

Points at issue on the Board (3)

I. The ideal state of the board in order to increase mid- to long-term corporate value and sustainable growth of companies

With the introduction of the Corporate Governance Code (the “Code”), major changes are occurring in the boards of listed companies with debate carried out on what kind of oversight role the board should fulfill, increasing number of appointments of independent directors in each listed company, and various cases of listed companies shifting to a monitoring model with the aim of achieving greater exercise of supervisory functions. On the other hand, as shown, for example, in the fact that the compliance rate (implementation) of the principle concerning the evaluation of board effectiveness is the lowest among the various principles of the Code, efforts on how to constitute, operate, evaluate and improve the board in response to the Code will gain momentum going forward.

With the environment and the market surrounding listed companies continuing to change drastically due to globalization, technological innovation, population decline and rapid aging of society, it has been pointed out that most companies in Japan may not necessarily be able to respond in a timely manner to such changes.

For listed companies to achieve sustainable growth and increase their mid- to long-term corporate value while responding to such changes in the environment, the management team led by the CEO needs to make accurate management decisions continuously with foresight.

For this purpose, the role played by the CEO is important in the first place. A process with objectivity, timeliness and transparency is required in the appointment and dismissal of the CEO. Therefore, above all else, it is necessary for the board that carries out the oversight of the management team including the CEO to ensure independence and objectivity. This is a required element for the board to fulfil its role of establishing business principles, setting the strategic direction as well as improving the environment to support appropriate risk-taking by senior management, and at the same time, carry out highly effective oversight. (Principle 4.1 to 4.3).

For the board to fulfill such roles and responsibilities,

- ① Composition of the board
Creating a board that is equipped with appropriate

credentials/diversity and ensuring its independence/objectivity

- ② Operation of the board
Enhancing discussions concerning management strategies and the appointment and dismissal of directors.
- ③ Evaluation of the board
Creating a PDCA cycle through the evaluation of the effectiveness of the board

Efforts are required in every single aspect.

From the perspective of turning this kind of efforts into effective efforts that do not merely serve as a formal response but actually lead to an “enhancement” in the “substance” of the board’s functions, we assume that the opinions regarding the implementation of the Code that have been raised so far can be organized in the following way.

1. Composition of the board (Principle 4.7 to 4.9, 4.11 etc.)

For the board to fulfil its expected role, it is important to aim to create a board that is equipped with appropriate credentials/diversity, and at the same time, ensure its independence/objectivity.

- (1) With regard to the composition of the board (Principle 4.11), considering the state of implementation of the Code so far, it can be seen that there are efforts to enhance diversity and balance in the credentials of board members according to the business/stage of companies.

(Examples of efforts)^(Note)

- Appointment of specialists in fields that the company has positioned as growth fields.
- Appointment of people with management experience in manufacturing and finance with an emphasis on experience/insights in fields that are different from the company
- Appointment of global talent for international business expansion

^(Note) The “examples of efforts” that are introduced in this opinion statement give an indication of the examples that were suggested for reference in follow-up meetings in relation to matters that are considered important for ensuring the effectiveness of the Code. It is necessary to pay attention so that these efforts do not constitute new formal rules.

It is necessary to aim to create a board that is equipped with appropriate credentials/diversity which can provide support for the improvement of mid- to long-term corporate value and sustainable growth of companies from an independent and objective standpoint through further promotion this kind of efforts.

- (2) Looking at independent directors, action is being taken to elect independent directors in listed companies, and more than 10% of the companies listed in the Tokyo Stock Exchange First Section, based on their own judgment, are appointing independent directors who constitute more than one-third of the board. Stakeholders are not merely concerned about an increase in the number of board members, but are shifting their focus to enriching the balance and diversity of the board's credentials. From this kind of perspective, it is expected, for instance, that greater effort will be made so that more independent directors will be appointed who have experience and knowledge that cannot be obtained within the company, and who have the credentials to contribute to discussions about management strategies targeted at improving mid- to long-term corporate value, as well as the oversight of management, such as the appointment and dismissal of directors.
- (3) Besides efforts concerning the composition of the board and the appointment of independent directors, there are listed companies that are making further efforts in order to ensure greater independence/objectivity of the board.

(Examples of efforts)

- Separating the CEO and chairperson of the board.
- Establishing a lead independent director in order to have effective division of roles between the board and the management team based on the examples in the US.
- Independent directors taking the initiative to participate in the appointment process of independent directors.

It is expected that through such efforts the independence/objectivity of the board in the listed companies will be improved.

- (4) The Code seeks the disclosure of a company's view on the composition of the board and , policies/procedures concerning the nomination of director candidates and the appointment of senior management, and explanations on the individual appointments and nominations (Supplementary principle 4.11.1, Principle 3.1 (iv) (v)). It

is important that this kind of disclosures and explanations communicate in a clear and concrete way regarding the question of how each company is trying to make the board fulfill its expected role effectively by adopting what kind of composition, and the relationship between the composition and the company's mid- to long-term corporate strategy.

2. Operation of the board (Principle 4.8, 4.10, 4.12 to 14)

For companies to achieve sustainable growth and increase mid- to long-term corporate value, it is necessary to enhance discussions concerning the setting of strategic direction by the board, the appropriate evaluation of company performance and the personnel matters of senior management based on the results of evaluation.

- (1) To enhance discussions on the setting of strategic direction and other matters, it is necessary to narrow down the agenda items and secure adequate discussion time (Supplementary principle 4.12.1).

(Examples of efforts)

- With regard to agenda items that are considered strategically important in terms of business activities, the board will carry out discussions regardless of the monetary value while delegating authority for decision-making on the execution of operations to the management team in order to narrow down the number of agenda items.
- Introducing “matters to be deliberated” in addition to “matters to be reported” and “matters to be resolved” to the agenda items of board meetings, and carrying out discussion at board meetings on important topics before resolutions are passed.
- With regard to the discussion time, allocating at least 20 minutes, for example, for each agenda item.

- (2) It is also important for internal directors to develop a greater awareness of the fact that their responsibilities in the company's board are different from their responsibilities as management executives of the company.

- (3) Furthermore, efforts are required which are targeted at improving the environment so that independent directors can contribute to discussions about setting of strategic direction during board

meetings.

(Examples of efforts)

- Taking measures to provide reports and information to independent directors.
- Utilizing the executive session (meeting that is made up of independent directors only) (Supplementary principle 4.8.1).
- Carrying out information exchange between independent directors and *kansayaku*.
- Utilizing optional advisory committees concerning nomination and remuneration mainly among Companies with *Kansayaku* Board or Companies with Supervisory Committee (Supplementary principle 4.10.1). In this regard, the majority of the committee is composed of independent directors, and the committee is chaired by an independent director.
- Providing appropriate training opportunities not only to people within the company but also to independent directors in order to get more value added advice (Principle 4.14).

- (4) In addition, as part of the roles and responsibilities of independent directors, it is important to appropriately reflect the opinions of stakeholders including minority shareholders in the boardroom (Principle 4.7 (iv)).

3. Evaluation of the effectiveness of the board (Principle 4.11)

It is important to analyze and evaluate the effectiveness of the board as a whole, such as whether efforts to enhance the credentials/diversity of the board and its operations are being carried out effectively, and connect to the next effort.

- (1) Considering that one year will have passed since the implementation of the Code in May this year, each company is expected to conduct appropriate evaluation on the credentials/diversity of the board and the effectiveness of its operating condition. In the implementation of evaluation, various initiatives have been conceived according to the status of each company, but frank evaluation by every single member of the board is considered important in the first place.

(Examples of efforts)

- Ensuring the proactive participation of independent directors such as utilizing nomination committees and meetings consisting solely of independent directors.
 - Including the operating status of each committee, as well as optional committees, which are established under the board as a target of evaluation.
 - Carrying out evaluation that includes the perspective of outsiders and announcing the name of the facility conducting the evaluation referring to the experience of the United Kingdom.
- (2) In addition, considering that the Code was formulated with the objective of achieving sustainable growth of companies and increasing their mid- to long-term corporate value, in the evaluation of the effectiveness of the board and the disclosure of the evaluation results, emphasis should also be placed on verifying how the board has been able to provide support for achieving sustainable growth of the company and increasing mid- to long-term corporate value from an independent and objective standpoint.

4. The ideal state for the appointment and dismissal of CEO

From the perspective of achieving sustainable growth of companies and increasing mid- to long-term corporate value, the appointment and dismissal of the CEO is considered the most important strategic decision-making to the listed companies. In formulating a successor plan for appointment, procedures that guarantee objectivity/timeliness/transparency are required. In addition, in cases where problems are found in the CEO after conducting appropriate evaluation of the company's performance, it is necessary to set a mechanism that makes it possible to dismiss the CEO. Some listed companies are promoting efforts from this kind of perspective.

(Examples of efforts)

- Identifying the CEO candidates within the board, and establishing a process so that the board including independent directors can spend a certain amount of time to examine the credentials of the candidates.
- Carrying out the appointment of CEO after conducting adequate discussion of the credentials (the ideal image) that are expected of the future CEO based on the company's mid- to long-term strategy.

- Utilizing nomination committees and optional advisory committees concerned with nomination in order to get the full participation of independent directors in the appointment and dismissal of the CEO. In this regard, sufficient time should also be ensured for deliberation in nomination committees.

By further promoting this kind of efforts, the CEO should be appropriately appointed and dismissed through procedures that are objective/timely/transparent. (Supplementary principle 4.3.1).

Besides the above, are there any other matters regarding the appointment and dismissal of CEO that should be discussed?

II. Appropriate exercise of audit functions

From the perspective of preventing scandals, the following points have been made in relation to the appropriate exercise of audit functions in the course of the discussions so far.

- To make the whistleblowing system function fully, it is necessary to have a structure that allows for reporting to outside directors and outside *kansayaku* as a reporting line.
- The *kansayaku* boards (including the *kansayaku* board, the audit committee and the supervisory committee) are the very kind of organization that should be entirely composed of independent people. The composition of *kansayaku* boards should be reviewed from the perspective of preventing a recurrence of corporate scandals. In addition, the role of the so-called third party committee should be fulfilled by the *kansayaku* boards in the first place.

Besides the above, what do you think of the following points in relation to the appropriate exercise of audit functions? Are there any other matters that should be discussed?

- Appointment of members of *kansayaku* boards

Cases have been seen in which a person with CFO experience is appointed as the head of the audit committee, but from the perspective of the audit committee fulfilling its roles and responsibilities from an independent and objective standpoint, what do you think of the appointment of members of *kansayaku* boards?

- Utilizing the internal audit department

From the perspective of utilizing the internal audit department functions, isn't it considered important to establish a framework for the internal audit department to provide information appropriately to the *kansayaku* boards? (Supplementary principle 4.13.3). Including this point, what do you think of the current state and the ideal state of coordination among the internal audit department, the board and the *kansayaku* boards?

- External auditors

Shouldn't the board and the *kansayaku* board at least implement each of the following measures to ensure appropriate auditing by external

auditors? (Supplementary principle 3.2.1, 3.2.2). What do you think of the current state and the ideal state of the response to these items?

<The *kansayaku* board> (Supplementary principle 3.2.1)

- Establish standards for the appropriate selection of external auditor candidates and proper evaluation of external auditors.
- Verify whether external auditors possess necessary independence and expertise to fulfill their responsibilities.

<The board and the *kansayaku* board> (Supplementary principle 3.2.2)

- Give adequate time to ensure high quality audits.
- Ensure that external auditors have access, such as via interviews, to the senior management including the CEO and the CFO.
- Ensure adequate coordination between external auditors and each of the *kansayaku* (including attendance at *kansayaku* board meetings), the internal audit department and outside directors.
- Ensure that the company is constituted in such a way that it can adequately respond to any misconduct, inadequacies or concerns identified by the external auditors.