



ICGN

International Corporate Governance Network

20th Council of Experts

Follow-up of Japan's Stewardship Code and Japan's Corporate Governance Code

20th October 2020

Dear Fellow Council Members,

ICGN Statement to the Council of Experts for the Follow-up of Japan's Stewardship Code and Japan's Corporate Governance Code (the "Council")

I have pleasure in sending you ICGN's comments on the items noted in the Agenda for the next Council Meeting which will take place on 20th October 2020. Regretfully, I will not be able to join you in person on this occasion and hope that the comments presented in this letter can serve as a contribution to the Council's discussion.

Led by investors responsible for assets under management of USD\$54 trillion, ICGN is a leading authority on global standards of corporate governance and investor stewardship. Our membership includes business leaders and institutional investors who have a shared interest - and thus a shared responsibility - in promoting the success of companies to preserve and enhance long-term value, contributing to strong economies and healthy societies.

ICGN's mission supports this shared responsibility, as advocated in the ICGN Global Stewardship Principles¹ and the ICGN Global Governance Principles², the latter of which is currently subject to Member consultation as part of a three-year review cycle. Our comments forthwith are therefore guided by ICGN Principles and largely written from the perspective of the global institutional investor community.

COVID-19 and Corporate Governance

ICGN understands that the first meeting of the Council is to assess the economic and social challenges brought about by the COVID-19 and how this impacts corporate governance.

The COVID pandemic presents the most significant public health and economic crisis of our time and calls for new forms of cooperation on a global scale. In response, ICGN published a letter to corporate leaders³ in April in the spirit of solidarity to provide an agenda for dialogue with investors as we navigate this unprecedented challenge together. This agenda elevates the importance of social factors as a key determinant to a company's long-term financial health and sustainability and respectfully suggests broad priorities companies might consider while dealing with the crisis. These include:

¹ ICGN Global Stewardship Principles, 2020: https://www.icgn.org/sites/default/files/ICGN%20Global%20Stewardship%20Principles%202020_0.pdf

² ICGN Global Governance Principles, 2017: http://icgn.flpbks.com/icgn_global_governance_principles/

³ ICGN letter to corporate leaders (English), April 2020: https://www.icgn.org/sites/default/files/6.%20ICGN%20Letter%20to%20Corporate%20Leaders_23%20April%202020_0.pdf
Japanese version: https://www.icgn.org/sites/default/files/6a.ICGN%20Letter%20to%20Corporate%20Leaders_23%20April%202020_Japanese%20version.pdf

- Ensuring employee safety and welfare while meeting short-term liquidity requirements to preserve financial health and solvency;
- Pursuing a long-term view on social responsibility, fairness and sustainable value creation and publicly defining a social purpose as we all adjust to a new reality;
- Taking a holistic and equitable approach to capital allocation decisions, considering the workforce, stakeholders and providers of capital; and
- Communicating comprehensively with all stakeholders to instil confidence and trust in a company's approach to building resilience into strategy and operations.

We published a statement of shared responsibilities for companies and investors alike which addresses the above points and organised a series of webinars, the summaries of which are available on the ICGN website.⁴

Japan's Corporate Governance Code Priorities

The Council has articulated priorities for consideration as part of the review of Japan's Corporate Governance Code. These subjects are identified by the Japan FSA as follows:

1. Cost of capital and capital efficiency
2. Board effectiveness, including independence and diversity
3. Sustainability
4. Ensuring confidence in audits
5. Governance of group subsidiaries

ICGN has already opined on these subjects in our contribution to previous Council meetings which we will reiterate in due course. We also published a series of Japan related policy priorities at the ICGN Annual Conference, hosted by the Japan Exchange Group in July 2019 and which we have taken the liberty of providing as an annex to this letter.

We agree that the aforementioned subjects are important, and we look forward to opining further on these matters. Additionally, we respectfully suggest that the Council considers three further matters being: (1) timing of publication of the securities report, (2) annual general meetings, and (3) human capital management.

Timing of publication of the Securities Report

The Securities Report (Yuho) includes valuable information for investors around the business model, corporate strategy, audited financial results, Key Audit Matters and other corporate governance related information such as cross-shareholdings. The Yuho should therefore be published pre-AGM, not post. Companies listed in TSE prime market should make both English translated Securities Report and Notice of AGM.

Our Japan related policy priorities (provided in the annex) encourage companies to move their respective record dates from March to April to allow AGMs to be held in July. Not only will this lead to less AGM clustering, but this will also give companies additional time to prepare the abovementioned materials in English before the AGM.

⁴ The Evolving Social Contract & Covid-19 Webinar Series, 2020: <https://www.icgn.org/events/webinars/evolving-social-contract-covid-19-webinar-series>

Annual General Meetings (AGM)

The AGM is an important forum for shareholders to hold the board and management accountable for preserving and enhancing long-term corporate value. Ideally AGMs should allow for the physical presence of participants, including provision for voting electronically by proxy, and ensure live interaction is possible between shareholders and the board and management.

During the COVID crisis, virtual-only AGMs have become the 'new normal' and has led to emergency legislation being enacted in multiple markets to allow companies to seek shareholder approval on things like dividend proposals, share issuance authorisations, director elections and auditor appointments. Hybrid AGM's have also been popular which allows for both physical and virtual presence by participants via 'live streaming' of the AGM proceedings accessible via the internet.

While ICGN Members recognise the need for hybrid and virtual-only AGMs in this current environment, we encourage regulators to ensure that shareholder rights are not infringed so as not to restrict their ability to hold companies properly to account. Certain minimum shareholder rights should be guaranteed to allow for robust challenge of boards and management through interactive and unmoderated questioning or statements made by shareholders to have meaningful dialogue on contentious proposals.

When holding a hybrid or virtual-only AGM, we strongly encourage companies to ensure interactivity with shareholders and to replicate as best as possible the in-person AGM experience. In doing so companies might consider the following as an optimal format as described in a Viewpoint from the ICGN Shareholder Rights Committee:⁵

- Publish AGM information at least one month ahead of the meeting, including the meeting format and procedures around registration, access, participant identification, shareholding verification and voting options.
- Use video technology as well as audio technology to allow for facial expression to be shown.
- Allow participants to ask questions and make statements – in advance and during the AGM – and allow for follow up questions and statements if necessary.
- Record and respond to all questions and made such responses promptly publicly available (avoid legalistic language).
- Enable participants to be able to cast votes live, noting all matters on the ballot should be voted by poll.
- Ensure accuracy of tracking and reconciling any advance votes received pre-AGM with any live votes cast during the AGM itself.

Disclosure around human capital management

The COVID-19 pandemic has exposed deep social inequalities, for example in terms of income, gender or race. ICGN Members are increasingly addressing these issues with companies including:

⁵ The Future of Annual General Meetings, ICGN Viewpoint, September 2020: <https://www.icgn.org/future-annual-general-meetings>

- health and safety especially in industries where human interactivity is high,
- diversity noting the disproportionate number of female redundancies,
- anti-discrimination policies and practices,
- human rights in the supply chain,
- staff training as companies have transitioned their operations to a virtual and socially distanced world, and
- income inequality to ensure ordinary employees are treated fairly in terms of pay, bonus, pension and other benefits, e.g., access to medical insurance.

Many ICGN Members are calling on regulators to require companies to publish better information around how human capital is managed as part of a longer-term strategy for value creation. ICGN recently issued a letter⁶ to support a coalition of our Members who had formed the Human Capital Management Coalition which called on the United States Securities and Exchange Commission (US SEC) to require companies to disclose information about their human capital policies, practices and performance.

We subsequently welcomed, a change of reporting rules by the US SEC to require companies to report 'material' human capital objectives. This is a helpful first step and we encourage the US SEC and other regulators to continue to require companies to provide more transparency around human capital management, particularly on things like workforce stability, total workforce costs and ethnic/racial diversity across different employee levels.

Thank you for this opportunity to provide commentary for the Council meeting and we look forward to the continued deliberations.

Yours faithfully,



Kerrie Waring
Chief Executive Officer

⁶ ICGN letter to US Securities and Exchange Commission, 26 August 2020:
<https://www.icgn.org/sites/default/files/12.%20ICGN%20Letter%20Reg%20S-K%20to%20%20SEC.pdf>

Annex: ICGN Policy Priorities: Japan *With Summary Japanese Translation*

As discussed at the ICGN Annual Conference, hosted by the Tokyo Stock Exchange, taking place between 16-18 July 2019.

ICGN Policy Priorities: Japan

1. Corporate reporting

ICGN welcomes the reforms proposed in the Report of the Disclosure Working Group convened by the Financial Services Agency which includes recommendations to enhance financial and narrative information and the reliability and timeliness of corporate reporting. Other matters of concern to ICGN members include:

- **AGM Clustering:** While the issue of AGM concentration in Japan has improved since the 1990s, many companies maintain a March fiscal year end with subsequent meetings in June. This clustering of AGM's, often within a few days in the last week of June, causes difficulties for investors to allocate appropriate time to read annual reports and make voting decisions.
- **AGM notifications:** Notices are issued on average 19 days in advance of the meeting taking place in Japan – compared to international best practice of 30 days.
- **Timing of Securities Report:** The Securities Report (Yuho) is published post AGM despite the fact that it includes valuable information for investors around the business model, corporate strategy, audited financial results, Key Audit Matters and other corporate governance related information such as cross-shareholdings.
- **English language:** As of May 2019, 40% of companies issued English AGM Notices this year and the Securities Report is often not published in English, despite companies wishing to attract overseas capital.

Recommendation: 1) AGM Notices and the Securities Report should be issued at least 30 days in advance of the AGM; (2) Companies should move their respective record dates from March to April to the allow AGMs to be held in July; and (3) Companies listed in TSE section 1 should make both English translated Securities Report and Notice of AGM

2. Board independence

Independent Directors are relied upon by investors to bring their industry knowledge and experience to the Board to assess the quality of managerial decisions, for example relating to strategic investments in fixed assets, acquisitions, research and development and human resources. ICGN welcomes that over 90% of 1st Section JPX listed companies now have two or more independent directors and 33% of companies have one-third. ICGN encourages further progress towards a majority of independent directors on Japanese boards, or at least one-third.

ICGN Members comment that it is difficult to determine the extent to which a director is independent in Japan. Further clarity around the definition of independence in the JPX Listing Rules might be helpful in this regard, for example around issues such as cross-shareholdings, major client and supplier relationships, business relationships, the provision of consultancy services and family ties. There should also be clarity around how long any conflicts should be absent before a candidate can be considered independent.

Often in Japan board directors are promoted from within the company and this has become a symbol of career progression. Furthermore, is no reference to how independent directors are nominated and appointed in Japan's Corporate Governance Code and the process is therefore often opaque. More disclosure around the process would be helpful along with the rationale for director selection.

Recommendation: (1) Listed company boards should comprise one-third independent directors, or preferably a majority of independent directors particularly in subsidiary companies. (2) Enhance the definition regarding the factors which impact a directors' independence in the TSE Listing Rules, aligned with international best practice. (3) Companies should disclose clear procedures and disclosure around the rationale for individual director appointments including how their experience aligns with company strategy and any factors affecting their independence.

3. Board evaluation and nomination committees

ICGN advocates that board evaluation (collectively, individually and for the Chairman) should take place annually by the board itself and periodically (e.g. every three years) by an external evaluator. A 'skills matrix' which maps the experience of the current board with the company's long-term strategic needs can be a helpful tool to aid the board evaluation process.

The board evaluation should be led by a Nomination Committee comprised of independent chair and a majority of independent directors. Outcomes from the board evaluation can help to inform the types of candidates of strategic relevance to the company

Recommendation: (1) All listed companies (not just those with a three-committee structure) should establish a Nomination Committee comprised of independent chair and a majority of independent directors. (2) Listed company boards should be subject to periodic external board evaluation and director tenure should be contingent on individual performance and annual re-election premised on satisfactory evaluations of his or her contribution to the board. (3) Board evaluation disclosure should include the process for board evaluation and any material issues of relevance arising from the conclusions.

4. Executive pay and remuneration committees

ICGN welcomes improvement to regulations for corporate disclosure on executive pay in January this year and also welcome reference in Japan's Corporate Governance Code under principle 4.2.1 regarding the board's role to determine executive remuneration through 'objective and transparent procedures.' We understand that 46% of 1st section JPX listed companies have a Remuneration Committee – up from 13% in 2015. The Committee should be responsible for establishing clear remuneration policies and reports which are aligned with the company's long-term strategic objectives and executive key performance indicators and progress towards achieving such indicators.

Regarding remuneration related disclosure, the board should disclose who is responsible for setting executive pay, the process for remuneration setting, rationale for individual levels and how it fits within the overall context of the company's human resource strategy. We note that the current rule in Japan only requires disclosure of individual remuneration above YEN 100 million (£700,000) which may create an artificial ceiling on pay levels.

Recommendation: (1) Listed companies to establish a Remuneration Committee comprised of independent chair and a majority of independent directors. (2) The rule requiring disclosure of individual remuneration in excess of YEN 100 million should be abolished. (3) A new rule to require

disclosure of CEO and senior executive pay on an individual basis and annually should be introduced. The disclosure should include the proportions of fixed pay, bonus and long-term incentives. This extends to non-cash items such as director and officer insurance, pension provisions, fringe benefits and terms of severance packages if any.

5. Capital efficiency and cross-shareholdings

ICGN notes that progress has been made since the minimum target of 8% return on equity (RoE) was introduced in the Ito Review in 2014 to a median of 11.5%. Whilst setting profitability targets are important, the rationale for targets and what progress is being made towards achieving them as part of a longer-term capital allocation strategy is of more interest to investors. For example, this includes information in relation to acquiring new businesses, making large capital investments, discontinuing existing businesses and research and development expenditure. ICGN members are likely to vote against management if RoE is less than expected over a prolonged period and not expected to improve.

Regarding cross-shareholdings, ICGN welcomed the revisions to Japan's Corporate Governance Code last year requiring companies to disclose their policies and rationale for cross-shareholdings as well as an annual assessment of the costs and benefits and how that impacts a company's cost of capital. However, we understand that cross-shareholdings are still high in companies as a proportion of overall shares with voting rights, despite the progress that has been made in Japan's banking sector. It is important that Issuer Companies do not prevent companies in receipt of cross-shareholding to sell through tactics employed to threaten trading relationships. Cross shareholdings impede shareholder rights and business relationships are prioritized over proper corporate governance practices at the expense of asset efficiency.

Recommendation: (1) Japanese companies should improve disclosure to shareholders on the company's capital policy which would highlight the Board's risk appetite and understanding of the company's cost of capital. (2) Companies should disclose a target to reduce their cross shareholdings over a specified period including their policies; and the nature of the cross-shareholding, for example if they are a parent company, subsidiary, supplier.

ICGN 重点方針（日本）＜要約版＞

ICGN（International Corporate Governance Network）はグローバルの機関投資家を主体とする組織（事務局：英国ロンドン）であり、効率的な市場と持続的な経済の促進に向け、実効的なコーポレートガバナンスの構築と投資家のスチュワードシップの醸成を目的としています。1995年に設立され、会員の運用資産合計金額は34兆米ドル（国別では45か国以上）、主要なグローバルの年金基金と大手運用会社が加盟しています。

ICGNでは、毎年、グローバルベースの「重点方針」の策定・見直しを行っていますが、今回、東京で開催されたICGN年次総会（7/16-18）の議論をより実りあるものとするため、国・地域別の「重点方針（日本）」をはじめて策定しました。今後とも、ICGN年次総会が開催される国・地域において（国・地域別の）重点方針を策定する予定です。

なお、本資料は“ICGN Policy Priorities”の日本語訳（要約版）となります。原文は、以下のリンクをご活用ください。

プレス資料 https://www.icgn.org/sites/default/files/2_AGREED_Policy%20Priorities_Japan.pdf 原文 https://www.icgn.org/sites/default/files/ICGN%20Policy%20Positions_Japan.pdf

ICGN 重点方針：日本＞ 重点方針は、以下の 5 項目から構成されます。

1. 企業報告 上場企業は、株主総会の少なくとも 30 日前までに株主総会の招集通知と有価証券報告書を発行すべきである。(3 月決算の場合) 株主総会の基準日を 3 月から 4 月に変更し、株主総会の 7 月開催を可能とすべきである。東証 1 部上場企業は、英文の有価証券報告書と株主総会の招集通知を作成すべきである。
2. 取締役会の独立性 取締役会の構成において、1/3 以上、望ましくは過半数以上(上場子会社のような場合)の独立社外取締役が設置されるべきである。国際的なベストプラクティスを参考に東証の独立性基準をより充実すべきである。また、取締役選任に関する透明性のあるプロセスの開示とともに、個々の取締役が企業戦略に沿った形で適切に選任されているか等の取締役選任に関する根拠や独立性において問題がないか、といった事項も開示されるべきである。
3. 取締役会評価と指名委員会 上場企業は、議長と構成員の過半数を独立社外取締役とする指名委員会を設置すべきである。定期的に、外部評価者も入れた取締役会評価を行うべきであり、取締役就任期間(再任)については、個々の取締役の活動と取締役会に対する貢献への十分な評価に基づき決められるべきである。取締役会評価の開示には、評価プロセスとともに、評価の結果として認識された重要な事項も含まれるべきである。
4. 役員報酬と報酬委員会 上場企業は、議長と構成員の過半数を独立社外取締役とする報酬委員会を設置すべきである。役員報酬の開示においては、1 億円以上の制限を撤廃し、CEO や経営陣の報酬の個別開示が毎年実施される仕組みの導入が行われるべきである。また、固定報酬・ボーナス・長期インセンティブは区分された形で開示され、開示内容となる報酬の対象には、役員保険、年金、退職金などの非金銭的な報酬も含まれるべきである。
5. 資本効率と政策保有株 「資本政策」についての株主への説明内容は改善されるべきである。また、その策定にあたっては、リスクや資本コストについての取締役会の認識を反映すべきである。上場企業は、政策保有株削減に関する方針の策定とともに、削減目標(期限を決めた上で)と政策保有株継続保有の理由の詳細な開示を行うべきである。

2019 年 7 月

以上