ICGN
International Corporate Governance Network

Counsellors Office
Civil Affairs Bureau
Ministry of Justice
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Tokyo 100-8977, Japan

By email: minji205@i.moj.go.jp

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Dear Sirs

Revision of Japan's Companies Act

The International Corporate Governance Network (ICGN) is pleased to respond to the request by the Ministry of Justice (MoJ) for comments regarding proposed revisions to Japan's Companies Act.

Led by investors responsible for assets under management in excess of US $34 trillion, ICGN is a leading authority on global standards of corporate governance and investor stewardship. Our membership is based in more than 45 countries and includes investors, companies, advisors and other stakeholders. ICGN's mission is to promote high standards of professionalism in governance for investors and companies alike in their mutual pursuit of long-term value creation contributing to sustainable economies world-wide. More information can be found on our website: www.icgn.org.

ICGN applauds the many corporate governance and investor stewardship reforms that are taking place under Japan's Revitalisation Strategy and welcome the positive initiatives being driven by the MoJ as well as other regulatory authorities including the FSA, METI and TSE. Many such reforms were discussed at an ICGN Conference held in Tokyo last month were over 400 global investors and companies and regulators joined to discuss the impact of these reforms following the seminal report from Professor Ito in 2014.

ICGN has actively contributed to helping to improve corporate governance standards for over two decades in Japan. This includes the delivery of high-profile events, submission of multiple responses to regulatory consultations and current participation in the Council of Experts Concerning the Follow-up of Japan's Stewardship Code and Japan's Corporate Governance Code.

The following comments address the corporate governance related aspects in the Companies Act which are of most relevance to our mission and which are also aligned with our recommendations as outlined in the ICGN Global Governance Principles:

1. Utilization of Independent Director (Part 2-IIof the Interim Proposal)

We strongly support establishing a new rule regarding the delegation of duties to

Independent Directors as outlined in Part 2-II-1 of the Interim Proposal.
ICGN welcomes the increase of Independent Directors on Japanese boards since the introduction of the Corporate Governance Code in 2015. We believe that companies should strive for at least one-third board independence or have a minimum of three independent directors as it would then be possible to have fully independent board committees – noting that our global standard for widely held companies is for there to be a majority of independent directors.

We note that it has not been traditional practice for Independent Directors to be involved in board decision-making around management buy-outs in Japan, which can give rise to serious conflicts of interest. We therefore encourage the empowerment of Independent Director decision-making, for example to help ensure an independent process for the determination of a fair bidding price in a management buy-out situation.

Independent directors, free from external influence, help offset the domination of decision-making by any single individual. By drawing on their personal competencies and experience, they can contribute a diversity of perspectives to generate healthy debate in the boardroom and are well placed to represent the interests of minority long-term shareholders.

2. Delegation of Decision on Execution of Material Operations by Board of Directors of Company with Auditors (Kansayaku) (Part 2-II-2 of the Interim Proposal)

We support Proposal A to establish a new rule which would require Kansayaku boards to have a majority of Independent Directors, noting that the new rule states that “the board of directors of a company with kansayaku may delegate decisions on a material operation execution to a specific director provided that the board has a majority of outside directors and fulfils a number of other requirements".

While ICGN queries whether or not this clause is practical given that there are so few Kansayaku boards that meet this requirement (i.e. a majority of outside directors), we believe it is useful to highlight that global best practice would encourage there to be a sufficient number of independent directors to ensure appropriate independent oversight of board decision-making and effectiveness.

3. Enhancement of Disclosure of Information (Part 2-I-1 of the Interim Proposal)

We strongly support the revised clauses as proposed relating to director remuneration which require companies to improve accountability around director remuneration, primarily through enhanced disclosure.

ICGN advocates that 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. It 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.

ICGN also strongly advocates the importance of a Remuneration Committee, comprised of Independent Directors, which would be responsible for matters such as:

- 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.

4. Notice & Access of Shareholders Meeting Material by Electronically Accessible Method (Part 1-I-2 of the Interim Proposal)

- **[Proposal A] Four weeks prior to the date of shareholders meeting**
- **[Proposal B] Three weeks prior to the date of shareholders meeting**

We strongly support the new clause [Proposal A] to encourage companies to use electronic methods to disseminate information. This is more time efficient and cost effective by reducing hard copy print.

Over the last decade, the exercise of voting rights by electronic means has been adopted worldwide and increasingly has enabled investors with international equity portfolios to vote their shares cross border. It is imperative to allow for sufficient time for investors to make informed voting decisions between the announcement of the meeting and the meeting date itself and we therefore support a four week notice period as described under Proposal A.

We understand that current practice in Japan is for around three weeks prior notice of the date of shareholders meeting. This is not sufficient when taking into account the time required by intermediaries (or their agents) to tabulate voting instructions. This leaves very limited time for investors to make voting decisions and is inadequate. The problem is particularly acute for foreign investors who are subject to a cross-border vote execution chain and thus even earlier vote deadlines.

5. Notice of Calling Shareholders Meeting (Part 1-I-3 of the Interim Proposal)

- **[Proposal A] by the day that is four weeks prior to the date of shareholders meeting**
- **[Proposal B] by the day that is three weeks prior to the date of shareholders meeting (the current average is about three weeks)**
- **[Proposal C] by the day that is two weeks prior to the date of shareholders meeting (the same as the existing rules)**

We support [Proposal A] whereby the notice of calling a shareholders meeting should be four weeks. We welcome improvement from the current practice whereby the Notice of Calling Shareholders Meeting should be written on paper and the material should be physically delivered to each shareholder which is inefficient and outdated.

To conclude, ICGN welcomes the revisions to Japan's Companies Act under the auspices of the MoJ. As the world's third largest capital market, with substantial overseas foreign investment, Japan is a very important market to ICGN members. My colleague George Dallas (ICGN Policy Director, george.dallas@icgn.org) and I remain at your disposal should you have any questions regarding our response.

Yours sincerely,

Kerrie Waring
Chief Executive Officer, ICGN