



ICGN

International Corporate Governance Network

TSE Listing Department
Japan Exchange Group

E-Mail: jojo-kikaku@jpx.co.jp

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To Whom this May Concern

ICGN Response to Revision of Japan's Corporate Governance Code based on the proposal of the Council

ICGN serves as a Member of the Council of Experts for the Follow-up of Japan's Stewardship Code and Japan's Corporate Governance Code. We applaud the efforts being undertaken by the Japan Exchange Group and other regulatory authorities to promote long term corporate value and sustainable economic growth. We are particularly grateful to the Japan Exchange Group and Tokyo Stock Exchange for our long-standing relationship in promoting ICGN initiatives in Japan to help support the development of high standards of corporate governance policies and practices.

This letter should be read alongside the comment letter submitted to the Japan Financial Services Agency in response to the consultation on Draft Guidelines for Investor and Company Engagement (the "Guidelines"). We welcome the objective of the Guidelines to enhance dialogue between companies and investors on issues of particular relevance in today's business environment in Japan.

It is understood that the TSE Listing Department is seeking comment on revisions to Japan's Corporate Governance Code (the "Code") as a result of the introduction of the new Guidelines. We offer commentary to the suggested changes as presented in the revised code and also respectfully suggest further recommendations for future consideration.

Supplementary Principle 1.1.1 securing the rights of shareholders

Following the general shareholder meeting, companies should promptly and publicly disclose the outcome of the vote, the vote instruction (reported separately for, against or abstain) and voting levels for each resolution on the company website. If a board-endorsed resolution has been opposed by a significant proportion of votes, the company should explain subsequently what actions were taken to understand and respond to the concerns that led shareholders to vote against the board's recommendation.

Supplementary Principle 1.2.2 notice of general meeting

As noted in our recent response to the Ministry of Justice regarding the Japan Companies Act Review, ICGN advocates that companies allow for sufficient time for investors to make informed voting decisions between the announcement of the meeting and the meeting date itself. The general meeting agenda should be posted

on the company's website, in English, at least one month prior to the meeting taking place.

Principle 1.4: cross shareholdings

ICGN supports the revisions to Principle 1.4 and in particular the new supplementary principles 1.4.1 and 1.4.2. It is hoped that the code revisions will help improve the quality of disclosure regarding the economic rationale for cross shareholdings. It is also hoped that the introduction of the supplementary principles will help encourage change in traditional business practices where cross shareholding relationships are prevalent which can have a detrimental effect on the standards of corporate governance and can be an impediment to investor stewardship.

ICGN advocates for boards to justify what the business benefits, in a financial sense, are for having cross shareholdings and disclose this in the form of a cost/ benefit analysis. We also encourage Japanese companies to commit to a target to reduce their cross shareholdings over a specified period of time. Additionally, we suggest that companies should disclose their policy towards capital allocation. This should include disclosure on the top 30 cross shareholdings by value as well as the total number, not only in the Japan Securities Report, but also on the company's website in English. It would also be helpful for such disclosure to include the real identify of the cross-shareholder, for example whether or not they are a parent company, subsidiary, supplier and so on. This would help provide greater transparency around progress being made and identify more clearly which companies are dominant in this practice.

Supplementary Principle 1.7: related party transactions

The board should disclose the process for approving, reviewing and monitoring related party transactions (RPTs) and any inherent conflicts of interest which, for significant transactions, includes establishing a committee of independent directors. This can be a separate committee or an existing committee comprised of independent directors, for example the audit committee. The committee should review significant RPTs to determine whether they are in the best interests of the company and, if so, to determine what terms are fair and reasonable. The conclusion of committee deliberations on significant RPTs should be disclosed in the company's annual report to shareholders.

Furthermore, shareholders should have the right to approve significant RPTs above an appropriate materiality threshold, and this should be based on the approval of a majority of disinterested shareholders. The board should submit the transaction for shareholder approval in the notice of the meeting and disclose (both before concluding the transaction and in the company's annual report):

- the identity of the ultimate beneficiaries including, any controlling owner and any party affiliated with the controlling owner with any direct / indirect ownership interest in the company;
- other businesses in which the controlling shareholder has a significant interest; and

- shareholder agreements (e.g. commitments to related party payments such as licence fees, service agreements and loans).

Principle 2.4: ensuring diversity, including active participation of women

A company's approach to board diversity (including gender, ethnicity, social and cognitive reasoning) should be described in a publicly disclosed Diversity Policy including measurable targets and a time period over which such targets will be achieved.

Principle 2.6: role of corporate pension funds as asset owners

ICGN welcomes the inclusion of reference to the important role that corporate pension funds play as asset owners responsible for preserving and enhancing value for their beneficiaries, i.e. company employees.

It is incumbent on such corporate pension funds to take seriously their stewardship obligations as recommended in Japan's Stewardship principles published under the auspices of the Financial Services Agency. ICGN's own Global Governance Principles call on asset owners – including corporate pension funds – to effectively oversee and monitor asset manager stewardship activities in alignment with the asset owner investment philosophy and time horizon. Policies should be disclosed which describe how real or potential conflicts of interest are minimised along with the remedies to mitigate them.

Supplementary Principle 4.1.3; 4.3.2; 4.3.3: role of the Board – succession planning

Independent directors can play a vital role in CEO appointment, removal and succession planning. ICGN would encourage wider use of Nomination Committees (sometimes known as Corporate Governance Committees) when practicable, comprised of a majority of independent directors. Furthermore, it would be advantageous if the Code referred to the role of a Nomination Committee, comprised of independent directors, to be actively involved in the appointment, dismissal and succession of the CEO.

The role of the Nomination Committee could include: regularly assess the composition of the board taking into account the Diversity Policy; develop a skills matrix describing desired board composition aligned with the company's strategic objectives; lead the process for nominating board candidates for shareholder approval; ensure that conflicts of interest among committee members are identified and avoided; oversee the process for board evaluation including the appointment of any external consultant, enter into dialogue with shareholders regarding board nominations; and lead the development, implementation and review of succession planning.

Supplementary Principle 4.1.3: role of the Board – executive remuneration

ICGN recommends that the Code refers to the role of a Remuneration Committee, comprised of independent directors, to be actively involved in the determination of management remuneration.

The role of the Remuneration Committee could include: determining the company's remuneration policy; designing implementing monitoring and evaluating short-term and long-term incentives for the CEO; ensuring that conflicts of interest among committee members are identified and avoided; appointing independent remuneration consultants; and maintaining appropriate communication with shareholders on the subject of remuneration.

Furthermore, we recommend that the Code makes reference to the importance of disclosing adequate information regarding executive remuneration. The board should disclose clear and understandable remuneration policies and reports which are aligned with the company's long-term strategic objectives. Such disclosure should facilitate comparability and accountability, and include reference to how awards were deemed appropriate in the context of the company's underlying performance and long term strategic objectives.

The disclosure should also indicate whether remuneration consultants were involved in the process. Disclosure should refer to executive officers, directors and the CEO, and be reported on an individual basis, whilst also taking into account the company's overall approach to human resource strategy. This extends to non-cash items such as director and officer insurance, pension provisions, fringe benefits and terms of severance packages if any.

Principle 4.7; 4.8: role of independent directors and definition

ICGN welcomes the increase of independent directors on Japanese boards since the introduction of the Code in 2015. We believe that companies should strive for one-third independent directors or have a minimum of three as it would then be possible to have fully independent board committees – noting that our standard for widely held companies is for there to be a majority of independent directors.

Furthermore, it may be useful to include definition of 'independence' in Japan's Corporate Governance Code as this would provide clarity to boards in their independent director appointment processes. In particular, we recommend disclosure on factors that could impact independence including, cross shareholdings, major client and supplier relationships, former regulatory body, the provision of consultancy services and family ties.

ICGN also advocates that independent directors must have the time to commit to a company - they should not be 'over-boarded' that is to say, sit on too many boards in order to be able to be effective in their role.

Additional comment

In addition to our suggestions regarding specific Code Principles ICGN advocates the following:

- Leadership. There should be a clear division of responsibilities between the role of the board chairman and the CEO. The chairman is responsible for leading the board, whilst the CEO is responsible for managing the company which is two distinct roles. This also helps to avoid the entrenchment of power in one single individual who may dominate board decision-making.
- CEO succession to chairman. ICGN discourages the practice of a company's retiring CEO remaining on the board and becoming chairman. We would encourage Japanese boards to communicate a convincing rationale in the annual report as to why CEO succession to chairmanship is in the best interests of the company.
- Komon and Sodanyaku. ICGN welcomes the decision by the TSE to encourage more disclosure from companies around the appointment of former executives being retained as advisors, Komon and Sodanyaku to the board. Such advisors should not be in a position to influence decision-making and it would be helpful for more transparency around the type of advice received and any associated fees.

We recognise that corporate governance practices take time to evolve and the above recommendations are presented in the spirit of supporting the ongoing reform taking place in Japan. ICGN congratulates the leadership of the Japan Exchange Group and Tokyo Stock Exchange once again on the progress that is being made and we remain at your disposal should you wish to discuss any of our recommendations.

Yours sincerely,



Kerrie Waring
Chief Executive Officer, ICGN
Kerrie.waring@icgn.org

Copy:

George Iguchi, Board Member, ICGN g_iguchi@nam.co.jp
George Dallas, Policy Director, ICGN George.Dallas@icgn.org