



Japan Financial Services Agency  
Corporate Accounting and Disclosure Division

Email: [corporategovernance1@fsa.go.jp](mailto:corporategovernance1@fsa.go.jp)

January 28, 2015

Dear Sir and/or Madam,

**Re: Response to “Japan’s Corporate Governance Code: Seeking Sustainable Corporate Growth and Increased Corporate Value over the Mid -to- Long-Term”**

The International Corporate Governance Network (ICGN) is an investor-led organisation of governance professionals with members including institutional investors responsible for assets under management in excess of US 18 trillion.<sup>1</sup> Our mission is to inspire and promote effective standards of corporate governance to advance efficient markets and economies world-wide. As such we welcome the opportunity to comment to the Japan Financial Services Agency (“FSA”) on the publication of “Japan’s Corporate Governance Code- Seeking Sustainable Corporate Growth and Increased Corporate Value over the Mid- to Long-term” (“Exposure Draft”).

ICGN commends the FSA’s efforts towards facilitating a more robust corporate governance system in Japan that supports investors and companies in achieving long-term economic growth. We are pleased, as an organisation of members with significant investments in Japanese companies, that we have been invited to comment at each stage of the development of good governance practices and principles.

Previously, the ICGN, on December 10, 2014, commented to the FSA about Japanese corporate governance issues ahead of the release of the English language exposure draft. In this letter we also shared with you aspects of ICGN’s own Global Governance Principles that are relevant for the corporate governance debate in Japan.<sup>2</sup> We also commented on February 8, 2014 in a response to the Japanese Consultation Exposure Draft of the Principles for Responsible Institutional Investors. In addition, the ICGN commented on May 21, 2014 on the METI “Building Favorable Relationships between Companies and Investors” Project stemming from the *Ito Review*.

These important consultations come at a crucial juncture for Japanese markets for a number of reasons. We particularly commend the Japanese Stewardship Code which signals to the international market that Japan is committed to corporate governance reform, in accordance with global best practices. This should help to encourage more

<sup>1</sup> For more information about ICGN, please visit [www.icgn.org](http://www.icgn.org).

<sup>2</sup> See ICGN Global Governance Principles 2014:  
[https://www.icgn.org/images/Global\\_Governance\\_Principles\\_2014.pdf](https://www.icgn.org/images/Global_Governance_Principles_2014.pdf)

foreign direct investment in Japan as longer term investors are drawn to stable financial markets with favorable corporate governance practices in alignment with clients' risk profiles and investors' fiduciary duties. More foreign direct investments potentially have a positive effect on economic growth.

An environment in which companies and investors may mutually work together for the long-term interests of companies creates a competitive advantage, one that has been studied and supported by academic research.

The ICGN's position on standards of corporate governance, applicable to both companies and investors, is set out in our Global Corporate Governance Principles, which are accessible on our website. In addition, the ICGN Statement of Principles of Institutional Investor Responsibilities clarifies the responsibilities of investors both in relation to their internal governance and their external role as investors in companies and other assets.

ICGN previously noted the composition of members of the Council of Experts for the Corporate Governance Code Exposure Draft and was pleased to see an array of company officials, academics, investors, attorneys, researchers, accountants, governmental and financial services representatives. As the existence of a corporate governance code is so important for investors, ICGN recommends a process of monitoring and evaluating the implementation of the Corporate Governance Code in practice after two but preferably no longer than four years. In addition, ICGN recommends that the establishment of a monitoring or evaluation committee would be advantageous. This should include an adequate balance between representatives of listed companies, investors, academics and advisors that are actually involved with the applied use of the Corporate Governance Code. In several countries, for instance The Netherlands and other regions, a monitoring committee has delivered specific guidance for companies and investors in understanding the merits of principles and global best practices.

## **General Comments**

In the definition of "Corporate Governance Code," on page 1, ICGN noted that the second paragraph indicated that Japan's Corporate Governance Code's "appropriate implementation will contribute to the development and success of companies, investors and the Japanese economy as a whole through individual companies' self-motivated actions so as to achieve sustainable growth and increase corporate value over the mid-to long-term." ICGN is hopeful that investors will be able to encourage companies to indeed support the adoption of the Code and develop stronger relationships that foster long-term economic growth for both parties. ICGN acknowledges that Japan's initiatives for a robust corporate governance system have accelerated in the past few years leading to this Exposure Draft.

We were intrigued by the Exposure Draft's development of General Principles, Principles and Supplementary Principles. In order to provide commentary for your review, we added comments under certain Principles in which we sought clarification or had additional information to offer. While the different structure for the three groups of Principles may be useful to provide a company with flexibility in applying

the Principles, ICGN would note that a streamlined approach may one day be useful so that companies and investors will have a single set of Principles to reference.

ICGN noted that the Principles do not follow a rules-based approach and instead follow a “comply or explain” model, similar to Japan’s Stewardship Code. ICGN has supported this approach in previous comment letters and understands that a rigid approach based in law may not be advantageous for global investors who invest in Japanese companies. We do, however, believe that companies should provide robust and full statements of disclosure and their rationale for situations in which they are not able to comply with any of the Principles.

The ICGN also recognises the risks of “boilerplate” responses to “comply or explain,” and we emphasize that for comply or explain to work effectively, investors must play an active role in monitoring and challenging company deviations from the Corporate Governance Code. As such, we suggest addressing the right of investors to be duly informed and to engage in dialogue with companies. The standard of “comply or explain” should be met by individual companies, with respect to their circumstances. The Principle should include language that a concrete and relevant company explanation has to be offered why the Principle has not been complied with should reduce the risk of “boilerplate” responses. A monitoring or evaluation committee that comments and gives guidance can be of great value for companies, their directors and investors.

We do appreciate that the Exposure Draft attempts to explain the three forms of corporate organization in Japan. ICGN does not generally take a position on one form or another and recognises that companies are in the best position to choose the organisational structure that best suits the business model and the investors to whom they owe a fiduciary duty.

ICGN also notes that the June 1, 2015 date of the Code’s implementation is fast approaching. We are pleased that the comments offered will be considered in a timely way to give companies the next several months to be prepared for its commencement and the implementation this year.

## **General Principles**

### **Section 1: Securing the Rights and Equal Treatment of Shareholders**

#### **Principle 1.1 Securing the Rights of Shareholders**

ICGN, as a membership organisation of investors across the globe, appreciates that the Principles recognise that foreign and minority shareholders deserve to have their issues and concerns considered by Japanese companies. Foreign investors and overseas institutions currently hold approximately 30% of the shares listed at the Tokyo Stock Exchange.<sup>3</sup> Therefore it is important that the Japan Corporate Governance Code aligns as much as possible with global practices that have developed and served both companies and investors well. Hence the possibility to

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<sup>3</sup> Based upon the Tokyo Stock Exchange shareownership survey, March 2014.

attract even more foreign direct investments into Japanese listed companies or other investment opportunities.

### **Principle 1.2 Exercise of Shareholder Rights at General Shareholder Meetings**

ICGN recognizes the value of shareholder rights, especially the responsibility of voting at the general shareholder meeting. It is imperative that accurate information be received by shareholders in advance of the annual meeting. The agenda should clearly reflect the content of the meeting, the names and background of directors who have been nominated to serve and all relevant information to allow investors to vote as fully informed owners of the company.

The current practice of holding a majority of Japanese company annual meetings during a brief time frame restricts the ability of investors to decide whether and how to effectively engage companies in dialogue before the meetings and whether they are physically able to attend all of the annual meetings. To that end, as stated in Principle 1.2.2, sufficient time is needed by shareholders to consider the agenda and cast informed votes.

Certain shareholders may wish to attend annual meetings, start a dialogue with the board and under Principle 1.2.5, should be afforded the ability to attend the meeting and to exercise their voting rights.

### **Principle 1.3 Basic Strategy for Capital Policy**

ICGN agrees that companies should explain their basic strategy with respect to their capital policy.

### **Principle 1.4 Cross-Shareholdings**

ICGN agrees that companies that hold shares of other listed companies should disclose their policy with respect to doing so. Such transparency would be welcomed by investors, who may not be aware of a company's business ties to other companies. The disclosure of standards with regard to the voting rights of their cross-shareholdings may allow investors to gain valuable insight into the nature of the company's holdings and how it is utilizing its voting rights. It will also indicate the level of market dependencies and the risks related to these holdings.

### **Principle 1.5 Anti-Takeover Measures**

ICGN does not support the use of anti-takeover measures by a board, especially if they are associated with the entrenchment of management or the board. In the event an anti-takeover provision is deemed necessary, ICGN supports the premise that shareholders be given the opportunity to cast a vote prior to the board's implementation of these measures at a special or annual general meeting, and not be unilaterally put into place. In addition, any anti-takeover measure should have a temporary nature, and as a frame of reference, the global standards are six to twelve months. If the anti-takeover measure is put in place without shareholder approval or is contrary to the interests of a large minority but still held in place by the company, the anti-takeover measure should be tested and assured by a judge if applicable in the Japanese context.

### **Principle 1.6 Capital Policy that May Harm Shareholder Interests**

ICGN believes that triggering events, such as a merger or acquisition, or major change in the companies' strategy that lead to a change of control should be presented to the shareholders in advance of any merger or acquisition. Shareholders should be informed whether the company has a single or double trigger for change in control provisions and for whom the provisions apply. Not only should shareholders be informed after a change in control, but a company should take appropriate steps to consider whether such provisions are in the shareholders' best interests. The same standard should apply to share offerings and management buyouts. Shareholders should be able to understand, prior to voting on any merger or acquisition, whether their shares face significant dilution or if management will be receiving a windfall due to the corporate action.

ICGN suggests that the Principle include language that sets forth the company's responsibility, prior to a change in control or other strategic action that is material or involves at least one-third of the company's assets, to seek shareholder approval. Application of the Principle may require a change in the law.

### **Principle 1.7 Related Party Transactions**

ICGN agrees that any transactions with its directors and/or major shareholders should be disclosed and that procedures how to deal with them should be set up in advance. Related party transactions may call into question the independence of board members and therefore, shareholders should know who on the board has the authority to approve them, who is monitoring these transactions, and determine whether a board member is no longer considered an independent member of the board due to these transactions. The corporate governance code could provide a standard materiality threshold that should be reached for shareholder approval. Greater disclosure as to why the transactions are in the best interests of the company and investors is necessary.

## **Section 2: Appropriate Cooperation with Stakeholders Other Than Shareholders**

### **Principle 2.1 Business Principles as the Foundation of Corporate Value Creation Over the Mid-to-Long Term**

ICGN acknowledges that there are a variety of stakeholders with differing interests in a company other than shareholders. There is a balance that must be achieved between the interests of all stakeholders, to demonstrate social license to operate and the need for a company to create corporate value over the long-term, as shareholders would expect. This balance is captured in the principle of 'going concern' because that expressed exactly the interests of all stakeholders. In the social responsibility arena, companies need to be good citizens and as such, the development of, and adherence to, its responsible business principles would be important for both stakeholders and shareholders. .

### **Principle 2.2 Code of Conduct**

ICGN supports the implementation of a company "Code of Conduct" for employees. In a global environment, a company should ensure compliance across the

organisation, including senior management, to support sound and ethical business practices.

### **Principle 2.3 Sustainability Issues, Including Social and Environmental Problems**

ICGN believes that the board should take a leadership role in establishing a framework for risk management including social and environmental considerations. Companies have an obligation to shareholders and stakeholders to disclose company policies when asked and to demonstrate effective company monitoring and oversight of environmental and social matters. Long-term investors committed to responsible investment routinely monitor company actions with respect to their triple bottom line performance- based on company disclosure of financial, environmental and social metrics.

### **Principle 2.4 Ensuring Diversity, Including Active Participation of Women**

The ICGN has taken a definitive stance on the inclusion and participation of women in the boardroom to foster diversity and improved board governance. In 2013, the ICGN Statement on Gender Diversity in the Boardroom was published. As a follow up to this important Statement, the Shareholder Responsibility Committee is undertaking a review of best practices to foster great diversity in the boardroom beyond gender. As a principle ICGN believes that diversity should explicitly refer to boards as a role model within the company and embrace global talent. A diversity principle should explicitly refer to boards of directors, not just employees and embrace the use of global talent that includes women and individuals with diverse backgrounds.

### **Principle 2.5 Whistleblowing**

ICGN believes that it is imperative for companies to establish appropriate procedures to allow for circumstances of whistleblowing, even where local law does not provide equitable protection for all whistleblowers. The board should require that management encourages employees to report illegal or inappropriate executive behavior without fear of retaliation, unfavorable treatment or firing. It is vital for independent directors to be named to a specially designated review committee or panel in order to maintain the confidentiality of the whistleblower.

## **Section 3: Ensuring Appropriate Information Disclosure and Transparency**

### **Principle 3.1 Full Disclosure**

ICGN applauds the inclusion of full disclosure within the Code to ensure effective corporate governance and enhance transparency. In addition, ICGN and its membership would appreciate the translation into English as Principle 3.1.2 provides.

### **Principle 3.2 External Auditors**

ICGN believes that it is imperative for investors to understand how the board undertakes the selection and tenure of the external auditor, who should have the independence, necessary qualifications and sufficient experience to fulfill their responsibilities. Any misstatements, restatements or concerns in financial records should be responded to by the board, which, in turn, should explain to shareholders how the financial issues have been handled immediately or contained and resolved.

The board should also explain the course ahead to ensure that it does not occur in the future. Every investor has the right to accurate financial information in the company in which he or she invests. It is critical that the internal audit and risk management systems function effectively in these challenging times.

#### **Section 4: Responsibilities of the Board**

##### **Principle 4.1 Roles and Responsibilities of the Board (1)**

ICGN concurs that the board should set its own goals and company strategic direction, so that long-term value creation may be achieved for its shareholders. By complying with the corporate governance code the focus of the listed companies will be on the framework of effective oversight and keeping the management forthcoming to deliver the best (business) results for long-term shareholders and other stakeholders. As mentioned in Principle 4.1.3, ICGN agrees that succession planning for the CEO and other top executives is very important. We suggest that board-terms are considered to encourage board refreshment, and that nominating committees cast a wide net to consider diverse candidates.

##### **Principle 4.2 Roles and Responsibilities of the Board (2)**

ICGN agrees that there is a certain level of risk in today's business environment and a board must rely on senior management to take care of day to day business issues. The executive remuneration plan should be designed to incentivise appropriate behavior in the long term interests of the company and its long term shareholders. This pay structure should be properly disclosed to shareholders, including any stock and cash payments and other incentives which tie to the company's growth over time. The complete remuneration structure of the company, board and senior management, should emphasize the alignment of shareholder and company interests.

##### **Principle 4.3 Roles and Responsibilities of the Board (3)**

ICGN agrees that the board should provide effective oversight of senior management. There should be a regular board level review and evaluation of set goals and measures, so that shorter duration and longer-term objectives for management are met.

##### **Principle 4.4 Roles and Responsibilities of *Kansayaku* and the *Kansayaku* Board**

ICGN agrees that the *Kansayaku* and the *Kansayaku* board are fiduciaries to the shareholders. As such, they should make decisions from an independent and objective point of view in the best interests of shareholders. If possible within the legal framework, the *Kansayaku* board members should inform shareholders about the considerations for the decisions that were made.

##### **Principle 4.5 Fiduciary Responsibilities of Directors and *Kansayaku***

ICGN agrees that directors, the *Kansayaku* members and management should work together as fiduciaries of the company's shareholders.

#### **Principle 4.6 Business Execution and Oversight of the Management**

ICGN believes that robust board composition is vital to the proper execution of business and effective management oversight. Companies should strive to find fully qualified, independent directors who are diverse and yet complement each other in order to, provide investors with a greater degree of confidence that business decisions are in their investors' best interests.

#### **Principle 4.7 Roles and Responsibilities of Independent Directors**

ICGN agrees that companies should make effective use of independent directors. While there are four items listed as appropriate roles for independent directors, ICGN believes that this not an exhaustive list. Independent directors should be able to participate fully in the affairs of the company.

#### **Principle 4.8 Effective Use of Independent Directors**

The ICGN is pleased with inclusion of two specific Principles that address the role and responsibilities of independent directors. It is the ICGN's position that independent directors are vital to a board's ability to consider multiple viewpoints on board matters. While the Principle states that companies should appoint at least two independent directors, ICGN does not believe this is sufficient to provide a critical mass of independent oversight. Therefore, we would call for a minimum of three, not two, independent directors; moreover, we think the board should be a minimum of one-third independent directors. We also note, as a body with a global perspective on corporate governance, that our expectations for board independence across other developed markets are notably higher than those currently proposed in Japan, and in many jurisdictions globally we call for boards with majority independence. We suggest that the Code call for companies to aim for higher rates of board independence over the years to coincide with expiry of board terms and the changing needs of their business. For example, we would suggest scheduling an independence evaluation within four years to determine whether positive change has occurred.

The Principle further mentions that if a company believes that it needs at least one-third of directors as independent directors, it qualifies the requirement by limiting the appointment of directors to those that have certain qualities that the company, in its own judgment, believes it needs to appoint, similar to a board skills matrix, but after the company discloses a "roadmap" for doing so. We recognise that independent directors should have experience and qualifications that add to the board dynamic. However, board members with objectivity and a lack of self-interest are essential for global investors. Therefore we would also encourage one-third board independence as a minimum standard. We also advise that the board, and not management, should be the ultimate authority to approve the board skills matrix.

#### **Principle 4.9 Independence Standards and Qualification for Independent Directors**

ICGN agrees that boards should establish independence standards. However, a number of jurisdictions have already opined on independence and therefore it would be useful for the Code to set forth some basic definition of independence, as reflected in the criteria set by the securities exchanges and the Tokyo Stock

Exchange. Investors would like to know why a company would need to set different levels of independence for its directors.

#### **Principle 4.10 Use of Optional Approach**

As noted in the ICGN Global Governance Principles and in codes of best practice in many other markets, board committees are a common feature of boards and should be made up of, at a minimum, of a clear majority of independent directors, especially for Nomination, Remuneration and Audit committees. Moreover it is good practice in many developed markets for Audit committees to be entirely independent. If majority or full independent status is not achieved, it is important for the company to explain why it is not able to achieve this level of director independence to its investors, and to explain how and when it intends to move toward director independence.

The ICGN appreciates that Japan has its own distinct approach to the use of committees in the corporate governance process. Specifically, we recognize that the *Kansayaku* system does not readily accommodate committee structures as they exist in differing jurisdictions globally. We interpret the possibility of forming optional committees as a way for *Kansayaku* boards to provide greater opportunities for independent directors in important areas such as nomination and remuneration. If this is the case we believe it would be useful for such committees to have clearer legal recognition and accountability. We believe the “comply or explain” standard should also apply to circumstances that fall within Principle 4.10.

One other suggestion would be to call for the creation of a committee made up of independent directors to address audit or financial concerns, investigations, and other situations where investors would need a fully independent review of the company’s actions. The “comply or explain” standard would apply under these circumstances as well. This action would potentially alleviate the appearance of a conflict of interest with directors who are considered affiliated with the company.

#### **Principle 4.11 Preconditions for Board and *Kansayaku* Board Effectiveness**

ICGN agrees with this principle as described in the Exposure Draft.

#### **Principle 4.12 Active Board Deliberations**

ICGN agrees that every board should foster a climate in which all board members are able to exchange views, provide an open and constructive dialogue among all the members, including any outside or independent directors. The board should also consider a self-evaluation process to make sure that all board members are fit for the job and are confident in the board’s deliberations. Periodically, every four years, the board could also use outside counsel for evaluation of the decision-making process and the self-evaluation. This encourages active participation by all board members.

#### **Principle 4.13 Information Gathering and Support Structure**

ICGN believes that directors should require that management provide them with the information they need to make informed decisions. ICGN supports the use of external consultants, when necessary, to provide the board with outside perspectives that may be essential to the company. Any coordination that is addressed in Principle 4.13 should be done in a fair and equitable manner so that the information is shared accurately and on a timely basis.

#### **Principle 4.14 Director and *Kansayaku* Training**

ICGN agrees that training for new directors is essential and should be encouraged. It is also important that sitting directors, on a regular basis, be exposed to educational sessions in which trends, new regulations and global developments can be presented.

### **Section 5: Dialogue with Shareholders**

#### **Principle 5.1 Policy for Constructive Dialogue with Shareholders**

In last year's *Ito Review*, with its emphasis on competitiveness and incentives for sustainable growth through building favorable relationships between companies and investors, Japan took a major step forward in recognizing the value of dialogue between companies and shareholders.

One study was featured that demonstrated the role that relationships play in company performance. In the findings, the report determined that:

“Companies that displayed strong performance during this tough period had the following shared characteristics: 1) pricing power through differentiation and providing value to customers; 2) a relentless focus on generating an indispensable position and business portfolio optimization; 3) continuous open innovation including collaboration with other companies; and 4) a fearlessness towards change and the ability to rationally and proactively carry out reforms as part of that change.” (The ITO Review of Competitiveness and Incentives for Sustainable Growth– Building Favorable Relationships between Companies and Investors Interim Report Executive Summary, p.1).

The reports showed that in order for Japanese companies to thrive and return value for their investors they must embrace change and enhance collaboration with investors and other stakeholders. In addition, the ICGN was pleased to note that the report recommended the engagement of company executives and directors by investors. ICGN supports engagement and disclosure, building networks within the investor community, and annual shareholder meetings as a forum for dialogue as well.

The ICGN is an organisation that was founded to inspire and promote effective corporate governance standards across the world. A “true dialogue” is one in which there is mutual respect and understanding, which can be achieved over the course of time and effort. A long-term relationship between the company and its investors will benefit all stakeholders.

#### **Principle 5.2 Establishing and Disclosing Business Strategy and Business Plan**

ICGN agrees that shareholders should receive information from the company on its business strategies, plans, targets for profitability and capital expenditures.

Thank you for the opportunity to provide comments to the Exposure Draft. Should you wish to discuss our comments further, please contact George Dallas, ICGN's Policy Director, by email at [george.dallas@icgn.org](mailto:george.dallas@icgn.org).

Yours faithfully,

Erik Breen  
Chair, ICGN Board

Cc:  
Kerrie Waring, Managing Director, ICGN  
Carol Drake, Co-chair, ICGN Shareholder Responsibilities Committee  
Niels Lemmers, Co-chair, ICGN Shareholder Responsibilities Committee