

Opinion on board evaluationboard evaluation

January 20, 2016
Yoshiko Takayama
J-Eurus IR Co., Ltd.

Board evaluation is a required item in the Corporate Governance Code. It has already become a general practice in major companies overseas, but this concept is still not fully understood in Japan. As shown in the current situation where the principle on the board evaluation in the Code has the lowest rate of compliance, there are quite a number of Japanese companies who have difficulty with the implementation of evaluation, and various types of misunderstanding have been seen in relation to the contents of evaluation. This opinion statement describes the important points in the board evaluation so that both companies and investors can make effective use of the evaluation. I would appreciate it if you could also refer to my published paper which is distributed separately for the details of my opinions expressed here.

Notes

The state of the board and board evaluation evaluation -Evaluation of the effectiveness of oversight function -

It is clearly stated in the Governance Code that the roles and responsibilities of the board are to carry out oversight with a high level of effectiveness from an independent standpoint. In the discussions at this Council, a major topic has been also the oversight function of the board towards the realization of growth-oriented governance. And in the board evaluation, a required item is the evaluation of whether the board has effectively fulfilled its oversight function. This is why when carrying out evaluation, first of all, it is essential to have a proper board discussion of the ideal state of the board in one's own company and what form the oversight function of the board should take. It is only when a common way of thinking on such areas within the board has been established that it is possible to carry out evaluation in a substantial rather a formal way.

It is important to evaluate the overall effectiveness of the board in its evaluation. In addition to that, each director who is a member of the board (including independent directors) as well as the main committees are also subject to evaluation. However, in the evaluation of individual directors, one should look at how each director is contributing to improving the overall effectiveness of the board, and pay attention to the fact that the

standards of evaluation are of a different nature from the evaluation of personnel affairs and remuneration.

Subject of evaluation - Evaluation by board members themselves-

From the perspective of increasing the independence and objectivity of evaluation, there are quite a number of companies overseas, including UK, which conduct evaluation with the support of external experts, and even in Japan, there are companies, although they form a minority, which do that kind of external evaluation. However, be it external evaluation or self-evaluation, the ultimate subject of evaluation is always the board. Rather than merely accepting evaluation reports by external experts, the board should review/discuss the contents of the report and do a final evaluation. Board evaluation means getting the board to verify its own effectiveness.

Items of evaluation - Verification of the main principles of the Governance Code -

The size of the board, its composition, operating status, decision-making process, external communication and so on are included among the main items of board evaluation. These items are also indicated in the clauses on the responsibilities of the board in the Governance Code, and the composition of the board, its operation and the ideal state of nomination which have also become the focus of discussions in this Council meeting are precisely the very focus of evaluation. Increasing the effectiveness of the board while verifying the condition of the board by taking reference from the main principles of the Code in line with the spirit and purpose of the Governance Code is what is required in board evaluation.

Objective of evaluation - Sustained efforts to raise the effectiveness of the board -

Board evaluation is not something that is carried out to show an outward compliance with the Governance Code and neither is it something that is done simply to get a good evaluation from investors. It is something that is implemented to build a framework so that the board can exercise its oversight function and conduct discussions on achieving an improvement in mid- to long-term corporate value. The aim is not to get a high score in all items of evaluation. The important thing is not to get a full score. What is important is the process of identifying the issues through sincere reviews, working on the issues and verifying the results.

As corporate governance has been often described as a long journey, it has a long way to go towards the improvement of corporate value. In the same way, the board evaluation is a long-term initiative that requires ceaseless effort so that the board can

raise its own effectiveness.

Disclosure of evaluation - Foundation for dialogue between companies and investors -

In the Governance Code, companies are required to disclose an outline of the results of board evaluations. The ACGA, an organization of major overseas institutional investors, submitted/released an opinion statement with the title “ACGA Feedback on the Japan Stewardship and Corporate Governance Codes” on December 17, 2015 in response to our call for public comments. The ACGA requested that overall board evaluation be carried out regularly in order to encourage board effectiveness and enhance shareholders’ understanding of critical component of corporate governance. In this way, investors think that it will be possible to increase their understanding of the board in companies through board evaluations.

On the other hand, from the perspective of confidentiality, there are limits to the contents that can be disclosed. Even in overseas countries, investors have expressed the opinion that “The result of review should remain confidential. Forcing too much transparency would change the nature of the exercise and could potentially become disruptive.” (Source: Survey by the All Party Parliamentary Corporate Governance Group, September 2013).

There are various kinds of issues in the disclosure of evaluation, but using this as the foundation, it will probably be possible for companies and investors to deepen their dialogue on governance leading to an improvement in mid- to long-term corporate value.