

October 26, 2021

## Engagement Agenda “Issues Concerning Corporate Governance of Parent-Subsidiary Listings”

### Interim Report on Collective Engagement on Issues Concerning Corporate Governance of Parent-Subsidiary Listings

The seven companies, namely The Dai-ichi Life Insurance, Meiji Yasuda Asset Management, Mitsubishi UJF Trust and Banking, Pension Fund Association, Resona Asset Management, Sumitomo Mitsui DS Asset Management, and Sumitomo Mitsui Trust Asset Management (in alphabetical order), the participants of the Collective Engagement Program presided by The Institutional Investors Collective Engagement Forum (hereinafter referred to as “IICEF”), with IICEF as secretariat, perform collective engagement with multiple listed companies on the corporate governance issues concerning so-called parent-subsubsidiary listings.

From March 2019 onwards, as a preparation for formulating a common view of investors, IICEF, in cooperation with ICJ, Inc., held a series of meetings to exchange opinions (collective hearings) with companies with parent-subsubsidiary listings. After formulating a common view of participating investors based on facts and companies’ views on parent-subsubsidiary listings learned through the collective hearings, from October 2020 onwards, we started collective engagement meetings with both parent companies (hereinafter referred to as “the Parent”) and subsidiaries in some of the leading corporate groups with parent-subsubsidiary listings.

Through these collective engagement meetings, we have clarified “the corporate governance issues concerning parent-subsubsidiary listings” and have compiled an interim report on them.

#### 1. Outline of the Agenda

There are some positive views on so-called parent-subsubsidiary listings in Japan in terms of bringing various benefits to management including benefits in fund-raising and securing human resources while also stressing the function of incubating companies inherent in the process of listing subsidiaries, etc. From the investors’ perspective, however, disadvantages have been pointed out, including the risk of certain “distortions” arising in the evaluation of stock prices as well as the propensity for the risk of conflicts of interest (especially among shareholders).

In many cases, passive investors and other major institutional investors participating in IICEF's Collective Engagement Program continue to hold both the shares of the Parent and the subsidiaries, etc., in principle due to the nature of their investments. As shareholders of the Parent, they have a keen interest in whether maintaining a parent-subsidiary listing is really the optimal option from the perspective of long-term management and value enhancement of the group as a whole. Additionally, as shareholders of the subsidiaries, etc., they cannot help but be concerned about the possibility of unfair impairment of the interests of minority shareholders of listed subsidiaries, etc. IICEF believes that having members of management of both the Parent and the subsidiaries, etc. become aware of these perspectives and concerns of the investors, consider corporate governance measures to alleviate such concerns, and improve disclosure of relevant information and their explanations to the investors, will be immensely productive as its program's collective engagement agenda.

Investors' awareness of the issues and primary concerns that should be re-acknowledged by members of management of listed Parent and subsidiary companies are described below. We understand that they include issues that require discussions not only with members of management of either the individual Parent or the listed subsidiaries, etc., but also with members of management of both the Parent and the listed subsidiaries, etc. When requesting the engagement dialogues, IICEF intends to hold dialogues concurrently with the members of management of both the Parent and the subsidiaries, etc. as much as possible.

- Wouldn't it cause some sort of disadvantage to the minority shareholders of the listed subsidiaries, etc.? Furthermore, wouldn't there be a risk that this fact is having an adverse effect on the evaluation of either the Parent or the subsidiaries, etc. or both on the stock market?
- Are the advantages of the reality of a parent-subsidiary listing great enough in terms of how each company is managed and its value is enhanced? Even if there were no problems in the past, couldn't a potential conflict of interest become visible in the event of a "contingency"?
- Wouldn't the emergence of minority shareholders as a result of the listing of the subsidiaries, etc. become an obstacle to the optimum management strategies of the entire group?
- What kind of discussions are made at a board meeting and other relevant dialogues on the issues above? In particular, how do independent outside directors view this issue and discussions at a board meeting?

For the details of this engagement agenda and specific questions, please refer to the disclosure material dated October 8, 2020 ([https://www.iicef.jp/pdf/en/pdf\\_en\\_20201008.pdf?20201116](https://www.iicef.jp/pdf/en/pdf_en_20201008.pdf?20201116)).

## 2. Issues of parent-subsidary listings further clarified through engagement and expectations for enhanced explanation by companies

As of September 30, 2021, including collective hearings in 2019, we have held collective engagement meetings with 18 companies (including both Parents and subsidiaries) belonging to some of the leading corporate groups with parent-subsidary listings. Through these meetings, we have received the following explanations from those companies.

### [Outline of explanations provided by companies]

#### (1) Companies proactively working on resolving parent-subsidary listings

- We listed a subsidiary originally as part of financing activities, and helped the subsidiary to grow through the listing of its shares. There were also other companies that became our subsidiaries through the acquisition. Our policy as a Parent was to respect the autonomy and independence of the management of subsidiaries and to refrain from meddling with their management. As a result, diversified management of our group has been successful.
- However, as the business environment has changed significantly in recent years, it has become necessary for us to undertake a group-wide restructuring. As a result, it became increasingly clear that there was a gap in the way of thinking between the Parent and the subsidiary. Because we cannot force the subsidiary to change its management even if we want them to, we have decided to undertake a group restructuring including delisting of the subsidiary (by either acquiring 100% ownership or divesting our holdings).
- We expected that the group restructuring efforts would naturally entail various resistance. On the other hand, the number of outside directors has increased at both the Parent and the subsidiary, enabling discussions from an objective standpoint. We see this as one of the advantages of such efforts.

#### (2) Companies that recognize the merit of the listing of subsidiary

- We have listed subsidiaries as part of the group management strategy that aims to maximize our consolidated financial performance. The directors of both the Parent and subsidiaries have a sufficient understanding of the management policies of the group as a whole including the listed subsidiaries. In addition, the board of directors of the Parent discusses the capital structure of the listed subsidiaries, etc. and the significance and the appropriateness of their listing as necessary from the perspective of group management.
- A listed subsidiary is expected to develop its own business independently, and its growth will contribute to the enhancement of corporate value of the group as a whole, which is also in

consistent with the interests of its minority shareholders. Maintaining the listing status for a subsidiary has advantages such as speedy decision-making, flexible corporate finance, recruitment, employee morale enhancement, and better business management at the subsidiary.

- Recognizing that parent-subsidary listings involve risks of structural conflict of interest, the Parent ensures the independence of its listed subsidiaries by implementing an effective governance structure at the subsidiaries. For example, while a sufficient number of independent outside directors are elected, directors of the Parent do not concurrently serve as directors of a listed subsidiary. In addition, a system is in place to check parent-subsidary transactions. For example, these transactions are subject to strict intercompany transaction rules, are required to be reported to and approved by the board of directors (outside directors) of both the Parent and the subsidiary, and are monitored by a committee established at each subsidiary.

Through these engagement meetings, investors understood these companies' policies on and approaches to parent-subsidary listings, their advantages and disadvantages, companies' responses to respect the independence and autonomy of the management of subsidiaries, initiatives to prevent conflict of interest, and other various aspects of the actual situation. We also believe that these companies understood the concerns of investors through the questions from them to the explanations above.

[Gap in understanding between companies and investors from the investor's perspective]

As stated above, detailed explanations have been provided from these companies through collective engagement meetings, which enabled us to deepen the understanding of their views. However, investors continue to have governance concerns about parent-subsidary listings.

These concerns of investors and the gap in understanding between companies and investors can be summarized as the issues outlined below. IICEF will continue to hold collective engagement meetings with companies to discuss these issues.

(1) Basic issues of parent-subsidary listings

- If a Parent respects the independence of the management of a subsidiary, there is no need to maintain the parent-subsidary relationship with the subsidiary, and it would suffice to enter into a business alliance agreement with the subsidiary in the area of collaboration. Conversely, if the Parent intends to increase synergies within the group as a whole, it should control the subsidiary as a wholly-owned subsidiary. It is considered problematic that keeping the parent-subsidary listing is an ambiguous situation with a dilemma as group management.

- In the first place, in a parent-subsidary listing arrangement, the Parent (controlling shareholder) bears risks and receives economic returns in proportion to its shareholding ratio in terms of the economic aspect (rights to self-interest). On the other hand, from the perspective of management participation (common interest rights), the Parent has substantive management control beyond its shareholding ratio. Although the minority shareholders of such a subsidiary have a right to ask questions at the general meeting of shareholders, their voting rights are substantially invalid. The parent-subsidary listing entails such a situation, that shareholders are deprived of part of their rights in effect.

For example, when a company purchases shares of an existing listed company to make it a subsidiary, it can obtain substantive management control through partial acquisition (such as 51%) of shares, rather than an outright acquisition. In other words, the Parent can obtain 100% control over the subsidiary with about a half of funds. On the other hand, the minority shareholders of the acquired company are left with their voting rights substantially invalid, and the value of their shares is discounted by the amount equivalent to the value of the voting rights.

This is the fundamental starting point of all issues of parent-subsidary listings.

- Through the parent-subsidary relationship, the Parent may siphon profit from its subsidiary by, for example, carrying out unfair related-party transactions or imposing trademark royalties and management guidance fees. In addition, there may be parent-subsidary contracts and arrangements that prescribe, for example, the permanent dispatch of a certain number of directors from the Parent. In many cases, such contracts and arrangements are not fully disclosed to shareholders. Moreover, there are “risks in emergency” such as the exercise of management control rights when there is a disagreement on management policies between the Parent and the subsidiary, and the purchase of shares of the subsidiary at a discount price to make it a wholly-owned subsidiary. The lack of transparency in such situations as described above, which can cause economic disadvantages to the minority shareholders of the subsidiary, is a discount factor to corporate value.

## (2) Advantages and costs in “peacetime”

- There is no problem with parent-subsidary listings when the management policies of both the Parent and its subsidiary are in accord, the subsidiary receives support from the Parent, and both achieve growth through synergy effects. We refer to this as “peacetime” in which the interests of the Parent (controlling shareholder) coincide with the interests of the minority shareholders of the subsidiary. If the subsidiary can take advantage of business synergy with the Parent and receive tangible and intangible benefits of being a member of the group (e.g., higher creditworthiness and reduction in management cost), and both the Parent and the

subsidiary achieve growth, the minority shareholders of the subsidiary can also receive benefits.

- On the other hand, the Parent must respect the independence and autonomy of the subsidiary. In that sense the Parent would have to spend time, effort, and cost for ensuring the alignment of management policies and introducing and supervising a group governance structure. The subsidiary is also required to elect multiple outside directors who are independent of the Parent, and to implement mechanisms to prevent conflict of interest, including the monitoring of related-party transactions with the Parent, and accounting audit to retain its earnings at appropriate levels. At the same time, the subsidiary has to properly disclose any arrangements with the Parent.
- Nonetheless, this may not be a serious issue as the time, effort, and cost will be absorbed if both the Parent and the subsidiary can benefit from their concerted promotion of strategies in an appropriate balance between the independence of the subsidiary and group-wide coordination.
- However, those management costs associated with the subsidiary listing may become a burden on the group if they increase in the future as a result of changes in shareholders' awareness and regulation tightening.

### (3) Issues to surface in “emergency”

- “The subsidiary does not obey the instructions of the Parent.” “The Parent forces its view on everything we do. The inflexible Parent makes our movement slow.” It may not cause a problem as long as such small frictions between the Parent and the subsidiary arising from differences in history, corporate culture, and management style or from the pride as a listed company are resolved through consultation. However, in an “emergency” in which there is a definitive disagreement between the Parent and the subsidiary on management policies due to changes in the business environment or for other reasons, and the disagreement cannot be resolved through consultation, serious issues may surface. The Parent would exercise its rights as a shareholder in accordance with its own will based on its management control, by which it could replace directors or even the independent outside directors that it has once approved in some cases.
- It is accepted if the management policies of the Parent imposed on the subsidiary are in line with the common interests of shareholders of the subsidiary. If they prioritize the interests of the Parent, however, the interests of the minority shareholders of the subsidiary may be undermined.
- In the case that the Parent acquires 100% ownership of its subsidiary, the Parent can purchase such shares at a discount price by using its status as the controlling shareholder. Any change

in the capital structure that will undermine the interests of the minority shareholders of the subsidiary will also constitute an “emergency.”

- The concerns of minority shareholders about such “risks in emergency” cannot be dispelled even if the Parent insists that “we will respect the independence of the management of the subsidiary” and “we will protect the interests of minority shareholders” because there is no way to guarantee such statements. Therefore, investors who are minority shareholders are forced to set their cost of capital at a higher level, which is a discount factor to stock price.

(4) Although “risks in emergency” cannot be eliminated, can a company explain the advantages of the existence of minority shareholders at the subsidiary?

- Although these risks in emergency cannot be eliminated, the Parent can reduce them by explaining “the advantages of the existence of minority shareholders at the subsidiary and the importance of their interests” and disclosing sufficient information to the minority shareholders in an emergency, and thereby convincing them of its intention to protect their interests.
- Some of the advantages of listing in terms of recruitment and trust of business partners arise from credibility as a listed company. However, this could well be synonymous with overreliance on the brand image of the listing on the TSE 1st Section. Such advantages can often be secured sufficiently if a listed subsidiary becomes a wholly-owned subsidiary with a trade name bearing the name of the Parent to take advantage of its brand and credibility. In some cases, management levels of a subsidiary have been raised due to the existence of minority shareholders. However, this can also be achieved by enhancing group governance by the Parent. Therefore, in these cases, the advantages cannot be directly attributable to the existence of minority shareholders.
- A Parent can explain the advantages for the Parent of the existence of a subsidiary within its group (such as synergy) or the advantages for the subsidiary of the brand value as a listed company (such as recruitment), but it is rather difficult to put forth a reasonable and persuasive advantage for the Parent of the existence of minority shareholders in the subsidiary.
- Possible examples of the latter include opportunities to listen to diverse opinions that are different from those of the Parent, securing business opportunities with competitors to the Parent, and the ability to introduce incentive plans that leverage the functions of the capital market, such as stock-based compensation and stock options to the officers and employees of the subsidiary. (It is particularly effective in incentivizing and securing the founding members and key employees in the case of a buyout of a venture company). These are the unique advantages of listing. If the advantages of maintaining the listing of a subsidiary and its minority shareholders are considered convincing, it might be possible to counteract the effect

of risks in emergency that work as a discount factor.

(5) Aim for the sharing of mutual understanding through engagement

- We request that the board of directors of applicable Parent discuss once again and share their understandings at its meetings and disclose externally not only the advantages of listing a subsidiary, which have been recognized so far, but also its disadvantages such as time, effort, and cost required, which have not drawn much attention in the past, and above all, the advantages of the existence of minority shareholders in the subsidiary and the Parent's responsibility as the controlling shareholder to respect the interests of minority shareholders.
- Parent-subsiidiary listings should be avoided or dissolved if their advantages are unclear, there are disadvantages to the minority shareholders of the subsidiary, or such risks have a potential to surface in the future. We request that if a Parent clearly recognizes advantages of maintaining listing of its subsidiary or the existence of minority shareholders and intends to maintain parent-subsiidiary listings, it should provide a sufficiently convincing explanation of their significance and advantages to shareholders.

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Based on the recognition of the issues outlined above, IICEF will continue to hold collective engagement meetings with companies on these points, and strive to share the understanding of the issues to resolve them.

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