



The 2008 Asian Roundtable on Corporate Governance

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*The views expressed in this paper are those of the author and do not necessarily represent the opinions of the
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(OECD Asian Roundtable: Speech Outline)

Thank you for the kind introduction. It is a great honor and a pleasure for me to be able to give this speech here today.

Today I would like to explain about the different circumstances recently surrounding corporate governance in Japan, then speak briefly on the issues related to this subject and where we are headed in the future.

For the past several years, we have seen a lot of very energetic discussions about corporate governance going on all over the world.

After the Asian financial crisis in the latter half of the 90's, our region identified the establishment and enhancement of corporate governance as a cornerstone policy for achieving economic stability. And I understand that this was one of the driving forces behind the adoption of the OECD corporate governance principles and the establishment of this Asian Corporate Governance Roundtable discussion as well.

In Japan, we have pushed forward with a variety of different efforts designed to strengthen corporate governance in recent years, and partly as a result of declining stock prices and influence from foreign investment funds, this year we have been seeing a particular heightening of interest in debates related to corporate governance.

Some of these enhancement efforts include advances made on the legal front. For example, first, through a series of regulatory reforms, we have strengthened the function of what we

call the statutory auditor system unique to Japan, while at the same time have enabled companies to introduce the U.S.-style company with committees system of corporate governance.

At the TSE as well, supporting listed companies' voluntary reform of governance has been at the forefront of our minds. For example, we have drawn up the TSE Listed Company Corporate Governance Principles based on those principles adopted by the OECD, and have worked to promote these among our listed companies. In addition, we have been requesting our listed companies to prepare corporate governance reports since June of 2006. These documents make it possible to browse the status of each company's corporate governance efforts in simple-to-read list form, and easily compare the efforts of one company versus another.

Aside from these, another specific measure that we have taken is the establishment of a set code for corporate behavior through the incorporation of the Code of Corporate Conduct into our listing regulations in November of last year. These are only a few of the various efforts that we are currently making to strengthen governance.

Individual listed companies have also been steadily working to improve and enhance corporate governance through efforts such as the introduction of management monitoring systems by external parties. The purpose of these systems is to prevent corporate malfeasance while boosting management efficiency and enhancing corporate value.

Similar to the ongoing efforts in Japan, many other countries around the world are also pursuing and establishing better systems of corporate governance through trial and error. As

a result, many different governance patterns are emerging due to differences in each individual company's unique management style.

The eventual shape of governance should take into account the actual circumstances of each country and each company, and they are thus naturally different from one another.

What's important is not to have a set, specific format, but the nature and function of the system. I believe this idea is also in line with the OECD's approach to corporate governance. With all these different formats, however, it becomes key to clearly explain to investors that governance will function effectively according to the company's specific format so that no misunderstanding arises. It is also vital for each company's management team to sufficiently understand the concept of corporate governance and to implement appropriate measures accordingly.

I believe that supporting these efforts is the fundamental and ideal job of an exchange.

Let's take the understanding of governance effectiveness as an example. While people around the world rave about the importance of independent directors, there are several companies that still use the traditional Japanese format of solely internal directors, yet are successful in their management and are highly valued by the market.

Naturally, the decision-making structures of companies differ from one country to the next, and as such, a superficial comparison may not be convincing enough for the rest of the world. I therefore believe that the managers of such companies have a responsibility to adequately explain the reason why they adopt a governance format that differs from international

standards as well as why this format is effective if they expect to draw investment from foreign investors. We at the TSE hope to lend a helping hand in this aspect.

Now with regards to management's recognition of the fundamental concept of corporate governance, there have recently been frequent instances in Japan of managers clearly not understanding this concept adequately enough, and it has become a major source of concern for the TSE.

For example, one company conducted a reverse stock split in which 10 previously issued shares were combined into one, and as a result, approximately 80% of shareholders lost their shareholder rights.

Again, there have been other instances of companies diluting shareholder rights through large-scale allocations of shares to third-parties.

As long as it is not an issue made at a notably discounted price, share allocations to third-parties without the consent of shareholders are currently possible for listed companies in Japan. Many see a problem, however, with cases in which a third-party allocation that results in a shift of control is made without shareholder approval.

But by no means are we just sitting on our hands and idly watching these things happen. We are stopping these problems at an early stage through advance consultations, and are sounding the warning bell by regularly expressing our position that this type of activity is undesirable.

The investors who own a company and the managers who represent them frequently have access to asymmetrical information, and their profit goals are often different as well. As a result, relatively short term-minded shareholders tend to restrain the actions that managers take in pursuit of business opportunities.

However, if we strengthen regulation of corporate activity in terms of capital policy too much, we run the risk of adversely affecting the flexibility and agility of corporate management. As such, summarily prohibiting such actions is difficult. We can take the step of publicly announcing that these actions have occurred due to the fact that they are a violation of the Code of Corporate Conduct introduced last year, but we are currently limited to this measure alone.

Making such an announcement has the effect of indicating to external parties that this is a company that shows no concern for shareholder rights, which is a deterrent that will make the company think twice before engaging in problematic behavior. It also becomes a warning for investors. However, many have pointed out that since this measure doesn't have the effect of directly prohibiting or intervening in the activity, a more direct, powerful measure is necessary. Addressing how to deal with problematic corporate behavior is becoming a priority issue this year not only for the TSE, but for Japan as a whole.

In addition, and this may be another phenomenon that is unique to Japan, many have brought up the issue of corporate governance surrounding listing subsidiary companies. This problem stands out as the typical example of the issue with related party transactions, an issue that is also being addressed at this roundtable.

In light of the expectations placed on stock exchanges for providing investors with a wide variety of investment products as well as their value to the public economy, the TSE has not taken the approach of summarily prohibiting the listing of subsidiary companies. Many believe that the interests of the parent company and the interests of minority shareholders are in conflict. They point out that the parent company may engage in some activity that will be detrimental to the rights and/or benefits of the subsidiary's minority shareholders. Such actions include the parent company forcing business coordination or transactions with disadvantageous terms, the siphoning of money from subsidiaries by capital-hungry parents, or the parent taking the subsidiary company private shortly after listing.

On the other hand, if the listing subsidiary company has a well-functioning corporate governance system, such as a board of directors that is composed of people totally independent of the parent company, I believe that the fear that such problems will occur is reduced. This shows that even if two subsidiary companies are listed, sometimes the circumstances are completely different. Thus, many in Japan say that banning subsidiaries from listing outright amounts to excessive regulation.

In any case, we certainly cannot allow the rights of the minority shareholders of a subsidiary company to be sacrificed for the sake of a parent company. We at the TSE have therefore announced the issues that subsidiaries should be aware of when they list, and are also currently reviewing how we can respond to different transactions they have with the parent company.

For starters, we will make several systematic adjustments from a disclosure approach. We announced that we will oblige listed companies to disclose their basic policy regarding how

they take minority shareholders into consideration when making transactions with the parent company or other controlling shareholders, and will also have them announce their compliance status with this policy once a year. These changes are slated to take effect in July this year, and the TSE will continue to consider whether further regulations are possible in the future.

These are a few of the problems that we are currently facing in Japan, but it is my hope that as the recent globalization of financial and capital markets moves forward, not only Japan, but other countries all around the world will share a common awareness of these issues.

As I had mentioned, the expected role of corporate governance is to prevent corporate malfeasance while enhancing corporate value through increased management efficiency. In consideration of the present circumstances, further creation of an environment to ensure that this role is fulfilled is integral for the sound development of our country's economy and securities markets into the future. We at the TSE have designated the implementation of systematic adjustments for the creation of such an environment as a pillar issue for this fiscal year.

Our exchange has made it our clear goal to create a market with the world's highest level of protection of shareholder's rights and one whose listed companies have sophisticated corporate governance, where investors domestic and abroad can invest with peace of mind. We will achieve this by enhancing support in many different areas to improve and strengthen the corporate governance of our listed companies. The TSE will work to promptly clarify all problems and issues involved, and will continue with our efforts in comprehensive corporate governance environmental development.

It is our quest to boost our international competitiveness by gathering many attractive investment products as well as quality risk money from within and without Japan, and it is the quest of Japan as a whole to promote the shift from savings to investment and make our country a financial powerhouse. Further examination of how to address this highest priority issue of corporate governance is, therefore, essential not only for TSE but also for our nation. This concludes my short report of the TSE's efforts in corporate governance. Thank you for your kind attention.