

October 28, 2015

To

Corporate Accounting and Disclosure Division, Planning and Coordination Bureau, Financial Services Agency

Secretariat of the Follow-up Council

Japan

Dear Sir/Madame,

Thank for the opportunity to provide comments on ways to improve the corporate governance of listed companies in Japan. These comments are the joint effort of the CFA Society of Japan<sup>1</sup> and CFA Institute<sup>2</sup>. CFA Institute represents the views of investment professionals before standard setters, regulatory authorities, and legislative bodies worldwide on issues that affect the practice of financial analysis and investment management, education and licensing requirements for investment professionals, and on issues that affect the efficiency, integrity and accountability of global financial markets.

### Summary

We support the efforts of the Financial Services Agency to improve corporate governance standards in Japan through the recent adoption of the Stewardship Code and the Corporate Governance Code. We hope that the FSA can build on these efforts in order to improve the corporate governance of listed companies in Japan. We believe that such improvements, when coupled with increased engagement fostered by the stewardship code will lead to improved company performance – which overtime will be recognized and rewarded by shareowners. Shareowners will reward companies with higher corporate governance standards with their capital because they believe that their capital is in safe hands when standards of transparency and corporate governance are high.

To this end, the Council of Experts should reiterate that “The significance of this approach is found in having parties confirm and share the aim and spirit of the principles of The Code and review

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<sup>1</sup> CFA Society of Japan represents about 900 investment professionals in Japan, and is a member society of CFA Institute. As a professional organization with an absolute interest in market integrity, CFA Society of Japan with support from CFA Institute seeks to promote shareholder engagement and good corporate governance.

<sup>2</sup> CFA Institute is a global, not-for-profit professional association of more than 129,000 investment analysts, advisers, portfolio managers, and other investment professionals in 146 countries, of whom more than 123,300 hold the Chartered Financial Analyst® (CFA®) designation. The CFA Institute membership also includes 146 member societies in 71 countries and territories

their activities against its aim and spirit, not against the literal wording of the Principles, even where the Principles may look abstract and broad on the surface.”

The following is our comments on issues to be discussed and reviewed in the meetings of the “Council of Experts Concerning the Follow-up of Japan’s Stewardship Code and Japan’s Corporate Governance Code” (the “Follow-up Council”), as well on further improvement of corporate governance.

## **Specific Comments**

### Voting and the AGM

We believe that companies should send convening notices for general shareholder meetings early enough to give shareholders sufficient time to consider the items on the agenda. Best practice for publishing annual general meeting agendas around the world is seen as at least five to six weeks prior to the meeting. Such specificity around international best practice will build investor confidence in the Japanese system of governance. Investment firms are responsible for reviewing, analyzing, and voting on many different issues presented by companies whose securities are held on behalf of clients. To enable them to perform these tasks for dozens or even hundreds of meetings within a short period of time and in a number of different jurisdictions, firms need to have received this information at least three weeks ahead of the meetings.

The mechanics of voting matter, and we urge the FSA to ensure that shareowners have access to a mechanism that ensures the exercise of their rights. We encourage the use of electronic voting and a requirement of an English translations of the convening notices of general shareholder meetings. Each of these mechanisms will allow for greater cross-border voting by an informed shareowner base.

We would like to reiterate our belief that in voting at the AGM or any special meeting each share has one vote. Many jurisdictions around the world have recently been discussing a move to dual class voting shares, stating that such a voting structure allows a company to reward long-term shareowners. However, any structure that permits one group of shareowners disproportionate votes per share creates the potential for a minority shareowner to override the wishes of the majority of owners for personal interest. Where such dual structures are legal, companies should disclose such arrangements and the situations, the manner, and the extent to which those arrangements may affect other shareowners.

We would like to reiterate that we believe companies should have to seek shareowner approval for matters that directly affect shareowner wealth, while leaving matters relating to operational concerns to the board and management to decide. This would require management to seek approval for issuance of stock options as compensation, compensation policies, mergers, acquisitions, divestitures, and capital structure decisions such as issuing large amounts of new equity shares or debt. Matters such as how to organize operating units, which products to develop, or non-capital decisions, would be left to management to decide.

### Related Party-Transactions

Principles of sound corporate governance call for companies to have appropriate thresholds for determining when related-party transactions require board and/or shareowner approval. Investors need to ensure that there are systems in place that monitor the legitimacy of major transactions pursued by company management. Board approval makes management more accountable, and shareowner approval makes management, as well as the board, accountable.

When related-party transactions require board or shareowner approval, those board members or shareowners involved in the transactions should abstain from voting. Related parties, be they "interested" shareowners or directors, should abstain from voting to avoid potential conflicts of interest which could impair their objectivity.

Companies should also provide full and fair disclosure of any relationships that exist between management and members or nominees for the board. Such relationships may affect the independence or the judgment of individual board members and affect their willingness to support the interests of shareowners. Disclosures of these relationships will enable shareowners to assess independently the extent of any connections between management and board members and nominees.

The disclosure of conflicts of interests is also paramount to sound corporate governance. Issuers must inform investors and other parties about potential conflicts of interest affecting board members, management, auditors, and other significant shareowners. These disclosures enable market participants to understand and interpret whether the information that companies provide to them has the potential for manipulation as a result of any conflicting interests of the reporting parties. Ultimately, these disclosures will allow investors to make informed decisions.

### Transparency

We feel that companies should include transparent and understandable discussions and analyses of their business activities, results of operations, and financial condition into their financial disclosures. Companies should aim to tell their story in a clear and concise manner so that their shareowner base is a well-informed one. Boilerplate phrases provide little, if any, substantive and meaningful information.

We feel that investors' need for full, fair, timely and transparent disclosure should supersede all other interests. Board members should ensure that the information that management provides to its owners meets these standards, regardless of what it might describe about management's methods or mistakes. Investors' needs for material price-sensitive information outweigh the company's need for confidentiality.

Boards should strive to provide all material information to investors in a timely manner – this includes information concerning remuneration policies, procedures and the decisions made to

support compensation. These disclosures also included thorough disclosures concerning a company's corporate governance policies and procedures. Investors use these disclosures to determine whether the board is acting in the best interest of shareholders and other stakeholders and is therefore vital in the analysis and investment process.

### Role and Responsibilities of the Board

We believe that corporate directors have a duty to act in the best interests of shareowners. Directors are representatives of shareowners and are stewards of their interests. Directors oversee management, who execute the strategy approved by the directors in a manner that maximizes the shareowner value.

It should be stated in JCGC or its follow-up material that a company board has power to dismiss CEO if he/she damage the shareholder value of the company by his/her misconduct and/or gross negligence.

Board should not combine multiple proposals in one resolution. For example, a proposal to alter "a company with board of company auditors" to "a company with a committee governance structure" should not be combined with a proposal to authorize the board to decide appropriation of retained earnings or grant contracts for limitation of liability to non-executive board members.

### Structure of the board and committees

We are encouraged to see Japanese corporate governance moving to embrace more independence on corporate boards. We acknowledge that this is the important step forward to the more desirable state and we respectfully call for a higher threshold of independence in due course. (i.e. The CFA Institute's official position is for majority independent boards.) We believe a Japanese market that is seen to have high governance standards and adequate protections for shareowners will become very attractive to capital around the world.

It would also be helpful for the Council of Experts to adopt a definition of director independence as a guide for both issuers and investors, so that both groups may understand when a director is truly independent. This definition of independence should be agreed upon with the Tokyo stock exchange so there is no confusion as to what is meant by director independence. We believe that true independence should preclude directors from having any material relationship with the company except for their board service.

We also feel that the committees of the board should be composed of a majority of independent directors, with fully independent board committees preferable. These committees should be free of conflicts that may adversely influence decisions concerning board nominations, remuneration, the audit and all other important board decisions.

Independent directors should not only be independent but should also represent minority shareholders. Independent directors should explain their contribution to shareholders values to shareholders.

## Engagement

We believe that companies should engage in constructive dialogue with shareholders even outside the general shareholder meeting. Engagement between shareowners and boards in many jurisdictions is on the rise, and often leads to a better understanding by both parties of the expectations and interests of the other. This engagement can lead to a better relationship between shareowners and boards. We therefore encourage the Council to foster increased engagement where possible.

We feel that issuers should disclose whether they have a method for shareowners to communicate directly and confidentially with directors. It is important that shareowners have and fully understand the mechanism for presenting information, concerns, or suggestions to the board members that oversee their interests.

In order to help the proper mechanism to work effectively, asset owners should recognize that stewardship and engagement incur costs and should pay the appropriate costs for the asset managers for their stewardship activities.

## Conclusions

We encourage the Council of Experts in their initiative to improve corporate governance in Japan. We encourage both companies and investors to move towards more effective corporate governance at listed companies in Japan. We believe that a Japanese market that is seen to have high governance standards and adequate protections for shareowners will become very attractive to capital around the world. Please feel free to contact us with any comments or questions.

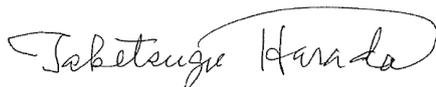
Yours sincerely,



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