

January 21, 2025

Institutional Investors Collective Engagement Forum

Summary of Engagement Agenda: "Explanation of the Necessity of Takeover Defenses"
(Correct Understanding of the Effectiveness of Pre-warning Type Takeover Defenses and Recognition of the Importance of Trust with Investors)

Seven companies—Pension Fund Association, Dai-ichi Life Insurance, Sumitomo Mitsui DS Asset Management, Sumitomo Mitsui Trust Asset Management, Mitsubishi UFJ Trust and Banking Corporation, Meiji Yasuda Asset Management, and Resona Asset Management (hereinafter, "participating investors")— with the Institutional Investors Collective Engagement Forum (hereinafter, "the Forum") serving as the secretariat, have conducted collective engagement for six years from 2018 to 2024. This engagement targeted 225 Japanese companies (393 cumulative instances) that had adopted "Measures Against Large-Scale Acquisitions" (hereinafter, "pre-warning type takeover defenses"). The agenda for this engagement was "Explanation of the necessity of continuing pre-warning type takeover defenses even at the risk of lowering capital market valuation".

In the collective engagement, letters were sent to top management and outside directors of companies whose pre-warning type takeover defenses were expiring in that year's general shareholders' meeting, among others, to convey investors' views. We also requested that an explanation regarding "the necessity of continuation" be included in the convocation notices, etc., in a manner that would satisfy investors. Furthermore, explanations were received from some recipient companies through written responses and meetings.

The table below shows the status of continuation or discontinuation of takeover defenses for the recipient companies. Out of the 225 companies (393 cumulative instances) that received letters, 79 companies discontinued their pre-warning type takeover defenses in the year the letter was sent. This decision was made by these companies understanding how investors view pre-warning type takeover defenses, and by considering the risk of losing investor trust by continuing the defense versus the risk of discontinuing it. Notably, a higher proportion of companies with large market capitalization discontinued their defenses. (As of the end of 2018, 383 listed companies had adopted pre-warning type takeover defenses, of which 102 had a market capitalization of JPY 100 billion or more. As of June 2024, 223 listed companies continue their defenses, of which 27 have a market capitalization of JPY 100 billion or more.)

(Table) Status of Pre-warning Type Takeover Defense Continuation/Discontinuation for Recipient Companies by Year

	2019	2020	2021	2022	2023	2024	Total
Letter recipient companies	59	29	13	53	108	131	Cumulative 393
First-time recipient companies	59	29	13	37	85	2	Total 225
Companies that discontinued in the current year	37	13	6	8	7	7+1(announced discontinuation)	Total 79
Companies that continued in the current year	22	16	7	45	101	44	-
Companies continuing as of June 2024	14	10	6	43	94	124	-
Companies discontinued as of June 2024	45	19	7	9	13	7	-
Companies delisted in the current year	0	0	0	1	1	0	Total 2

On the other hand, companies that continued pre-warning type takeover defenses did include reasons in their convocation notices, but there were no instances where the necessity was sufficiently explained to the satisfaction of participating investors. The content of written responses and explanations during meetings from companies were consistently the same, stating the possibility of receiving unsolicited acquisition proposals that could impair corporate value, and the need to secure sufficient time and information for shareholders to make appropriate judgments. The background for this was often cited as inadequacies in the current legal framework. In particular, smaller market capitalization companies expressed concern about being targeted by activists seeking short-term shareholder profits.

During meetings, the Forum's secretariat engaged in dialogue and shared the details of these dialogues with participating investors. Some companies expressed difficulty understanding

investors' thinking and rationale. In response, we explained the impact of pre-warning type takeover defenses on share value and the message they convey to the capital market, as follows:

- **Impact on Share Value** Takeover defenses place restrictions on a portion of co-benefit rights, which are among the multiple rights of shareholders. This means that the value of "control rights", one of the three characteristics of shares along with "profit rights" and "property rights", is impaired. Naturally, this leads to a decrease in share value.
- **Meaning of the Message to Capital Markets** Takeover defenses allow for the exclusion of those who seek to change current management policies. Many companies that have adopted pre-warning type takeover defenses are characterized by insufficient efforts despite the need for reform and stagnating stock prices. Despite such circumstances, they convey a message to the capital market that "current management policies will not change."

Participating investors believe it is extremely difficult to support pre-warning type takeover defenses for reasons other than an explanation that they are "a temporary measure until corporate value improvement is realized through the current management's reforms," in which case investors might accept a partial restriction of shareholder rights.

Amidst these circumstances, in August 2023, the Ministry of Economy, Trade and Industry (METI) compiled the "Guidelines for Corporate Takeovers", which presented fair rules concerning M&A. Additionally, on May 15, 2024, an amended Financial Instruments and Exchange Act, including the tender offer rule, was enacted. Concurrently, multiple judicial precedents concerning takeover defenses have been issued, clarifying the scope of "event-triggered takeover defenses," which are activated when an acquisition truly impairs the common interests of shareholders. In light of these developments, participating investors believe that the issue of legal system inadequacies has significantly receded.

It is now a situation where market risk should be prioritized over legal risk. Instead of attempting corporate defense through pre-warning type takeover defenses, companies should focus on management that achieves capital profitability exceeding capital cost and ensures sustainable growth. This is considered the most powerful corporate defense. Participating investors will support management teams committed to such efforts.

As understanding on the companies' side (especially among large market capitalization firms) has progressed, and the legal framework has advanced, we have judged that the environment surrounding unsolicited acquisitions has significantly changed. Therefore, the Forum has decided to

temporarily suspend collective engagement through mass letter sending to companies that have adopted pre-warning type takeover defenses. Dialogue will continue with companies still maintaining pre-warning type takeover defenses through other agendas and individual meetings. Furthermore, public engagement will be strengthened to urge further legal and institutional improvement with relevant ministries, experts, and market participants.

[Attached Material]

Forum Participating Investors' View on Pre-warning Type Takeover Defenses

1. Investors' Recognition and Concerns Regarding Pre-warning Type Takeover Defenses

Participating investors, focusing on passive and long-term stable investments, broadly invest in the entire Japanese stock market. Thus, they possess a "universal owner" perspective for "Japan Inc.". From a super long-term investment stance, they support enhancing corporate value through sustainable growth and do not pursue short-term shareholder profits. Consequently, they do not approve of abusive acquisition behaviors by short-term investors that sacrifice mid-to-long-term corporate value.

Moreover, even if an acquirer pursuing short-term shareholder profits emerges, participating investors will make their voting decisions on the adoption and activation of event-triggered takeover defenses based on specific circumstances and from the perspective of whether the common interests of shareholders are not impaired.

On the other hand, participating investors are concerned that management, by introducing pre-warning type takeover defenses, might mistakenly believe they can block even legitimate, strategically-motivated acquisition proposals if they are not in line with management's wishes. This could relax the sense of accountability to shareholders and weaken governance. There is also a concern that the true purpose of introducing or continuing pre-warning type takeover defenses is not for the benefit of general minority shareholders, but for management's self-preservation. In such cases, this could lead to a spread of distrust towards management. Because of these factors, some investors discount the governance evaluation of companies that have adopted pre-warning type takeover defenses.

Fundamentally, it is a misconception that introducing pre-warning type takeover defenses will deter "activists" who only pursue short-term shareholder profits and quickly sell off shares after realizing gains. Companies where general investors' distrust grows due to perceived management weaknesses and where stock prices stagnate are precisely the prime targets for "activists". Introducing pre-warning type takeover defenses can even signal that a company is a potential target.

While companies strive for information disclosure and IR activities to build trust with investors and form appropriate stock prices, participating investors find it difficult to accept the reasons for introducing pre-warning type takeover defenses, given the risk of losing investor trust and lowering corporate value evaluation. Participating investors believe that instead of "corporate defense" through pre-warning type takeover defenses, companies should focus on improving corporate value through governance reform, and they want to support such efforts, which is why they engage in collective dialogue.

2. Evolution of M&A Rules

M&A rules in Japan have gradually evolved. First, with the amendment of the tender offer rule in 2006, regulations on surreptitious acquisition of control and the obligation for all-share tender offers were introduced. Concurrently, companies gained the right to ask questions to the tender offer or and request extension of the tender offer period.

Subsequently, multiple judicial precedents concerning takeover defenses have been issued, clarifying the scope of event-triggered takeover defenses that are activated when an acquisition truly impairs the common interests of shareholders. Specifically, for acquisition activities involving gaining control through market transactions (which had been pointed out as an issue for some time), a judicial precedent in 2021 recognized the adoption and activation of takeover defenses if supported by a majority of shareholders excluding the acquirer, largely addressing the issue. (Supreme Court decision, November 18, 2021, the case of TOKYO KIKAI SEISAKUSHO, LTD.). Furthermore, in 2022, the Supreme Court denied a takeover defense as a countermeasure against accumulation through market transactions in a case where the design of the takeover defense was deemed problematic, such as an excessively broad scope of shareholders subject to activation. (Supreme Court decision, July 28, 2022, the case of Mitsuboshi Belting Ltd.).

Then, in August 2023, METI published the "Guidelines for Corporate Takeovers" ("the Guidelines"). These guidelines presented principles and best practices to be shared in the economic society for forming fair M&A rules, focusing on how parties should act in acquisitions to gain management

control of listed companies. Under these Guidelines, the following three principles were presented as those to be respected in general acquisitions aiming to obtain management control of listed companies:

- **Principle of Corporate Value and Shareholders' Common Interests**
Whether or not an acquisition is desirable should be determined on the basis of whether it will secure or enhance corporate value and the shareholders' common interests.
- **Principle of Shareholders' Intent**
The rational intent of shareholders should be relied upon in matters involving the corporate control of the company.
- **Principle of Transparency**
Information useful for shareholders' decision making should be provided appropriately and proactively by the acquiring party and the target company.

Under these three principles, "Code of Conduct for Directors and Board of Directors regarding Acquisition Proposals", "Increased Transparency Regarding Acquisitions", and "Takeover Response Policies and Countermeasures" were clarified as matters to be complied with by acquirers and target companies through M&A-related laws and regulations.

Furthermore, in December 2023, "The Working Group on Tender Offer Rule and Large Shareholding Reporting Rule of the Financial System Council" (the "WG") published a report. Following this report, an amendment bill for the Financial Instruments and Exchange Act (FIEA) was approved by the Diet on May 15, 2024, leading to revisions of the tender offer rule and large shareholding reporting rule. Under the amended law, the threshold for the so-called "one-third rule" was lowered from one-third to 30%, and on-exchange market transactions were included in the scope of this rule. This generally makes it impossible to acquire shares exceeding 30% ownership ratio through on-exchange market transactions. Additionally, the WG Report stated a policy to strengthen authorities' response to violations of the large shareholding reporting rule as a countermeasure against cases where multiple parties are suspected of implicitly coordinating to acquire shares. Moreover, if an acquirer attempts to commence a tender offer without complying with the large shareholding reporting rule, the policy indicates that submission or correction of the large shareholding report will be requested during the pre-consultation for the tender offer rule statement.

Thus, due to the development of various legal systems, the accumulation of past judicial precedents regarding event-triggered takeover defenses, and the guidelines and reports published by authorities, the environment surrounding takeover defenses has significantly changed. End

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