Study Group to Review Minority Shareholder Protection and other Framework of Quasi-Controlled Listed Companies: Second Phase
Minutes of the Third Meeting

Date: Friday, May 19, 2023 10:30 - 11:50
Place: Tokyo Stock Exchange 15F Special Conference Room
Attendees: See member list
Absent: Mr. Kikuchi, Mr. Kuronuma

[Kikuchi, Director, Listing Department, TSE]
The time has now come to begin the third meeting of the second phase of the Study Group to Review Minority Shareholder Protection and other Framework of Quasi-Controlled Listed Companies.
Thank you for gathering here today, despite your busy schedules.
First of all, I would like to mention that Mr. Kikuchi and Mr. Kuronuma are absent today. Mr. Kato and observers from the FSA and the Ministry of Justice are participating online.

Now, I would like to begin the proceedings. First, we will explain today's agenda.

[Ikeda, Senior Manager, Listing Department]
We appreciate your contributions to our discussions on information disclosure up to the second meeting held in March. With regard to our actions on information disclosure, we are coordinating with companies on practical aspects, taking into account your opinions at the last meeting. We will report on the details once they are finalized.
From this meeting onwards, as the next issue, we would like to deepen the discussion on corporate governance. Based on the suggestions we have received in the past Study Group meetings, we would like to start our discussion with the issue of the use of independent directors and we would like to hear your comments on this point, with reference to Document 2.

[Kikuchi, Director, Listing Department, TSE]
Next, a TSE representative will provide explanations based on the documents.

[Shirozu, Manager, Listing Department, TSE]

On behalf of the Secretariat, I will explain Document 2, which has been distributed to you. As we were given time to explain this during the preliminary explanation, I will keep this explanation concise.

First, on page 3, we have presented a big picture of how we intend to proceed with our discussions on governance.

The premise of the discussion is that, in the case of listed companies with a controlling shareholder, in the typical governance situation of monitoring the management, the controlling shareholder's commitment to do so is expected, but this creates a risk of structural conflicts of interest between the controlling shareholder and minority shareholders, and thus governance in this regard is necessary. Therefore, what is important from the perspective of protecting minority shareholders is that an effective governance system should be in place and functioning to monitor the risk of structural conflicts of interest between controlling shareholders and minority shareholders. And from this perspective, we are aware that it is widely considered important that independent directors be envisioned as central players and utilized in terms of the development and functioning of such a governance structure.

Based on this, we believe the first thing that TSE needs to consider is what measures are needed at TSE and in the listing system in order to create a situation in which independent directors can be utilized. In terms of specific issues, we would like to start our discussion by asking what roles independent directors should play and how to ensure their independence from the controlling shareholder, which is a prerequisite for independent directors to fulfill such roles.

The first major topic, starting on page 4, is a discussion of the role of independent directors.

On page 5, we have provided a general overview of the issues we would like you to discuss. At this point, we would first like you to discuss the role that independent directors and special committees composed in a way that includes independent directors should play by envisaging specific situations. We will then take an action to summarize and present the details as a basic approach to this issue.

With this in mind, we would like you to have a discussion on the situations in which it is important for independent directors and special committees to be involved, and the actions that are required in each such situation. We would like to hear your views on the following: what specific situations in the internal decision-making process you envisage independent directors should be involved in, including which situation under each of the three types of situations that typically pose a risk of conflicts of interest should they be involved in; and whether there are other situations in addition to these three that would require their involvement. Furthermore, the listing rules require that companies obtain opinions from disinterested third parties as a procedural regulation in order to protect minority shareholders. We would like to hear your opinions on whether independent directors should play the role in providing their opinions in the said procedure of obtaining opinions, and if so, what should be the content of the opinion to be expressed. In addition to this, we would like to ask if there are any other matters that independent directors need to fulfill or take into account in order to play their role of protecting minority shareholders within each company.

A list of related comments we have received to date is provided on page 6. We have just received a suggestion that TSE should provide principles on the role of independent directors and the matters to be deliberated by independent directors.

Page 7 illustrates how the role of independent directors is presented in the Governance Code and how listed companies are responding to the code.

Regarding page 7, Principle 4.7 of the Governance Code states that the role of independent directors are to monitor the risk of conflicts of interest between controlling shareholders and minority shareholders and to reflect the views of minority shareholders.

Regarding page 8, in addition to this, Supplementary Principle 4.8.3 of the Governance Code requires listed companies with a controlling shareholder to develop a governance system that centers on independent directors who are independent from the controlling shareholder: specifically, they are required to either appoint independent directors in a specified ratio or establish a special committee to manage conflicts of interest.

On age 9 is a tabulation of the status of 329 companies that "comply" with Supplementary Principle 4.8.3 and 119 companies that "explain" for the principle. We can see that many companies are working to improve their

governance structure by establishing special committees.

Beginning on page 10, we present materials for you to refer to when discussing situations in which independent directors are involved and their role in such situations.

On page 10, we have grouped the types of transactions and actions that raise the risk of conflicts of interest, into three categories. The first category is direct transactions, the second is business transfers or business adjustment, and the third is conversion into a wholly-owned subsidiary. In each category, both so-called contingency situations, in which a conflict of interest arise as an issue in a particular transaction or action is an issue, and ordinary situations, in which day-to-day monitoring is conducted, are anticipated. We would like you to envisage such typical situations and map out the role of independent directors in terms of the kinds of situations in which independent directors should be involved, and whether there are any other situations in which independent directors need to be involved in terms of monitoring conflicts of interest.

Regarding category (3), conversion into a wholly-owned subsidiary, the roles of the special committee and independent directors as a measure to ensure fairness are laid out in Fair M&A Guidelines of the Ministry of Economy, Trade and Industry. Page 11 is an excerpt of the relevant sections of the Guidelines.

Page 12 is a tabulation based on disclosure for the use of special committees in situations in which a controlling shareholder makes a company a wholly-owned subsidiary after the publication of the Guidelines. The top half of the table shows that in most cases, special committee members include outside directors and company auditors, and the only cases in which outside directors or company auditors are not included are cases in which there is some kind of relationship between outside directors and the controlling shareholder. In light of this, we could say that the establishment of special committees that include outside directors is well established in practice. Looking at the bottom half of the table, we could say that it is also now common for the board to follow the decision of the special committee.

On page 13, as examples of how companies have designed the involvement of the special committees, we present examples of the matters discussed by the special committee that are disclosed in Corporate Governance Reports. For example, one company formulates certain corporate actions as the subject matters of a special committee's deliberations, while another formulates

transactions over a certain amount as the subject. In addition, one company formulates management policy decisions on group business strategies, and personnel matters as the subject of a special committee's deliberations.

On page 14, there is a discussion of how independent directors should be involved in the TSE's procedural regulations. Under the listing rules, the Code of Corporate Conduct requires companies to obtain an opinion from a person who does not have a conflict of interest with the controlling shareholder on whether the transaction is disadvantageous to minority shareholders, in the event of a significant transaction involving a controlling shareholder, etc. The material shows a aggregation of opinion providers for the period after the revisions of the M&A Guidelines and the Corporate Governance Code. Compared to past totals, we believe it can be said that obtaining opinions from independent directors or special committees that include independent directors is at present becoming more common.

In light of the above situation, we would like to sort out the role of independent directors.

Continuing on, page 15 onwards is a discussion of what is needed to ensure their independence, based on the fact that independent directors must be "independent from the controlling shareholder" in order to fulfill their role of protecting minority shareholders.

On page 16, we would like to discuss the requirements for independent directors, namely independence standards, in terms of independence from the controlling shareholder. In particular, we would like to hear your opinion on whether, when looking at the current independence standards for independent directors, there are any elements that are not covered as minimum formal requirements to ensure "independence from controlling shareholders." In addition, we would like to hear your opinion on what measures, if any, could be taken to address such uncovered elements, including whether they should be required as independence standards in the listing rules.

On page 17, we have provided a summary of the independence standards. We have established abstract and substantive requirements for independent directors/auditors to be "a person who is not likely to have a conflict of interest with general shareholders." On top of that, TSE sets independence standards as minimum formal requirements to be secured and requires that these standards not be violated. This is a framework under the listing rules. The

independence standards mostly require independence from the management, as indicated in (1) in the table. In addition to this, the current independence standards already partially incorporate independence from the controlling shareholder by requiring that there be no employment relationship with the controlling shareholder or close relationship with a person who has an employment relationship with the controlling shareholder, as indicated in (2) in the table. On the other hand, it is not required to have no business or economic relationship with the controlling shareholder.

Based on this summary, we would like to hear your opinion on the current independence standards from the perspective of ensuring independence from the controlling shareholder.

Regarding page 18, we believe that a key issue to be discussed when considering independence from the controlling shareholder is how to balance the controlling shareholder's authority of appointment and independence from the controlling shareholder. We expect to have further discussions on this point in the future, and page 18 lists the opinions we have received so far. We would appreciate any additional comments you may have at this time.

Lastly, on page 20. In terms of other issues, in addition to the role of independent directors, we would like to hear opinions, if any, about issues that should be addressed in the listing system from the perspective of utilizing independent directors. More broadly, we would also like to hear your views on issues that you think are highly important other than the use of independent directors.

That is all from the secretariat.

[Kikuchi, Director, Listing Department, TSE]

Now I would like to hear from our members. Since there are multiple issues to be discussed today, I would like to divide the discussion into two halves. For the first half of the meeting, I would like to ask you to discuss the "Items to be Discussed (Role of Independent Directors)" listed on page 5 of the document.

[Sampei, member]

First, before discussing page 5, I would like to voice my opinion on "Plan for

Future Discussions (Governance)" on page 3. I would like to confirm this before delving deeper into the discussion items.

When holding discussions from the perspective of protecting the minority shareholders of a listed subsidiary with a controlling shareholder, the parent company, which is the controlling shareholder, is often viewed as if it were an enemy, and the discussion tends to lean toward the argument that that anything the parent company tells the subsidiary to do is wrong. However, originally, in cases where there are no conflicting interests between the parent company and its subsidiary, such as a scandal at the subsidiary, it is the parent company/controlling shareholder that essentially monitors the subsidiary. Since it is natural for the parent company to properly govern the subsidiary, it is important first of all that discussions do not go too far in the direction of eliminating such governance.

With that in mind, here are my thoughts on the discussion items on page 5. Although not specifically mentioned here, when envisioning specific situations, I think there is a division between ordinary and contingency situations. In fact, many companies are attempting to manage certain conflicts of interest by establishing special committees, but it is often hard to understand the details of the committee thorough the explanations published by such companies. It can be hard to tell whether a special committee is permanent or established for a contingency. In some cases, they can read as if a special committee will be formed if something happens.

What concerns me about the way such explanations are written is that unless something happens, the conflicts of interest can be passed off as not being a particular problem. Although special committees are formed in contingencies, in normal times each and every independent director should be constantly keeping a close eye on the company to see if anything is amiss, even if a special committee is not formed. Unless they do so, it is impossible to determine whether a special committee should be established. If special committees are only established when an obvious transaction occurs, that will be a problem.

Related to this, I would like to express my opinion on whether there are situations other than the transactions/activities described that need to be addressed. When a parent company and its subsidiary are engaged in similar businesses, they often segregate their customers. Simply put, the parent company takes on large clients, and the subsidiary takes on small and medium-

sized clients, even though they offer a similar service. In such cases, I think it would be a problem if the parent company were to take over clients handled by the subsidiary company when such clients grow larger and exceed a certain size. In some cases, parent companies make decisions regarding the assignment of key personnel and transfers between the parent and subsidiary companies. Furthermore, there is also the issue of intellectual and intangible property. Intangible property especially includes, in particular, brands. In the case of intellectual property, I think there are issues regarding which party will do the research and development, or which party will ultimately own the intellectual property even if it is jointly developed. In that sense, those may be more of an action than a transaction, and I believe we should look at such situations.

[Kanda, member]

I fully agree with the direction you have indicated on page 5. I think it would be very good to organize the role of independent directors and present it as a basic idea. As we move forward, I think we need to sort out the issues that have been exemplified. In connection to this, I would like to make three points.

Some of what I will say has been covered in Mr. Sampei's comments. For my first point, I believe it would be helpful if we could identify the situations in which it would be better to have a special committee and the situations in which it would not. Whether we can completely identify such situations will likely depend on each company's circumstances, but I think it would be good to identify them, at least at the concept level. Special committees have no authority under the Companies Act, so decisions are made by the board of directors under the Companies Act. Having said that, there are clearly times when a special committee can be useful. Therefore, I think it would be good to identify those situations.

My second point is that regardless of whether special committees are set up, I believe it is good to move in a direction in which independent directors play more of a role. Of course, there are many situations in which it is useful, for example, to seek the judgment of outside experts, but the reason why it is desirable for independent directors to play a role is that there is a statutory basis where directors have duties under the Companies Act. Persons who are

not directors may have contractual obligations based on contracts, but they do not have duties under the Companies Act. Therefore, I think it would be better to sort out the role based on the idea that directors who have duties under the Companies Act, and especially independent directors, are a little bit more in the foreground, and I believe that looking at the bigger picture, that is the direction in which things are moving.

My third point is not directly included in the document. In relation to the part on page 18 regarding future considerations, although it overlaps with Mr. Sampei's comments, I would like to make comments on group management. There are cases where listed subsidiaries or quasi-controlled companies are operated in accordance with the group policies. I call this the "integrated management" type. On the other hand, there is what I call the "independent management" type, where the management of the company is left to the management of that company. In the extreme, there are these two ideal or philosophical forms, and in reality, there are some forms in between.

As has been written on page 18, in what could be called a fundamental contradiction, it is the parent company and controlling shareholder that appoints directors. So if you hold 51%, you can appoint directors. Then, the question becomes what the role of the nomination committee is, if the company has one. Unless the majority of minority or MoM rule is adopted, in the extreme cases, no matter who the company's nomination committee recommends as a director candidate, if the controlling shareholder holds 51% of the votes, the right to appoint directors belongs to the controlling shareholder. Therefore, it seems to me that this is an issue that needs to be discussed and examined in the future.

One point I have been concerned about so far is that while it doesn't matter that there are two types of group management, integrated and independent, I feel that suddenly changing the type would catch investors and general shareholders by surprise. Changing from the integrated management type to the independent management type is still okay, but suddenly changing from the independent management type to the integrated management type based on the controlling shareholder's preference would be a surprise, I think. This reminds me of the issue of voting class shares. I think all countries are very reluctant to fix control after listing, although this may differ from country to country. Therefore, I think this is a very difficult issue, including whether a change after listing is acceptable, and I would like to see that considered. I

mentioned this because I think it is relevant to our discussion.

Turning to the second half of the discussion, I would like to make three points regarding the discussion of independence from controlling shareholders on pages 16 and 17.

My first point is that, as the document says, the principle idea thus far has been that independent directors mean independence from the management, so we need to carefully rethink about independence in terms of independence from the controlling shareholder. For example, the absence of a business relationship with a controlling shareholder is not required under the current rules, so the issue is whether it should be added to the requirements.

My second point is that independence from the controlling shareholder varies greatly from group to group. For example, if the entire group constitutes an ecosystem through a system such as a point system, we should consider the independence of controlled listed companies within that group from the perspective of independence in the group, not just independence from the controlling shareholder. Further consideration, including this point, is needed.

My third point, which is also included on the last page, is that it is conceivable to extend independence not only from the parent company and controlling shareholder, but also from the quasi-controlling shareholder. The current independence standards based on the relation of "parent" relationship, and this can be expanded. This should be considered in conjunction with other issues.

[Kato, member]

There may be some overlap with the comments made earlier by Mr. Sampei and Mr. Kanda, but I would like to make two comments.

My first point relates to the role of independent directors and special committees on page 5. Page 5 mentions monitoring the risk of conflicts of interest . I think this is a very important role. On the other hand, since independent directors serve as directors of a subsidiary, their primary role is to maintain and enhance the corporate value of the subsidiary. I think one of the specific subdivisions of this role is to monitor the risk of conflicts of interest. In

other words, while monitoring the risk of conflicts of interest is very important, in order to maintain and enhance the corporate value of the subsidiary, it should not always be adversarial in the relationship between the parent company and the subsidiary, as Mr. Sampei pointed out. I understand that there may be situations in which the parent company's support is necessary, and that the role of independent directors is to establish an appropriate relationship between the parent company and the subsidiary, and that this requires them to monitor the risk of conflicts of interest.

Next, with regard to specific methods of monitoring the risk of conflicts of interest, it should be noted that the relationship between a parent company and its subsidiary varies widely. For example, it may not always be appropriate to require that a special committee, made up of independent directors, be consulted on each and every transaction between the parent company and the subsidiary or on instructions from the parent company relating to the subsidiary's business activities, as this may interfere with the parent-subsidiary relationship. A risk-based perspective is also important in terms of monitoring the risk of conflicts of interest.

Furthermore, and this overlaps with Mr. Sampei's comments, I think it would be very good to have a system that allows independent directors to see where the key risks lie in the parent-subsidiary relationship.

I have one question relating to this point. The role under the procedural regulations in the Code of Corporate Conduct is mentioned on page 14. Currently, these regulations apply when a listed company undertake a significant transaction involving a controlling shareholder. Knowing how this judgment on significance is made by listed companies would be helpful when independent directors monitor conflicts of interest under the new framework, and I would appreciate if you could provide us with any materials you are researching.

[Shirozu, Manager, Listing Department, TSE]

For ease of reference, the document states that "significant transactions" are subject to the procedural regulations set forth in the Code of Corporate Conduct. However, significance is not judged as a substantial criterion; rather, as indicated by an asterisk (*) in the boxed area, the procedures for obtaining

an opinion apply to corporate actions that fall under specific items listed from among the timely disclosure items and that are subject to timely disclosure because they do not meet insignificance criteria, are subject to the procedures for obtaining an opinion. On the other hand, if the importance of the disclosure is not necessarily high because it meets insignificance criteria, procedures for obtaining opinions are not required. Thus, rather than making a substantial judgment on significance, the current listing regulations formally stipulates that actions which fall under the prescribed items from among the timely disclosure items are subject to obtaining an opinion.

[Kato, member]

I slightly misunderstood the system. Indeed, I have also investigated the system and found that the procedure is linked to the timely disclosure items. Then, I think it would be conceivable to review whether using the item subject to timely disclosure as a standard allow us to capture problematic situations from the perspective of monitoring the risk of conflicts of interest between controlling shareholders and subsidiaries without exaggeration or omission.

[Goto, member]

My thoughts are similar to those of Mr. Kato. To clarify the discussion, as I am sure you are aware, it is premised on the ideal state of the board of directors. Directors are entrusted with management on behalf of all shareholders, and so I believe that their most important theme is to promote the maximization of corporate value.

That said, although this is a minor detail, the top of page 7 states that independent directors are expected to take on the role of reflecting the views of minority shareholders. I think they have a check function rather than a role of proactively reflecting minority shareholders' suggestions and ideas in management decisions. However, this check function is an important check function. Checking is often seen as simply checking, but it is not really the case. I would like each and every independent director to properly fulfill his or her role as a function of the board of directors to check whether the interests of minority shareholders are being obstructed. This is the same as what Mr. Sampei said. Basically, minority shareholders and major shareholders should be on the same page when it comes to maximizing corporate value, but this should not lead to

carelessness. I would like to make sure that independent directors conduct proper checks.

When using checks by independent directors in cases where there is a risk of conflicts of interest, I believe it would be better to have guidelines set by TSE that are enforceable. When we discussed this internally, from the perspective of whether such guidelines would cause us any trouble, we concluded that we are already conducting checks as we believe that they should be conducted. I feel that there should be room for discussion about having penalties for not conducting checks if there is a conflict of interest, regardless of the amount involved.

On the other hand, I think it is necessary to have a parallel discussion about the various downsides of assigning responsibilities and roles to an independent director as an important task. Independent directors are important as a check function, but ultimately the decision-making body is the board of directors. While the board of directors should bear in mind that independent directors are an essential and important part of the check function, ultimately decisions are made by the board. I believe that is the most important point. I think that boards of directors that do not discuss this point lack effectiveness. My argument may be a bit of a jump, but I think this point is inseparable from the discussion of the role of independent directors.

I do not disagree with the argument that special committees should be established on a case-by-case basis when necessary. However, unless the level of necessity and importance is properly discussed when establishing special committees, companies will end up in a situation where everything is discussed by special committees, regardless of the scale of the transaction, and this will be cumbersome. Outside directors come from various different backgrounds. In the case of my company, we recognize that current managers and people with management experience are the most suitable people to enhance corporate value. When we ask such people to serve as outside directors, the CEOs are too busy to serve on committees other than the board meetings, and we are often told that they cannot take on the position if such a commitment is necessary. We would like to see such persons make a significant contribution at regular board meetings, so it is important that the role not be a burden. From the perspective of outside directors and the companies that hire

them, it is important to create a framework that allows them to fully demonstrate their abilities without placing excessive burden on them.

In order for the board of directors to properly check conflicts of interest, preparations are important. Agendas for board meetings is, of course, all sorted out and checked by the secretariat in advance, and in our case, distributed to each board member one week before the meeting. We also hold preliminary briefings for each board member, as the agendas include a lot of specialized topics. At such briefings, we try to prepare by asking outside directors to think about the issue in advance, especially from the perspective of conflicts of interest, and to have them attend the board meeting with that in mind. This would ensure that the board of directors can thoroughly discuss conflicts of interest.

I agree with today's discussion on when to establish special committees. Nothing should slip through the cracks. I believe that the role of the office staff is very important in making sure that nothing slips through the cracks. I think it is important to establish a system that enables proper discussion by the board of directors, a system that ensures that checks are not overlooked.

[Kansaku, member]

I would like to comment on the role of independent directors, which is listed as a discussion item on page 5. As stated on this slide, independent directors, especially at controlled listed companies, are strongly expected to control conflicts of interest not only with executive directors, but also with the parent company and quasi-controlling shareholders. I think the direction described on page 5 is the right direction.

Specifically, I believe it is very important to discuss three types of transactions - direct transactions, business transfers/adjustments, and wholly-owned subsidiaries - and to discuss the types in which conflicts of interest with the controlling shareholder or parent company are structurally particularly problematic.

In this connection, one point that has not been mentioned here, and which may be important from the perspective of independent directors checking the conflicts of interest with the parent company and controlling shareholder, as I just mentioned, is what kind of person will be appointed as an independent

director. In other words, whether they are someone who will properly protect the interests of the minority shareholders, from the parent company and the controlling shareholder. From that perspective, one thing that is not mentioned in the document as a role of independent directors is that, although it may not be a direct conflict of interest, it is very important for the management to be less involved and for independent directors to be more actively involved in selecting a candidate to replace an independent director.

Moving on to my second comment. In the slide on page 5, it seems to me that the special committees are almost equated with independent directors. I think the two have the major difference, as Mr. Kanda pointed out earlier, in that they do or do not have duties and responsibilities under the Companies Act. Also, I think the current situation is quite different from the situation of the percentage and number of independent directors at listed companies in Japan when this discussion arose.

So, my question is, given the reality described on page 9 is that many listed companies are responding to the situation by establishing special committees, what percentage of independent directors are members of special committees? Moreover, I do not believe that special committees are always necessary, if the reality is that independent directors are key members of special committees, rather than a special committee having only one independent among the members of the committee. I doubt that special committees are really necessary if independent directors are functioning properly on a regular basis. Since this relates to the actual situation, I would like to know the composition of the members of special committees at companies that have responded by establishing special committees and, in particular, the extent to which independent directors are included in such special committees.

[Shirozu, Manager, Listing Department, TSE]

As I explained during the discussion of disclosure, we are working on the assumption that not many listed companies currently disclose the composition of their special committees. Based on this assumption, while I cannot present any data, so this is just my impression, when we see details of the disclosure of companies that disclose the composition of their special committee in addition to the fact that they have a special committee, quite a few companies state that the special committee is composed of all independent directors, or only of

independent directors, or that the committee is composed of all independent directors and independent auditors, or only of such persons. This may mean that many companies believe that such a structure is optimal for a permanent special committee.

[Kansaku, member]
Thank you. I understood that the reality is that there are quite a few independent directors sitting on special committees.

[Ouchi, member]
I would like to say this in the context of gathering feedback from Keidanren members and conveying them to you.

I think the issue of significance has come up in our discussion, and I also think that how we handle significance is the most important issue. The outside director position is not a full-time position and cannot handle a lot of details. Also, if we were to ask outside directors to look into all the details, in practice, they would probably not be able to do so.

In that sense, while you have listed the types of transactions and activities that may give rise to a risk of conflicts of interest from (1) to (3) on page 10 of the document, I think it is indisputable that (3) is important. As was just explained, it seems to me that the majority of cases involve a special committee composed of independent directors.

Next, looking at (2), business transfers will also be important, depending on their size. The argument is whether every transaction should be included, even when small businesses are transferred. The difficult part is the business adjustment. In cases in which intellectual property rights were transferred from a subsidiary to its parent company 10 years ago as a part of a business adjustment, and the business has since grown into a large business, the question would be whether such a turn of events was predictable at the time of the transfer. For example, it may be possible if you incorporate a quantitative element, such as a certain percentage of all intellectual property assets, However, if it cannot be quantified, I don't think it can be designed in practice.

Also, regarding (1) direct transactions, I think it is impossible for independent directors to get involved and look at all the details of all the transactions with the parent company. One way to break down the work is first to check whether

there is a discrepancy between the profit margin from other similar services or goods and the profit margin from transactions with the parent company, and then, if there is a discrepancy, to examine a reason. In such cases, I think it's okay to exclude minor cases.

In this case, as mentioned in the METI's document, how to address fund management such as cash management systems will also remain a complicated issue. I am aware that there have been many court cases and that this has become a bone of contention. If we take a conservative view of the concept, I believe that the primary judgment on whether to deposit surplus funds belongs to a management decision. After that, I think it is possible to check whether the interest rate is not lower compared to a bank deposit. Whether it is better to leave funds in deposits for immediate use, or whether they should be invested, or whether they should be paid out in light of the dividend payout ratio, is a big topic for discussion and a consideration that goes beyond conflicts of interest. In the current era of low interest rates, this discussion may be almost meaningless, but I still think that in this case, making quantitative comparisons, such as checking the divergence in profit margins and then discussing those with large divergences, is the most practical approach.

[Kikuchi, Director, Listing Department, TSE]

Next, I would like to move on to the second half of the discussion. For the second half of the meeting, I would like to ask you to discuss the "Items for Discussion (Ensuring Independence from Controlling Shareholders)" listed on page 16 of the document. Also, while we will discuss this issue in more detail in the future, today we would like to ask for your comments, if any, on the issue of independence from the controlling shareholders, which is on page 17. And, we would also appreciate your comments regarding the other issues listed on page 20.

[Sampei, member]

First, I would like to comment on the discussion points on page 16. At the bottom of page 12, there is a section on "Reasons for appointment where the committee is composed solely of outside experts." I believe that the details listed in the top three arrow points are important points that should be thoroughly considered to ensure independence. Since the directors and

employees of a controlling shareholder's group company and a law firm that is a legal advisor to the controlling shareholder are in close proximity to the controlling shareholder, such relationships are important criteria for examining independence. The chart on page 17 would then include additional items that differ from the existing items.

Regarding page 18, when considering the relationship between the parent company or controlling shareholder and the subsidiary, as I mentioned at the beginning, I think it is inappropriate to deprive the parent company or controlling shareholder of too much authority, and I think it is important to find a balance. For example, there may be situations where measures such as MoM should be considered. However, in this case, the extent to which the MoM should be applied should be limited. When discussing a situation where MoM should be applied in a limited way, the MoM may be necessary, for example, if the dismissal of an independent director of a subsidiary may create a situation where conflicts of interest management is not possible. I also think that we might adopt the idea of using the MoM in cases where a special committee composed primarily of independent directors has been consulted but its recommendation has not been followed although there remains a difficulty as to when the company is able to confirm the shareholder's intent. However, I think the scope should be limited because there is a concern that allowing the MoM too broadly may preclude the parent from governing the subsidiary in the first place.

Regarding page 20. It is about the issue of the responsibilities of the controlling shareholder, in other words, the parent company, which is stated in "(Reference) Previous Opinions." In the 2021 revision of the Corporate Governance Code, the "Notes" to General Principle 4 states that parent companies must think about minority shareholders. I would like to see this reflected in the Code of Corporate Conduct. To begin with, the parent company has a responsibility to govern the subsidiary, and there is a balance in which the subsidiary says "no" when a conflict of interest arise in a particular event. Since the parent company also has to understand and handle this overall balance appropriately, I think it is necessary to clearly state in the Code of Corporate Conduct how the parent company and its board of directors should think and act.

Regarding the section at the bottom of page 20 "Expansion of the scope of the minority shareholder protection framework with respect to governance." The second line says that some companies have certain contracts even with shareholders whose shareholding ratios are low. I think TSE provided us with the relevant data for this at a previous meeting. If there are certain contracts, especially if they involve the appointment of directors of subsidiaries, then the relationship is not independent.

Therefore, I believe we need to discuss the "a certain level" in the second arrow point, which says that there is a shareholder whose shareholding ratio is at a certain level. When I thought about this, I concluded that one possible option is to set the percentage at 1% or more. Having shareholder proposal rights means that the shareholder can exercise certain special rights, and so I believe that this may be a reason that should be considered here.

[Goto, member]

I believe that if we look at it only from the perspective of preventing conflicts of interest between parent companies and subsidiaries, it is the best solution to raise the bar regarding independence from the controlling shareholder in the selection of directors. However, I think we need to be careful because focusing solely on that may cause a bit of friction with revitalization of the board of directors and the original purpose of the boar. If we only think about the selection of outside directors solely from the perspective of independence from the controlling shareholder, and I am not saying this in a negative way, but the candidates would be mainly people with a high level of expertise, such as lawyers, accountants, and other professionals. If the board of directors is composed only of such people, it will tend to be more controversial. From this perspective, and this overlaps with what I mentioned earlier, I believe that in the outside director appointment process, it is advisable to search for candidates based on how they can contribute to the company from the perspective of increasing corporate value, and then narrow down the candidates by focusing on whether they are very knowledgeable about independence as that person's qualities.

I also believe that the positioning of the auditors is very important. I believe it is best to have a full-time auditor with a high level of expertise. Our company has formed a team of such auditors. I think that if the independent directors and

the auditor team work together to conduct the checks, we will have a good balance of people.

I think there are problems in utilizing the Majority of Minorities. I believe it is difficult to resolve the issue of inhibiting the fundamental shareholder rights. Therefore, I think that directors should be appointed through a general meeting of shareholders as in the past. In order to submit a proposal for the election of directors to a general meeting of shareholders, the proposal must go through the board of directors, and this is the key point. I am speaking on the assumption that outside directors sit on the board of directors. If the board of directors determines that a new director candidate is qualified, that is one check right there. I think it would be smooth, necessary, and sufficient for decisions to thereafter be made at the general meeting of shareholders.

In order to avoid making a mistake at the candidate selection stage, I think it is important that the secretariat properly absorb the opinions of outside directors and that the Board of Directors to make effective decisions.

One more thing, which may be slightly different from today's discussion, Japan has a narrow market for outside directors. Inevitably, there are many cases in Japan where the single highly skilled person receives many requests for outside directorships, resulting in them serving as an outside director for four or five companies. As an example from overseas, looking at the board composition of our group companies and other companies with which I am familiar with, I see a very rich pool of directors, and the market is such that even if new outside directors are brought in to replace them, they all have excellent career backgrounds. I hope Japan will quickly become such a market.

Finally, regarding the other issues, the discussion so far has been based on the assumption that every board has one or more independent directors. In our company, the majority of the board members have been outside directors since 2000, but in fact, looking at the data, 1% to 2% of listed companies do not have independent directors. I find this is very problematic. I believe it would be a good idea to specify that having an independent director is a requirement for maintaining the listing. If it is not specified, I'm concerned that the arguments we have made so far may be irrelevant to some companies.

[Kansaku, member]

Regarding the independence standards, as explained by the secretariat, I think it is necessary to create criteria that reflect independence from the controlling and quasi-controlling shareholders. Regarding the point that there has been no requirement to ensure no business relationship with the controlling shareholder, I still think it would be desirable to incorporate this into the independence standards, as influence based on business relationships may not be ignored.

However, as Mr. Goto has just pointed out, when the net is cast a little wider in terms of independence standards, I think there will be a problem in that appropriate people will be excluded. I mentioned earlier that incumbent independent directors should be involved in the appointment of their successors, but I believe it is possible to find a way to exempt from the wide net by having some more substantial requirements, including the MoM. For example, the idea of having two types of independence standards is plausible. One type of criteria are requirements that absolutely must be met, and another, like the business relationship mentioned earlier, that are covered but that could be exempted by some other procedure or discussion. Basically, from the perspective of influence, typical or formal conflicts of interest could arise when there are shareholding relationships, command and order relationships based on business execution, blood relationships, and also business relationships. I think it is possible to cover those relationships in one way and then allow certain requirements to be overridden by the MoM or some other arrangement.

[Ouchi, member]

I may express completely opposite opinions immediately afterwards, but I hope it will stimulate discussion.

Although we are discussing controlling shareholders at this meeting, I think we need to think carefully about why we are having this discussion on whether to broaden the scope to include quasi-controlling shareholders. Given that the reason is because a decision on selecting directors can in practice be made by a certain shareholder alone, the subject of discussion should still be the controlling shareholder.

That being said, since the voting rate at shareholder meetings is not 100%. Therefore, I think an argument naturally occurs that a shareholder who has

lower percentage of voting rights ownership could make decisions. If we were to contrive a way to do this, in my personal opinion, it would be conceivable to determine the percentage of voting rights that enables single shareholder to make decisions by working backwards from the average voting rate over the last 10 years. This percentage should not fluctuate too frequently and should be decided based on the actual results of several years ago. In other words, if the most recent figures are used taking, the percentage will change immediately before it is determined. So, it is conceivable to make a decision based on the actual results of previous years, taking into consideration the timing of the change of directors (such as two years in the case of Company with Supervisory Committee member).

We should not leave aside the point that independent directors are important because a controlling shareholder can effectively appoint directors by itself and should not have a vague argument based on the reason that they somehow have a large share of the voting rights. I think this is the start of the discussion.

Regarding the independence standards, while business relationships with a company itself have an impact on independence, the question is how to address business relationships with a controlling shareholder. I don't think we should be too vague in our discussions, such as being closely related to a group in some way. Considering why having a business relationship is important as an attribute of independent directors, it is not necessarily the case that they are close because of their business dealings, but rather because there may be errors in judgment regarding their business dealings precisely because of those business dealings.

If so, while a business partner of a listed company obviously has a business transaction with the listed company, a business partners singled out for having a business relationship with a parent company are not necessarily related to every subsidiary among so many subsidiaries. For example, subsidiaries have various businesses. If a listed subsidiary has a business, which related to business A that is part of the parent company's business, then the parent company's business partners may be related to the listed subsidiary. On the other hand, if a listed subsidiary is engaged in Business B, which is completely unrelated to a parent company's business, I think it would be too stringent to disqualify a business partner of the parent company from serving as an independent director. Basically, I think we should avoid taking into consideration

having business relationships in the independence standards, and we also need to think carefully about and discuss why having business relationships should be taken into consideration.

In addition, if you look at business relationships at a group level, the scope becomes very broad and it is problematic that it will be difficult to find candidates for independent directors.

The next substantive issue is the discussion of MoM as a method of appointment. This is certainly an appealing discussion. This is because it clarifies that there is no influence at all from the controlling shareholder.

However, if we are going to discuss this, then we need to discuss stakeholders. In other words, minority shareholders are just one category of stakeholders. The shareholders as a whole are the owners of the company, but the minority shareholders alone are not owners, they are one of the stakeholders, stakeholders with mainly dividend rights. If we have a discussion about the majority of minority shareholders, it is accompanied by an argument about whether or not it is necessary to elect representatives of labor unions and representatives of local concerned parties. We must solve concurrently the argument of whether to include partial representation of stakeholders.

Also, under the Companies Act, companies are allowed to prohibit cumulative voting, and there is basically a mechanism that allows companies to eliminate partial representation. If this prohibition were to be lifted entirely, it would be a serious matter.

Because these discussions exist, I believe that while the MoM is a very attractive card, it is also a very important step that requires us to resolve a major argument. In my opinion, it is not easy to take the plunge, and we should be cautious in our approach, even as soft law.

My third point relates to my personal experience. The worst independent director with whom I have had the most difficulty was a friend of the corporate manager. No matter what element of independence is used, a drinking buddy, for example, cannot be categorized as not being independent. However, I have experienced cases, although not in the case of the parent-subsidiary listing, in which management goes downhill when those persons unite in a bad way. There is a limit to distinguishing independence based on attributes, so if we approach this issue with the idea that independence must be absolutely

maintained with theoretical elaboration, it could cause the most important points to be overlooked and make it more difficult for companies to respond in some respects. I think it would be better to have a somewhat general discussion and to chase companies by using the results, for example by questioning whether it is not appropriate for companies to continue to propose director candidates despite receiving many negative votes.

In that sense, while the idea of an independent director being involved in the selection of candidates, as suggested by Mr. Kansaku, is an attractive proposal in some contexts, but it will not break a chain of bad friends. My experience was also a case of a chain of bad friends who were in cohorts. Therefore, I think we should be cautious about these discussions. I am not going to say outright that it is no good at all, but I do think it is more difficult than one might think.

[Takei, member]

I would like to express my opinion on the first half and the second half together because they are intertwined.

First, the first half of the discussion. There is an example of disclosure on page 13, and I think companies should consider and disclose the details shown here. I have heard that there are few examples of such disclosures, so I believe this kind of approach should be organized and disclosed by each company.

In disclosing their approach, when I look at (1), (2), and (3) of the target categories on page 10, I think that (2) and (3) are rarely observed in day-to-day management. In that sense, I believe that (2) and (3) represent contingencies, while companies need to decide to what extent independent directors will look at (1) which is for normal circumstances. On top of that, I think it is important for companies to disclose a little more about the framework of their arrangement, taking into consideration the point made by Mr. Sampei earlier, as to under what circumstances the interests of Company S (subsidiary) would be unfairly impaired by Company P (parent company) in practice. The situation at parent-subsidiary listings is so diverse that it is difficult to sort out everything from a single angle. In particular, there are contradictory structures and tensions, such that seeking too much independence from Company P will instead weaken Company P's discipline over Company S. The overlap between the businesses of Company P and Company S varies widely, as do the circumstances in which Company S is harmed by Company P. The first step is for companies to

organize their approach on their own initiative. On top of that, it is assumed that TSE will provide at least a general idea of the arrangement, but from that point forward, I believe it would be good to have companies deepen their approach by looking at future examples of disclosure. I think that each company should disclose at least the approaches described on page 13. I think it is important for TSE to indicate the basics of the general approach first, but then to let Company P and Company S think independently. These are my views about the first half.

Next, here is the discussion of Company P's business partners in the second half. I think this is a more difficult question than expected, and either conclusion could be acceptable. In my opinion, at this point, it would be wise to be cautious about extending the independence standards to Company P's business relationships. There are several reasons for this.

First, there are two aspects to address conflicts of interest. One is the "vertical" in the sense of the Companies Act, which means conflicts between all shareholders and Company S (management) and independence from the management of Company S, and the other is the "horizontal," which means conflicts between Company P and the general shareholders of Company S. So the discussion points here are intertwined with the vertical and horizontal aspects. The current independence standards regulate the situation focused on the vertical, and the question we are discussing now is to what extent attributes related to the horizontal should be included, and to what extent the current discipline of attributes rerated the vertical should be diverted for the horizontal. On the other hand, as other members mentioned earlier, expanding the scope of the attributes to cover the horizontal, may weaken the role that Company P has to play in the vertical discipline. It seems to me that we need to design the regulations thinking about such contradictory relationships and tensions between the vertical and the horizontal.

The current approach to the independence standards first covers the direct relationships with incumbent officers or employees of the company in question. It also covers some indirect elements. For example, being a close relative is an indirect relationship, and the business partner relationship we are discussing here is also an indirect relationship. Also, having a relationship at any time in the past 10 years is a kind of indirect relationship. From the viewpoint of the horizontal relationship, now, in addition to the direct relationship of being an

incumbent officer or employee of Company P, the indirect relationship of being a close relative and the indirect relationship of having a relationship at any time in the past 10 years are covered. Moreover, even the indirect-indirect relationship of being a close relative of those who had a relationship for the past 10 years is covered. If too much is demanded of the indirect relationship with respect to the horizontal conflicts of Company P, there could be a negative impact on vertical discipline, and a negative impact on discipline from Company P.

Expanding the scope of not granting independence to the indirect attributes more and more is not necessarily appropriate in terms of the extent to which the indirect relationship will really have an impact and is, in a sense, an assumption. For example, with regard to being a close relative, it is not really clear how much influence it really has. What I mean by that is that the second degree of kinship is quite broad and includes, even, for example, the spouse's siblings, for example. So you have to question how much influence that level of relationship really has.

Another issue is that there may be no way for Company S to investigate the indirect relationship. In reality, for example, companies also have great difficulty in identifying employees' close relatives in practice, and they often fail to find out the situation of employees' close relatives. When a relative you have never met becomes a board member, there could be situations in which an employee says, "This person is my spouse's brother." The problem here is that the pre-screening of the relationship cannot be thorough enough.

Furthermore, there is the issue of who can be an independent director. By expanding the indirect relationships that should be eliminated not only vertically but also horizontally, the question arises as to whether it will be possible to find candidates for independent directors at Company S.

The question here is how far to extend the scope to horizontal indirect relationships. Company P's incumbent officers and employees are already covered, and relationship at any time for the past 10 years is covered, including being a close relative. At which point, the question of whether to extend the scope to indirect relationships of business relationships should be decided based on the overall balance rather than on the notion that because they were included in the vertical relationship, they should also be included in the horizontal relationship. In some respects, it is not appropriate to extend independence from Company P too far based on the formalism of using vertical attributes in the same way for the horizontal. The independence standards here

are, so to speak, an all-encompassing concept. In addition, the Governance Code refers to the appointment of at least one-third of independent directors or a majority of independent directors and is grouping directors according to whether a director is "independent" or not. It does not focus on with individual circumstances within the concept of independence. The concept of independence is used in a way to exclude someone from everything if he/she lacks independence in a certain aspect or situation, instead of excluding him/her depending on a specific situation where independence is required. Then, there is also the issue of the tension between the vertical and the horizontal relationships, and with regard to the extent to which indirect relationships should be covered under independence standards, it is not immediately clear that we reach the argument that since indirect relationships are covered in the vertical relationships, they should also be covered in the horizontal relationships in a same manner.

From the perspective of Company S, there is also the question of whether it is actually possible to assess Company P's major business partners. Assuming that Company S makes a pre-screening assessment of whether a director candidate meets the independence standards, and assuming that the scope of what Company S can assess is limited, there is also the practical issue of whether Company S can inquire as to whether a company is one of Company P's major business partners. Furthermore, when the scope of the indirect relationship is expanded to include business relationships, the question arises as to whether there will be a sufficient number of candidates if it is necessary (in accordance with the Governance Code) to have at least one-third of the directors who are both independent from Company S and independent from Company P.

Instead, rather than just covering attributes of business relationship with Company P in the concept of independence, and dismissing all out of hand, it could be handled on a case-by-case basis, where independence is granted on a day-to-day basis, but independence is not granted in specific events. A person who is dependent on Company P for business transactions is not always independent. Therefore, I believe that for topics where there is a conflict of interest between the interests of Company P and the interests of Company S, the individual is “disqualified from the perspective of independence" on a case-by-case basis.

From the perspective of improving the corporate value of Company S, the

matters that should be of concern regarding horizontal relationships rather than vertical relationships are categories (1), (2), and (3) on page 10, and I believe matters under these three categories are not quite in proportion to the daily management matters at Company S. I think that this will come up in contingencies and in some situations during normal times, but the horizontal relationships being a problem does not happen frequently. If such circumstances arise, companies can take measures by individually not treating persons who are dependent on Company P as independent directors. Is it appropriate to uniformly exclude all cases where a business relationship exists under the independence standards? Although independence itself is not uniformly denied for run-of-the-mill matters of Company P, even if there is an indirect or business relationship, is it better to take an individualized approach where independence is not granted for certain matters? I think the approach will be decided based on the tension from the vertical relationship.

[Sampei, member]

Since my earlier comments on page 20 were fairly brief and concise, I may not have conveyed what I meant, so I would like to reiterate my comments.

Regarding the section at the bottom of page 20 on "Extension of the scope of the minority shareholder protection framework with respect to governance," I am assuming a case where a company owns shares in the relevant company and has entered into a certain agreement with the company, although its shareholding is small, and that a director comes from that shareholding company. The point of my earlier comments is that such a director may not be independent. At that time, when considering what level is a certain ratio to be used as a criterion for the shareholding ratio, a situation where a company has only a 1% shareholding but has signed a contract, but a shareholder proposal is possible, means that although 1% may be a trivial shareholding, a special relationship has been formed. Therefore, if a director comes from the 1% shareholder, that director may not be considered an independent director. That was the point of what I was saying.

[Kikuchi, Director, Listing Department, TSE]

Thank you for the discussion.

Since there seem to be any no further comments, I would like to adjourn today's Study Group meeting.

Thank you very much for your participation today. We look forward to seeing to you all again at the next meeting.

End