Provisional translation

Guidelines for Investor and Company Engagement

Financial Services Agency

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Guidelines for Investor and Company Engagement

The Guidelines herein provide agenda items for engagement that institutional investors and companies are expected to focus on based on the Stewardship Code and the Corporate Governance Code, in recognition of the corporate governance issues prevalent at this time. Through constructive engagement with institutional investors, companies are expected to generate sustainable growth and increase corporate value over the mid- to long-term based on their own business principles[1], which will eventually lead to the growth of the Japanese economy as a whole and stable asset formation for the Japanese people.

The Guidelines are intended to be a supplemental document to the Stewardship Code and the Corporate Governance Code. Although the intention is not to require institutional investors and companies to "comply or explain" with respect to the Guidelines themselves, the Guidelines are intended to encourage institutional investors and companies to implement both Codes effectively on a "comply or explain" basis[2]. Companies are expected to consider the contents of the Guidelines when they comply with a principle of the Corporate Governance Code, including principles calling for disclosure, or, if not, explain the reasons why they are not doing so.

Because corporate governance issues and company priorities are diverse, it is not appropriate to use the Guidelines' agenda items as a mechanical checklist, and it is important to have effective engagement between investors and companies that takes into consideration each company's specific circumstances[3].

1. Management Decisions in Response to Changes in the Business Environment

1.1 Are specific business strategies and business plans established and disclosed to generate sustainable growth and increase corporate value over the mid- to long-term? Are these business strategies and business plans consistent with the company's business principles?

1.2 Does management accurately identify the company's cost of capital, reflecting risks associated with the business in an appropriate manner? Does management manage the business with a recognition of the company's cost of capital by setting targets on profitability and capital efficiency to generate sustainable growth and increase corporate value over the mid- to long-term? Does management clearly explain why they decided upon such targets? Does the company achieve returns which cover the cost of capital on a mid- to long-term basis?

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1 Depending upon the company, "business principles" may be described as a "vision," "mission," or "philosophy".

2 In order to enhance constructive engagement between institutional investors and companies, even when a company complies with a principle, it is beneficial for the company to proactively explain its specific implementation activities.

3 There are many cases where a company is managed as part of a corporate group, and the Guidelines have been established taking such companies into consideration. In such cases, it is expected that investors will view the company in light of its corporate group status.

1.3 Does management understand the business environment and business-related risks appropriately and make decisions decisively, such as restructuring the company's business portfolio, including investment in new businesses and exit from or sale of existing businesses, based on the company's business strategies and business plans? Is a policy on reviewing a business portfolio clearly established, and is the review process effective?

2. Investment Strategy and Financial Management Policy

2.1 Are investments in fixed assets, R&D, and human resources to generate sustainable growth and increase corporate value over the mid- to long-term carried out strategically and systematically using the company's resources and from the standpoint of generating returns which cover the company's cost of capital on a mid-to long- term basis?

2.2 Is financial management policy (including capital structure decisions and use of cash on hand in recognition of the company's cost of capital) established and managed appropriately based on the company's business and investment strategies?

3. CEO Appointment/Dismissal and Responsibilities of the Board

CEO Appointment/Dismissal and Development

3.1 Is there an established policy on CEO qualifications in order to appoint a CEO who can make decisions decisively to generate sustainable growth and increase corporate value over the mid- to long-term?

3.2 Is a qualified CEO appointed through objective, timely, and transparent procedures, deploying sufficient time and resources? In order to make these procedures effective, is an independent nomination committee actively involved?

3.3 Is a CEO succession plan appropriately established and implemented, and are CEO candidates developed or, if necessary, selected from outside the company, systematically deploying sufficient time and resources?

3.4 Are objective, timely, and transparent procedures established such that a CEO is dismissed when it is determined, via an appropriate evaluation of the company's business results, that the CEO is not adequately fulfilling the CEO's responsibilities?

Determination of Management Remuneration

3.5 Are objective and transparent procedures established to design management remuneration systems such that they operate as a healthy incentive to generate sustainable growth and increase corporate value over the mid- to long-term and to determine actual remuneration amounts appropriately? In order to make these procedures effective, is an independent remuneration committee actively involved? Is the appropriateness of the remuneration system and of the actual remuneration amount clearly explained?

Responsibilities of the Board

3.6 In order to generate sustainable growth and increase corporate value over the mid- to long-term, is the board of directors constituted in a manner such that it is equipped with appropriate knowledge, experience, and skills as a whole and ensures diversity, including gender and international experience? Are there women appointed as directors?

3.7 Is evaluation of the board's effectiveness as to whether the board fulfills its roles and responsibilities implemented appropriately, and are the evaluation results, including issues identified through such evaluation, clearly disclosed and explained?

Appointment of Independent Directors and Their Responsibilities

3.8 Is a sufficient number of qualified independent directors appointed? Do the independent directors possess the necessary knowledge to effectively contribute to sustainable growth and increasing corporate value over the mid- to long-term, including knowledge of finance, such as capital efficiency, and understanding of relevant laws and regulations?
Are appropriate actions taken for the reappointment or retirement of independent directors, taking into consideration the issues and changes facing the company?

3.9 Do independent directors recognize their roles and responsibilities, and provide advice and monitor management appropriately in response to business issues?

Appointment of *Kansayaku*[4] and Their Responsibilities

3.10 Are persons with appropriate experience and skills as well as necessary knowledge on finance, accounting, and the law appointed as *kansayaku*?

3.11 Do *kansayaku* conduct business audits appropriately and act effectively to secure proper accounting audits? Is a sufficient support structure for *kansayaku* established and appropriate coordination between *kansayaku* and the internal audit department ensured?

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[4] The contents of this section are also intended to apply to Audit Committee Members of Companies with Three Committees and Supervisory Committee Members of Companies with Supervisory Committee. Companies may choose one of three main forms of organizational structure under the Companies Act (Revised in 2014): Company with *Kansayaku* Board, Company with Three Committees (Nomination, Audit and Remuneration), or Company with Supervisory Committee. A Company with *Kansayaku* Board is a system unique to Japan in which certain governance functions are assumed by the board, *kansayaku*, and the *kansayaku* board. Under this system, *kansayaku* audit the performance of duties by directors and the management and have investigation power by law (See Notes to the General Principle 4 of Japan's Corporate Governance Code).

4. Cross-Shareholdings

Assessment of Cross-Shareholdings

4.1 Does the company clearly explain the purpose of each cross-shareholding[5,6] and the status of its cross-shareholdings, including any changes in its cross-shareholdings?
Does the board assess whether or not to hold each individual cross-shareholding, specifically examining whether the purpose is appropriate and whether the benefits and risks from each holding cover the company's cost of capital? Does the company appropriately make decisions based on such assessment? Does the company clearly disclose and explain the results of this assessment?
Has the company established appropriate standards that are clearly disclosed with respect to the voting rights as to cross-shareholdings? Does the company vote appropriately in accordance with the standards?

4.2 As part of its cross-shareholding policy disclosure, does the company make clear its policy regarding the reduction of cross-shareholdings, and take appropriate actions in accordance with the policy?

Relations with Cross-Shareholders

4.3 When cross-shareholders (i.e., shareholders who hold a company's shares for the purpose of cross-shareholding) indicate their intention to sell their shares, does the company hinder the sale of the cross-held shares by, for instance, implying possible reduction of business transactions?

4.4 Does the company engage in transactions with cross-shareholders which may harm the interests of the company or the common interests of their shareholders by, for instance, continuing the transactions without carefully examining the underlying economic rationale?

5. Asset Owners

5.1 As a pension fund sponsor, does the company take measures to improve human resources and operational practices, such as recruitment or assignment of qualified persons (including hiring outside experts), in order to increase the investment management expertise of corporate pension funds (including stewardship activities such as monitoring the asset managers of corporate pension funds), thus making sure that corporate pension funds perform their roles as asset owners?[7] Are these measures clearly disclosed and explained?

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[5] There are cases where listed companies hold the shares of other listed companies for reasons other than pure investment purposes, for example, to strengthen business relationships. Cross-shareholdings here include not only mutual shareholdings but also unilateral ones.

[6] Cross-shareholdings include shares that are not directly held by a company but in practice are under the company's control.

[7] During engagements, investors and companies need to be careful to appropriately manage conflicts of interest which could arise between plan sponsor companies and pension fund beneficiaries as a result of these activities.