

Japan's Approach to Enhance Corporate Governance

---in the context of growth strategy

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**** This presentation represents the presenter's own views, and not necessarily those of the FSA.***

Corporate Governance in the context of Growth Strategy

“Japan Revitalization Strategy” (approved by cabinet in June, 2013) refers specifically to the following:

- (1) intensifying Government's efforts for **more outside directors (“OD”s)**;
- (2) drawing up Japan's **“Stewardship Code;”** and
- (3) encouraging stock exchanges to take measures for better corporate governance(**“CG”**), including **developing new stock indices for high-profile companies** with good profitability and governance.

Outside directors and the Stewardship Code

(1) Amendment to the Companies Act for more ODs has been submitted to the Diet.

- *Stricter “Comply or Explain” policy will be enforced:*

e.g. large public companies without an OD shall disclose rationales for not appointing an OD at their annual shareholders’ meetings.

- *“Review Clause:”* the amendment bill provides that the CG framework shall be reviewed in 2 years, checking whether ODs will have actually been increased, and, as necessary, take such measures as mandatory ODs.

(2) Japan’s Stewardship Code

- Japan’s “Stewardship Code” was finalized on February 26, 2014, to promote constructive engagement and dialogue between institutional investors and investee companies.

JPX-Nikkei Index 400

(3) A new stock Index

● JPX group (stock exchanges) and Nikkei **launched a new stock index “JPX-Nikkei Index 400,”** on January 6.

● **The benchmarks to select 400 constituents are unique:**

1) **ROE (40%) and operational profit (40%)**, in addition to commonly used market capitalization etc.; and

2) some **supplementing benchmarks**, such as
a) **OD element (at least two independent outside directors)**,

b) **adoption of IFRS** (International Financial Reporting Standards) ; and

c) **disclosure in English on earnings information**

● **The list of the 400 companies is reviewed every year.**

Japan's New Initiatives to enhance ROE & CG

Initiatives

Actions

Expected Result

Stewardship
Code(SC)

disclosure of
names of IISCs

disclosure of
IISCs' voting
policy & result

investors(e.g. GPIF)
would favor IISCs with
enhanced fiduciary
duty
⇒ more IISCs will have
more active dialogue
for higher ROE

Legislation
for more
outside
directors(OD)

Institutional
Investors
adopting SC

dialogue

vote

("IISC")

Shareholders

disclosure of
reasons for
no ODs
at GSMs(*)

(*) GSM: General
Shareholders' Meeting

more incentives
for appointing ODs

Nikkei – JPX
400

JPX
&
Nikkei

check
ROE

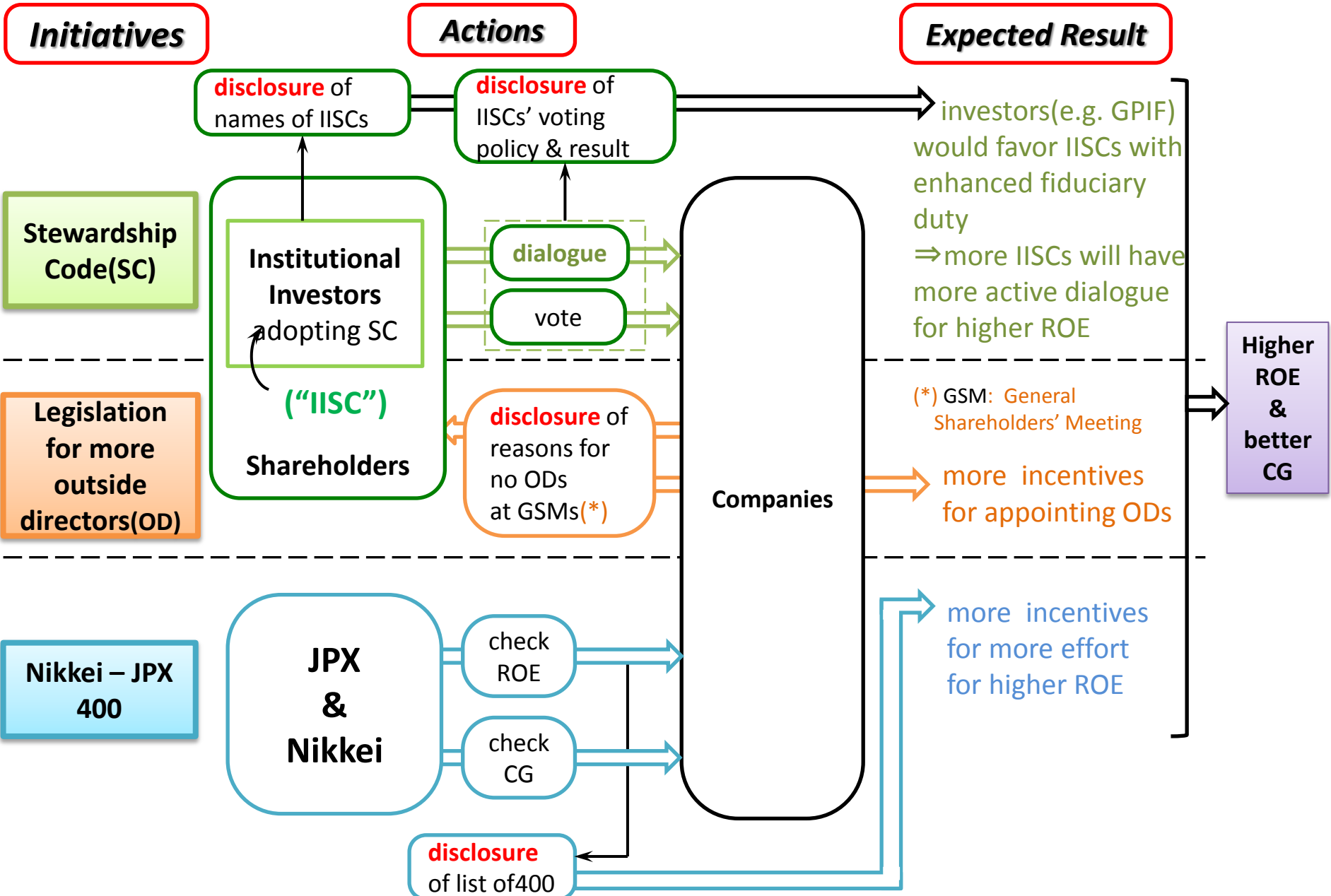
check
CG

Companies

more incentives
for more effort
for higher ROE

disclosure
of list of 400

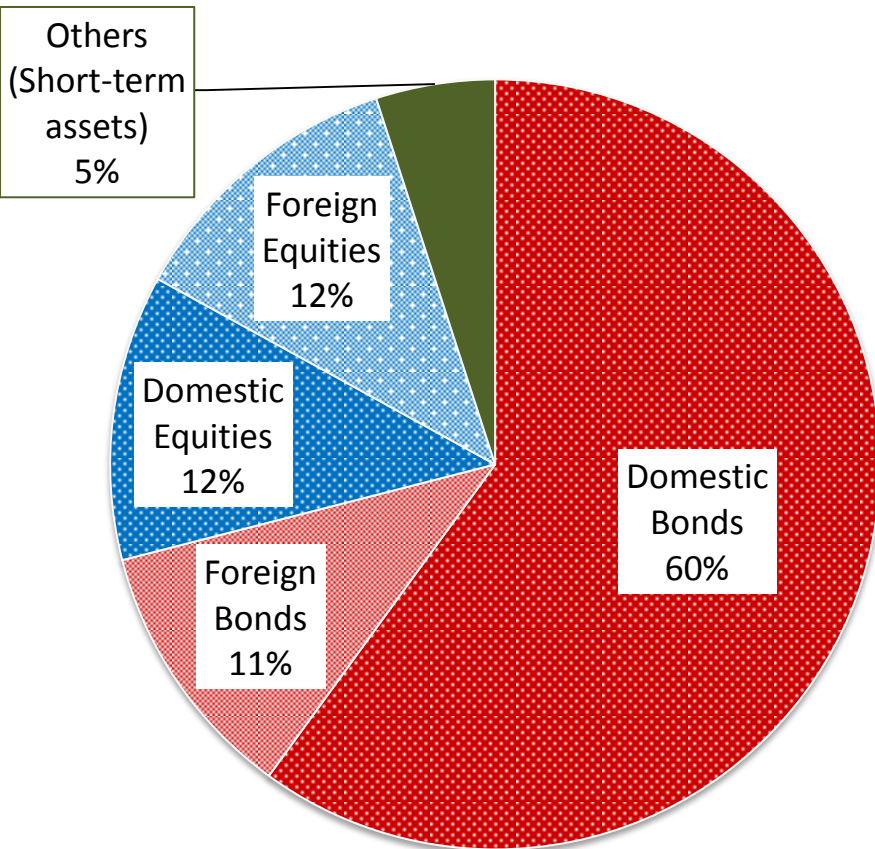
Higher
ROE
&
better
CG



GPIF Reform

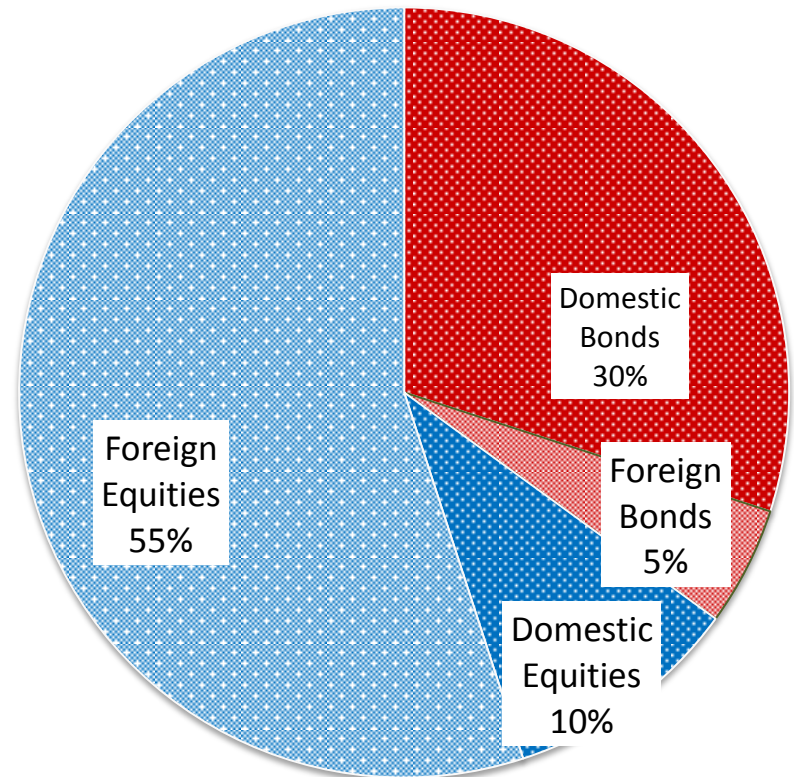
Japan

Government Pension Investment Fund (GPIF)



Canada

Canada Pension Plan Investment Board (CPPIB)



Timetable for the GPIF Reform

The experts' panel for reform of public funds issued a report on Nov.20, 2013, presenting timelines for GPIF reform.

1) Immediate Actions

- Revising asset allocation using the permissible range of deviation
- Working out investment return targets and risk tolerance

(*) The current framework of allocation [total value : ¥120.5 trillion (end- March 2013)]

- ① Domestic Bonds 60% ($\pm 8\%$) ② Domestic Equities 12% ($\pm 6\%$) ③ Foreign Bonds 11% ($\pm 5\%$)
- ④ Foreign Equities 12% ($\pm 5\%$) ⑤ others(5%)

2) Actions to be taken within about one year

Revising the current allocation framework, investing in new asset types and establishing baby funds

3) Actions to be followed

- Investing in new asset types (including capital assets and assets without easily identifiable market values)
- Reform to a new legal entity with enhanced governance structure

J-N 400 and SC in the GPIF Report

[Excerpts]

II-3-(3) Benchmarks of passive investments

Given that TOPIX includes stocks lacking sufficient investment profitability, funds should consider using other indexes that enable more efficient investment (including, for example, the use of a new stock index which is due to be introduced at the beginning of 2014 (the [JPX-Nikkei 400](#)), that takes into account factors such as return on equity ([ROE](#))).

IV Maximizing returns on equity assets

Each fund, needs to hold close dialogues with investment targets and exercise voting rights appropriately through an investment outsourcer. To this end, each fund needs to publish a policy based on the outcome of the FSA's ongoing consideration of [the Japanese stewardship code](#) and [urge investment outsourcer to comply with the policy](#).