



ICGN

International Corporate Governance Network

22nd Council of Experts

Follow-up of Japan's Stewardship Code and Japan's Corporate Governance Code

8th December 2020

Dear Fellow Council Members,

ICGN Statement to the Council of Experts for the Follow-up of Japan's Stewardship Code and Japan's Corporate Governance Code (the "Council")

I have pleasure in sending you ICGN's comments on the items noted in the Agenda for the next Council Meeting which will take place on 8th December 2020. Regretfully, I will not be able to join you in person on this occasion and hope that the comments presented in this letter can serve as a contribution to the Council's discussion.

Led by investors responsible for assets under management of USD\$54 trillion, ICGN is a leading authority on global standards of corporate governance and investor stewardship. Our membership includes institutional investors and business leaders and who have a shared interest - and thus a shared responsibility - in promoting the success of companies to preserve and enhance long-term value, contributing to strong economies and healthy societies.

ICGN's mission supports this shared responsibility, as advocated in the ICGN Global Stewardship Principles¹ and the ICGN Global Governance Principles², the latter of which is currently subject to Member consultation as part of a three-year review cycle. Our comments forthwith are guided by ICGN Principles and largely written from the perspective of the global institutional investor community and our Japan Policy Priorities, published in July 2019 (see annex).

Our comments refer to the core items on Council's meeting agenda being: (1) the Draft Opinion Statement No.5; and (2) Annual General Meetings.

1. Draft Opinion Statement No.5: Board Effectiveness and ensuring Diversity in the Core Human Resources in Companies for Post-COVID Transformation of Companies ("Statement No.5")

ICGN understands that the Opinion Statement will be published to announce the consensus opinion of the Council members on key aspects of board effectiveness with a focus on independence and diversity. ICGN's position on these subjects was articulated in our letter submitted on 18th November 2020. We offer further suggestions in terms of the drafting of the Opinion Statement outlined below:

1.1 Independence level

We recognise that the FSA must balance a range of views when taking a decision on the desired level of independence on corporate boards that is deemed appropriate in

¹ ICGN Global Stewardship Principles, 2020: https://www.icgn.org/sites/default/files/ICGN%20Global%20Stewardship%20Principles%202020_0.pdf

² ICGN Global Governance Principles, 2017: http://icgn.flpbks.com/icgn_global_governance_principles/

the context of Japan. Nevertheless, we encourage companies in Japan to move further towards international best practice and ICGN maintains the position that there should be a majority of independent directors on the boards of listed companies on the JPX prime market and at least one-third independent directors on other segments. For listed subsidiary companies, there should be a majority of independent directors serving on the board to mitigate infringements to minority shareholder interests.

1.2 Committee independence

Page three of the Opinion Statement refers to a series of bullet points which refer to urgent issues, the first two of which state:

- Establishment of the Nomination Committee and improvement of its functions
- Establishment of the Compensation Committee and improvement of its functions

ICGN recommends that the word 'independent' be added before the words 'Nomination' and 'Compensation'. The importance of committees being comprised of independent directors is already clarified in Supplementary Principle 4.10.1 of Japan's Corporate Governance Code "Code". It is also recommended to mention that the chair of the committees should be independent directors in order to ensure the "independent" function of such committees.

1.3 Role of Nomination Committee

Following from the reference to the 'establishment of the Nomination Committee', the Opinion Statement refers to "(strengthening the CEO selection and dismissal function, such as enhancing the candidate pool and improving disclosure of its activities)".

ICGN agrees that this is an important role of the Nomination Committee, but perhaps a more prominent role of the committee is to manage the appointment and evaluation of board members (i.e. Independent Directors) and succession planning among other tasks. The lack of reference to this role in the drafting of the Opinion Statement may infer that the Council think that the primary role of the Committee is purely focused on the CEO whereas international best practice is for the committee to have a more comprehensive role, particularly regarding board appointments.

ICGN recommends that 'board diversity and composition' be added before the reference to 'strengthening CEO selection...'

1.4 Role of the Board

Finally, we refer the Council to the second paragraph under 'board effectiveness' on page one which states that 'the board is required to support management's timely and decisive risk-taking and make important decisions in light of this discontinuity in the business environment.'

The role of the board is to oversee and direct the affairs of the company and, while undoubtedly acting as a support, also serving as a check and balance to managerial decision-making. ICGN therefore recommends that the word 'support' be changed to 'oversee' to avoid any inference that the Council may believe that the role of the board is to 'rubber stamp' management decisions alone.

2. Annual General Meetings

2.1 AGM Format

The AGM is an important forum for shareholders to hold the board and management accountable for preserving and enhancing long-term corporate value. Ideally AGMs should allow for the physical presence of participants, including provision for voting electronically by proxy, and ensure live interaction is possible between shareholders and the board and management.

During the COVID crisis, virtual-only AGMs have become the 'new normal' and has led to emergency legislation being enacted in multiple markets to allow companies to seek shareholder approval on things like dividend proposals, share issuance authorizations, director elections and auditor appointments. Hybrid AGM's have also been popular which allows for both physical and virtual presence by participants via 'live streaming' of the AGM proceedings accessible via the internet.

While ICGN Members recognize the need for hybrid and virtual-only AGMs in this current environment, we encourage regulators to ensure that shareholder rights are not infringed so as not to restrict their ability to hold companies properly to account. Certain minimum shareholder rights should be guaranteed to allow for robust challenge of boards and management through interactive and unmoderated questioning or statements made by shareholders to have meaningful dialogue on contentious proposals.

When holding a hybrid or virtual-only AGM, we strongly encourage companies to ensure interactivity with shareholders and to replicate as best as possible the in-person AGM experience. In doing so companies might consider the following as an optimal format as described in a Viewpoint from the ICGN Shareholder Rights Committee:³

- Publish AGM information at least one month ahead of the meeting, including the meeting format and procedures around registration, access, participant identification, shareholding verification and voting options.
- Use video technology as well as audio technology to allow for facial expression to be shown.
- Allow participants to ask questions and make statements – in advance and during the AGM – and allow for follow up questions and statements if necessary.
- Record and respond to all questions and made such responses promptly publicly available (avoid legalistic language).
- Enable participants to be able to cast votes live, noting all matters on the ballot should be voted by poll.
- Ensure accuracy of tracking and reconciling any advance votes received pre-AGM with any live votes cast during the AGM itself.

³ The Future of Annual General Meetings, ICGN Viewpoint, September 2020: <https://www.icgn.org/future-annual-general-meetings>

Note, we also observe that it may be appropriate for companies to refrain from giving gifts to shareholders at the AGM and instead allocate the cash into the dividend instead.

2.2 AGM Timing

This year, the AGM season in Japan has proved that it is possible for companies with March fiscal year-end to hold AGMs outside the month of June – approximately 60 of such companies held AGMs in July and thereafter. The traditional clustering of AGMs in Japan, often within a few days in the last week of June, causes difficulties for investors to allocate appropriate time to read annual reports and make voting decisions.

ICGN encourages companies in Japan to maintain the momentum and to consider moving record dates from March to April to allow AGMs to be held in July. This is possible by setting a record date after the year-end by changing the company's Articles, allowing for AGMs to be held beyond the traditional June period. Not only will this lead to less AGM clustering, but this will also give companies additional time to prepare materials in English before the AGM.

2.3 Timing and translation of the Securities Report (Yuho)

The Securities Report and the Notice of AGM should be published pre-AGM, not post and be translated in English.

The Securities Report includes valuable information for investors around the business model, corporate strategy, audited financial results, Key Audit Matters and other corporate governance related information such as cross-shareholdings. It is therefore imperative that overseas investors are able to receive this information in English in a timely manner in order to make considered use of their votes.

2.4 AGM questions and proposals

Companies should allow shareholders the opportunity to submit questions in advance of the shareholder meeting date and/ or during the meeting proceedings. Companies should ensure that transparent, unmoderated and interactive questioning by shareholders to the board and management is facilitated to ensure accountability is upheld. Answers to the questions should be recorded and made available to all shareholders of the company.

Companies should ensure that shareholders have the right to place proposals on the agenda of AGMs, subject to reasonable limitations. All shareholder proposals should be voted upon and contingency provisions should be made to ensure that proponents are able to present their proposal should they have difficulties in attending an AGM, particularly a virtual AGM.

If a shareholder has failed to signify a position 'for' or 'against' either a company or a shareholder resolution (blank votes), the vote should be considered invalid. Companies should not use their discretion to execute the vote unless the proxy form explicitly states that any blank votes can be exercised at the company's discretion. Alternatively, companies might consider adding an 'abstain' vote option to allow shareholders to signify a level of discontent but not go as far to vote against.

2.5 Vote disclosure and shareholder accountability

The board should ensure that equal effect is given to votes whether cast in person or in absentia and all votes should be properly counted and recorded via ballot. The outcome of the vote, the vote instruction (reported separately for, against or abstain) and voting levels for each resolution should be published promptly after the meeting on the company website.

There are many occasions where management proposals fail to attract 80% support of the shareholder vote in companies in Japan. In the spirit of entering into constructive dialogue, ICGN encourages companies to demonstrate their accountability to shareholders by providing clarity around how shareholder concerns are addressed, particularly when there is a significant vote against a particular resolution.

ICGN acknowledges that the Japan Code states:

"When the board recognizes that a considerable number of votes have been cast against a proposal by the company and the proposal was approved, it should analyse the reasons behind opposing votes and why many shareholders opposed and should consider the need for shareholder dialogue and other measures."

We recommend that this principle be strengthened and emulate the drafting of paragraph 1.4 of the UK Corporate Governance Code (2018) whereby a specific threshold is referred and disclosure around resulting actions with regards to shareholder consultation within six months after the shareholder meeting:

"When 20 per cent or more of votes have been cast against the board recommendation for a resolution, the company should explain, when announcing voting results, what actions it intends to take to consult shareholders to understand the reasons behind the result. An update on the views received from shareholders and actions taken should be published no later than six months after the shareholder meeting. The board should then provide a final summary in the annual report and, if applicable, in the explanatory notes to resolutions at the next shareholder meeting, on what impact the feedback has had on the decisions the board has taken and any actions or resolutions now proposed."

Thank you for this opportunity to provide commentary for the Council meeting and we look forward to the continued deliberations.

Yours faithfully,



Kerrie Waring
Chief Executive Officer

Annex: ICGN Policy Priorities: Japan *With Summary Japanese Translation*

As discussed at the ICGN Annual Conference, hosted by the Tokyo Stock Exchange, taking place between 16-18 July 2019.

ICGN Policy Priorities: Japan

1. Corporate reporting

ICGN welcomes the reforms proposed in the Report of the Disclosure Working Group convened by the Financial Services Agency which includes recommendations to enhance financial and narrative information and the reliability and timeliness of corporate reporting. Other matters of concern to ICGN members include:

- **AGM Clustering:** While the issue of AGM concentration in Japan has improved since the 1990s, many companies maintain a March fiscal year end with subsequent meetings in June. This clustering of AGM's, often within a few days in the last week of June, causes difficulties for investors to allocate appropriate time to read annual reports and make voting decisions.
- **AGM notifications:** Notices are issued on average 19 days in advance of the meeting taking place in Japan – compared to international best practice of 30 days.
- **Timing of Securities Report:** The Securities Report (Yuho) is published post AGM despite the fact that it includes valuable information for investors around the business model, corporate strategy, audited financial results, Key Audit Matters and other corporate governance related information such as cross-shareholdings.
- **English language:** As of May 2019, 40% of companies issued English AGM Notices this year and the Securities Report is often not published in English, despite companies wishing to attract overseas capital.

Recommendation: 1) AGM Notices and the Securities Report should be issued at least 30 days in advance of the AGM; (2) Companies should move their respective record dates from March to April to allow AGMs to be held in July; and (3) Companies listed in TSE section 1 should make both English translated Securities Report and Notice of AGM

2. Board independence

Independent Directors are relied upon by investors to bring their industry knowledge and experience to the Board to assess the quality of managerial decisions, for example relating to strategic investments in fixed assets, acquisitions, research and development and human resources. ICGN welcomes that over 90% of 1st Section JPX listed companies now have two or more independent directors and 33% of companies have one-third. ICGN encourages further progress towards a majority of independent directors on Japanese boards, or at least one-third.

ICGN Members comment that it is difficult to determine the extent to which a director is independent in Japan. Further clarity around the definition of independence in the JPX Listing Rules might be helpful in this regard, for example around issues such as cross-shareholdings, major client and supplier relationships, business relationships, the provision of consultancy services and family ties. There should also be clarity around how long any conflicts should be absent before a candidate can be considered independent.

Often in Japan board directors are promoted from within the company and this has become a symbol of career progression. Furthermore, is no reference to how independent directors are nominated and appointed in Japan's Corporate Governance Code and the process is therefore often opaque. More disclosure around the process would be helpful along with the rationale for director selection.

Recommendation: (1) Listed company boards should comprise one-third independent directors, or preferably a majority of independent directors particularly in subsidiary companies. (2) Enhance the definition regarding the factors which impact a directors' independence in the TSE Listing Rules, aligned with international best practice. (3) Companies should disclose clear procedures and disclosure around the rationale for individual director appointments including how their experience aligns with company strategy and any factors affecting their independence.

3. Board evaluation and nomination committees

ICGN advocates that board evaluation (collectively, individually and for the Chairman) should take place annually by the board itself and periodically (e.g. every three years) by an external evaluator. A 'skills matrix' which maps the experience of the current board with the company's long-term strategic needs can be a helpful tool to aid the board evaluation process.

The board evaluation should be led by a Nomination Committee comprised of independent chair and a majority of independent directors. Outcomes from the board evaluation can help to inform the types of candidates of strategic relevance to the company

Recommendation: (1) All listed companies (not just those with a three-committee structure) should establish a Nomination Committee comprised of independent chair and a majority of independent directors. (2) Listed company boards should be subject to periodic external board evaluation and director tenure should be contingent on individual performance and annual re-election premised on satisfactory evaluations of his or her contribution to the board. (3) Board evaluation disclosure should include the process for board evaluation and any material issues of relevance arising from the conclusions.

4. Executive pay and remuneration committees

ICGN welcomes improvement to regulations for corporate disclosure on executive pay in January this year and also welcome reference in Japan's Corporate Governance Code under principle 4.2.1 regarding the board's role to determine executive remuneration through 'objective and transparent procedures.' We understand that 46% of 1st section JPX listed companies have a Remuneration Committee – up from 13% in 2015. The Committee should be responsible for establishing clear remuneration policies and reports which are aligned with the company's long-term strategic objectives and executive key performance indicators and progress towards achieving such indicators.

Regarding remuneration related disclosure, the board should disclose who is responsible for setting executive pay, the process for remuneration setting, rationale for individual levels and how it fits within the overall context of the company's human resource strategy. We note that the current rule in Japan only requires disclosure of individual remuneration above YEN 100 million (£700,000) which may create an artificial ceiling on pay levels.

Recommendation: (1) Listed companies to establish a Remuneration Committee comprised of independent chair and a majority of independent directors. (2) The rule requiring disclosure of individual remuneration in excess of YEN 100 million should be abolished. (3) A new rule to require

disclosure of CEO and senior executive pay on an individual basis and annually should be introduced. The disclosure should include the proportions of fixed pay, bonus and long-term incentives. This extends to non-cash items such as director and officer insurance, pension provisions, fringe benefits and terms of severance packages if any.

5. Capital efficiency and cross-shareholdings

ICGN notes that progress has been made since the minimum target of 8% return on equity (RoE) was introduced in the Ito Review in 2014 to a median of 11.5%. Whilst setting profitability targets are important, the rationale for targets and what progress is being made towards achieving them as part of a longer-term capital allocation strategy is of more interest to investors. For example, this includes information in relation to acquiring new businesses, making large capital investments, discontinuing existing businesses and research and development expenditure. ICGN members are likely to vote against management if RoE is less than expected over a prolonged period and not expected to improve.

Regarding cross-shareholdings, ICGN welcomed the revisions to Japan's Corporate Governance Code last year requiring companies to disclose their policies and rationale for cross-shareholdings as well as an annual assessment of the costs and benefits and how that impacts a company's cost of capital. However, we understand that cross-shareholdings are still high in companies as a proportion of overall shares with voting rights, despite the progress that has been made in Japan's banking sector. It is important that Issuer Companies do not prevent companies in receipt of cross-shareholding to sell through tactics employed to threaten trading relationships. Cross shareholdings impede shareholder rights and business relationships are prioritized over proper corporate governance practices at the expense of asset efficiency.

Recommendation: (1) Japanese companies should improve disclosure to shareholders on the company's capital policy which would highlight the Board's risk appetite and understanding of the company's cost of capital. (2) Companies should disclose a target to reduce their cross shareholdings over a specified period including their policies; and the nature of the cross-shareholding, for example if they are a parent company, subsidiary, supplier.

ICGN 重点方針（日本）＜要約版＞

ICGN（International Corporate Governance Network）はグローバルの機関投資家を主体とする組織（事務局：英国ロンドン）であり、効率的な市場と持続的な経済の促進に向け、実効的なコーポレートガバナンスの構築と投資家のスチュワードシップの醸成を目的としています。1995年に設立され、会員の運用資産合計金額は34兆米ドル（国別では45か国以上）、主要なグローバルの年金基金と大手運用会社が加盟しています。

ICGNでは、毎年、グローバルベースの「重点方針」の策定・見直しを行っていますが、今回、東京で開催されたICGN年次総会（7/16-18）の議論をより実りあるものとするため、国・地域別の「重点方針（日本）」をはじめて策定しました。今後とも、ICGN年次総会が開催される国・地域において（国・地域別の）重点方針を策定する予定です。

なお、本資料は“ICGN Policy Priorities”の日本語訳（要約版）となります。原文は、以下のリンクをご活用ください。

プレス資料 https://www.icgn.org/sites/default/files/2_AGREED_Policy%20Priorities_Japan.pdf 原文 https://www.icgn.org/sites/default/files/ICGN%20Policy%20Positions_Japan.pdf

ICGN 重点方針：日本＞ 重点方針は、以下の 5 項目から構成されます。

1. 企業報告 上場企業は、株主総会の少なくとも 30 日前までに株主総会の招集通知と有価証券報告書を発行すべきである。(3 月決算の場合) 株主総会の基準日を 3 月から 4 月に変更し、株主総会の 7 月開催を可能とすべきである。東証 1 部上場企業は、英文の有価証券報告書と株主総会の招集通知を作成すべきである。
2. 取締役会の独立性 取締役会の構成において、1/3 以上、望ましくは過半数以上(上場子会社のような場合)の独立社外取締役が設置されるべきである。国際的なベストプラクティスを参考に東証の独立性基準をより充実すべきである。また、取締役選任に関する透明性のあるプロセスの開示とともに、個々の取締役が企業戦略に沿った形で適切に選任されているか等の取締役選任に関する根拠や独立性において問題がないか、といった事項も開示されるべきである。
3. 取締役会評価と指名委員会 上場企業は、議長と構成員の過半数を独立社外取締役とする指名委員会を設置すべきである。定期的に、外部評価者も入れた取締役会評価を行うべきであり、取締役就任期間(再任)については、個々の取締役の活動と取締役会に対する貢献への十分な評価に基づき決められるべきである。取締役会評価の開示には、評価プロセスとともに、評価の結果として認識された重要な事項も含まれるべきである。
4. 役員報酬と報酬委員会 上場企業は、議長と構成員の過半数を独立社外取締役とする報酬委員会を設置すべきである。役員報酬の開示においては、1 億円以上の制限を撤廃し、CEO や経営陣の報酬の個別開示が毎年実施される仕組みの導入が行われるべきである。また、固定報酬・ボーナス・長期インセンティブは区分された形で開示され、開示内容となる報酬の対象には、役員保険、年金、退職金などの非金銭的な報酬も含まれるべきである。
5. 資本効率と政策保有株 「資本政策」についての株主への説明内容は改善されるべきである。また、その策定にあたっては、リスクや資本コストについての取締役会の認識を反映すべきである。上場企業は、政策保有株削減に関する方針の策定とともに、削減目標(期限を決めた上で)と政策保有株継続保有の理由の詳細な開示を行うべきである。

2019 年 7 月

以上