

Preambles etc. of Corporate Governance Codes of Other Countries

September 4, 2014

2. Explanation of Corporate Governance 1/4

Japan Revitalization Strategy Revised in 2014 (abridged)

Approved at a Cabinet meeting on June 24, 2014

Part Two: Three Action Plans

I.1.3.i-1 Drafting the Corporate Governance Code

Corporate governance the system which supports companies making timely entrepreneurial decisions with transparency and integrity and with due regards to the views of shareholders as well as customers, employees, local communities and other stakeholders. Principles outlining key elements of good governance should help companies' initiatives towards sustainable growth of their corporate values and would thereby contribute to the prosperity of the companies themselves, investors and, ultimately, the whole economy.

● The OECD Principles of Corporate Governance

... Corporate governance is one key element in improving economic efficiency and growth as well as enhancing investor confidence. Corporate governance involves a set of relationships between a company's management, its board, its shareholders and other stakeholders. Corporate governance also provides the structure through which the objectives of the company are set, and the means of attaining those objectives and monitoring performance are determined.

2. Explanation of Corporate Governance 2/4

● OECD Principles of Corporate Governance

(continued from the previous page) Good corporate governance should provide proper incentives for the board and management to pursue objectives that are in the interests of the company and its shareholders and should facilitate effective monitoring. The presence of an effective corporate governance system, within an individual company and across an economy as a whole, helps to provide a degree of confidence that is necessary for the proper functioning of a market economy. As a result, the cost of capital is lower and firms are encouraged to use resources more efficiently, thereby underpinning growth.

【Paragraph 2】

The degree to which corporations observe basic principles of good corporate governance is an increasingly important factor for investment decisions. Of particular relevance is the relation between corporate governance practices and the increasingly international character of investment. ... Even if corporations do not rely primarily on foreign sources of capital, adherence to good corporate governance practices will help improve the confidence of domestic investors, reduce the cost of capital, underpin the good functioning of financial markets, and ultimately induce more stable sources of financing.

【Paragraph 6】

2. Explanation of Corporate Governance 3/4

● The UK Corporate Governance Code

The purpose of corporate governance is to facilitate effective, entrepreneurial and prudent management that can deliver the long-term success of the company.

... Corporate governance is the system by which companies are directed and controlled. ...

Corporate governance is therefore about what the board of a company does and how it sets the values of the company, and is to be distinguished from the day to day operational management of the company by full-time executives.

【Paragraphs 1-3 of “Governance and the Code”】

2. Explanation of Corporate Governance 4/4

● Japan's Stewardship Code

At a company, the board of directors has the responsibility to enhance the corporate value by exerting adequate governance and proper oversight on the management, taking decisions on key policy and business matters. The function of the board and that of institutional investors as defined in the Code are complementary and both form essential elements of high-quality corporate governance, which are indispensable in ensuring the sustainable growth of the company and the medium- to long-term investment return for the clients and beneficiaries.

【Paragraph 5】

● TSE “Principles of Corporate Governance for Listed Companies”

Corporate governance is generally defined as the framework for disciplining corporate activities. Most corporate activities have been undertaken principally with a view to generating revenue and thereby enhance the corporate value to shareholders. In expecting the listed companies to generate such performance on a continuous basis, it inevitably becomes necessary to motivate or monitor the management accordingly through a framework for disciplining corporate activities, namely corporate governance.

In other words, the appropriate operation of corporate governance for listed companies is a vitally fundamental demand for enhancing corporate value on a continuous basis, and the underlying aims of corporate governance are to provide an environment for such enhancement.

【Paragraphs 1 and 2】₄

3. Explanation of Stock Corporation System 1/2

● German Corporate Governance Code

A dual board system is prescribed by law for German stock corporations.

The Management Board is responsible for managing the enterprise. Its members are jointly accountable for the management of the enterprise. The Chairman of the Management Board coordinates the work of the Management Board.

The Supervisory Board appoints, supervises and advises the members of the Management Board and is directly involved in decisions of fundamental importance to the enterprise. The chairman of the Supervisory Board coordinates the work of the Supervisory Board.

The members of the Supervisory Board are elected by the shareholders at the General Meeting. In enterprises having more than 500 or 2 000 employees in Germany, employees are also represented in the Supervisory Board, which then is composed of employee representatives to one third or to one half respectively. For enterprises with more than 2 000 employees, the Chairman of the Supervisory Board, who, for all practical purposes, is a representative of the shareholders, has the casting vote in the case of split resolutions. The representatives elected by the shareholders and the representatives of the employees are equally obliged to act in the enterprise's best interests.

3. Explanation of Stock Corporation System 2/2

● France “Corporate Governance Code of Listed Corporations”

French law offers an option between a unitary formula (Board of Directors) and a two-tier formula (Supervisory Board and Management Board) for all corporations.

In addition, corporations with Boards of Directors have an option between separation of the offices of Chairman and Chief Executive Officer and maintenance of the aggregation of such duties. The law does not favour either formula and allows the Board of Directors to choose between the two forms of exercise of executive management. It is up to each corporation to decide on the basis of its own specific constraints. When a corporation opts for separation of the offices of Chairman and Chief Executive Officer, if appropriate, the tasks entrusted to the Chairman of the Board of directors in addition to those conferred upon him or her by law must be described.

French public limited companies (sociétés anonymes) accordingly can choose from three forms of organisation of management and supervisory powers.

【Although there are no such descriptions in Preamble, Article 3-1 contains the above quote.】

4. Explanation of ‘Principles-based’ 1/2

● OECD Principles of Corporate Governance

It was agreed that the revision should be pursued with a view to maintaining a non-binding principles-based approach, which recognises the need to adapt implementation to varying legal economic and cultural circumstances.

【Although there are no such descriptions in Preamble, Paragraph 4 of the opening statement contains the above quote.】

● The UK Corporate Governance Code

The FRC’s review of the implementation of the Code in 2011 reinforced the two principal conclusions reported in the preface to the 2010 edition. First, that much more attention needed to be paid to following the spirit of the Code as well as its letter. ...

... [The FRC made] limited but significant changes to signal the importance of the general principles which should guide board behaviours. It is to be hoped that these changes will promote greater clarity and understanding with regard to the tasks of a board and that communication with shareholders will be more effective as a result.

【Paragraphs 1 and 5 of the “Preface”】

4. Explanation of ‘Principles-based’ 2/2

● Japan’s Stewardship Code

The principles in the Code should be applied in a manner suited to each institutional investor’s specific conditions and situations. For example, the manner in which the Code is implemented may differ, depending on such factors as the investor’s size and investment policies (e.g., whether the policies are oriented toward long-term or short-term returns, or active or passive strategies).

To allow for such flexibility, the Code adopts a principles-based approach instead of a rule-based approach; a principles-based approach in this context expects institutional investors to fulfill their stewardship responsibilities focusing on substance, while a rule-based approach would prescribe actions to be taken by investors in detail.

A principles-based approach may not be well known in Japan yet and some elaboration, such as the following, may be in order: even if principles may look abstract and broad on the surface, they can work effectively if relevant parties confirm and share the aim and spirit of the principles, and review their activities against the aim and spirit, not necessarily against the letter of the principles. In implementing the Code, institutional investors should respect such intent of the principles-based approach.

The Code is not a law or a legally binding regulation. The Council expects those institutional investors who support the Code and are prepared to accept it to publicly disclose their intention.

【 Paragraphs 9-11 】

5. Explanation of ‘Comply or Explain’ 1/5

● OECD Principles of Corporate Governance

In several countries, companies must implement corporate governance principles set, or endorsed, by the listing authority with mandatory reporting on a “comply or explain” basis.

【Although there are no such descriptions in Preamble, V. A. 8 contains the above quote.】

● The UK Corporate Governance Code

The Code is not a rigid set of rules. It consists of principles (main and supporting) and provisions. The Listing Rules require companies to apply the Main Principles and report to shareholders on how they have done so. The principles are the core of the Code and the way in which they are applied should be the central question for a board as it determines how it is to operate according to the Code.

【Paragraphs 2 and 3 of “Comply or Explain”】

5. Explanation of ‘Comply or Explain’ 2/5

It is recognised that an alternative to following a provision may be justified in particular circumstances if good governance can be achieved by other means. A condition of doing so is that the reasons for it should be explained clearly and carefully to shareholders, who may wish to discuss the position with the company and whose voting intentions may be influenced as a result.

In providing an explanation, the company should aim to illustrate how its actual practices are consistent with the principle to which the particular provision relates, contribute to good governance and promote delivery of business objectives. It should set out the background, provide a clear rationale for the action it is taking, and describe any mitigating actions taken to address any additional risk and maintain conformity with the relevant principle. Where deviation from a particular provision is intended to be limited in time, the explanation should indicate when the company expects to conform with the provision.

【Paragraphs 2 and 3 of “Comply or Explain”】

5. Explanation of 'Comply or Explain' 3/5

● German Corporate Governance Code

The recommendations of the Code are marked in the text by use of the word "shall". Companies can deviate from them, but are then obliged to disclose this annually and to justify the deviations (comply or explain). This enables companies to reflect sector and enterprise-specific requirements. A well justified deviation from a Code recommendation may be in the interest of good corporate governance. Thus, the Code contributes to more flexibility and more self-regulation in the German corporate constitution. Furthermore, the Code contains suggestions which can be deviated from without disclosure; for this the Code uses the term "should". The remaining passages of the Code not marked by these terms contain descriptions of legal regulations and explanations.

【Paragraph 10】

5. Explanation of ‘Comply or Explain’ 4/5

● **France “Corporate Governance Code of Listed Corporations”**

Listed corporations referring to this Corporate Governance Code should report, with particulars, in their reference documents or in their annual reports, on implementation of these recommendations and, if applicable, provide an explanation of the reasons why they have deviated from any of them.

The explanation to be provided when a recommendation has not been applied must be comprehensible, relevant and detailed. It must be substantiated and adapted to the company's particular situation and must convincingly indicate why this specific aspect justifies an exemption; it must state the alternative measures that have been taken if applicable, and must describe the actions that allow the company to comply with the aims of the relevant measure within the code.

If a company intends to implement a recommendation in the future from which it has provisionally deviated, it must state when this temporary situation will come to an end. Companies must indicate in a specific section or table the recommendations that they have not implemented and the respective explanations.

5. Explanation of ‘Comply or Explain’ 5/5

● Japan’s Stewardship Code

The Code adopts the “comply or explain” (comply with the principles or explain why they are not complied with) approach. If an institutional investor finds that some of the principles of the Code are not suitable for it, then by explaining a sufficient reason, the investor can choose not to comply with them. In other words, an institutional investor who made its intention to accept the Code public does not have to comply with all of the principles uniformly. Institutional investors, when they make the aforementioned explanation, should aim to articulate to clients and beneficiaries the approach they chose to adopt in lieu of the principles they have decided not to comply with.

The “comply or explain” approach may not be well known in Japan yet either. Both institutional investors and clients and beneficiaries are encouraged to familiarize themselves with the approach. In particular, due regard should be paid to the specific situations of the institutional investors who made their intention to accept the Code public; it is not appropriate to focus on the letter of the Code and automatically consider that an investor who does not comply with a part of it is not fulfilling its stewardship responsibilities.

【Paragraphs 12 and 13】

6. Shareholders should not automatically give a negative evaluation to ‘Explain’

● The UK Corporate Governance Code

In their responses to explanations, shareholders should pay due regard to companies’ individual circumstances and bear in mind in particular the size and complexity of the company and the nature of the risks and challenges it faces. Whilst shareholders have every right to challenge companies’ explanations if they are unconvincing, they should not be evaluated in a mechanistic way and departures from the Code should not be automatically treated as breaches. Shareholders should be careful to respond to the statements from companies in a manner that supports the “comply or explain” process and bearing in mind the purpose of good corporate governance. They should put their views to the company and both parties should be prepared to discuss the position.

【 Paragraph 4 of “Comply or Explain”】

● Japan’s Stewardship Code

The “comply or explain” approach may not be well known in Japan yet either. Both institutional investors and clients and beneficiaries are encouraged to familiarize themselves with the approach. In particular, due regard should be paid to the specific situations of the institutional investors who made their intention to accept the Code public; it is not appropriate to focus on the letter of the Code and automatically consider that an investor who does not comply with a part of it is not fulfilling its stewardship responsibilities.

【Paragraph 13】

7. Applicable Scope of the Codes 1/3

● OECD Principles of Corporate Governance

The Principles focus on publicly traded companies, both financial and non-financial. However, to the extent they are deemed applicable, they might also be a useful tool to improve corporate governance in non-traded companies, for example, privately held and state-owned enterprises.

【Paragraph 1】

● The UK Corporate Governance Code

The new Code applies to accounting periods beginning on or after 1 October 2012 and applies to all companies with a Premium listing of equity shares regardless of whether they are incorporated in the UK or elsewhere.

【Paragraph 6 of “Governance and the Code”】

Smaller listed companies, in particular those new to listing, may judge that some of the provisions are disproportionate or less relevant in their case. Some of the provisions do not apply to companies below the FTSE 350. Such companies may nonetheless consider that it would be appropriate to adopt the approach in the Code and they are encouraged to do so. Externally managed investment companies typically have a different board structure which may affect the relevance of particular provisions; the Association of Investment Companies’ Corporate Governance Code and Guide can assist them in meeting their obligations under the Code.

【Paragraph 5 of “Comply or Explain”】

7. Applicable Scope of the Codes 2/3

● German Corporate Governance Code

Primarily, the Code addresses listed corporations and corporations with capital market access pursuant to Section 161 (1) sentence 2 of the Stock Corporation Act. It is recommended that companies not focused on the capital market also respect the Code.

【Paragraph 12】

(Note) Based on the fact that the definition in the Stock Corporation Act and the Stock Exchange Act is applied to the above-mentioned ‘listed corporations’ etc., it is understood that the Code is applicable to companies listed in ‘EU Regulated Markets’ in Germany.

● France “Corporate governance code of listed corporations”

These recommendations are aimed at those companies whose securities are admitted to trading on a regulated market. It is also advisable and recommended that other companies apply these recommendations in whole or in part while adapting them to their own specific features.

【Paragraphs 3 and 4】

7. Applicable Scope of the Codes 3/3

● **France “Middlenext Governance Code For Small and Midcaps”**

This code adapts these principles to Small and Midcaps. These principles may also be adopted by companies whose stock is not traded on regulated markets, and in particular by companies whose stock is traded on multilateral trading facilities (Alternext...), or by unlisted companies.

【Paragraph 1】

(Note) Footnote of the Code: Small and Midcaps are companies with stock market capitalisation of less than €1 billion: they are all the stocks in Segments B and C of Euronext (position of the Autorite des Marches Financiers (AMF) of 9 January 2008).

This process is in no way in opposition to that of the AFEP/MEDEF corporate governance code for listed companies. It offers an alternative for Small and Midcaps, as some of the recommendations in the AFEP/MEDEF code are not completely suited to such companies.

【Paragraph 2】

● **TSE “Principles of Corporate Governance for Listed Companies”**

In addition, the Principles of Corporate Governance apply to listed companies. However, with the recent development of forming a group of companies through the use of a holding company, etc., it is important for a listed company to ensure corporate governance of not only the parent company, but also the corporate group as a whole. Therefore, a listed company is required to make efforts so that corporate governance functions effectively as a corporate group as a whole.

【Paragraph 12】

8. Review of the Codes in the Future 1/2

● OECD Principles of Corporate Governance

The Principles are evolutionary in nature and should be reviewed in light of significant changes in circumstances.

【Paragraph 9】

● The UK Corporate Governance Code

The Code has been enduring, but it is not immutable. Its fitness for purpose in a permanently changing economic and social business environment requires its evaluation at appropriate intervals.

【Paragraph 5 of “Governance and the Code”】

● German Corporate Governance Code

As a rule the Code will be reviewed annually against the background of national and international developments and be adjusted, if necessary.

【Paragraph 13】

8. Review of the Codes in the Future 2/2

● France “ Corporate governance code of listed corporations”

... proposing updates to the code to reflect changes in practice, including at the international level, AMF recommendations or areas for reflection, and investor requests.

【Although there are no such descriptions in Preamble, Article 25-2 contains the above quote.】

● Japan’s Stewardship Code

The Council expects that the Code will continue to be improved in response to the progress in the implementation of the Code (including progress in acceptance and disclosure of required information) and in light of global developments. The Council expects the Financial Services Agency to take appropriate steps so that the Code will be reviewed periodically, about once every three years. Reviewing the Code periodically is supposed to enable institutional investors and their clients and beneficiaries to be better versed in the stewardship responsibilities, and help the Code to become more widely accepted in Japan.

【Paragraph 15】