Corporate Governance Reform in Japan

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This presentation represents the presenter’s own views, not necessarily identical to those of the Financial Services Agency of Japan or OECD.
Synchronized Processes

Participation
Including non-OECD members

OECD Principles of Corporate Governance
Finalized in Sep 2015

Interaction
Corporate Governance Committee
Council of Experts

G20 in Ankara Sep 2015

G20

Ankara Communique Sep 2015

Finalized in June 2015

Japan’s Corporate Governance Code
Finalized in Feb 2014

Finalized in Sep 2015

Japan’s Stewardship Code
Antalya Summit Nov 2015
Relationship between Japan’s Codes and OECD Principles

Corporate Governance for Growth

- Rights and equitable treatment of shareholders
- Disclosure and transparency
- Role of stakeholders
- Responsibilities of the board

OECD: Institutional investors, stock markets, and other intermediaries

Japan’s Stewardship Code

Principle-based (not rule-based)

Unique Features of Japan’s codes
- Dialogue with Shareholders
- Synergy of Two Codes (Corporate governance and Stewardship)
- Growth-oriented governance
Responsibilities for shareholders

**Corporate Governance Code**

Entered into force in June 2015

- Principles of good practices for companies
- Responsibilities for shareholders and other stakeholders

**Stewardship Code**

Established in February 2014

- Principles of good practices for institutional investors
- Responsibilities of final beneficiaries (entrusters of assets)

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Company

Stewardship responsibilities

Institutional investors (shareholders)

Constructive dialogues

Final Beneficiaries
(individuals, pensioners, insurance policyholders, etc.)

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Shareholders

Other Stakeholders (employees, creditors, customers, etc.)

Responsibilities for shareholders

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Japan’s Stewardship Code was finalized in February 2014 under the Japan Revitalization Strategy (Cabinet decision in June 2013).

Japan’s Corporate Governance Code [Final Proposal] was finalized in March 2015 under the Japan Revitalization Strategy [Revised in 2014] (Cabinet decision in June 2014).
Japan’s Stewardship Code and Corporate Governance Code

Stewardship Code

Corporate Governance Code

Two Wheels of a Cart

Investment

Companies

Stakeholders

(shareholders, employees, creditors, customers, etc.)

Institutional Investors (Shareholders)

Final Beneficiaries

(individuals, pensioners, insurance policyholders, etc.)

Constructive Dialogue

Increase of Returns over the Mid- to Long-Term

Creation of Virtuous Cycle

Increase of Corporate Value over the Mid- to Long-Term

Growth of Entire Economy
Appointment of two or more Independent Directors

48.4% of the 1st Section appoint two or more independent directors.

[Ratio of 1st Section Companies with two or more Independent Directors]

* Figures for years prior to 2015 are based on corporate governance reports. The figures for 2015 are based on corporate governance reports submitted by listed companies as of July 14, 2015.
## Reduction of strategic shareholdings

<table>
<thead>
<tr>
<th></th>
<th>Book value of domestic listed stocks (March 2003)</th>
<th>Book value of domestic listed stocks (March 2015)</th>
<th>Disposal Plan (proportion)</th>
<th>Targeted period</th>
</tr>
</thead>
<tbody>
<tr>
<td>MUFG</td>
<td>6.1 (JPY tn)</td>
<td>2.8 (JPY tn)</td>
<td>▲ 0.80 (JPY tn) (approx. ▲ 30%)</td>
<td>Over the next 5 years</td>
</tr>
<tr>
<td>Mizuho</td>
<td>3.9 (JPY tn)</td>
<td>2.0 (JPY tn)</td>
<td>▲ 0.55 (JPY tn) (approx. ▲ 30%)</td>
<td>Over the next 3.5 years</td>
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<tr>
<td>SMFG</td>
<td>3.2 (JPY tn)</td>
<td>1.8 (JPY tn)</td>
<td>▲ 0.50 (JPY tn) (approx. ▲ 30%)</td>
<td>Over the next 5 years</td>
</tr>
</tbody>
</table>
Participants of The Stewardship Code

- Trust banks : 7
- Investment managers : 141
- Pension funds : 24
- Insurance companies : 22
- Others (service providers, etc.) : 7

Total : 201

(30 November 2015)

Almost all major institutional investors in Japan have already accepted the Stewardship Code. In total, 201 domestic and foreign investors have expressed compliance with it.
Implementation of Stewardship Code

- 201 investors comply with around 90% of Stewardship Code’s Principles.

Principles:

1: Policy on responsibility: 96%, Comply (94%), Explain (2%), Non-disclosure (2%), (November 2015)
2: Conflicts of interest: 95%, Comply (93%), Explain (3%), Non-disclosure (2%), (November 2015)
3: Monitoring Investee companies: 88%, Comply (86%), Explain (2%), Non-disclosure (10%), (November 2015)
4: Solving problems: 87%, Comply (85%), Explain (3%), Non-disclosure (10%), (November 2015)
5-①: Policy on voting: 82%, Comply (76%), Explain (6%), Non-disclosure (12%), (November 2015)
5-②: Policy on disclosure of voting activity: 63%, Comply (53%), Explain (10%), Non-disclosure (27%), (November 2015)
6: Periodical Report: 86%, Comply (84%), Explain (2%), Non-disclosure (12%), (November 2015)
7: Skills and resources: 85%, Comply (83%), Explain (2%), Non-disclosure (12%), (November 2015)
Roughly 80% of the companies listed on TSE First/Second Section comply with more than 90% of the Code’s principles.

【Compliance results by each section】 (December 2015)
Improving the reform of corporate governance from “forms” to “substances”

- Regarding reform of corporate governance, we have formulated Japan’s Stewardship Code and Japan’s Corporate Governance Code. However, it is just a starting point, not a goal. As it was pointed out that the measures taken remain merely a formality, we need to improve the dimension of the reform from “forms” to “substances”. In this respect, we will establish the “Council of Experts Concerning the Follow-up of Japan’s Stewardship Code and Japan’s Corporate Governance Code” and will encourage further improvement of corporate governance of all listed companies, by disseminating information regarding discussions, proposals and best-practices from experts including corporate executives, local and foreign investors, and academics.
## The topic of Follow-Up Council

<table>
<thead>
<tr>
<th>The Council</th>
<th>Date</th>
<th>Topic</th>
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</thead>
<tbody>
<tr>
<td>The 1st Council</td>
<td>September 24, 2015</td>
<td>Procedures to Run the Follow-up Council</td>
</tr>
<tr>
<td>The 2nd Council</td>
<td>October 20, 2015</td>
<td>The Board of Directors（1）</td>
</tr>
<tr>
<td>The 3rd Council</td>
<td>November 24, 2015</td>
<td>The issue of cross-shareholdings</td>
</tr>
<tr>
<td>The 4th Council</td>
<td>December 22, 2015</td>
<td>The Board of Directors（2）</td>
</tr>
<tr>
<td>The 5th Council</td>
<td>January 20, 2016</td>
<td>The Board of Directors（3）</td>
</tr>
<tr>
<td>The 6th Council</td>
<td>February 18, 2016</td>
<td>The Board of Directors（4）, Institutional Investors（1）</td>
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</tbody>
</table>
Changes in management environments and increasing complexity of management challenges.
(e.g., globalization, progress of technological innovation, population decline and the rapid aging of society, increased attention to social and environmental issues)

Management led by the CEO
Managerial decisions adequately respond to business challenges and are far-seeing.

Board
Establishing an environment that supports appropriate risk-taking by the management. Conducting effective oversight.

Achieving sustainable corporate growth and increased corporate value over the mid- to long-term.
Corporate Boards Seeking Sustainable Corporate Growth and Increased Corporate Value over the Mid- to Long-Term (2)

Opinion Statement
The Council of Experts Concerning the Follow-up of Japan’s Stewardship Code and Japan’s Corporate Governance Code

Objective, Timely and Transparent Appoint/Dismissal of CEO

• In order to enable appropriate managerial decisions led by the CEO, appointment/dismissal of the CEO is the most important strategic decision for companies.

− Appointment:
Some argue that Japanese companies need to secure talented executives qualified for the position of CEO. Companies need to invest sufficient time and resources in the development of candidate talent and the actual appointment of the CEO. In addition, it is important to secure objective, timely and transparent procedures for the appointment of the CEO.

− Dismissal:
It is necessary to set a mechanism that makes it possible to dismiss the CEO in a timely manner, in cases where problems are found with the CEO after conducting appropriate evaluation of the company’s performance.

Independent and Objective Board Composition

• Securing sufficient independence and objectivity in order to support appropriate managerial decisions.
• Securing adequate qualifications and diversity required by the business environment and challenges.
(Shareholders are shifting their focus from the number of independent directors to the qualifications of the board members.)

Board Operations Emphasizing Strategies

• Discussion putting more weight on strategic directions.

Continuous Evaluation of the Board’s Effectiveness

• Making a proper self-evaluation of the effectiveness of the board’s composition and operations, in order to reflect such evaluation in the next steps of the board.
⇒ Realization of a PDCA (plan-do-check-act) cycle.