



ICGN

International Corporate Governance Network

Tokyo Stock Exchange (TSE),
2-1 Nihonbashi Kabutocho
Chuo-ku 103-0026
Tokyo
Japan

Via email: jojo-kikaku@jpx.co.jp

15 February 2017

Dear Sirs,

RE: Survey on the System of Outside Directors under the Companies Act of Japan

The International Corporate Governance Network (ICGN) welcomes the opportunity to respond to the Tokyo Stock Exchange (TSE) survey on the system of outside directors in Japan.

ICGN's mission is to promote high standards of governance in companies and responsible investment practices by investors, with a long-term perspective on sustainable value creation. This mission extends systematically to promoting efficient financial markets and economies world-wide. ICGN was established over 20 years ago, and today our membership of governance professionals spans over 45 countries, and include investors representing assets under management in excess of US\$26 trillion. Many of our members have significant investment holdings in Japanese companies.

Our policy positions are guided by the ICGN Global Governance Principles and the ICGN Global Stewardship Principles both of which have been developed in consultation with ICGN Members and as part of a wider peer review. We are pleased to offer our comments and observations in accordance with your request.

Q1. Should all listed companies be required to appoint outside directors?

We recognise that many TSE Listed companies now have at least one independent director however we would recommend that more encouragement is needed to increase this number. Normally, we believe this should be guided by a voluntary code rather than by hard law on a comply or explain basis. However, if improvements are not forthcoming within an appropriate time frame (e.g.; three years) then other enforcement means should be considered.

A firm recommendation in the TSE Listing Rules could be advantageous. We note that the New York Stock Exchange Listing Rules require there to be external directors. However ICGN also advocates that inclusion of an independence requirement in a Corporate Governance Code could also be effective as in the case of the UK.

Q2. Should "the person shall not be from any major client", which is a main requirement on independence, be an eligibility requirement for outside directors under the Companies Act?

Yes, ICGN believes that in the case of Japan there is merit in strengthening and clarifying this requirement. As a point of further clarification, an outside director who is also with a major client should not be regarded as independent in terms of the TSE listing rules. But, as noted in Question 1, in principle we would not object to such a director serving on the board if he or she is clearly designated as non-independent and adds value to the board. But in such a case this director should avoid participating in or having influence over client related issues that would present a conflict of interest.

Our normal stance is to prefer the adoption of such requirements as a Corporate Governance Code principle or as a Stock Exchange Listing Rule. However, conflicts of interest arising as a result of 'independent' directors being a former client of the company can be more prevalent in Japan.

The ICGN position on independence criteria as described in our Global Governance Principles is highlighted below:

"The board should identify in the annual report the names of the directors considered by the board to be independent and who are able to exercise independent judgement free from any external influence. The board should state its reasons if it determines that a director is independent notwithstanding the existence of relationships or circumstances which may appear relevant to its determination, including if the director:

- a) is or has been employed in an executive capacity by the company or a subsidiary and there has not been an appropriate period between ceasing such employment and serving on the board;
- b) is or has within an appropriate period been a partner, director or senior employee of a provider of material professional or contractual services to the company or any of its subsidiaries;
- c) receives or has received additional remuneration from the company apart from a director's fee, participates in the company's share option plan or a performance-related pay scheme, or is a member of the company's pension scheme;
- d) has or had close family ties with any of the company's advisers, directors or senior management;
- e) holds cross-directorships or has significant links with other directors through involvement in other companies or bodies;
- f) is a significant shareholder of the company, or an officer of, or otherwise associated with, a significant shareholder of the company;
- g) is or has been a nominee director as a representative of minority shareholders or the state;

has been a director of the company for such a period that his or her independence may have become compromised.

Q3. Please feel free to provide any other comments on the outside director system or corporate governance in Japan.

We applaud Japan's positive strides towards improving its corporate governance regime. Particularly since over 30% of TSE market capitalisation is held by overseas Investors, we think it is important for Japan to continue its ongoing governance reforms. We believe that most institutional investors outside of Japan, and many within Japan, would be pleased to see stronger listing requirements for independent non-executive directors.

However, it is important to mitigate the risk of superficial compliance in a "tick the box" context. In this regard, an alternative might be to create a subsection of the market (such as the distinction between a Premium Listing and a Standard Listing in the UK, or the Novo Mercado in Brazil) to differentiate those companies that are showing leadership in governance from those companies with limited compliance with the Code.

We would also advocate for better English language disclosure in annual reports regarding board nominees. This should include the names of the directors considered by the board to be independent and who are able to exercise independent judgement free from any external influence. This may help investors determine the 'quality' as well as the 'quantity' of independent board members being recommended. This should be accompanied by efforts to enhance diversity on the board overall which will have a positive impact on board effectiveness.

We hope our comments are useful to elaborate on our observations or to provide a view on the questions expressed in your consultation.

Once again we would like to congratulate the Department for leading this very important consultation and to please contact ICGN Policy Director George Dallas (george.dallas@icgn.org) if you have any questions or comments.

Yours faithfully,



Kerrie Waring
Executive Director, ICGN

Copy:
Erik Breen, Chairman, ICGN Board of Governors