Opinion Statement for the 3rd Meeting of the Council of Experts on the Stewardship Code

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Regarding the draft of the revised version of the Stewardship Code, the revisions are clear, and I am in agreement with all of them, including the promotion of the strengthening of the functions of the investment chain and the enhancement of the effectiveness of corporate governance by improving the quality of exercises of shareholder rights.

With regard to the Corporate Governance Code, however, a number of recent problems have highlighted areas in need of pressing and important revision, and I strongly recommend that work start immediately on performing the revisions at the Council of Experts Concerning the Follow-up of Japan's Stewardship Code and Japan's Corporate Governance Code (hereafter, the Follow-up Council).

The first is the revision concerning the "duty that dominant shareholders should have to protect minority shareholders of the companies under their domination," which has emerged as an issue since last year following the incidents at Nissan/Renault and Yahoo/ASKUL. This point has long been discussed in the context of an amendment to Japan's Companies Act, but was not included in the current amendments due to opposition from some in the business sector and opposition from legal scholars bound by formal legal principles, and this has led to us falling way behind the international trend. Triggered by the Nissan/Renault incident, the Ministry of Economy, Trade and Industry established group governance guidelines, but the Yahoo/ASKUL incident highlighted the fact that a system under which independent outside directors are expected to regulate conflicts of interest between dominant shareholders and minority shareholders is severely restricted when dominant shareholders have the power to appoint and dismiss independent outside directors, who are supposed to play the key role. For dominant shareholders, too, this duty of protection not constituting either hard law or soft law, so when their own interests conflict with the common interests of shareholders, they are faced with the dilemma of which to act faithfully to when exercising their influence as shareholders. This is because managers of parent listed companies and dominant shareholders primarily have a fiduciary duty toward their own shareholders and asset owners.

Obviously, the issue of both parents and subsidiaries being listed has been seen especially frequently, and has been exposed to criticism from institutional investors, in Japanese capital markets for many years. However, the listing parent-subsidiary pairs has historically also served an incubation function through spin-offs and a transitional function during business reorganizations and consolidations. The core issue here is not parents and subsidiaries being listed in itself, but the fact that the structure makes it easy for opaque conflict-of-interest actions to be conducted between listed parents and subsidiaries or between dominant shareholders and controlled companies. This is because in the case of a listed company whose shares can be purchased by anyone, i.e. a public company, there is no clear duty to protect minority shareholders. As a result, there is a higher risk of the rights of minority shareholders of listed subsidiaries and listed controlled companies being improperly infringed and a possibility of trust in capital markets being harmed, and nothing has been done to address this situation.

To bring about fair and transparent corporate governance, the most important and most pressing revision task is to include the duty of dominant shareholders to protect minority shareholders in the Corporate Governance Code. The Tokyo Stock Exchange has established a study group to look into the issue, but without waiting for the study group to reach its conclusions, work should start on revising the Corporate Governance Code at the Follow-up Council.

The second is the revision concerning the substantial strengthening of the functions of Audit & Supervisory Board and Audit Committee, which is vital for defensive governance in the face of repeated scandals. In the case of problems such as fraudulent accounting, data falsification, and inappropriate exchanges of money or goods, there is a tendency to criticize the failure of outside directors to spot the problems, but from my experience of working frequently on the exposing side in cases such as the Kanebo incident, I would at least say that there are limits to what outside directors can do in terms of uncovering the incidents at an early stage. For example, it is clearly pretty much nonsense to expect outside directors to complain about securities reports that have been signed off by a specialist audit firm that had multiple personnel working on the engagement. What they can do instead is rigorously investigate the facts when an incident is discovered without hesitation to the current management, find out who was responsible, and take steps to prevent recurrences.

The real problem with preventing serious wrongdoings or discovering them early and nipping them in the bud before they become serious is that the functions of internal or full-time kansayaku (audit and supervisory board members) and audit committee members, who have chances to come into contact with them through internal information and various types of whistleblowing at an early stage, are not necessarily strong.

When such problems occur, there are calls to strengthen internal audit functions, but as became clear with the Toshiba incident and the Nissan incident, in cases where top management are the direct or indirect source of the problem, or in other words, in cases that are going to become more serious, there are limits to the functions of internal audit, whose staff report to top management. So kansayaku and audit committee members are the last bastion, as they are directly accountable not to top management, but to all shareholders and stakeholders.

Particularly from the standpoint of early discovery, internal or full-time kansayaku can play an important role, but the fact is that the post of internal full-time kansayaku or audit committee member is seen as a consolation prize for people who failed to become directors or people who couldn’t be properly rewarded for their achievements. So they are often not specialists in accounting, legal affairs, or compliance, and some of them have spent their entire careers in sales or production, and are therefore complete novices when it comes to accounting or legal affairs. With regulations and societal norms become increasingly global, codified, complex, and fluid, companies are faced with a greater risk of receiving a deadly blow from compliance matters. In response to this situation, the slipshod practices of kansayaku and audit committee members should be radically overhauled, and the posts of former-employee or full-time kansayaku or audit committee members should be re-positioned as important and high-status posts that specialists from the compliance line or financial-accounting line can aspire to. Furthermore, those taking up the posts should act with a sense of mission and exercise internal influence in a manner consistent with their professional responsibilities. In addition, there should be a direct report line from internal audit departments, and the independent financial foundation required for that should be secured. These matters should be included in the Corporate Governance Code.

Therefore, with regard to these two points, namely the "duty of dominant shareholders to protect minority shareholders of the companies under their domination" and "elevating the status of internal or full-time kansayaku or audit committee members," I strongly urge the committee to immediately, and without resting, begin considering revisions to the Corporate Governance Code.