

Opinion Statement for the 18th Council of Experts Concerning
the Follow-up of Japan's Stewardship Code and Japan's Corporate Governance Code

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Please accept my sincere apology for not being able to attend the meeting today.

I'd like to express my opinions on issues facing the Japanese market in enhancing the substance of corporate governance.

1. Global investors' views on parent-subsidary listings

I currently live in London, and since the end of the last year, I have been frequently asked to discuss the issue of parent-subsidary listing (system, the actual situation) in the Japanese market. Because of a series of parent-subsidary listings that took place last year in the Japanese market, I feel the issue has been drawing international attention in particular.

The parent-subsidary listing is not uncommon in the Japanese market. As a part of group management, this method has been used in Japan as a means for subsidiaries to raise funds from the external sources, while allowing parent companies to maintain their control over the subsidiaries.

However, the issue of the parent-subsidary listing in the Japanese market is often discussed with negative implications in such a context that the Japanese market is different from other global markets. The continued listing of a subsidiary for a certain period could be considered as an option during an M&A process in some cases. However, many global market players feel uncomfortable about a subsidiary listed company as a final and persistent form while maintaining the close relationship with the parent company. While the collective efforts by the Japanese market participants and policy makers to improve corporate governance are appreciated globally, I'm very concerned that the above-mentioned situations in Japan might undermine confidence in the Japanese market, and be recognized as a defect of the market system.

2. Corporate governance issues of the listed subsidiaries

In many cases, the purpose for a parent company to have a subsidiary listed is to use the financing mechanism of the market through the subsidiary, while maintaining its control over the subsidiary. I therefore believe that, the listed subsidiary, compared to other independent listed companies, must be required to establish proper arrangements to protect the interest of minority shareholders, as an adequate user of the market. Especially, during the processes of decision-making and implementation of business and financial strategies in the context of group management, there may be conflict between the interest of the parent company and that of the minority shareholders of the subsidiary. In that case, the conflict of interests with the parent company might not allow the board of directors of the subsidiary to make decisions giving the interest of itself the highest priority.

Therefore, listed subsidiaries are required to establish the robust corporate governance system from the perspective of enhancing the protection of minority shareholders.

However, looking at the listed subsidiaries and their corporate governance, you will find that some listed subsidiaries have registered the external directors with the background in the parent company as

independent executives of the listed subsidiaries to the Tokyo Stock Exchange (See the following table).

		Number of candidates at 2018 AGM	Ratio to all candidates for external directors
Listed subsidiaries	External directors	260	
	Those who have some sort of managerial background in large shareholders (excl. parent company)	16	6.2%
	Those who have some sort of managerial background in large shareholders (excl. parent company), and registered as independent executives with the TSE	13	5.0%
	Those who have some sort of managerial background in the parent company	23	8.8%
	Those who have some sort of managerial background in the parent company, and registered as independent executives with the TSE	9	3.5%
Companies other than listed subsidiaries	External director	4,362	
	Those who have some sort of managerial background in large shareholders	730	16.7%
	Those who have some sort of managerial background in large shareholders, and registered as independent executives with the TSE	409	9.4%

Note: 'Large shareholders' refers to any of the 10 largest shareholders (prepared by Ueda)

Japan's Corporate Governance Code stipulates that the roles and responsibilities of independent external directors are to "appropriately represent the views of minority shareholders and other stakeholders in the boardroom from a standpoint independent of the management and controlling shareholders" (Principle 4.7 iv). However, I would have to say that there are practices in place against the spirit of the Code. Furthermore, many institutional investors do not validate the independence of external directors with the background in the parent company, and vote against at general shareholders' meetings.

3. Future initiatives

Given that the listing of subsidiaries is a well-established business practice for group management in Japan, and that we do see many listed subsidiaries on the market, the immediate prohibition of the listing of subsidiaries will have a significant impact, and it might be necessary to take time to study the feasibility. In the meantime, for the purpose of enhancing confidence in the Japanese market, the rigid corporate governance standards should be applied to listed subsidiaries.

As the first step to this end, I suggest the "Practical Guidelines for Corporate Governance Systems (CSG Guidelines)" issued by the Ministry of Economy, Trade and Industry refer to the issue of listed subsidiaries so that concerned parties share common awareness of the issue, and also provide guidance to listed subsidiaries.

Furthermore, to increase effectiveness of the Japanese market as a whole, I suggest the revision of the Corporate Governance Code be effective. With regard to independent directors, the 2018 Corporate Governance Code stipulates, "[Irrespective of the above,] if a company believes it needs to appoint at least one-third of directors as independent directors based on a broad consideration of factors such as the industry, company size, business characteristics, organizational structure and circumstances surrounding the company, it should appoint a sufficient number of independent directors" (Principle 4.8). For listed subsidiaries, rigid code provisions on the board structure would be required, which require "the appointment of the majority of directors as independent directors". In addition, the TSE's independence criteria (measuring factors when considering the conflicts of interest with minority

shareholders) and its independent executive registration rules will also have to be revised more rigidly to define the independence of an external director, who comes from the parent company.

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