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Asian Corporate Governance Association (ACGA)

“Corporate Governance in Japan 2010:
Issues for Long-Term Investors”

ACGA 2nd Investor Delegation to Japan
Tokyo, September 6-9, 2010

Note: This presentation complements one prepared for ACGA's first investor delegation to Japan in March 2009. It is designed to be read alongside the earlier one.

Introducing ACGA

- The Asian Corporate Governance Association (ACGA) was formed to help facilitate the implementation of effective corporate governance in Asia. We are:
 - A provider of expert and empirical information, analysis and advice on corporate governance in 11 major Asian markets.
 - An independent advocacy organisation focussed on tangible improvements: We work closely with investors and engage with regulators and companies on pertinent issues.
 - An educational body: We organise conferences and events, and provide speakers and resources to a range of educational, business association, and public groups.

ACGA was incorporated in Hong Kong in October 1999 as a non-profit membership association.

ACGA Member Network

- **ACGA has 86 member organisations:**
 - 53 in Asia-Pacific and 33 in Europe and North America.
 - Members include influential financial and investment institutions (asset owners and managers), leading Asian listed and unlisted companies, international law and accounting firms, and educational bodies.
 - Members have, in aggregate, more than US\$10 trillion under management globally.

Japan Delegation

- This visit to Tokyo marks the second investor delegation that ACGA has organised to Japan. Our first was in March 2009 and followed our 2008 "White Paper".
- Interest in Japan and its corporate governance is strong: our 2010 delegation comprises 28 people and is almost double the size of our 2009 delegation.
- The organisations in our delegation manage, in aggregate, more than US\$3 trillion globally. Investments in Japan typically account for between 3-5% of total assets (for the foreign funds), with some allocating as much as 10% of their international equity portfolios to Japan.
- Participation in the Japanese market dates back as early as the 1960s for some members (and 1980s for most).

Topics

1. Recap of ACGA "White Paper on Corporate Governance in Japan" (May 2008)
2. Recap of ACGA "Statement on Corporate Governance Reform in Japan" (December 2009)
3. New or emerging issues
 - TSE rule on independent directors
 - FSA rule on disclosure of voting results
 - METI proposals for amending the corporate law
 - Obstacles to AGM participation*
 - Clustering of shareholder meetings*
 - Fiduciary responsibilities of investors

**Contributed by Governance for Owners Japan, an ACGA member.*

1. ACGA "White Paper" (2008)

The White Paper outlined our views and recommendations on six key issues:

- 1.The fairer treatment of shareholders
- 2.Utilising capital more efficiency and effectively
- 3.The value of independent boards in advising and supervising management
- 4.Strengthening pre-emption rights of shareholders (the third-party allotment issue)
- 5.Removing artificial takeover defences (poison pills)
- 6.Enhancing the transparency of shareholder meetings and voting results

➤ While tangible progress has been made in most of these areas, the reform process is ongoing.

Corporate governance is a broad system

- “Corporate governance” is often discussed in somewhat narrow and technical terms: board best practices, independent directors, executive remuneration, and disclosure.
- We see it more broadly—as a system for enhancing the transparency and accountability of companies, promoting ethical business behaviour, promoting responsibility among investors, treating shareholders and other stakeholders fairly, and improving the regulation of capital markets.
- For this reason, ACGA’s regional survey of country corporate governance, “CG Watch”, covers five categories:
 - Rules and regulations
 - Enforcement
 - Political and regulatory environment
 - Accounting/auditing standards and practices
 - “CG culture” (voluntary efforts by market participants)

2. ACGA “Statement” (2009)

Our Statement responded to papers published in 2009 by the Keidanren, METI and FSA, and to some new rules from the TSE. It developed the arguments in our White Paper and added some new ones:

- 1.The different and complementary roles of independent directors and statutory auditors (kansayaku)
- 2.Shareholder meetings and voting—elaborating on the meaning, importance and mechanics of “voting by poll”
- 3.Private placements and pre-emption rights—more clarity in new TSE rules would be helpful
- 4.Greater disclosure of cross-shareholdings and corporate equity investments (and reduction in the latter)
- 5.Encouraging stronger dialogue between companies and their shareholders

On boards

- We view the development of “hybrid boards” in Japan as generally positive (ie, strengthening the system of statutory auditors and adding outside directors and committees to boards of directors).
- Most, if not all, listed companies would benefit from having independent outside directors on their boards of directors. Investor confidence in these companies and the country’s capital markets would rise as a result.
- Independent directors have a valuable role to play, but must be selected carefully and allowed to speak.
 - More director training and the sharing of best practices on nomination and selection of directors would help.
 - Japan could do this better than the rest of Asia (ie, learn from mistakes made elsewhere).

3. New or evolving issues

1. TSE rule on independent directors
2. FSA rule on disclosure of voting results
3. METI proposals for amending the corporate law
4. Obstacles to AGM participation
5. Clustering of shareholder meetings

(Note: The above issues represent only a selection of topics of interest and concern to ACGA and our members. It is not intended as a complete list.)

3.1 TSE rule on independent directors

- In late 2009, the Tokyo Stock Exchange (TSE) introduced a new rule requiring all listed companies to appoint one independent director or one independent statutory auditor no later than by June 2011.

ACGA's view:

- We believe this rule marks a significant step forward for corporate governance in Japan.
- We recommend that TSE extend the rule by requiring listed companies to have both independent directors and independent statutory auditors.
- We recommend that the number of independent directors be increased to two or three over time.
- We recommend that the definition of "independent director" be tightened and clarified.

3.2 FSA rule on disclosure of voting results

- In March 2010, the Financial Services Agency (FSA) introduced a new rule requiring listed companies to disclose the detailed voting results on each resolution in shareholder meetings.

ACGA's view:

- We believe this rule marks a significant step forward in the transparency of shareholder meetings.
- We recommend that the FSA extend the rule by requiring listed companies to count the votes of any shareholders attending a meeting as well as those who have voted by proxy beforehand (ie, "voting by poll").
- We recommend that the FSA study the mechanics and best practices on voting by poll in other developed markets.

3.3 METI proposals for amending the corporate law

- In June 2010, the Ministry of Economy, Trade and Industry (METI) published a paper proposing a series of changes to the company law, with the aim of reinvigorating corporate Japan.

ACGA's view:

- Some of the proposals seem constructive. For example:
 - Encouraging the use of shares to finance takeovers.
 - Creating a specialist "commercial/financial high court".
 - Encouraging more flexible board structures (eg, the formation of nomination, compensation and other committees in companies with the traditional "Kansayaku" system)
 - Allowing web-based broadcasting of general shareholder meetings.

(continued)

3.3 METI proposals (*continued*)

- Some of the proposals, however, look less attractive and could erode shareholder rights (although more information is needed on how they will work). For example:
 - Removing the need for a shareholder meeting in a target companies that will become a 100%-owned subsidiary of another company.
 - Removing the need for shareholder approval of directors sent from a parent to subsidiary.
 - Allowing companies with board committees comprising a majority of “outside directors” to pass resolutions that would otherwise be decided in a shareholders’ meeting.
 - Allowing statutory auditors to serve as directors in companies with “joint audit committees”.

3.4 Obstacles to AGM participation

- Fund managers and other investors whose shares are held by a custodian bank often find it difficult to attend shareholder meetings, even if they have a letter of attorney from the custodian bank. This is because they are not the “nominal” or “legal” shareholder (ie, their name is not on the shareholder register)—the custodian bank is.
- The Articles of most Japanese companies allow investors to exercise voting rights only through an authorised (legal) shareholder.
- Other shareholder rights, such as submitting a shareholder proposal, normally apply only to legal shareholders.

ACGA's view:

- “Beneficial shareholders” (such as fund managers) should be treated equally to legal shareholders.

3.5 Clustering of shareholder meetings

- While the clustering of shareholder meetings in late June is gradually lessening, this issue remains a major impediment to the effective exercise of shareholder rights.
- TSE-listed companies with a March year-end make up 75% of the 2,300+ firms on the exchange (hence must have their AGMs within three months, ie, before end-June).
- 43% of these firms (a total of 742) held their AGM this year on June 29, 2010, the peak day.
- Although an improvement on earlier years—the peak-day ratio hit 96% in 1995—it is still extremely high.

ACGA's view:

- Either companies should be encouraged to change their record dates, or the company law amended, to allow for more a extended and flexible AGM season.

Contact details

Jamie Allen
Secretary General
Asian Corporate Governance Association Ltd

Room 203, 2F, Baskerville House
13 Duddell Street, Central, Hong Kong

Tel: (852) 2160 1788 (general)

Tel: (852) 2872 4048 (direct)

Fax: (852) 2147 3818

Email: jamie@acga-asia.org

Website: www.acga-asia.org