation that will support sustainable growth. Medium to long term funds are defined as the source of funds for innovation. The committee focused on equity financing, although corporate financing also includes debt issuance such as bonds, etc.

The primary driver for the increasing demand for medium to long-term funds is the short-termism of investment. Short-termism pressurizes companies to improve earnings in the short term, thus increasing concerns of weakening resilience of companies for innovation. Further, the CEFP Committee addressed concerns that if the investment decisions of a company are solely based on the maximization of shareholder profits, it may make it difficult for the company to maintain overall corporate value and end up damaging shareholder value.

The section titled “Challenges and Future Direction” provides what is considered necessary to ensure that medium to long-term funds are available. Firstly, improvement of overall corporate value. In the report, this is defined as the equity value and other various values including those that are difficult to quantify, such as efforts to address environmental issues, coexist in harmony with local communities and ensure safety/security. It should be noted that it is essential that companies improve such overall value, and clearly communicate their corporate vision and measures to achieve such vision. To do so, the report recommends that companies should actively communicate with their investors and various other stakeholders, and present to them the medium to long-term prospects of the company.

In addition, the CEFP Committee acknowledged the importance of expanding the investor base by enhancing the investor’s general understanding of investments. The report refers to the need to increase the investor base by promoting a broader understanding of medium to long-term investment, improving general financial literacy and offering financial products such as NISA, etc. The report also refers to the importance of investor intervention in company management, which is related to the stewardship code.

Further, the report states that it is necessary that incentives for making medium to long-term investment are properly communicated through the equity market.

The next section is considered a further review of challenges and future direction particularly from the aspect of companies, highlighting the need for corporate governance that will enhance overall corporate value and outlining the related issues. In today’s corporate world, it has become important to generate corporate value by involving various stakeholders, addressing environmental issues, coexisting in harmony with local communities and ensuring safety/security. Therefore, it is important to increase overall corporate value from the medium to long-term point of view by expanding on the traditional “*sampo yoshi* (triple-win)” concept and by focusing on various stakeholders. Specifically, it is necessary to establish a corporate governance framework that prioritizes the balancing of the interests of various stakeholders or that enables development and utilization of human resources along with the process of corporate renewal. It is also necessary to improve corporate investment by investors through the fulfillment of fiduciary duties.

The report recommends the use of independent directors to facilitate corporate governance that focusses on balancing the interests of various stakeholders. Additionally, the report also refers to the development of the Japanese version of the stewardship code as one of the measures for improving corporate investment through the fulfillment of fiduciary duties by investors.

In the section titled “Challenges and Future Direction”, the report notes in relation to the stewardship code that investors should fulfill their fiduciary duties as a responsibility of institutional investors, which should cover the medium to long term improvement of overall corporate value without focusing excessively on maximizing shareholders value in the short term.

Further, in section titled “Improvement of Corporate Governance through Efforts by Institutional Investors”, the report refers to the importance of developing the Japanese version of the stewardship code. To elaborate this further, it is important for institutional investors to maintain constructive communications with investee companies in order to discipline corporate management and encourage investee companies to achieve sustainable growth by making medium to long-term investments. Through these actions, institutional investors will be able to fulfill their fiduciary duties appropriately. Development of the Japanese version of the stewardship code is one of the specific measures to achieve this. While using the U.K. Stewardship Code as a basis, the Japanese version of the stewardship code should reflect circumstances in Japan, putting particular emphasis on achieving sustainable corporate growth through constructive communication between institutional investors and investee companies.

The report also refers to the improvement of communication by companies. Companies are required to improve communication and disclose both financial information such as return on equity (ROE) and

nonfinancial information such as contribution to environmental issues and local communities. To do so, it is essential for investee companies to provide information that shows overall corporate value including nonfinancial information (e.g., integrated reporting). It is also essential to develop a system to present the entirety of corporate activities, and this should be considered one of the elements in the process of clarifying the management strategy.

Further, the report points out that in order to achieve a stable financial system and avoid the occurrence of large-scale financial crises, it is necessary to actively participate in international efforts for financial system reform and effectively supervise financial markets through a prudent macro policy to mitigate the risk of the financial system going out of control and negatively influencing the real economy.

This section is followed by the committee's conclusion. A desirable market economy system will be established by addressing issues and determining future direction, and by working on initiatives for establishing such a system. Under the desirable market economy system, we hope that companies will not implement short-sighted cost containment measures that will result in a state of diminishing returns, but will take actions that will bring about steady growth, thereby promoting medium to long-term investment, innovation and high-quality employment. Such a system should be communicated to the world.

The section following the conclusion provides the list of committee members and meeting dates. As mentioned earlier, the committee had six meetings in the period from April 2013 to date.

The last page of Material 1-1 provides a summary of issues that need to be resolved to achieve the desirable market and economy system and necessary actions for each of investee companies (borrower of funds) and investors (provider of funds). In addition, capital markets, which function as the intermediary, should be informed and incentivized for medium to long-term investments. Through these, companies will take actions that will bring about steady growth thereby securing a stable source of medium to long-term funds.

I hereby end my presentation on the CEFP Committee. Thank you very much.

[Kansaku] Please feel free to ask questions and give your opinions with regard to Mr. Sakuma's explanation.

[Kawada, member] The section titled "Challenges and the future direction" under "Corporate governance to improve overall corporate value" in Material 1-1 refers to balancing the interests of various stakeholders by appointing independent directors. Please advise how the utilization of independent directors is linked with the act of balancing the interests of various stakeholders. I assume "various stakeholders" here include shareholders, employees, customers, business partners, and citizens in local communities, etc., but it is slightly difficult to understand how utilization of independent directors actually facilitates the balancing of interests among these various stakeholders. Please advise.

[Mr. Sakuma] What the report means to convey is the idea that compared with internal directors, outside directors are independent and less constrained. Thus, they may be able to keep the interests of various stakeholders balanced and play a key role in making decisions for the improvement of overall corporate value without getting caught up with the existing management policy, vested interests, etc. It is because, in a sense, outside directors are less restricted and able to take actions based on the third party point of view. Of course, there is a view that outside directors are required to address the interests of shareholders accurately. This is not to say that they should emphasize the interests of various other stakeholders at the expense of shareholders. But the CEFP Committee acknowledged the fact that in essence, outside directors are less constrained and may be able to stay objective and consider the balance among stakeholders, thereby contribute to the decision making at board of directors meeting more effectively.

[Tanaka, member] I think a report like this should not be targeted at readers who are in favor of the direction of its argument only. It should provide convincing arguments to investors who are doubtful --to put it baldly, to readers who may view such arguments as a means to give an excuse for the currently stagnant profitability. In this sense, the report's contents should be backed by adequate evidence. For example, the report refers to the lack of medium to long-term funding due to investment decisions based on concepts such as short-term investment horizon and maximization of shareholder profits. Does such a situation really exist? Are there any facts pointing to such an assertion? Only addressing concerns will not convince some readers, who will likely consider such an argument as an excuse for the stagnant profitability. I only read the summarized version of the report and thus may be mistaken, but I would like to note that the report would be more convincing if backed by factual evidence.

[Mr. Sakuma] Indeed, I agree with your opinion and the report's argument should not be read as an excuse for low profitability. Although this may be a deviation from your point, as noted by the report briefly, by encouraging medium to long-term investment, the CEFP Committee does not intend to criticize short-term investment at all. In order to execute medium to long-term investment properly, the report refers to the need to maintain "liquidity" in transactions, that is, a certain mechanism that guarantee that transactions are executed freely and smoothly. To achieve this, it is important to make sure that short-term transactions are also executed smoothly in the market.

Rather than criticizing short-term investment, both the CEFP Committee and the CEFP to which the CEFP's Committee's report was presented have expressed their view that the ideal market is one that calls for medium to long-term investment while accepting short-term investments.

From a medium to long-term point of view, improvement of what we call "overall corporate value" does not contradict improvement of shareholder value. I hope you will understand that it is not our intention to use our argument about short-termism and the lack of medium to long-term funding as an excuse for the stagnant state of profitability.

Also, the CEFP Committee was in a sense initiated by a concept similar to Public Interest Capitalism as noted by Mr. Hara, Deputy Chairman of the committee. In view of such background, I would appreciate your understanding as to the difficulty we faced in putting ideas together as the secretariat to the CEFP Committee.

[Eguchi, member] I have various questions as to the details of the report, but today, I will ask questions in relation to the discussions at the Council.

The report discusses the promotion of corporate governance that facilitates the development and utilization of human resources while also promoting the regeneration process of organizations, on one hand, and the improvement of corporate governance by involving institutional investors, on the other. As a general argument, it is possible to say that there is a trade-off between the ability to develop/utilize human resources and active intervention by shareholders. It has been pointed out that, excessive intervention by shareholders could interfere with long-term human resources development. It has also been pointed out that a highly open and liquid labor market would be necessary for strengthening the involvement of shareholders. In the report, human resources development/utilization and shareholder involvement are linked in the context of corporate governance, implying that the two issues should be considered as a whole. An issue in this regard might be how to increase flexibility of employment while acknowledging the benefit of the long-term employment system. What is the CEFP Committee's view on the relationship between long-term human resources development and the strengthening of shareholder involvement? I am asking this as this is related to the issues discussed at the Council.

[Mr. Sakuma] I think balancing the two issues is quite a difficult task. The development and utilization of human resources is important for both the economy and companies in Japan. In an effort to categorize these issues, we tentatively concluded that they were best categorized as issues related to corporate

governance. In addition, some members pointed out at the CEFP Committee the importance of the human resources issues, which was also classified as a corporate governance issue.

Ultimately, it is important to maintain a good balance between the two. At the same time, the report points out that establishing an employment environment that promotes various styles of working is achievable not only though each company's corporate governance activity but also through the efforts of society as a whole.

In my view, ultimately, it is not possible for companies to continue generating value over the medium to long term without developing human resources properly. It is important to gain the understanding of institutional investors and create a win-win situation for both investee companies and institutional investors.

[Kansaku] We will move on to the next topic and hear an explanation as to clarification of interpretation of legal issues, etc. The presentation was prepared in response to the opinion given in the past meetings, which addressed the need for legal clarification so that there is no confusion in relation to Japan's existing legal framework in the dialogue, etc., with investee companies.

[Yufu] Please look at Material 2. In sum, it was pointed out in past meetings that a legal clarification is necessary to avoid uncertainties as to legal terms in Japan when institutional investors conduct dialogues with investee companies.

Refer to Material 2

[Kansaku] The secretariat has just provided the FSA's interpretation of related regulations currently in effect. Please provide your opinions/comments on the potential impact of such related regulations on dialogue between institutional investors and investee companies, ideas for improvement, and points to be considered on the basis of the FSA's interpretation, rather than discussing the appropriateness of the FSA's interpretation itself.

[Oguchi, member] In accordance with Mr. Kansaku's instruction, I would like to ask for confirmation. In the explanation of an Act of Making Important Suggestions, we were given examples of cases to which this concept does not apply, including circumstances where the institutional investor is requested to give opinions by the issuer and where the issuer voluntarily sets up meetings such as earnings briefings, IR meetings, etc. I would like to note that realistically, meetings are also initiated at the request of investors and such requests are accepted by the issuer voluntarily. In many cases, dialogue under the stewardship code will likely occur this way, which, in my view, will still qualify as "meetings voluntarily set by the issuer", as the fact that the issuer is agreeing to meet with the investor evidences the issuer's voluntary acceptance. Please confirm if my understanding is correct?

[Yufu] The FSA's view does not include such a case where the dialogue takes place at the investor's request to the issuer. In our view, this should be discussed and judged on a different level. Meetings independently arranged by issuers are not considered an Important Proposed Act.

In other words, even if they are requested by investors, many of the dialogues will not be considered an Important Proposed Act, depending on the mode of the dialogue. For example, even if a dialogue is requested by institutional investors, it is highly unlikely that actions such as the abovementioned (i) through (iii) and statement of opinions in response to the issuer's request are considered an Important Proposed Act.

[Oguchi] Specifically speaking, the process of dialogue will naturally be initiated by the investor's request to the issuer to provide explanation. The investor will give opinions in response to the issuer's

explanation. Thus, based on your explanation, I assume my example case will not be considered an Important Proposed Act. Then, what is the FSA's view regarding the situation where the investor is not convinced by the issuer's explanation and wishes to discuss further, or the enquiry of the shareholder gets intensified through a series of explanation and statement of opinions.

[Yufu] I think we can only deal with such a situation by reviewing the characteristics of the actions on a case by case basis. It is not easy to make an *a priori* statement determining whether the action in question is an Important Proposed Act by identifying the initiator of the dialogue.

[Eguchi] I understand that the purpose of inserting additional contents this time is to clarify the execution of shareholders' voting rights and other rights, in particular the other shareholder rights. The problem of these explanations from the point of view of investor behavior appears to me that a distinction between the exchange of opinions about executing voting rights and agreement as to executing voting rights is not yet clear; the concern of investors has not been solved. As a possible solution, for example, it may be appropriate to take the U.K. approach and introduce the concept of "lasting agreement" to differentiate from the one-time agreement. Alternatively, it may be appropriate to break down the content of an Act of Making Important Suggestions based on the typical agenda of a general shareholders meeting in Japan and provide more detailed explanation. What is your view on this ? I wonder if there is a possibility for taking these approaches.

[Yufu] As you may know, the European Securities and Markets Authority (ESMA), an association of authorities of securities businesses under EU, released its intention to clarify circumstances relating to "acting in concert" in the public statement as of November 12. The ESMA's intention is probably similar to ours.

While overall, the requirement related to this issue is similar between Japan and the EU, the primary difference between the two regimes is in that in Europe, the concept of "acting in concert" (i.e., joint holder and person in special relationship) is applicable when the purpose of the act is to acquire rights to exercise control over the investee company, which seem considerably narrower than in Japan; hence the scope in which shareholders can cooperate without being regarded as "acting in concert" can be set broadly in Europe.

In Japan, the large shareholding report rules, for example, have been set not only to capture the potential impacts of large shareholdings on company management but also to acquire information regarding the purchase of shares in large quantity and the demand/supply situation in the market. Hence, we need to keep in mind that the reporting requirements in Japan are not a legal system for monitoring control over management only. Broadening the scope of actions that are not subject to the concept of "acting in concert" to this level will be acceptable, but going beyond this level will probably require legal reform or a drastic change to the basis of this reporting system.

Further, to respond to Mr. Eguchi's initial comment, an exchange of opinions will not constitute an agreement, given the FSA's clarification that a discussion, so long as it is an exchange of opinions, and will not be considered to fall under the definition of Joint Holder/Persons in a Special Relationship. However, if the discussions with other shareholders go beyond an exchange of opinions and reach a certain agreement, then, basically, the Joint Holder concept will likely be applied.

[Tanaka] The task of legal clarification has progressed thanks to the substantial efforts made by by the secretariat. I would like to give comments on two issues. Firstly, I feel it is necessary to clarify a little more in depth the concept of "agreement" that will be regarded as joint holding as mentioned by Mr. Eguchi.

I certainly agree with the Q&A stating that the concept of Joint Holder will not apply if a shareholder simply has a discussion with other shareholders. However, I should note that the instruction manual

written by FSA officers (Hidenori Mitsui and Ichiro Tsuchimoto "Detailed Explanation: The TOB system and the Reporting Requirement for Large Shareholdings Q&A" p. 187) refers to, as an example, a circumstance where the discussion ends inconclusively. Discussion ending inconclusively means no agreement being made. Conversely, it is highly concerning if the same direction of thinking is demonstrated among shareholders in the discussion, then this may be regarded as an agreement being made.

In my view, reaching agreement means legal agreement. That is, under the Civil Code in Japan, a verbal agreement is enforceable on agreed parties assuming that there is no other legal specification. This in turn means that the agreement cannot be qualified as legal agreement without enforceability.

For example, I planned to attend today's stewardship council meeting, and let us assume that I talked with Mr. Eguchi yesterday, and he asked if I planned to attend the meeting and I answered "yes". Mr. Eguchi also mentioned he was also going to attend the meeting. In my opinion, this is not an agreement at all. We simply informed our future schedule to each other, and we had the same plan by coincidence. In order to call this a valid "agreement" under Japanese law, each person indicates awareness that he or she is bound by the statement made and such awareness must be identical between the two, which is very clearly defined under Anglo-American law called "agreement of promise". This is fundamentally the same in Japan, thus an agreement is not established without the element of promise.

In any case, it is not possible to avoid ambiguities completely when bringing these concepts into practice. However, I think it is important to disseminate the basic idea of agreement; that is, informing each other of a plan for the future does not qualify as an agreement. Please consider adding this kind of information somewhere appropriate. Further, this information is valid regardless of the decision as to whether, as in EU, to include the intention to control as one of the definitions for "acting in concert". I appreciate your consideration.

My second point relates to the Act of Making Important Suggestions, specifically, in relation to item (vi): request for comments/resolution on a specific matter at the general shareholders meeting. Firstly, I think the wording should be corrected to "acts of requesting resolutions as to specific matters and making comments", as a resolution is requested by the company to the shareholders, while comments are made by shareholders themselves. Also relating to the nuance of item (vi), the current proposal can be read that the action falling under (vi) is highly likely to be regarded as an Act of Making Important Suggestions, and raising questions in this context will not fall under an Act of Making Important Suggestions as an exception to (iv). However, under the Companies Act, shareholders are entitled to ask questions as well as to propose motions at the general shareholders meeting. That is to say, shareholders have the right to ask for explanation through questions, and the directors of the company are obliged to provide answers. To propose a motion means to make a suggestion; thus it is likely to be regarded as an act of Making Important Suggestions. On the other hand, asking questions relates to enquiring for explanation at the shareholders meeting as described under items (i) through (iii) of the proposed Q&A. Thus, it is is outside the scope of the Act of Making Important Suggestions as a general rule, not an exception.

The act of shareholders making comments at the general shareholders meeting in the proposed insertion in the Q&A probably assumes the situation where shareholders state their opinions although stating opinions is not clearly permitted under the Companies Act. In reality, the investee company often accepts such action as long as time allows. Shareholders, in stating their opinions, may make suggestions which can be regarded as making important suggestions. The rules under the Companies Act, in essence, assume either proposing a motion or asking question as possible actions of the shareholder at the general shareholders meeting. As such, clarification should be made to the relevant laws and regulations, rather than in the Q&A, explaining that asking questions will not be considered an Act of Making Important Suggestions. Otherwise, the rules will remain confusing, giving an impression that if a shareholder's action falls under item (vi) (i.e., commenting at the general shareholders meeting),

it will be regarded as making important suggestions even in the case of asking questions. Although this is rather an issue of wording, I would appreciate your consideration.

[Kansaku] A subtle case such as a gentlemen's agreement will need to be considered. I would like to ask the secretariat to review the possibility of further clarification as to the act of agreement.

Next, we will hear about the results of discussions by the Panel for Sophisticating the Management of Public/quasi-public Funds (the Panel). Public/quasi-public funds, including the Government Pension Investment Fund (GPIF), are considered in the broader sense of institutional investors covered by the Japanese version of the stewardship code. The Panel, set up specifically to discuss the desirable way to manage such funds, recently compiled a final report. The secretariat has requested a presentation in relation to this report.

[Mr. Shirakawa, Counsellor] Based on the secretariat's request, I will provide a presentation about the report compiled last week by the Panel in light of the Japan Revitalization Strategy, focusing on the contents related to the stewardship code.

The Panel's review started as an initiative under the Japan Revitalization Strategy, a cabinet decision on June 14, 2013. Specifically, the Panel was established to discuss and review a wide range of issues relating to public/quasi-public funds (the "Funds") encompassing investment management (promotion of diversification), governance of risk management system and initiatives for improving returns on long-term investment in shares.

The Panel was chaired by Professor Takatoshi Ito, Faculty of Economics and Dean of the Graduate School of Public Policy, the University of Tokyo. Members included Mr. Horie, who is also a member of the stewardship council. Mr. Hamaguchi, Chief Investment Officer of the Pension Fund Association, also participated in the process of the Panel's discussions, providing informative opinions. The report was completed last week, and I would like to give an overview of the report. Firstly, the report, in the section titled "revising the investment profile in view of a post-deflationary economy", recommends restructuring the existing portfolios which are currently domestic bond focused.

In order to promote portfolio diversification, the report also recommends expanding investment targets and including investments in infrastructure, venture capital, private equity in the portfolios.

The report also addresses the need to consider an increase in the ratio of active investments and for selecting benchmarks for passive asset management carefully.

Further, the report recommends improving the governance and risk management systems, etc., of the Funds. In terms of the relationship between the Funds and the minister in charge, the report emphasizes the importance of ensuring the independence and creativity of the Funds. A key investment policy should be determined essentially through a collegial decision-making system where full-time experts play a central role.

The majority of public/quasi-public funds are managed by incorporated administrative agencies. Focusing on the fact that, due to certain restrictions, these agencies can only offer employment terms and conditions equivalent to those of national public servants, the report suggests giving flexibility to their remuneration system, etc.

The last topic of the report is maximizing returns on investments in equity assets, which is closely related to the Council's discussion. The report states that the Funds, when making investments in equities such as shares, should aim for improving returns assuming long-term investment. To this end, the Funds, even if their position is public/quasi-public, should conduct close dialogues with the investee companies and exercise voting rights appropriately as the trustee of assets through their investment

manager. Further, the Funds should develop a policy of keeping in mind that the expected results of ongoing discussions by the FSA on the Japanese version of the stewardship code (note: the report uses the term "expected results" as the Panel's discussion started prior to the stewardship council), and urge their investment manager to comply with such policy.

However, the report points out that the Funds should take care to avoid excessive involvement with the business management of investee companies and formal exercise of voting rights by uniformly applying their policy.

In this sense, it may be helpful to use, as necessary, investment managers that will work to achieve sustainable growth of corporate value of investee companies through dialogue based on a solid relationship. Given the lack of human resources, the exercise of voting rights by the Funds themselves is not feasible, thus the voting action is typically taken through their asset managers. The report recommends the use of asset managers, emphasizing close dialogue with investee companies and the appropriate exercise of voting rights.

Furthermore, the Panel also discussed the possibility of using proxy advisors, and agreed and concluded that proxy advisors can be used if an appropriate environment is developed for using those who are able to accurately capture the management status of investee companies in Japan under the the appropriate governance framework (referring to the statement under note 5 on page 8 of Material 3-2). I suspect that this statement sound ambiguous to you. It is because, at this juncture, as opined by some members of the Panel, the existing proxy advisors are not necessarily equipped with adequate capability but we wanted to address our expectations for the future.

It should be noted that some members of the Panel opined that when investing, the Funds should consider non-financial elements (i.e., environment, society and governance or ESG) in addition to the financial element. The Panel agreed that each fund should individually consider this matter.

[Kansaku] Please feel free to ask questions or give opinions in relation to Mr. Shirakawa's presentation.

[Oguchi] As to the explanation on proxy advisors at the end of your presentation (referring to note 5, page 8 of Material 3-2), I understand the part "with ability to accurately capture the status of business of investee companies in Japan" but not sure if I understand what you mean by appropriate governance. Please expand your explanation and advise what specifically you envisage regarding this?

[Shirakawa] The Panel discussed this issue assuming that the majority of existing proxy advisors in Japan are non-Japanese who also manage funds themselves. Hence some panel members addressed concerns of potential conflicts of interest. The report refers to the importance of an appropriate governance framework as a general issue, not specific to Japan.

[Ishida, member] As to the proxy advisor that manages its own funds, as far as I know, there is no such proxy advisor in Japan.

[Kansaku] Next, continuing from the last meeting, please comment freely about each principle under the Japanese version of the stewardship code. The materials used at the last meeting have been distributed today (Reference Material 1 & 2). Please refer to these, and make comments freely on any points.

[Eguchi] I would like to talk about an issue that has not been addressed before, but considered useful when considering the development of the stewardship code in Japan.

The draft proposal by the secretariat is based on the U.K. Stewardship Code that is premised on the environment existing in the U.K. Thus, it is important to be aware that Japan's institutional environment is different from the U.K. environment. One of the concerns investee companies have expressed in our

conversation is the ambiguity as to which investors they should be having dialogues with. Typically, a very large number of investors are invested in a company; is the investee company required to have dialogues with all of their investors? If it talks with only a subset of its investors, other investors will be excluded, and this will be a problem. However, it is not realistic to have dialogues covering each and every investor, from large shareholders to small shareholders.

Given such circumstances, the issue is to whom investee companies should be talking. This indicates the need for some body or mechanism that represents the investors at large in relation with a dialogue between investors and investee companies. I think that the Japanese version of the stewardship code should include a statement pointing out the importance of the effort to form such body or mechanism.

[Ishida] From a slightly different angle, I would like to raise an issue in relation to the appropriateness of naming the code the "Japanese version of the Stewardship Code". The FSA's attempt to develop the code is becoming quite widely known under the name of "Japanese version of the Stewardship Code". I am often asked to explain the code, and I always have to explain the meaning of "stewardship" first, a new and unfamiliar concept expressed in *katakana* (a style of writing, primarily used for the transcription of foreign language words into Japanese and the writing of loan words) to the Japanese people. That being said; honestly, I do not have solid knowledge about the original meaning of a word "stewardship" and how in British history this came to be used as a concept for disciplining investor's activities. Therefore, I wonder if we can use an easy to understand, simplified name rather than a name that is complex and difficult to explain. It is not meaningful to spread the term "stewardship" itself to the public. I think it is best to name the code by describing what is essentially required.

Then what expression is suitable? In the post crisis discussions regarding the ideal behavior of institutional investors, on the whole, the term "short-term" is almost always interpreted in a negative sense. On the other hand, the term "long-term" is viewed positively. Also the expression "responsible investor" inherently has a good meaning. Thus, if we name the code, for example, "Principles for Long-term Responsible Institutional Investors", the code's requirements would be more evident in the title.

Of course, it is important to retain the context of the influence of the globally widespread U.K. Stewardship Code over the Japanese version. Thus, I do not think there is a problem in adding a sub-title such as "Japanese version of the stewardship code" in parenthesis to the official and main title as mentioned above to indicate that this document is the so-called stewardship code in Japan. Making the common name ("Japanese version of the stewardship code") the official name is not appropriate. As the code will be developed in Japan, it is important to develop a code that is easy to understand for people overseas when disseminated outside Japan. It feels strange if we disseminate outside Japan something that is not easily explained by Japanese people.

Additionally, I am afraid that using the term "stewardship" in the official title of the code may interfere with the efforts to increase the number of the code's signatories. One cannot sign a document called "stewardship code" without believing that the stewardship is a good thing. In that sense, investors will have difficulty joining this code, not fully understanding the meaning of stewardship or the significance of the code in relation to fiduciary duties. I am afraid that such title may prevent increasing the number of signatories which is our top priority at this juncture. However, if we call the code "Principles for Long-term Responsible Investors", it is very easy for Japanese to understand what it is.

[Kansaku] Indeed, similar codes developed overseas do not necessarily have the term "stewardship" in their titles. Thank you for your valuable opinion.

[Oguchi] I would like to make quite specific points as to the contents of the Japanese version. I sent out my opinions via email based on the instructions at the end of the previous meeting to use email to

address any opinions; thus I assume council members have already been informed of my opinions. However, I would like to take this opportunity to mention them again. The first one relates to the exercise of voting rights under Principle 6. The secretariat provided explanation on the June 2009 report issued by a study group under the Financial System Council at the first meeting. This report clearly recommended disclosure of voting results, based on which many organizations set out the industry regulation. Thus, such disclosure has already been widely accepted as part of business practice. The guideline to Principle 6 under the U.K. Stewardship Code clarifies that the voting activities should be publicly disclosed. As I noted before, disclosing voting activities has already become part of business practice, thus I would like to request not to do anything that will reverse this situation.

My second point also relates to the exercise of voting rights. At the last meeting, Mr. Hamaguchi addressed an issue in relation to anti-takeover defense measures. Specifically, many companies are still adopting anti-takeover defense measures, despite the fact that rules for financial markets are appropriately set such as the Financial Instruments and Exchange Act. In mitigation, in one sense, some of the entities that disclose their voting activities are making specific disclosure as to the voting on anti-takeover defense measures, and the number of such entities is increasing, while legally they are only required to disclose their voting actions on anti-takeover measures in the category "voting actions as to other proposal". Assuming that disclosure of voting activities is required for the purpose of causing substantial effects rather than formality, voting actions on material issues should be disclosed separately. Significant issues, such as anti-takeover defense measures that I happened to talk about today, should be highlighted separately in accordance with the purpose of disclosure. Please note that separate disclosure means disclosure of voting actions on each important issue, not based on each individual investee company.

[Horie, member] I am of the same opinion with Mr. Oguchi. However, in terms of disclosure of voting activities, I view that aggregate disclosure is sufficient. I think that the separate disclosure, although it is certainly important, should be made individually to clients, not to the general public. However, given aggregate results have been disclosed already, a requirement to disclose aggregate results should certainly be drafted into the code's guideline.

I would like to add one more comment. As I indicated at the last meeting, I am still of the view that Principle 2 on conflicts of interest still lacks specific examples. In turn, specific cases to give rise to the issue of conflicts of interest are provided in the ICGN Statement of Principles for Institutional Investor Responsibilities. Today's discussion is focused on engagement between institutional investors and investee companies, and I am not requesting further discussions as per my comment. However, I would like to note that governance within institutional investors has a lot of room for improvement. Currently, in the U.K, the governance of institutional investors is under review as part of the efforts to revise the stewardship code. Please add discussion of the governance of institutional investors at the next revision of the Japanese version.

[Mr. Iwasaki] The Life Insurance Association of Japan (LIAJ), as mentioned at the last meeting, does not require life insurance companies to disclose aggregate results of voting, leaving the method of disclosure to the discretion of each company.

In relation to the Japanese version, it is important to make efforts to obtain as many signatories as possible by giving recognition to the existing governance activities of a wide range of investors.

As mentioned last time, I think it is important to keep in mind that the performance of institutional investors should be evaluated in light of the depth/degree of dialogue, not number of opposing votes.

[Kawada] The last white bullet point under the section titled "Others" on page 6 of Reference Material 1 states that the efforts of investee companies as well as institutional investors are important to promote constructive dialogue between institutional investors and investee companies. As I briefly noted at the

last meeting, the statement sounds a little strange. I agree with the statement itself, but I am having a hard time understanding the reason behind the insertion of such a statement in the code, because the purpose of the stewardship code is to stipulate the responsibilities of institutional investors. Further, In addition, the last three lines under the same white bullet point suggests the insertion of a paragraph to the code stating that "investee companies are also expected to make efforts to ensure that investors are given adequate time to fully review the proposed agenda for the general shareholders meeting. Requiring investee companies to appropriately adjust the review period in terms of the general shareholders meeting, the paragraph sounds as if investee companies are given discretion to decide the length of review period in terms of the general shareholders meeting. Under the Companies Act, investee companies are required to send out the proposed agenda for the general shareholders meeting 14 days before the meeting date. While this means that under the Companies Act, 14 days is deemed adequate for shareholders to fully review the proposed agenda, investee companies are actually making efforts to make such review period longer. I wanted to comment on this because the expression on page 6 sounds a little unreasonable, requiring investee companies to secure a review period longer than the legal requirement just because the 14 day-period under the Companies Act is not adequate.

[Oguchi] My opinion relates to the linkage between Principle 6 that has been discussed (i.e., a clear policy on voting and disclosure of voting activity) and Principle 7 (i.e., reporting of voting activities to the clients/beneficiaries). Regarding public disclosure and the reporting to the clients/beneficiaries, my understanding is that if a client or a beneficiary, that is, a policyholder for insurance companies or a beneficiary for pension funds, wishes to receive detailed information as to activities of the funds or insurance companies, they should be provided such information. Is this correct?

[Yufu] For that, please look at the first hyphen point under the two toned arrow on page 15 of Reference Material 1. In view of circumstances where reporting is not required by clients or beneficiaries and where there is no means for reporting to ultimate beneficiaries, the secretariat addressed the need for inserting wording in the code recommending general disclosure of information that can be made public, rather than separate disclosure to clients or beneficiaries.

[Hamaguchi, member] The largest institutional investors in Japanese financial markets are foreign investors, followed by corporates. Are these included in the code's scope of application? The secretariat suggested not setting a definition of institutional investor. Are they going to be required to comply with the code?

[Yufu] Please see section titled "shareholding by domestic and foreign investors" on page 3. In the third to fourth lines of the white bullet point, the secretariat suggested that the Japanese version of the stewardship code should be drafted in such a way that it will not limit the scope of application only to Japanese institutional investors registered in Japan.

Views on corporates may vary, and in my opinion corporates are not institutional investors. In any way, the secretariat's suggestion is to keep the cut-off point of definition deliberately ambiguous.

[Hamaguchi] Then, foreign institutions, so-called foreign investors, will be required to declare their compliance with the stewardship code. This sounds reasonable. Do codes overseas function in the same way?

I understand that corporates have a different image than institutional investors. However, in a broad sense, they essentially have the same fiduciary duty. Thus, if they are banks, etc., it is not necessarily strange to require a declaration of their policies in managing conflicts, etc., in the same logic as the requirement to provide explanation as to cross shareholding.

[Yufu] The flip side of not setting a clear cut-off in the definition of institutional investor is, for example, that if an institution, after clarifying conflicts of interest issues etc., voluntarily requests to become a

signatory of the code, we will accept such a request.

As for the treatment of overseas investors, the U.K. Stewardship Code calls for compliance by overseas investors, even though these investors may comply with other similar standards such as the ICGN Statement of Principles for Institutional Investor Responsibilities. On the other hand, treatment of overseas investors varies. Although I do not remember precisely, there are three to four countries that have developed their own stewardship code by referencing the U.K. Stewardship Code, including South Africa, the Netherlands, Switzerland, etc. Among these countries, two different approaches were identified as to the treatment of overseas investors; one specifying the code's scope of application to domestic institutional investors only and another following the U.K.'s approach, universally requiring compliance with their code. I should note that given the status of the U.K. market, the U.K. code would be meaningless without covering foreign investors.

[Matsushima, member] I would like to comment on the costs associated with discharging responsibilities as institutional investors on page 3 of Reference Material 1. My comment is not necessarily from the position of investment trusts.

I understand that whether to comply with the code is up to the individual company's decision. However, in view of the importance of ensuring the participation of a wide range of institutional investors, the burden of costs arising from observing the code is somewhat unavoidable. Further, although asset owners may have to bear the increased costs temporarily, considering the positive effect from the long-term perspective, it will be helpful if the code can recommend adjusting the fees charged on institutional investors (asset managers) to an appropriate level, as a possible solution to cope with the cost issue. This will ultimately achieve overall improvement of relevant system for institutional investors to comply with the stewardship code.

[Noguchi, member] Please see page 16 of Reference Material 1, which talks about principles unique to the Japanese version of the stewardship code. Potential guidelines to such principles are outlined including the following: (i) institutional investors should make efforts to gain an in-depth knowledge of their investee companies; (ii) institutional investors should develop a framework necessary for conducting dialogues and making judgment appropriately; and (iii) institutional investors should conduct ex-post verification as to whether their dialogue and judgment were appropriate.
Certainly, one should reflect on actions taken and evaluate the results. I had discussions within my institution as to the actions subject to ex-post verification and verification method that would meet the purpose of the above guideline. Judging from the purpose of the stewardship code, it is not probably meaningful to use the increase/decrease of number of dialogues as a benchmark for evaluation. A rise in the share price as a result of the institutional investor's action is not necessarily a reasonable measure. Medium to long-term efficiency of capital/assets could be good benchmark but it may take a long time to see actual improvement and it is not effective in capturing short-term (1-2 years) performance. Thus, ex-post verification/assessment will have to be in the form of quantitative assessment.

To date, we have provided explanation to and conducted hearings with certain plan sponsors focusing on the exercise of voting rights. Going forward, plan sponsors will likely ask questions and conduct hearings in the context of the stewardship code. However, I would like to note that there are some elements in the ex-post verification that do not necessarily fit with short-term qualitative evaluation.

Institutional investors, including plan sponsors, are expected to review their activities and take actions which will result in the growth of financial markets or Japanese companies. Through reviewing for improvement every year, we came to realize that this is not an easy task. We will continue our review and analysis regarding how effectively we should conduct dialogues with issuer companies; exchange opinions with plan sponsors about the results of such dialogues; and ultimately generate better results on the whole.

[Yufu] Just as noted by Mr. Noguchi, the significance of developing the Japanese version of the stewardship code is in part that it will create an opportunity to review and discuss stewardship issues among related parties based on the code. I think this thought process is extremely important. I am pleased to hear that such discussions are being held.

It should be noted, however, that the statement on the third line from the bottom of page 16 is rather unclear. I plan to investigate further and expand on this statement at the stage of drafting the actual code. Assessment as to whether the investee company changed its management approach/policies as a result of opposition votes or dialogue; whether earnings were improved due to such changes; and whether such earnings improvement contributed to a rise in the share price thereby increasing returns for investors will probably fall under Principle 4. Guideline (ii) to Principle 4 on page 11 (i.e., institutional investors should regularly assess the outcomes of intervention) seems to have been drafted assuming such type assessment, which, based on opinions received at the last meeting, may not best fit conditions in Japan.

For example, in brief, casting opposition votes rarely results in rejection of the proposal of the investee company, making it quite difficult to take a qualitative assessment approach. It will also be difficult to assess changes made by the issuer as a result of dialogues, given a lack of clear assessment methodology.

In this context some members stated the opinion that guideline (ii) under Principle 4 will not fit the circumstances in Japan. On the other hand, the statement on page 16 is based on more rough ideas. Let us assume, for example, a situation 4-5 years ago. There was a material dispute/issue between an investee company and an institutional investor, and the institutional investor took actions such as dialogue with and requests to the investee company, resulting in casting affirmative (or opposition) votes. After a while, such as 3 years or 5 years later, the institutional investor, looking back, makes judgment on the appropriateness of actions taken. By ex-post verification, we envisaged a situation where investors reflect on and confirm the appropriateness of their actions in the past. Further, we did not mean to say investors should do this on every single issue in the past, but regarding important issues only. It is our assumption that in essence, it is highly unlikely that the quantitative assessment approach will fit the circumstances in Japan.

[Ishida, member] Just for reference, I would like to remark on Mr. Yufu's comments. Successful issuer-investor engagement is difficult to achieve. Issuer-investor engagement is already quite advanced in the U.S., and my company (International Shareholders Services, Inc.) conducted an engagement study as to the state of U.S. issuer-investor engagement in the form of a questionnaire survey targeting issuers, asset owners, and asset managers separately. According to the study, in answer to the question as to the definition of successful engagement (i.e., what outcomes of an engagement process are sufficient to make an engagement successful), 57% of issuers responded to the questionnaire thought establishment of a dialogue itself is considered successful. Only 44% of asset owners considered it a successful engagement, thus the majority of asset owners do not think conducting dialogue itself means successful engagement. Further, only 50% of asset managers considered the establishment of a dialogue a successful engagement.

On the other hand, 78% of asset owners and 73% of asset managers considered it successful if the issuer made additional disclosure or made changes in practices, while only 33% of issuers regarded such an outcome as successful.

The above is just for information, but even the U.S., where issuer-investor engagement is at an advanced stage, is facing challenges. That is, conducting a dialogue itself is not meaningful, and it is very difficult to set a benchmark to measure how successful an engagement is. On top of that, such benchmark is different among asset managers, asset owners and issuers. As the code becomes widespread in Japan, I think discussion will progress as to what outcomes are sufficient to make an engagement successful.

[Oba, member] I will address my opinion in relation to Mr. Noguhi's comments. Japanese characteristics,

or should I call it the Japanese sense of values, are taken into account very strictly when adopting a new system. Post implementation, however, status is not appropriately followed up. This is not limited to the case of the stewardship code. Analogous to this, in corporate management, many companies, while they make significant efforts to develop a medium term management plan, are often criticized for not achieving the goals under such plan. In addition to Principle 7 and issues pointed out by Mr. Noguchi, in view of the feasibility of the Japanese version of the stewardship code, it is very important to ensure that a mechanism is in place for a follow-up, ex-post verification or review after implementation of the stewardship code. Taking some kinds of measures, such as development of a follow-up process in advance, will help the Japanese version become widely accepted as principles for the conduct of institutional investors. Please consider this.

[Kansaku] To conclude today's meeting, I would like to ask the secretariat if there is any closing message.

[Yufu] The secretariat will decide the date of the next meeting considering the schedules of the members, and formally inform you when the date is fixed.

[Kansaku] Given questions asked in relation to the effectiveness of issuer-investor engagement to date, I will ask the secretariat to distribute the empirical analysis on stakeholder engagement drafted by CalPERS (The California Public Employees' Retirement System) in the U.S. Please read it as a reference for our future discussion.

End.