

Appendix

The Preamble of the “Japan’s Corporate Governance Code [Final Proposal]”

The Council of Experts Concerning the Corporate Governance Code

March 5, 2015

Background

1. Japan's initiatives for the corporate governance system have significantly accelerated in recent years.
2. The Japan Revitalization Strategy approved by the Cabinet in June 2013 specified as one of its measures the “preparation of principles (a Japanese version of the Stewardship Code) for institutional investors in order to fulfill their stewardship responsibilities, such as promoting the mid- to long-term growth of companies through dialogue.” This led to discussions starting in August 2013 by the Council of Experts Concerning the Japanese Version of the Stewardship Code established under the Financial Services Agency, which drafted and released the “Principles for Responsible Institutional Investors (Japan’s Stewardship Code)” (hereinafter, “Japan’s Stewardship Code”) in February 2014. Japan’s Stewardship Code is currently in effect.

In addition, the Legislative Council of the Ministry of Justice adopted the “Outlines for the Revision of the Companies Act” in September 2012. Subsequently, a bill was submitted to the Diet as an amendment to the Companies Act, including a provision requiring companies to explain if they do not appoint outside directors. The bill was passed in the Diet and became law in June 2014.

3. Another measure specified in the Japan Revitalization Strategy was the encouragement of “securities exchanges in Japan to take measures that lead to the enhancement of corporate governance, for example, by clarifying listing rules concerning the appointment of outside directors and developing new indices for companies that are highly evaluated for their profitability and management.” This led to the establishment by the Japan Exchange Group, Inc. of the JPX-Nikkei Index 400, a new stock index composed of “companies with high appeal for investors, which

meet the requirement of global investment standards, such as the efficient use of capital and investor-focused management perspectives.” The operation of this index began in January 6, 2014.

4. In this context, the Japan Revitalization Strategy (Revised in 2014) approved by the Cabinet in June 2014 specified as one of its measures the establishment of “a council of experts of which the Tokyo Stock Exchange and the Financial Services Agency will act as joint secretariat, aiming to prepare the key elements of the Corporate Governance Code by around autumn 2014 for the Tokyo Stock Exchange to newly prepare the Corporate Governance Code in time for the 2015 season of general shareholder meetings.” This led to the formation of the Council of Experts Concerning the Corporate Governance Code (hereinafter, the “Council of Experts”) in August 2014, with the Financial Services Agency and the Tokyo Stock Exchange serving as joint secretariat. The Council of Experts met nine times since August, and developed its basic thought on a corporate governance code as the “Corporate Governance Code [Final Proposal]” (hereinafter, the “Code”). The Japan Revitalization Strategy (Revised in 2014) also specified that the formulation of a corporate governance code should be based on the OECD Principles of Corporate Governance. The Council of Experts thus engaged in their discussions by giving due reference to the OECD Principles, and the content of the Code is based on them. Furthermore, before finalizing the Code, the Council published an exposure draft both in Japanese and English and has received valuable suggestions from 80 individuals/entities in Japanese and 41 individuals/entities in English. Taking these suggestions into account, the Council reviewed and finalized the Code.
5. In accordance with the Japan Revitalization Strategy (Revised in 2014), the Tokyo Stock Exchange is expected to revise its listing rules and related regulations and formulate a corporate governance code, which is expected to have the same content as the Code.

Objectives of the Code

6. The Code has its foundation in the Japan Revitalization Strategy (Revised in 2014), and is formulated as part of Japan's economic growth strategy. As noted above, in the Code corporate governance means a structure for transparent, fair, timely and decisive decision-making by companies, with due attention to the needs and perspectives of shareholders and also customers, employees and local communities. On this basis, the Code establishes fundamental principles for effective corporate governance.
7. It is important that companies operate themselves with the full recognition of responsibilities to a range of stakeholders, starting with fiduciary responsibility to shareholders who have entrusted the management. The Code seeks "growth-oriented governance" by promoting timely and decisive decision-making based upon transparent and fair decision-making through the fulfillment of companies' accountability in relation to responsibilities to shareholders and stakeholders. The Code does not place excessive emphasis on avoiding and limiting risk or the prevention of corporate scandals. Rather, its primary purpose is to stimulate healthy corporate entrepreneurship, support sustainable corporate growth and increase corporate value over the mid- to long-term.

Recognizing the board's fiduciary responsibilities to shareholders and other stakeholder responsibilities, the Code includes language that calls for a certain measure of corporate self-discipline. It would not be appropriate, however, to view them as limits on companies' business prerogatives and activities. Indeed, quite the opposite: without appropriately functioning corporate governance, the reasonableness of management's decision-making processes cannot be secured. In such a case, the management may become risk-avoiding due to concerns that their responsibility with respect to business decisions may be put in question. Such a situation would significantly restrict decisive decision-making and companies' business activities. By calling for appropriate corporate governance disciplines at Japanese companies, the Code aims to have the management free from such restrictions and establish an environment where healthy entrepreneurship can flourish and where the management's capabilities can be given full force.

8. Given the concerns regularly perceived about the growth of short-term investment activities in capital markets, it is hoped that the Code will also have the effect of

promoting mid- to long-term investing. Market participants who have the strongest expectations for the improvement of corporate governance are usually shareholders with mid- to long-term holdings, and they usually wait until the improvements of corporate governance are achieved. Notwithstanding recent concerns over the growth of short-termism in the market place, such shareholders have the potential to become important partners for companies. The Code asks companies to examine whether there are issues in their corporate governance in light of the aim and spirit of the principles of the Code, and take self-motivated actions in response to those issues. Such efforts by companies will make possible further corporate governance improvements, supported by purposeful dialogue with shareholders (institutional investors) based on Japan's Stewardship Code. In this sense, the Code and Japan's Stewardship Code are "the two wheels of a cart", and it is hoped that they will work appropriately and together so as to achieve effective corporate governance in Japan.

“Principles-Based Approach” and “Comply-or-Explain Approach”

9. The Code specifies General Principles, Principles and Supplementary Principles. The manner of their implementation may vary depending on industry, company size, business characteristics, company organization and the environment surrounding the company. The Code's principles should be applied in accordance with each company's particular situation.
10. Given the above, the Code does not adopt a rule-based approach, in which the actions to be taken by companies are specified in detail. Rather, it adopts a principles-based approach so as to achieve effective corporate governance in accordance with each company's particular situation.

This principles-based approach has already been adopted in Japan's Stewardship Code. The significance of this approach is found in having parties confirm and share the aim and spirit of the principles and review their activities against the aim and spirit, not against the literal wording of the principles, even where the principles may look abstract and broad on the surface. For this reason, the terminology used in the Code is not strictly defined as is the case with laws and regulations. It is anticipated that companies that are accountable to shareholders and other stakeholders will apply appropriate interpretations of the terminology in accordance with the aim and spirit of the Code.

Shareholders and other stakeholders are also expected to fully understand the significance of this principles-based approach in their dialogue with companies.

11. Moreover, unlike laws and regulations the Code is not legally binding. The approach it adopts for implementation is “comply or explain” (either comply with a principle or, if not, explain the reasons why not to do so). In other words, the Code assumes that if a company finds specific principles (General Principles, Principles and Supplementary Principles) inappropriate to comply with in view of their individual circumstances, they need not be complied with, provided that the company explains fully the reasons why it does not comply.
12. While this comply-or-explain approach is also adopted in Japan’s Stewardship Code, it is an approach that may not yet be well known in Japan. It is necessary to bear fully in mind that companies subject to the Code are not required to comply with all of its principles uniformly. Shareholders and other stakeholders should also understand the aim of this approach and should fully respect the particular circumstances of individual companies. In particular, it would not be appropriate to consider the literal wording of each principle of the Code superficially and conclude automatically that effective corporate governance is not realized by a company on the ground that the company does not comply with some of the principles. Of course, when companies explain their reasons for non-compliance, they should do so by explaining the measures they have taken or they will take for those non-compliant principles in a manner that non-compliance will gain full understanding from shareholders and other stakeholders. Offering a superficial explanation using boiler-plate expressions would be inconsistent with the concept of “comply or explain.”

Implementation of the Code

13. The Code is applicable to all companies listed on securities exchanges in Japan (hereinafter, “companies”).¹ For the application of the Code to the companies listed in the markets other than the main market (namely, the Tokyo Stock Exchange First and Second Sections), some consideration may need to be given to the size and characteristics of such companies with respect to the applicability of principles such as governance structure and disclosure. In this respect, it is expected that the Tokyo Stock Exchange will clarify what sorts of consideration will need to be given to which parts of the Code for the companies listed in the markets other than the main market.

14. Companies in Japan may choose one of the following three forms of corporate organization²: Company with *Kansayaku* Board, Company with Three Committees (Nomination, Audit and Remuneration), or Company with Supervisory Committee. The Code does not express a view on any of these forms of company organization. It specifies fundamental principles for corporate governance that should be applicable to whichever form of organization a company may choose.

Given that most Japanese companies are Companies with *Kansayaku* Board, a number of principles specified in the Code are drafted under the assumption that the form of Company with *Kansayaku* Board is chosen. It is anticipated that companies that take a form other than Company with *Kansayaku* Board will apply these principles by making necessary adjustments in accordance with their form of company organization.

15. It is expected that the Code will enter into force on June 1, 2015, after the Tokyo Stock Exchange takes necessary institutional steps.

Depending on their situation, there may be companies that will find it difficult to fully implement certain principles of the Code from the implementation date noted

¹ For overseas companies that are listed on securities exchanges in Japan, it is generally the case that home country regulations exist and are applicable to their corporate governance. Since the content of such regulations may differ from that of the Code, there may be cases where it will not be appropriate to apply the content of the Code as it exists. For this reason, it is expected that the Tokyo Stock Exchange will clarify how this situation should be handled.

² See [Notes](#) to the General Principle 4 for the explanations for these three forms of corporate organization.

above even if they desire to do so, such as the principles on governance structures. In such situations, if companies undertake serious investigations and preparations for the commencement of the Code's application but still find immediate full compliance difficult, these companies' provision of clear explanations on their plans and conceivable schedule for future compliance should not be ruled out as being against the Code.

Moreover, some principles in the Code call for disclosure or explanation, including cases where companies are asked to "explain" the reasons for non-compliance. Since it would be desirable that companies disclose and explain some of these matters in a standardized framework (for example, through the Corporate Governance Report submitted to the Tokyo Stock Exchange), it is expected that the Tokyo Stock Exchange will offer clarification for handling this matter.

Future Revisions of the Code

16. As noted above, while the Code establishes fundamental principles for effective corporate governance, these principles do not remain unchanged. Under rapidly changing economic and social circumstances, in order to ensure that the Code continues to achieve its objectives, the Council of Experts expects that the Code will be periodically reviewed for possible revisions.

[Background] of the Principles in “Japan’s Corporate Governance Code [Final Proposal]”

The Council of Experts Concerning the Corporate Governance Code
March 5, 2015

Supplementary Principle

- 1.1.2 When proposing to shareholders that certain powers of the general shareholder meeting be delegated to the board, companies should consider whether the board is adequately constituted to fulfill its corporate governance roles and responsibilities. If a company determines that the board is indeed adequately constituted, then it should recognize that such delegation may be desirable from the perspectives of agile decision-making and expertise in business judgment.

[Background]

Japanese companies are generally said to include a broader range of items for resolution at general shareholder meetings than companies in other countries. It is not, however, always desirable to bring all important decisions for companies before shareholders for a direct vote. When a board is capable of adequately fulfilling its fiduciary responsibilities towards shareholders, delegating parts of decision-making to the board – in accordance with the Companies Act – may at times be a rational choice in order to secure agile decision-making and expertise in business judgment. The appropriateness of such delegation depends greatly on whether the board is adequately constituted to execute its corporate governance roles and responsibilities.

Supplementary Principle

- 1.2.3 The determination of the date of the general shareholder meeting and any associated dates should be made in consideration of facilitating sufficient constructive dialogue with shareholders and ensuring the accuracy of information necessary for such dialogue.

[Background]

The following points were raised within the Council of Experts with respect to the procedures for holding general shareholder meetings:

- *In order to ensure effective corporate governance, the period between shareholder record date and the date of the general shareholder meeting should be as short as possible. (For reference, the United Kingdom requires that this period be “within two days.”)*
- *To allow careful consideration of the agenda, the period between sending the convening notice and the date of the meeting should be as long as possible. (For reference, the UK Corporate Governance Code stipulates this period be “at least 20 working days.”)*
- *There should be a period between the closing of financial accounts and issuance of an audit certification in order to allow for effective auditing aimed at preventing fraud.*
- *Given the above points, if necessary, one possibility that can be considered is companies with fiscal year-ends in March holding their general shareholder meetings in July instead of June (existing practice). However, in order to allow shareholders to base part of their decisions on recent earnings performance, an overly lengthy period between the closing of financial accounts and the date of the general shareholder meeting should be avoided.*

In consideration of the above points, pushing back the provision of audited financial information or the date of the general shareholder meeting is something that can be considered. In this regard, it should be noted that the delivery of timely information through earnings releases (kessan tanshin) will become even more important and that consistency with other existing systems may need to be considered as well.

With respect to this issue, the public comments submitted in relation to the Code will be taken into consideration together with other views, and the Council of Experts may engage in further discussion as needed to determine whether this issue will need to be reflected in the final version of the Code to be issued by the Tokyo Stock Exchange.

Supplementary Principle

2.2.1 The board should review regularly (or where appropriate) whether or not the code of conduct is being widely implemented. The review should focus on the substantive assessment of whether the company's corporate culture truly embraces the intent and spirit of the code of conduct, and not solely on the form of implementation and compliance.

[Background]

The above code of conduct can also be referred to as "ethical standards" or "rules of behavior."

Principle 4.8 Effective Use of Independent Directors

Independent directors should fulfill their roles and responsibilities with the aim of contributing to sustainable growth of companies and increasing corporate value over the mid- to long-term. Companies should therefore appoint at least two independent directors that sufficiently have such qualities.

Irrespective of the above, if a company in its own judgement believes it needs to appoint at least one-third of directors as independent directors based on a broad consideration of factors such as the industry, company size, business characteristics, organizational structure and circumstances surrounding the company, it should disclose a roadmap for doing so.

[Background]

While there is a range of debate with respect to independent directors, it would not be appropriate to think that the mere appointment of independent directors will drive corporate growth. Rather, success will depend on whether measures are taken to take advantage of the presence of independent directors and their expected roles and responsibilities. The Companies Act (Revised in 2014) and Listing Rules already refer to the appointment of one or more independent/outside directors, with many companies adopting these provisions. The Code specifies that at least two independent directors should be appointed, taking the perspective that having multiple independent directors will significantly enhance the possibility that their presence will be fully leveraged.

It was noted at the Council of Experts that there are some organizations that undertake the collection, updating and provision of information on candidates for independent directors to support their ready appointment and that it would be desirable for such activity to be broadly promoted.

Supplementary Principle

4.8.1 In order to actively contribute to discussions at the board, independent directors should endeavor to exchange information and develop a shared awareness among themselves from an independent and objective standpoint. Regular meetings consisting solely of independent directors (executive sessions) would be one way of achieving this.

[Background]

The meetings can consist solely of independent directors or can also include independent kansayaku¹.

Principle 4.9 Independence Standards and Qualification for Independent Directors

Boards should establish and disclose independence standards aimed at securing effective independence of independent directors, taking into consideration the independence criteria set by securities exchanges. The board should endeavor to select independent director candidates who are expected to contribute to frank, active and constructive discussions at board meetings.

[Background]

With regard to the independence criteria and related disclosure requirements established by securities exchanges, there is a view that their content is abstract and that they present considerable room for interpretation. While on the one hand there is a favorable view that this ensures flexibility in applying the criteria, it is also noted that the varying interpretations of the exchange criteria by institutional investors and proxy advisors results in the adverse effect of companies applying these criteria too conservatively. Moreover, Japan's exchange criteria differ from those of other countries in several regards. The Council of Experts expects that, while taking into account future developments, securities exchanges will undertake appropriate reviews as necessary.

¹ Independent *kansayaku*: The listing rules of securities exchanges provide that the outside *kansayaku*, as defined in the Companies Act, are independent *kansayaku* where they satisfy the independence criteria of securities exchanges and the company determines that they do not have the possibility of conflicts of interest with its shareholders.

Supplementary Principle

4.10.1 If the organizational structure of a company is either Company with *Kansayaku* Board or Company with Supervisory Committee and independent directors do not compose a majority of the board, in order to strengthen the independence, objectivity and accountability of board functions on the matters of nomination and remuneration of the senior management and directors, the company should seek appropriate involvement and advice from independent directors in the examination of such important matters as nominations and remuneration by, for example, establishing optional advisory committees under the board to which independent directors make significant contributions.

[Background]

With respect to the expected roles and responsibilities of a board in providing explanations and performing effective oversight, the importance of functions related to audit, nomination and remuneration has been noted. In many other countries decisions in these areas are seen to require a particularly independent and objective standpoint. As a means of strengthening the independence and objectivity of such functions (excluding audit functions that can be fulfilled by the kansayaku board or by the supervisory committee), the use of an advisory committee, for example, can be considered. With respect to Companies with Supervisory Committee, the supervisory committee can be used to full advantage, given that the committee has the statutory right to state its opinion in relation to nominations and remunerations of directors at general shareholders meetings. A variety of measures can be taken, taking into consideration the specific circumstances of individual companies; for example, a variety of corporate governance-related matters (e.g. related party transactions or nomination of kansayaku candidates) can be reviewed at the advisory committee

