Opinion Statement on Code Draft Revision and Guidelines for Investors and Companies Engagement (Draft)

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Member
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About the revision of the Code

As has been acknowledged by the government, corporate governance reform by Japanese companies is steadily advancing thanks to the efforts up until now including the formulation of the Corporate Governance Code. There has been an increase in companies that are accelerating reviews of the business portfolio through M&As, business sales, etc., and it can be recognized that efforts aimed at “sustainable growth and medium to long-term improvements in corporate value by companies” that is the focus of the code.

Meanwhile, in light of the many “comments” on the approach towards corporate governance by companies, this proposal (draft) on “the revision of the Corporate Governance Code and the formulation of the Guidelines for Investors and Companies Engagement (draft)” stipulates that the Code is to be revised.

Although a stance of considering the individual “comments” is important, in considering the necessary revision of the code, while various efforts are being pursued by companies, we should first objectively and comprehensively examine sufficiently what kind of effects the introduction of the Code has had and conversely what kind of effects have not been achieved and share the result among stakeholders including companies and investors. If revisions are made without such examinations and sharing of the result, there are concerns of companies' response to the revision being only on the surface level and moving backward from reforms going from form to substance that is our original goal.

I. Independent advisory committees including nomination committees and remuneration committees (Supplementary Principle 4.10.1 of the Code, 3.2 and 3.5 of the Guidelines (Draft))

[Opinion]

It should be clarified that “establishing independent advisory committees” is one of the various measures that can be taken by a company and means for seeking appropriate involvement and advice from independent directors are not limited to this. Accordingly, the wording “by establishing independent advisory committees under the board, such as an optional nomination committee and an optional remuneration committee” newly added to the Code Draft Revision should only be an example, and this should be restated as “by, for example, establishing independent advisory committees, etc. such as an optional nomination committee and an optional remuneration committee”.

The same applies for 3.2 and 3.5 of the Guidelines (Draft).

[Reasons]

(1) It is not necessary to limit the means to "strengthen the independence, objectivity and accountability of board functions on the matters of nomination and remuneration of the senior management and directors" and "seek appropriate involvement and advice from independent directors" to the establishment of nomination committees and remuneration committees.

If the comment is being made that under current conditions "appropriate involvement and advice from independent directors" is not being sought, first the facts should be examined at companies that have not established a committee regarding whether or not "appropriate involvement and advice from independent directors" are insufficient.

(2) In addition, as the 70% of TSE First Section-listed companies are Companies with *kansayaku*, it is not appropriate to require these companies to establish a nomination committee even if it is on a comply or explain basis. In contrast to Companies with Three Committees, at Companies with *kansayaku,* the directors (as executive persons) are elected at the general meeting of shareholders. For nomination and remuneration at Companies with *kansayaku* based on the articles of incorporation, uniform requirements on the involvement of committees like that at Companies with Three Committees could compel governance in an unsuitable manner which is not the selection made by the company. It could also lead to intervention in competition between systems as assumed by the Companies Act.

(3) Even in the case of a nominating committee at a Company with Three Committees, the legal power under the Companies Act only involves the nomination of director candidates.

However, the voluntary nomination committee assumed in 4.10.1 is stipulated to be a committee which should involve in the overall nomination of senior management. Further careful discussions are necessary on requiring the establishment of a committee that would have broader authorities than those stipulated in the Companies Act.

II. Cross-shareholdings

1. Reducing cross-shareholdings (Principle 1.4 of the Code and 4.1 of the Guidelines (Draft))

[Opinion]

Principle 1.4 of the Code Draft Revision states "When companies hold shares of other listed companies as cross-shareholdings, they should disclose their policy with respect to doing so, including their policies regarding the reduction of cross-shareholdings." It should not be interpreted as an obligation for companies to reduce them uniformly. Accordingly, for example, this should be changed to "… they should disclose their policy with respect to cross-shareholdings, such as their policy regarding reduction and holding of cross-shareholdings."

The same applies for 4.1 of the Guidelines (Draft).

[Reasons]

(1) There are various purposes for cross-shareholdings that depend on the industry or business, and there are also reasonable holdings such as those related to strengthening partnerships or expanding transactions. What is important is to examine the reasonableness of holdings, provide explanations through engagement, and dispose of holdings that have lost significance. Wording that could be understood as requiring reduction without exception should not be used.

(2) As I have said multiple times up until now, cross-shareholdings by companies other than financial institutions are also on a declining trend. When comparing the number of companies whose shares are held as cross-shareholdings by Nikkei 225 companies (excluding financial institutions) at the end of FY2013 and the end of FY2016, the number of companies has decreased for 160 of these companies, or approximately 80%. For 78 of these 160 companies (about half), the decrease has been more than 10%. It is not necessary to revise the Code under these circumstances.

2. Disclosures on assessment of cross-shareholdings (Principle 1.4 of the Code and 4.1 of the Guidelines (Draft))

[Opinion]

In the assessment of cross-shareholdings, specific details on the shares of individual companies should not be subject to disclosure. Accordingly, for example, although Principle 1.4 of Code Draft Revision states "the board should annually assess whether or not to hold each individual cross-shareholding,... The results of this assessment should be disclosed.", this should be "the board should annually assess appropriateness of holding each individual cross-shareholding,...an overview of the assessment should be disclosed."

4.1 of the Guidelines (Draft) also states "Do the companies clearly disclose and explain the results of the assessment?", and this should be "Do the companies clearly explain about the contents of the assessment?"

[Reasons]

Although assessment of cross-shareholdings is important, disclosure of the details of the assessment of individual cross-shareholdings is something that would result in huge volumes of disclosures, which would be a burden for issuers. In addition, because the contents of such assessment also deal with details of business transactions and corporate strategies (for example, holdings of shares of a company in a business domain that is being considered for full-scale entry in the future, holdings of shares of a company that is being considered for a partnership), many cases in which companies would not be able to disclose because of corporate confidential information can be assumed.

3. Prohibitions on implying possible reduction of business transactions to cross-shareholders indicating intentions to sell (Supplementary Principle 1.4.1 of the Code)

[Opinion]

Although Supplementary Principle 1.4.1 that prohibits implying possible reduction of business transactions to cross-shareholders indicating intentions to sell has been newly added to Code Draft Revision, this section should be deleted.

[Reasons]

Cross-shareholdings include holdings aimed at strengthening partnerships or expanding transactions through the mutual holding of shares (so-called "capital alliances"). It is only natural the sales of such shares should lead to a reduction in partnerships or business transactions. Reduction of business transactions should not be uniformly prohibited.

III. Asset owners (Principle 2.6 of the Code and 5.1 of the Guidelines (Draft))

[Opinion]

Although Principle 2.6 "Roles of Corporate Pension Funds as Asset Owners" has been newly established in the Code Draft Revision, this section should be deleted. In addition, 5.1 of the Guidelines (Draft) that states "Are the contents of such measures clearly disclosed and explained?" should be changed to "Are the contents of such measures clearly explained?"

[Reasons]

(1) Because there is significant variation in corporate pension funds in terms of scale and the ability to bear costs, this should not be incorporated into the Code and uniformly applied. In addition, so that investment monitoring by corporate pension funds doesn't lead to increased costs for asset management companies and for pensions in turn, it is necessary to first try to put appropriate systems in place.

(2) It is a company that incurs losses if investment by its corporate pension fund (defined-benefit pension fund) does not go well, and from this perspective, it is not different from other business areas in the company. Under these circumstances, establishing specific regulations on the scheduled recruitment or assignment of appropriate human resources for the specific area -- investments by corporate pension funds -- is not appropriate in consideration of the objective of the Corporate Governance Code.

IV. Matters that should be clarified

1. Knowledge and skills required of *kansayaku*

(1) A section in Principle 4.11 stating " persons with appropriate experience, skills as well as necessary knowledge on finance, accounting and the laws should be appointed as *kansayaku*" regarding *kansayaku* has been newly added. However, it should be clarified that each individual person of *kansayaku* is not necessarily required to have a certain level of knowledge of finance, accounting and the laws, and that it would be preferable for the members of *kansayaku* as a whole to cover a certain level of knowledge on these matters.

(2) I believe that similar knowledge, experience and skills would also be required of directors who are members of the Audit Committee, and the approach towards this point should be clarified.

2. Relationship with the Companies Act

Although Supplementary Principle 4.2.1 of the Code Draft Revision describes remuneration, etc., at Companies with Three committees, the remuneration of directors is decided on by the Remuneration Committee, not the board of directors. Matters on the roles of the board of directors should be described carefully so that there are no misunderstandings that the Code requires the board to take the roles which are not authorized under the Companies Act.

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