Document 2

JPX
TOKYO STOCK EXCHANGE

TSE Explanatory Material

Study Group to review Minority Shareholder Protection and other Framework of Quasi-Controlled Listed Companies (Second Phase, Third Meeting)

Exchange & beyond

Tokyo Stock Exchange, Inc.

May 19, 2023

Plan for Future Discussions　(Governance)

Plan for Future Discussions (Governance)

- **Regarding the governance of listed companies with controlling shareholders, 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.**
  - The 2021 revision of the Corporate Governance Code (CG Code) established a new principle that requires companies with controlling shareholders to establish a governance system centered on independent directors who are independent of the controlling shareholders.

- In light of the discussions to date in this Study Group and the situation surrounding the CG Code, **it is widely thought to be important that independent directors be utilized in terms of the development and functioning of such a governance structure.**

- **In order for independent directors to be utilized in the development and functioning of governance systems,** we would like to **discuss the role of independent directors and how to ensure their independence from controlling shareholders from the perspective of what** measures are necessary at the stock exchange and in the listing rules (under the current legal system).

Role of Independent Directors

Items for Discussion (Role of Independent Directors)

- Given that under the current CG Code, independent directors and special committees are expected to play a role in monitoring the risk of conflicts of interest, it would be useful to further define what these roles could be in view of specific situations.

Items for discussion

- What are your thoughts on the idea of TSE presenting the results of the Study Group's discussions as a "**basic approach" on the role of independent directors**?

Presuming this as the outcome, potential discussion topics are:

- **In what situations is it important for independent directors and special committees to be involved?**
- **What actions are required of independent directors and special committees in each situation?**
  - For example,
    (1) **In what categories of transactions/activities that may involve a risk of conflict of interest** (i.e., (i) direct transactions, (ii) business transfers/adjustments, and (iii) conversions into wholly-owned subsidiary) **is it important for them to be involved? In addition to these, are there any other cases in which involvement is necessary?**
    In each case, what kinds of action are required? (see pages 10-13)
    (2) **Regarding the procedural regulations of the Code of Corporate Conduct** (procedures for obtaining opinions from disinterested third parties), **in principle, should independent directors and special committees be involved (be the opinion provider)?**
    What kind of opinions are independent directors and special committees required to give? (see page 14)
- **Are there any other matters that need to be addressed or kept in mind in order for independent directors to fulfill their roles?**

(Reference) Previous opinions

- **It is important to clarify in the Code of Conduct, as a principle, the role of independent directors at a company with a controlling shareholder.**
- **A principle is also necessary to clarify in what matters independent directors should get involved.** Having independence means that the independent directors may not understand the business. Having independent directors deciding everything about a listed subsidiary would not necessarily lead to enhanced corporate value.
- Special committees should not always deliberate under normal circumstances but should **discuss where the transaction is a category which could cause a conflict of interest between a parent company and general shareholders of the subsidiary, or when a specific transaction becomes problematic.**
- **Since there are various relationships between a parent company and a subsidiary, it would be too rigid to require consultations with a special committee whenever there is any transaction between the parent company and the subsidiary.** It is essential to take a more balanced approach of having each company consider what transactions are important to the interests of the listed subsidiary and minority shareholders, and then have the listed subsidiaries disclose the situations in which the special committee plays an important role.
- As a general approach, **rather than encouraging further use and expansion of special committees, it would be better to encourage the use of independent directors.**

Role of Independent Directors Under CG Code (Principle 4.7)

- Principle 4.7 in the CG Code expects **independent directors of companies with controlling shareholders to monitor the risk of conflicts of interest between the controlling shareholder and minority shareholders and to reflect the views of minority shareholders**.
  - Listed companies are required to comply with each principle of the CG Code, or if not, to explain why not (comply or explain)
- **Almost all listed companies with a controlling shareholder report compliance with Principle 4.7.**

Principle 4.7

Companies should make effective use of independent directors, taking into consideration the expectations listed below with respect to their roles and responsibilities:

i), ii) (omitted)

iii) **Monitoring of conflicts of interest between the company** and the management or **controlling shareholders**; and

iv) Appropriately representing the views of minority shareholders and other stakeholders in the **boardroom from a standpoint independent of** the management and **controlling shareholders**.

Status of compliance with Principle 4.7

Existence of controlling shareholder	Comply	Explain
Number of listed companies with controlling shareholder	344	4
Number of listed companies without controlling shareholder	2,820	25

Governance Structure Under CG Code (Supplementary Principle 4.8.3)

- CG Code Supplementary Principle 4.8.3 requires **listed companies with a controlling shareholder to establish a governance system centered on independent directors who are independent of the controlling shareholder (appointing a specified percentage of independent directors or establishing a special committee to manage conflicts of interest)**

Supplementary Principle 4.8.3

Companies that have a controlling shareholder should either

- **appoint at least one-third of their directors (the majority of directors if listed on the Prime Market) as independent directors who are independent of the controlling shareholder** or
- **establish a special committee composed of independent persons including independent director(s) to deliberate and review material transactions or actions that conflict with the interests of the controlling shareholder and minority shareholders**.

Responses to public consultation regarding Supplemental Principle 4.8.3

- With regard to ensuring greater independence within the Board of Directors, at the Follow-Up Council, while some members said that **listed companies with controlling shareholders should appoint a majority of independent directors regardless of market segment**, others said that **it would be excessive to require listed companies with controlling shareholders to make all business decisions with a majority independent of the parent company. In light of these suggestions and the concept that a higher level of governance is required of companies listed on the Prime Market**, listed companies on the Prime Market that have controlling shareholders are required to appoint a majority of independent directors who are independent of the controlling shareholder, and those on other market segments are required to appoint at least one-third independent directors who are independent of the controlling shareholder.
- In addition, based on the above suggestions, **depending on individual circumstances**, companies are **required to adopt at least one** of the following two measures: (1) ensuring further independence of the Board of Directors and (2) establishing a special committee to manage conflicts of interest.

Governance Structures (Status of Compliance with Supplementary Principle 4.8.3)

- **Of the Prime Market listed companies that have "complied" with Supplementary Principle 4.8.3,**
  - **less than 20% have appointed a majority of independent directors.**
  - the remaining over 80% have established a special committee to manage conflicts of interest.
- **Companies "explaining" are more likely to say they are considering establishing a special committee to manage conflicts of interest.**

(Based on CG reports as of July 14, 2022)

Companies that "comply" with Supplementary Principle 4.8.3

: compliance through appointment of a specified percentage of independent directors

: compliance through establishment of a special committee

Ratio of independent directors	Prime Market			Standard Market		
	No. of companies	Percentage	With special committee	No. of companies	Percentage	With special committee
More than 1/2	21 (+8)	16.7% (+6.2pt)	1 (+1)	15 (+7)	7.4% (+3.2pt)	1 (+0)
More than 1/3 or more – 1/2	97 (+1)	77.0% (–0.4pt)	64 (+34)	135 (+10)	66.5% (+1.4pt)	15 (+5)
Less than 1/3	8 (–7)	6.3% (–5.7pt)	4 (±0)	53 (–6)	26.1% (–4.6pt)	15 (+4)
Total	126 (+2)	–	69 (+33)	203 (+11)	–	40 (+18)

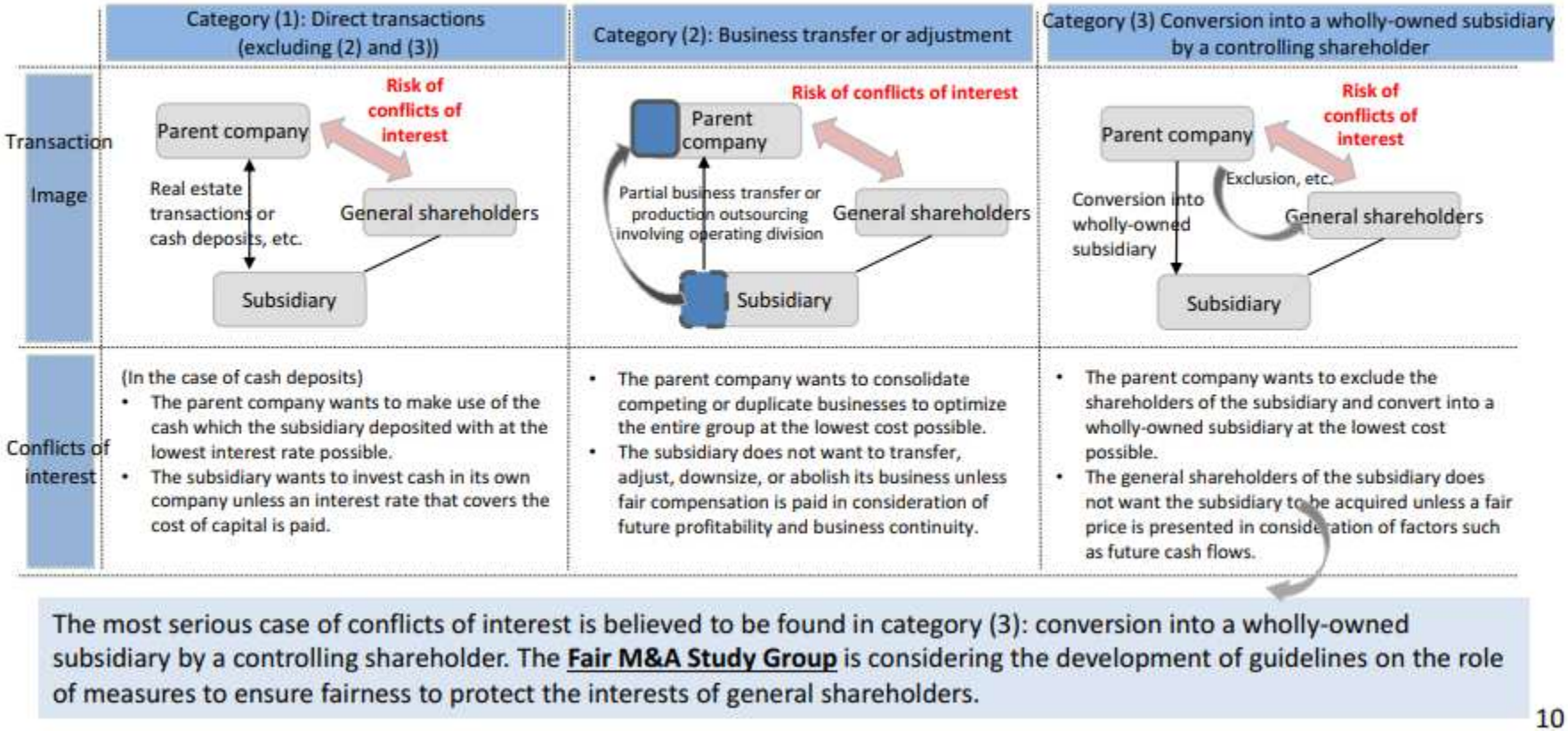
Note: Figures in parentheses indicate increase/decrease from the aggregate results as of December 31, 2021.

Companies that "explain" for Supplementary Principle 4.8.3

Category	Prime Market		Standard Market	
	No. of companies	Percentage	No. of companies	Percentage
Total	38		81	
- Planning/discussing increase of independent directors	10	26.3%	33	40.7%
- Planning/discussing establishment of special committee	17	**44.7%**	29	35.8%

Categories of Transaction that Have Potential for Conflicts of Interest with Minority Shareholders

- **The following three major categories of transactions and actions can occur in a company with a controlling shareholder, which may cause conflicts of interest risk.**
  - Category (1) can include general transactions and recurring/ongoing transactions.
  - Category (2) can include business adjustments that do not involve specific transactional activities (e.g., starting a competing business with a subsidiary or preventing a subsidiary from starting a new business).
  - These categories can be considered both for situations where conflicts of interest in a specific transaction/action become an issue and in daily supervision situations.



Source: Material 2 prepared by Ministry of Economy, Trade and Industry for The Council of Experts Concerning the Follow-up of Japan's Stewardship Code and Japan's Corporate Governance Code at the eighteenth council on March 5, 2019

(Reference) Fair M&A Guidelines

Chapter 3 Practical Specific Measures (Fairness Ensuring Measures)

3.2 Establishment of an Independent Special Committee

3.2.4 Practical Measures for the Effective Functioning of the Special Committee

3.2.4.2 Committee Composition

A） Independence

(Omitted)

Specifically, **persons who will become Special Committee members should be required to maintain independence from (1) the acquiring party and (2) the success or failure of the M&A transaction (in other words, they should have no significant interest in the success or failure of the M&A transaction different from that of general shareholders).** This independence should be appropriately determined for each M&A transaction taking into account the specific circumstances, such as the relationship between the candidate and the acquiring party/target company and between the candidate and the M&A transaction, and from the perspective of whether such candidate generally can be expected to make an appropriate decision from the point of view of increasing corporate value and protecting the interests of general shareholders.

With respect to independence from the acquiring party (factor (1)), in cases involving an acquisition of a controlled company by the controlling company, it is advisable that, taking into account the requirements to qualify as an outside director or outside company auditor under the Companies Act (for example, Article 2, Item 15a of the Companies Act), potential Special Committee members who are former executives or employees of the controlling company have not been either an executive or an employee of the controlling company during the period of at least 10 years prior to becoming a Special Committee member.

In addition, with respect to business relationships with an acquiring party and personal relationships other than those described above, it is beneficial to apply the independence criteria for independent officers established by the financial instruments exchanges to relationships with the acquiring party; however, it is difficult to establish a uniform objective standard, and it is necessary to make a practical decision taking into account the specific circumstances of each.

B） Attributes / Expertise of Special Committee Members

It is advisable that the Special Committee be composed of outsiders, that is, outside directors, outside company auditors, and outside experts, in order to eliminate the influence of structural conflicts of interest. Persons eligible for membership on the Special Committee are described generally below.

a) Outside Directors**: (1) are appointed at a general meeting of shareholders, have legal obligations and liability to the company, and may also be subject to liability claims from shareholders, (2) are by nature expected to participate directly in business decisions as a member of the Board of Directors, and (3) have a certain degree of knowledge of the target company's operations. Taking into account these attributes, and the role of the Special Committee, an outside director is the most suitable type of member. In principle, if independent outside directors exist, it is advisable to select members from among such directors.** In addition, one practical measure to enhance the effectiveness of the Special Committee is to have an outside director act as committee chair.

(Omitted)

If all outside directors have issues, such as a lack of independence, that prevent them from being selected as Special Committee members, establishing a Special Committee consisting only of outside company auditors and outside experts may be considered the second-best solution.

On the other hand, the fundamental role expected of an outside director is to manage the Special Committee appropriately and responsibly while employing the expert advice of advisors and others, based on a proper understanding of the Special Committee's role and the legal obligations and liability they have to the company. Because they are not expected to exercise expert judgment on their own, the fact that an outside director does not have expertise in M&A cannot justify a decision not to select that outside director as a Special Committee member.

The most advisable approach is that the Special Committee be composed of only outside directors, who are most suitable to serve as members, and that M&A expertise be supplemented by obtaining expert advice from advisors and others. At present, it appears that many companies may encounter difficulty in forming Special Committees with this composition due to having a small number of outside directors; however, in the future, many companies are expected to appoint multiple independent outside directors, and it will become easier to form Special Committees with this advisable composition.

Source: Ministry of Economy, Trade and Industry, Fair M&A Guidelines — Enhancing Corporate Value and Securing Shareholders' Interests —June 28, 2019
https://www.meti.go.jp/policy/economy/keiei_innovation/keizaihousei/pdf/fairmaguidelines_english.pdf

Note: Bold and underline formatting is added by TSE

Role in Conversion to Wholly-Owned Subsidiary Situation

(1)

- **Since the publication of the Fair M&A Guidelines by the Ministry of Economy, Trade and Industry, it has been established in practice that a special committee including outside officers should be established when a controlling shareholder conducts a tender offer to take a listed subsidiary private.**
- **It is also now common for the board to comply with the decision of the special committee.**

Disclosure status based on Fair M&A Guidelines

Disclosure items	July 2019 - June 2020	July 2020 - June 2021	July 2021 - June 2022
Cases covered by survey	19	24	27
Information on the eligibility of members of special committees	19	24	27
Disclosure that the committee consists solely of outside officers (Of which, disclosure of reasons for appointment, etc.)	9 (3)	9 (3)	11 (1)
Disclosure that the committee is composed of outside officers and outside experts (Of which, disclosure of reasons for appointment, etc.)	9 (3)	13 (6)	15 (12)
Disclosure that the committee consists solely of outside experts (Of which, disclosure of reasons for appointment, etc.)	1 (1)	2 (2)	1 (1)
Handling of the decision of the special committee by the board of the company	9	20	25
Disclosure (1) that the board will respect the decision of the special committee to the maximum extent ＋(2) that it is stipulated in advance by the board that if the special committee determines that the terms of the transaction are not appropriate, the company will not support the M&A.	9	20	25
No disclosure on any of the above	0	0	0

Note: ”Outside officers” is not limited to independent directors, but includes outside directors and outside company auditors (*kansayaku*)

Reasons for appointment where the committee is composed solely of outside experts

- Independent director concurrently serves as **outside director of a subsidiary of the controlling shareholder**
- Outside director concurrently serves as **an employee of a subsidiary of the controlling shareholder** / belongs to **a law firm that serves as a legal advisor to the controlling shareholder**
- Outside director concurrently serves as **a director or official of a subsidiary of the controlling shareholder** / belongs to **a law firm that is a legal advisor to the controlling shareholder**
- All directors and sompany auditors (*kansayaku)*, including independent directors, **are from the controlling shareholder group**

Examples of Discussion Items at Special Committee
(Examples of Disclosures in CG Reports)

（1）

Itmedia Inc.／2148　（September 29, 2022）

[ガバナンス委員会]

取締役会の諮問機関として、取締役会付議事項における利益相反取引等に対し、経営陣・支配株主から独立した立場より、少数株主の意見を取締役会に適切に反映させ、当社の意思決定の公正性を担保することを目的に特別委員会を設置しております。
社外取締役全４名を構成員とし、以下に該当する取締役会付議事項における取引の合理性や取引条件の相当性の審議・提言を行っております。

① 合併、会社分割、株式移転その他の組織再編行為
② 他社株式に対する公開買付
③ 自社株式の非公開化
④ 新株予約権の割当（親会社の役員を兼務している役員に付与する場合）
⑤ 親会社やグループ会社との重要な取引
⑥ ①～⑤に準じた当社の経営ないし統治機構に関し、取締役会議長から諮問を受けた事項
⑦ ⑥の他、本委員会の委員が必要と判断し委員会に付議した事項

Suntory Beverage & Food Limited／2587（February 13, 2023）

(1) The Company has established the Special Committee as a system to safeguard the interests of general shareholders.
To ensure fairness, transparency and objectivity regarding transactions, activities, etc. with the Suntory Group, the Special Committee verifies the necessity and reasonableness, the appropriateness of the terms and conditions, etc., and the fairness of **transactions equal to or exceeding a certain amount with the Suntory Group, including Suntory Holdings Limited, and transactions, activities, etc. related to the business resources forming the source of Company's corporate value, such as brands, human resources, key assets and information** (hereinafter collectively referred to as "Important Transactions, Activities, etc."), and reports to the Board of Directors.

Rakuten Bank,Ltd.／5838　(April 21, 2023)

なお、＜原則１－７：関連当事者間の取引＞で述べたとおり、当行は、独立役員（一般株主と利益相反が生じるおそれのない社外取締役及び社外監査役をいいます。）から構成される「特別監視委員会」を設置し、**楽天グループ(株)からのグループ事業戦略上の要請に基づく経営方針の決定や当行グループと楽天グループの相互に関連する人事案件及び楽天グループとの取引及び行為の実行**に際して、アームズ・レングス・ルールや利益相反取引等について、銀行の業務の健全かつ適切な運営確保の観点から妥当性を検証するするとともに、少数株主保護の観点から必要性及び妥当性を検証することとし、同委員会に事前に諮問又は事後に報告をしなければならないこととしており、上述のような様々な提携を行うにあたっては同委員会への諮問・報告を通じて妥当性を検証するため、当行の独立性が阻害され得る事態や少数株主の利益が毀損される事態は生じないと考えています。（中略）

楽天グループに属する者を候補者として指名する場合には、対象者が当行役員に就任することが楽天グループと当行の更なるシナジーの追求及び楽天グループ外における当行の事業基盤拡充に資する等、当行の企業価値向上の観点から有益であるか等を検討のうえ、＜原則３－１：情報開示の充実＞（ⅳ）で述べた通り、**当行グループと楽天グループの相互に関連する人事案件として、あらかじめ当行の業務の健全かつ適切な運営及び少数株主保護の観点から支障がないかを特別監視委員会に諮問することとしています。**

If the company does not disclose the information in English, only the Japanese is provided

Note: Relevant parts of each company's disclosure have been extracted and partially edited for inclusion here. Blue text formatting was added by TSE.

Role in Procedural Regulations under Code of Corporate Conduct

- Under the Code of Corporate Conduct, **when carrying out a material transaction or activity involving the controlling shareholder**, listed companies with controlling shareholders **are required to obtain an opinion from a person who has no interest in the controlling shareholder regarding whether the transaction would undermine the interests of minority shareholders**.
- In recent years, **it has become an established practice to obtain opinions from independent directors or special committees that include independent directors as members.**

Rule 441-2. Matters to be Observed Pertaining to Significant Transactions, etc. with Controlling Shareholder

A listed company that has a controlling shareholder shall, in the cases referred to in the following items, obtain opinion from an entity that has no interest in such controlling shareholder, that any decision on the matters prescribed in such items* will not undermine interests of minority shareholders of such listed company. (omitted)

* Prescribed actions among the events for timely disclosure (third-party allotment of shares, organizational restructuring, transfer/accession of business/fixed assets, becoming a wholly owned subsidiary, etc.), which are related to a controlling shareholder Recurring/ongoing transactions or business adjustments that do not accompany with transactions are not covered.

Opinion providers (Jan. 2022 – Apr. 2023)

Opinion provider	Number	Share
Independent director	**63**	**33.3%**
Independent auditor	5	2.6%
Special committee (including independent directors)	**108**	**57.1%**
Special committee (including independent auditors)	4	2.1%
Special committee (others)	3	1.6%
Lawyer or CPA	5	2.6%
External calculation agency	1	0.5%
Other (disinterested director, etc.)	0	0.0%
Total	189	100%

90.4%

(Ref.) Opinion providers (Jan. 2014 – June 2019)

Opinion provider	Number	Share
Independent director	174	34.3%
Independent auditor	151	29.8%
Third party committee	115	22.7%
Lawyer or CPA	21	4.1%
External calculation agency	15	3.0%
Other (disinterested director, etc.)	31	6.1%
Total	507	100%

Ensuring Independence of Independent Directors from Controlling Shareholders

Items for Discussion
(Ensuring Independence from Controlling Shareholders)

Items for discussion

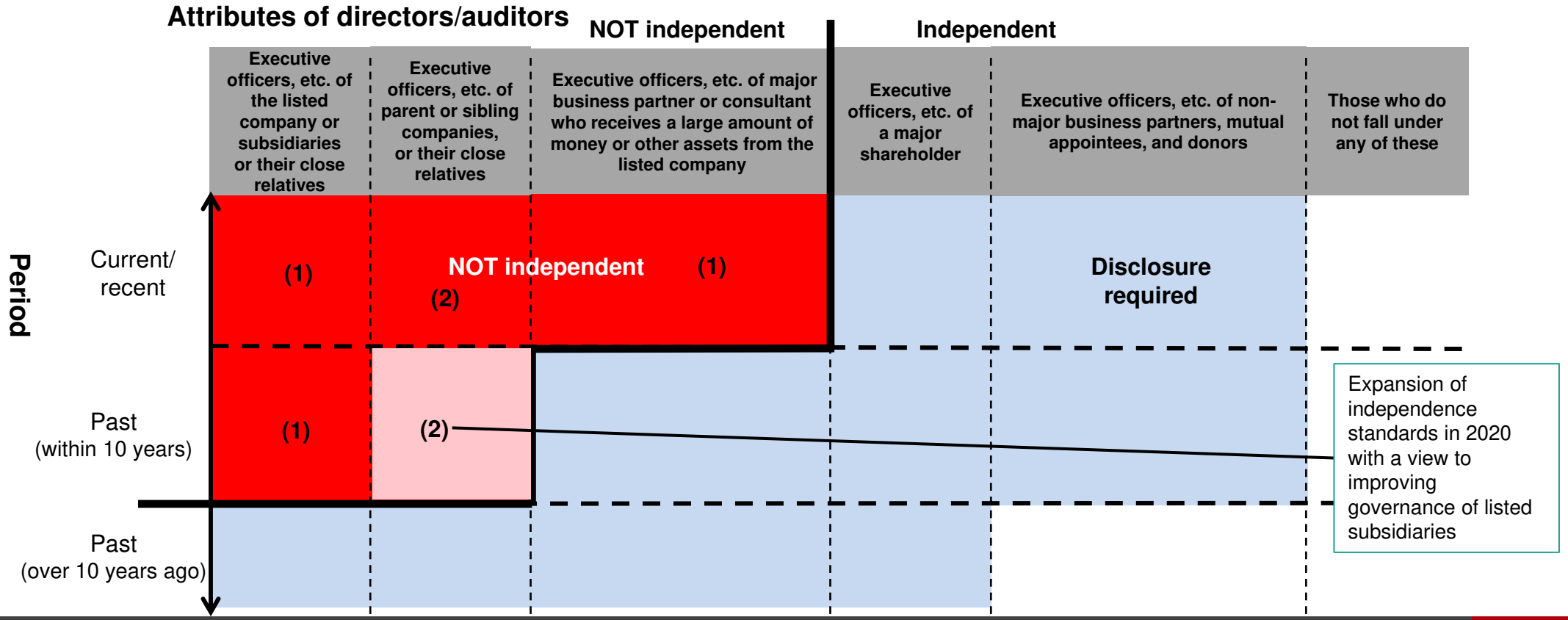
- **How could "independence from controlling shareholders" be ensured in the requirements for independent directors (independence standards)?**
  - **Are there any elements not covered in the current independence standards for independent directors in terms of minimum requirements to ensure "independence from controlling shareholders"?**
  - **If there are elements that are not covered, how might this be addressed in the listing rules?**

(Reference) Previous opinions

- Independent directors of a listed company with a controlling shareholder **must be independent from the controlling shareholder (including group companies with a controlling shareholder at their core) as well as the management of the listed company.**
- As an independent director/auditor rule for listed subsidiaries, **it is necessary to establish a rule whereby the listed subsidiaries appoint at least one director/auditor who is independent from the parent company or controlling shareholder (in particular, independent in terms of economic and business relationships).**

Overview of Independence Standards

- The independent director/auditor rules require an independent director/auditor to be "a person who is unlikely to have a conflict of interest with general shareholders" as a qualitative requirement, and within that, establishes **independence standards as the minimum requirements that must be satisfied (e.g., when there would typically be deemed to be a likelihood of a conflict of interest with general shareholders)**.
  - Current independence standards apply to all independent directors/auditors.
  - ➢ Independence standards primarily require independence from management (see (1) in the table below)
  - ➢ In terms of independence from the controlling shareholder, **it is required that the director/auditor has no employment relationship with the controlling shareholder and is not a close relative of someone who has an employment relationship with the controlling shareholder** (see (2) in the table below)**, but there is no prohibition of business relationships with the controlling shareholder.**



Items for discussion
(Ensuring Independence of Independent Directors from Controlling Shareholders)

- **How can the voting rights of the controlling shareholder and independence from the controlling shareholder be reconciled?**
  - TSE anticipates further future discussion on Majority of the Minority (MoM) and the relationship with the Nominating Committee in the appointment of independent directors.)

(Reference) Previous opinions

- A possible measure to protect minority shareholders from a governance perspective would be **a MoM mechanism that would allow listed subsidiaries to file the appointment of independent directors/auditors only if they are elected by a majority of minority shareholders.**
  - ✓ **Without a certain level of support from minority shareholders, it may not be possible to justify that an independent director is an advocate for the interests of the general and minority shareholders.**
  - ✓ **Requiring a MoM condition would not prevent a parent company from exercising its right to appoint and dismiss the executive directors of its subsidiaries.** Moreover, the entire board of directors of the subsidiary has the authority to supervise the subsidiary's operations, and therefore, requiring a MoM condition would not disable the parent company's ability to supervise the subsidiary.
  - ✓ At a company without a controlling shareholder, independent directors are qualified through the independence requirements plus an appointment by the general meeting of shareholders, which is also independent. **A MoM condition is equivalent to requiring companies with a controlling shareholder to secure similar requirements in practice, and it follows naturally from the current Corporate Governance Code and listing rules.**
- **Because the basic structure of the stock company is based on control backed by the share of voting rights, it would be excessive to always require approval by a majority of minority shareholders for independent director appointments, even in the ordinary course of business.**
  - ✓ We should go back and review the original concept of what shareholder rights and voting should mean. **The perspective that the voting rights themselves represent how much responsibility they have in investing in the company is also very important.**
- **The concept of independent directors/auditors is to determine independence based on objective attributes, whereas the MoM ensures independence through focusing on the process. Mixing these two ideas is questionable** and only one of them should be taken.
- **Establishing a nomination committee at a listed subsidiary makes it look like the company is giving consideration to governance, but there are considerable differences among companies in terms of the actual situation. The role that can be expected of a nomination committee** when the parent company or controlling shareholder controls most of the voting rights at the AGM is **very different from that of a normal company**.
- **Use of nomination committees in listed subsidiaries requires careful consideration.**
- TSE should take steps to stop "companies with three committees (nomination, audit and remuneration)" from entering into agreements with controlling shareholders regarding the nomination of director candidates, even though such agreements violate the principle of the law and can be thought to be invalid. Such agreements are also not desirable at companies with a voluntary nomination committee, even though that may depend on the characterization of the nomination committee.

Other Topics

Items for Discussion (Other Topics)

Items for discussion

- **Are there any additional topics that should be discussed from the perspective of changing the listing rules with regards to the use of independent directors?**
- **Are there any topics that should be prioritized for discussion in addition to the use of independent directors?**

(Reference) Previous opinions

Responsibility of controlling shareholder

- The note to General Principle 4 in the Corporate Governance Code states “controlling shareholders should respect the common interests of the company and its shareholders and should not treat minority shareholders unfairly.”
  - ✓ Since the Code is principle-based, these "notes" are very important, **so we should be considering how to implement this concept as some kind of framework.**
  - ✓ **These "notes" should be utilized when designing specific rules related to governance.**

Extension of the scope of the minority shareholder protection framework with respect to governance

- **Under TSE's independence standards, persons who execute operations at a parent company are not considered "independent," but persons related to the so-called major shareholders are considered "independent." TSE's independence standards need to be reviewed** in light of the survey results showing that some companies have certain contracts even with shareholders whose shareholding ratios are low.
- **It could also be discussed how the independence of independent directors/auditors should be considered under the independence standards when there is a shareholder whose shareholding ratio is at a certain level but is not a parent company.**
- **It is necessary to consider expanding the scope of procedural regulations in the Code of Corporate Conduct.**