

Important Things For Japan To Include in Its Corporate Governance Code

(These are the ideas, items and examples that I submitted to the FSA very early in their process of considering what to include in the Corporate Governance Code (mainly, on July 24, /2014), based on my experience as an external director. This was not intended to be a comprehensive listing or a draft code. I also submitted other ideas later on.)

By Nicholas Benes

Still Needed: Practices that were not included in the Code, but which are still needed

More Detail and Emphasis Needed: Practices that were mentioned in the Code, but only as examples or without enough detail, and therefore lack sufficient emphasis

1. Corporate Governance Guidelines: The board must write down, approve, and periodically amend and update the company's Corporate Governance Guidelines, which should be made available on the company's web site, and which must set forth at minimum: (a) the company's principles and governance practices related to all of the subjects referred to below, in particular those related to board practices and the chairmanship, leadership and agenda-setting of board meetings, as well as any other items that the board believes a well-informed shareholder would wish to know; (b) the board's articulation of the company's mission and value creation model; (c) the board's articulation of its priorities in supporting and supervising management so as achieve the company's mission and create value; (d) the company's code of business conduct and ethics for directors, shikkou yakuin executive officers and employees, including its commitment to promptly disclose any waivers or exceptions made in the case of directors or senior managers; (e) the company's policies with respect to the duties, role and employment position of shikkou yakuin and attendance at the keiei kaigi, including by kansayaku; (f) the company's policies with respect to director training and orientation (topics, requirements, and timing), with summary details about the policy with respect to each type of director or kansayaku; and (g) the procedures which the board intends to employ to consider, evaluate and respond to: (i) takeover bids of any type; (ii) management buyouts, or similar transactions with related parties; and (iii) offers by third parties to acquire material divisions or affiliates of the company; - in all three cases, with a view to maximizing corporate value and neutrality in decision-making and negotiations while minimizing any adverse impact to shareholder value that might arise from conflicts of interest or other types of self-interest, personal loyalty, or related party status
2. Role of the Board: Every company should be headed by an effective board to lead, direct, and control the company. The board must be collectively responsible for the long-term

success of the company. The board works with management to achieve this objective. Management remains accountable to the board, which oversees and supervises it. There should be a clear understanding that all directors are responsible to work in good faith towards fulfilling the supervisory role of the board over the entire company and its executives, and that this responsibility is separate from executive responsibilities for the running of the company's business.

The board's role is to: (a) provide entrepreneurial leadership, set strategic objectives, and ensure that the necessary financial and human resources are in place for the company to meet its objectives; (b) establish a framework of prudent and effective controls which enables risks to be assessed and managed, including safeguarding of shareholders' interests and the company's assets; (c) review management performance; (d) identify the key stakeholders and recognize the relative extent to which their perceptions affect the company's reputation, business and long-term growth and profitability; (e) set the company's values and standards (including ethical standards), and ensure that obligations to shareholders and other stakeholders are understood and met; and (f) consider sustainability issues, e.g. environmental and social factors, as part of its strategic formulation.

As part of their role as members of a unitary board, non-executive directors should constructively challenge and help develop proposals on strategy. No one individual should have unfettered powers of decision.

3. **Board composition:** At least one-third of the members of the board of directors should be independent, and identified as such in TSE disclosure required by the Code, in the proxy materials, and in the annual report. When such independent directors are nominated by the company, such nomination should be based on an affirmative decision (by resolution of the board) with respect to each director that he or she is independent in terms of character, background and judgment, taking into account the views of the nomination committee as to whether there are relationships or circumstances which are likely to affect, or could appear to affect, the director's judgment. Independent directors should disclose to the board any such relationship as and when it arises, on an ongoing basis.

In the aforementioned disclosure, the company should set forth all information that the board considered relevant in making the decision that each such director is both independent and well-qualified, as well as any significant prior relationships (including the details of any compensation) between the candidate and the company, its directors and/or executives or their families (including regulatory relationships), etc. that a reasonable shareholder might wish to know in assessing independence. Any compensation received from the company or as a result of such relationships, either directly or indirectly, other than approved compensation related to that person's position as a director or kansayaku, should be disclosed on ongoing basis, along with relevant details. When a director is no longer

considered to be independent by the board, that fact shall be immediately disclosed, along with relevant details and the reasons for that determination.

For a three-year period after any director or kansayaku has retired from service, all compensation received from the company, either directly or indirectly, should be disclosed.

4. **Board size and service:** Boards should have no fewer than five and no more than 12 director members. Directors and kansayaku with full-time jobs (whether at the company or not) should not serve on more than two other companies' boards. Directors and kansayaku without full-time jobs should not serve on more than four companies' boards. Representative directors should not serve on more than one other company's board. No director should serve for more than six years, and no kansayaku should serve for more than eight years, absent an explanation of the reason he or she should serve longer.
5. **Committees:** The board should form committees composed of at least two independent directors to study, deliberate upon, and advise the board in writing with respect to: (a) nominations and succession planning for the board and kansayaku board, and also for all representative director and senior executive officer (shikkou yakuin) positions; (b) the executive compensation plan and compensation of specific executives, including compensation for shikkou yakuin executive officer positions and any other senior managers; (c) any material related-party transaction; and (d) any other matter for which a director has recommended, based on his or her own responsibility and judgment, that an independent committee should be formed in order to avoid the impact of personal relationships or inherent managerial or other self-interest on the board's decision making, and a majority of the board has voted in agreement with the proposal. At least one kansayaku should be present at any committee meeting, and fair rules of procedure related to confidentially of discussions, advance notice and information provision, and similar matters shall be established and set forth in advance in the company's corporate governance guidelines. However, any kansayaku present will not vote. Minutes shall be kept, to be released to the board with the unanimous consent of all voting members, not to be withheld without a specific reason with which the kansayaku states his or her agreement in writing.

"Third-party committees" or informal committees should not be used unless the board affirmatively determines by a vote that for a specific reason (stated in the board meeting minutes) that in the particular case it is not appropriate to set up a committee composed of independent directors who have fiduciary duties to serve the best interests of the company, along the lines of the standard rules of the company governing independent committees.

6. **Nomination committee:** The board should have a nomination committee composed of at least two independent directors and attended by at least one kansayaku. Executive directors and any other managers or consultants should advise the committee in detail at the

committee's request and at the company's expense, as desired, but should not be present at its final deliberations and voting. The board of directors should clearly determine and write down in its corporate governance guidelines the primary mission and functions of the committee, which should include at a minimum: (a) qualification standards and minimum knowledge required for all directors and kansayaku, respectively; and criteria for independence, in the case of independent directors; (b) advance identification and succession planning for potential future directors and kansayaku in order to assure an orderly nominations process and appropriate board expertise, including suggested career development training; (c) nominating, and advising upon training for, new directors and kansayaku to be proposed at the AGM, based on consideration of a wide and diverse range of candidates from both inside and outside of the company, which does not only include include persons suggested by management; (d) nominating the kansayaku who will attend the nomination committee, compensation committee, and other committees; and (e) succession planning advice to the board (identifying replacement candidates in advance) regarding CEO and other representative director positions, and promotion/hiring of senior executive officers (shikkou yakuin). The nomination committee should provide its clear advice on these topics to the board in writing, on a continuing basis.

7. **Compensation committee:** The board should have a compensation committee composed of at least two independent directors and attended by at least one kansayaku. Executive directors and any other managers or consultants should advise the committee in detail at the committee's request and at company expense, as desired, but should not be present at its final deliberations and voting. Each company's corporate governance guidelines should include a clear description of the primary mission and functions of the compensation committee, which should include at a minimum: (a) confirming in writing the priorities and purposes, principles, and incentives that the executive compensation plan should, at each level, strive to reflect; and (b) confirming, and as necessary, assisting in designing and advising the board upon, the executive compensation plan and compensation of specific executives, including compensation for shikkou yakuin executive officer positions and any other senior managers; and (c) assuring that there is sufficient disclosure of the details of actually received executive compensation each year, including the calculations, targets and formulas upon which it is based, to satisfy shareholder expectations of transparency and secure their general agreement .
8. **Lead independent director:** The independent directors should meet and appoint one of the independent directors to serve as the lead independent director to serve as an intermediary for the other directors and the kansayaku when necessary, including but not limited to the addition of items to the agenda and the acquisition or reporting of information needed to perform director and kansayaku roles. The lead independent director is responsible for ensuring that all directors receive accurate, timely and clear information. He or she should be available to directors who have requests for information. The lead independent director

should be available to shareholders if they have concerns which contact through the normal channels of chairman, CEO or other executive directors has failed to resolve or for which such contact is inappropriate.

9. Lead outside kansayaku: The kansayaku board should appoint one of the outside kansayaku to supplement the full-time kansayaku as an intermediary for the other kansayaku and the directors when necessary, including but not limited to the addition of items to the agenda and the acquisition or reporting of information needed to perform director and kansayaku roles. Together with the lead independent director, the lead outside kansayaku is responsible for ensuring that all directors receive accurate, timely and clear information. Separately, he or she also bears this responsibility with respect to all kansayaku. The lead independent kansayaku and the full-time kansayaku should be available to shareholders if they have concerns which contact through the normal channels of chairman, CEO or other executive directors has failed to resolve or for which such contact is inappropriate.
10. Information flow: No director or kansayaku should be denied access to information held by the company. Barring exceptional circumstances, pursuant to written board policy, all materials and information to be considered at board meetings should be provided to all directors and kansayaku at least five days before each board meeting.
11. Executive sessions: On a quarterly basis, following the regularly scheduled board meeting, the independent directors shall meet separately, with no executive directors present. The lead independent director will serve as chair. On a semi-annual basis, the first half of this meeting should be conducted jointly with the members of the kansayaku board, to facilitate the sharing of information and views.
12. Director and kansayaku training: All incoming directors and kansayaku should obtain comprehensive and tailored induction when they join the Board. This should include their fiduciary duties and liabilities and how to discharge those duties, and an orientation program to ensure that they are familiar with the company's business and governance practices. For directors and kansayaku who have never served on the board of a public company, the company should provide third-party professional training in corporate law, securities law, accounting, finance, M&A, risk management and controls, and governance best practices; and other legal, audit and industry-specific knowledge as appropriate. In case of executive directors, such training should be given before nomination to the board, as part of basic training for all shikkou yakuin executive officers, inasmuch as they support the board and may later be nominated as directors or kansayaku.

Similar training should be obtained by non-executive or external directors and kansayaku who have not served on the board of a public company for more than two years. Such training should be obtained prior to their election.

It is equally important that all directors and kansayaku should receive regular training, particularly on relevant new laws and regulations, changes in commercial risks, emerging best practices for directorship and compliance matters, and other relevant matters, from time to time. The company should be responsible for arranging and funding such training, and for paying for any training that directors or kansayaku receive of their own volition which is reasonably related to their duties.

The lead independent director should meet with each director and kansayaku on an annual basis, to ensure that they continually update their skills and the knowledge and familiarity with the company required to fulfill their role both on the board and on board committees. Each year, the company should disclose in its TSE disclosure related to the Code, its proxy materials, its web site, and its annual report, a summary of the director and kansayaku training (or preparatory training) that was given in the prior year.

13. Professional advice: The board and the company should ensure that directors, especially non-executive directors, will be permitted to receive independent professional advice at the company's expense where they judge it necessary (at their own discretion) to discharge their responsibilities as directors. Committees should be provided with sufficient resources to undertake their duties, and automatically funded for expenses that the committee deems necessary.
14. Dialogue with Shareholders: There should be a dialogue between the company and its shareholders based on the mutual understanding of objectives. The board as a whole, and the kansayaku board, has responsibility for ensuring that a satisfactory dialogue with shareholders takes place. While recognizing that most shareholder contact is with the CEO, IR department and CFO or financial department general manager, the lead independent director should ensure that all directors and kansayaku are made aware of major shareholders' issues and concerns.
15. Board evaluation: The nomination committee should undertake a formal and rigorous annual evaluation of the board's performance and that of its committees and individual directors including the CEO, taking into account survey results, input from the executive session of outside board members, and other inputs. Evaluation of the board should consider the balance of skills, experience, independence and knowledge of the company on the board, its diversity, including gender, how the board works together as a unit, and other factors relevant to its effectiveness. The nomination committee should make a formal report to the board. The lead independent director, the nomination committee, and the board should act on the results of the performance evaluation by recognizing the strengths and addressing the weaknesses of the board and, where appropriate, proposing changes in board or committee practice, and/or proposing new members to be appointed to the board or seeking the

resignation of directors. Individual evaluation should aim to show whether each director continues to contribute effectively and to demonstrate commitment to the role (including commitment of time for board and committee meetings and any other duties).

16. Retirement allowances paid before retirement as a director: If retirement allowances in respect of service as an employee (i.e., not as a director or kansayaku) will be paid to internal executives at the time when they are appointed as directors or kansayaku (or any time after), the total amounts paid or expected to be paid to each new director or kansayaku must be disclosed in the proxy materials in which that person is nominated. If retirement bonuses are paid to any directors or kansayaku at the time of their retirement or afterwards, the amount paid to each such person shall be disclosed when the obligation to pay it accrues.
17. Post-retirement compensation: Compensation should not be paid to prior executive officers, directors of any type, or kansayaku of any type (following their retirement from active service) unless for specific, contractually pre-defined and actually provided services, and in that case, only in amounts that are normal for such services when provided in the market on an arms-length basis by unrelated third parties. If any such compensation is paid, within one month following the end of each fiscal year the amount paid to each such person during that fiscal year, his or her name, the nature of the services, and the reason why that person was selected instead of a third party who never was in active service to the company in any of the aforementioned positions, shall be disclosed.
18. Shareholder meetings. In order to treat all shareholders equitably by providing equal access to shareholder meetings and convenient voting methods, companies shall avoid scheduling their shareholder meets during any week when, during the previous year, a very large number of companies, such as more than 40%, also scheduled their meetings. Where necessary in order to do this, companies should consider proposing to their shareholders that the Articles of Incorporation be amended in order to change the cutoff date for determining the voting of shares. In addition, companies shall provide investors with the opportunity to provide electronic voting: a) for individual investors; and b) for institutional investors (whether Japanese or foreign), via the ICJ's electronic voting platform, or similar method; and in both cases, shall also disclose whether they so provide, on their web sites.
19. Comply or explain principle mechanics: (a) All TSE-required disclosure related to comply-or-explain regarding these Code provisions should be in a single report that is always available on an updated basis both on the company's web site and also on the TSE's web site, and also in any other materials where the corporate governance code and/or shareholder convenience requires inclusion (e.g., the proxy materials and the annual report; incorporation by reference to web site permitted); (b) in the single report, items for which the company is compliant should be clearly listed as "fully compliant", by Code section and sub-section number, and any items where there is not full compliance will require an

explanation; (c) any changes in the compliance (or not) of specific items, or the explanation, must be made in the report within 10 days, the change being notified to the investing public with “timely disclosure” that is available on the company’s web site; and (d) all disclosure in the single report or regarding changes in circumstance shall be subject to that TSE’s rules for all other “timely disclosure” items; i.e., subject to possible censure or other disciplinary action.

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