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How is corporate governance in Japan changing? Developments in listed companies and roles of institutional investors

Ryoko Ueda

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How is corporate governance in Japan changing?

Developments in listed companies and roles of institutional investors

By
Ryoko Ueda*

Abstract

This research analyses the improvements to corporate governance within Japanese listed companies and the influence of institutional shareholders.

Firstly, in order to analyse the external factors that have promoted the recent corporate governance reform, the report starts with an overview of the changes in the Japanese market post 1970s. The main players before the 1990s were the banks, who provided credit to companies as well as being shareholders. Corporate governance in Japan was characterised by the "main bank" system. However, after the "bubble economy" burst in the early 1990s, institutional investors, including domestic pension funds and foreign asset managers, started to have a greater presence.

Secondly, the report analyses the recent developments in corporate governance within listed companies. Developments were influenced considerably by institutional shareholders through proxy voting. Further, the report reviews the legislation and relevant rules on corporate governance including the reform of the Companies Act and the Cabinet Office Ordinance on Disclosure of Corporate Information.

Thirdly, the report examines the influence of institutional shareholders and their activities towards good corporate governance. In 2009, the "Report by the Financial System Council's Study Group on the Internationalization of Japanese Financial and Capital Markets" was published and asset managers, such as investment trusts and investment advisory companies, started to disclose policy and results of proxy voting. In February 2014, pursuant to the recommendation of the "Japan Revitalization Strategy 2013", Japan's Stewardship Code was published and it is now expected that institutional shareholders play a significant role to engage with investee companies and improve corporate governance within them. The report also analyses the historical changes to practices within shareholder meetings along with examination of the role that institutional shareholders have played in the improvement of corporate governance within Japanese listed companies.

Approved by Pierre Poret, Deputy Director, OECD Directorate for Financial and Enterprise Affairs

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INTRODUCTION

Since the enactment of the Commercial Code in 1890, Japan has been working to modernise traditional business practices and systems by referring to European systems. In addition, since the end of World War II, Japan has been building its own system of corporate governance, influenced by the US system. Against this historical background, Japan has developed a corporate governance framework that features "the separation of executive and supervisory roles" through a combination of boards of directors that have both executive and supervisory functions and company auditors/corporate audit boards that are independent audit bodies.

Meanwhile, the strong executive function of Japan's boards of directors is a notable feature of the country's corporate culture; this is due to the fact that boards are comprised of employees whose backgrounds lie in the lifetime employment system. On the other hand, in terms of supervision and the prevention of fraud, checks are carried out by people from all parts of the company including employees, directors and retirees. Moreover, many employees have spent the majority of their lives in the company since joining as new recruits, and consequently their mental attitude shows a strong tendency toward the pursuit of company interests, rather than personal gain.

Thus Japan has, both formally and practically, created its own system. This does not conflict with the spirit of aiming for sound management - the goal of corporate governance. However, the increasingly international nature of the business environment and shareholder structures means that corporate culture in Japan is sometimes criticised as lacking transparency. Furthermore, there is a possibility that Japan’s corporate governance system may suffer from "Galapagos Syndrome", which refers to an isolated development of an internationally common framework (named after the islands that are famed for the vast number of endemic species).

Aware of such issues, Japan has been studying how to implement a system that is attractive to international investors by utilising the advantages of corporate governance entrenched in society and corporate culture to enable support for the globalisation of business and market environments. In terms of methods of corporate governance, in addition to the traditional two-tier audit system, Japan has been designing systems to increase the scope of voluntary corporate initiatives, such as the potential for a company to voluntarily select to adopt a single-tiered committee governance structure. In addition, from a practical aspect, Japan is working to design systems for the introduction of new schemes to allow a harmonisation of two-tier and one-tier audit systems and leverage their respective advantages in terms of improving accountability and transparency for shareholders and investors and ensuring the quality of corporate governance.

Moreover, there is growing recognition of the importance of the role shareholders, particularly institutional investors, who play in the improvement of corporate governance, with increasing expectations placed on such investors. The responsibilities that the company should fulfil and those that the institutional investors should assume are "two halves of the same whole" (Japan’s Stewardship Code), and it is vital that both sides fulfil the responsibilities and roles required of them. It is from this standpoint that Japan has established its Stewardship Code, which clarifies the responsibilities of institutional investors as responsible shareholders.

This paper discusses the systems and actual circumstances pertaining to corporate governance in Japan, from the point of view of both corporations and institutional investors. First, the paper provides an overview of the assumed environmental changes surrounding Japan's corporate governance, and analyses the external factors affecting this governance such as changes in market participants. Next, it reviews changes in the system, such as the Companies Act and rules on disclosure with regard to company initiatives to improve corporate governance. The paper further analyses these initiatives in terms of the actual status of important corporate governance issues such as shareholder meetings, board meetings and remuneration. The final analysis looks at the role of institutional investors in corporate governance and examines the reforms made to date, as well as the actual participation of institutional investors in shareholder meetings, and the disclosure of their voting strategies and results.

PART I. CORPORATE GOVERNANCE IN JAPAN

This section analyses long-term changes in the environment surrounding corporate governance and examines the influence of these changes on Japan's corporate governance system.

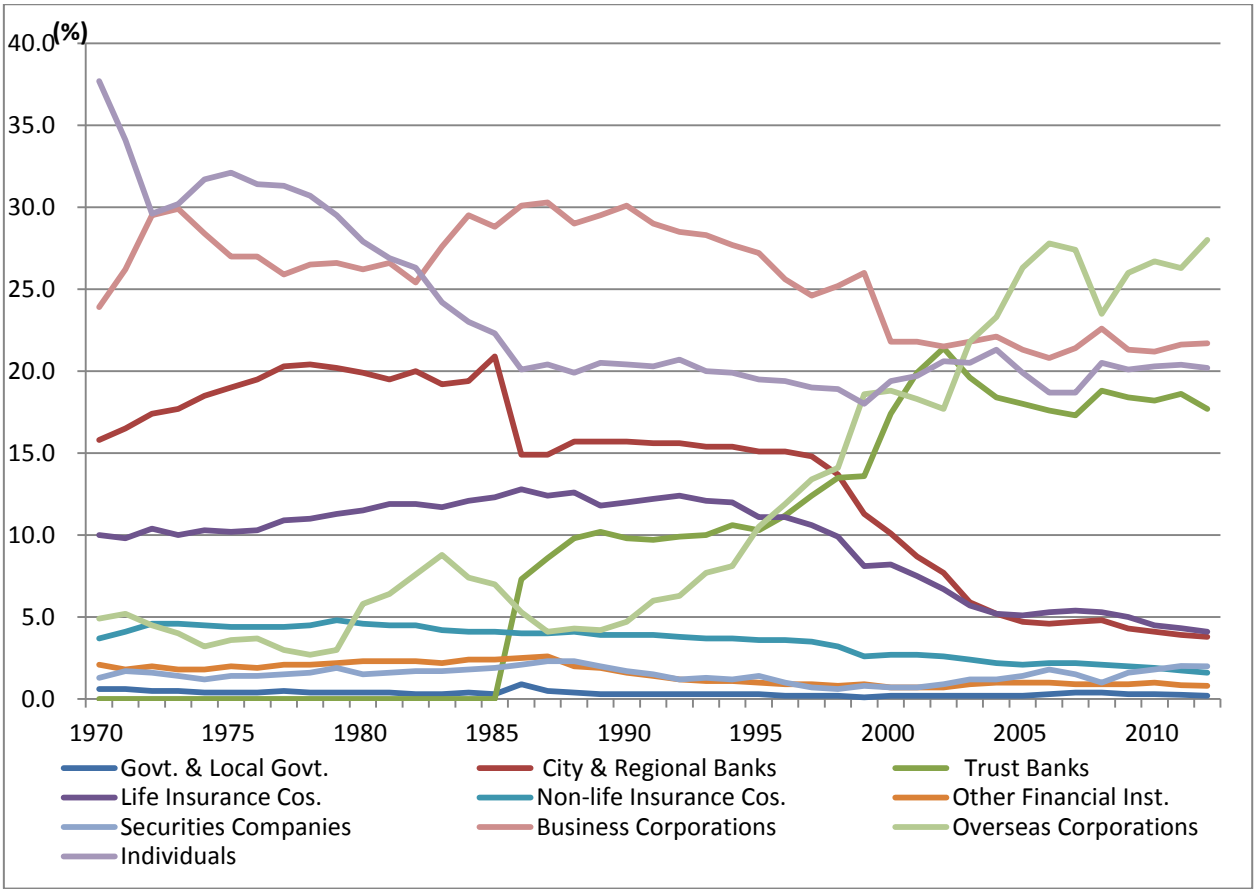
1.1 Changes in types of shareholder within **the Japanese market**

1.1.1 The rise of institutional investors

After World War II, the main type of shareholder in Japan's market changed from individual investors to institutional investors, with a steep rise in the percentage of foreign investors.

Figure 1 shows the changes in the structure of shareholdings in Japan's securities markets since 1970. Trust banks, life insurance companies, non-life insurance companies and other financial institutions are recognised as domestic institutional investors. In addition, many overseas corporations are foreign institutional investors.

Figure 1. Shareholding ratio by shareholder type (Japanese markets)



Source: Tokyo Stock Exchange

Until 1985, individuals, business corporations, major commercial banks (aka city banks), and regional banks were the main market participants. However, since 1985 the proportion of domestic and foreign institutional investors has risen, and since 2003 more than 40% of the stock market has been owned by such investors.

At the end of 2012, the breakdown of shareholdings in the Japanese markets was as follows: individuals/others – 26.2%; overseas corporations etc. – 24.3%; business corporations – 23.3%; trust banks – 15.7%. The percentage held by domestic institutional investors such as trust banks and insurance companies was 20.9%. The percentage is 45.2% when foreign institutional investors are included.

As mentioned later, there has also been an increase in the proportion of shares owned by pension funds (Figure 2). Institutional investors are expected to play a part in improving corporate governance in Japanese companies.

1.1.2 The "main bank" system

Japanese companies and banks have built business ties, with the banks providing operating funds and settlement systems in normal times and acting as vital sources of funding during times of crises. More specifically, companies refer to a bank that belongs to their own corporate group and with whom they have strong ties, for example significant loans, as their "main bank". In the past, main banks often held shares in companies and consequently exerted considerable influence on corporate governance in Japan. However, these days the ratio of shares held by main banks has declined.

According to Figure 1, city and regional banks held more than 20% of the Japanese stock market between 1975 and 1985, and more than 10% thereafter until the year 2000. From 2000 the banks sold their shareholdings at a rapid pace, so that by 2012 they held merely 2.9% of shares. This is only about the same level as the stock held by securities companies for trading purposes (which was 2.3% as of 2013).

1.1.3 Cross-shareholdings

In Japan, the problem of cross-shareholdings is, in many cases, discussed in the context of the main bank system, where banks hold shares in companies. However, as described above, there has been an on-going decline in the percentage of shares held by banks. In contrast, recent years have seen an increase in the number of cross-shareholdings between operating companies themselves.

Figure 1 shows how the percentage of stock owned by corporations has gradually increased since 1950, when it stood at 11%, and has stayed in the 20% range since the 1970s; standing at 23.3% as of 2012. However, it must be noted that the term "business corporations" in Figure 1 includes companies which manage the assets of individuals and families. It is reported that the cross-shareholding ratio (i.e. the market value of shares held by listed companies in listed companies) stood at 10.8%, down 0.3 ppt from the end of FY 2012[1].

As mentioned above, listed companies have increased mutual crossholdings of shares in companies with whom they have business ties. This has arisen due to a decline in the shareholdings of the main banks and a desire to secure shareholders who are close to the management. This mutual holding of shares between companies has led to a hollowing out of capital, and has been criticised by many institutional investors as blocking minority shareholders' voting rights.

[1] Kengo Nishiyama, "Cross-shareholdings at Japanese companies", Nomura Equity Research (2014.6.23).

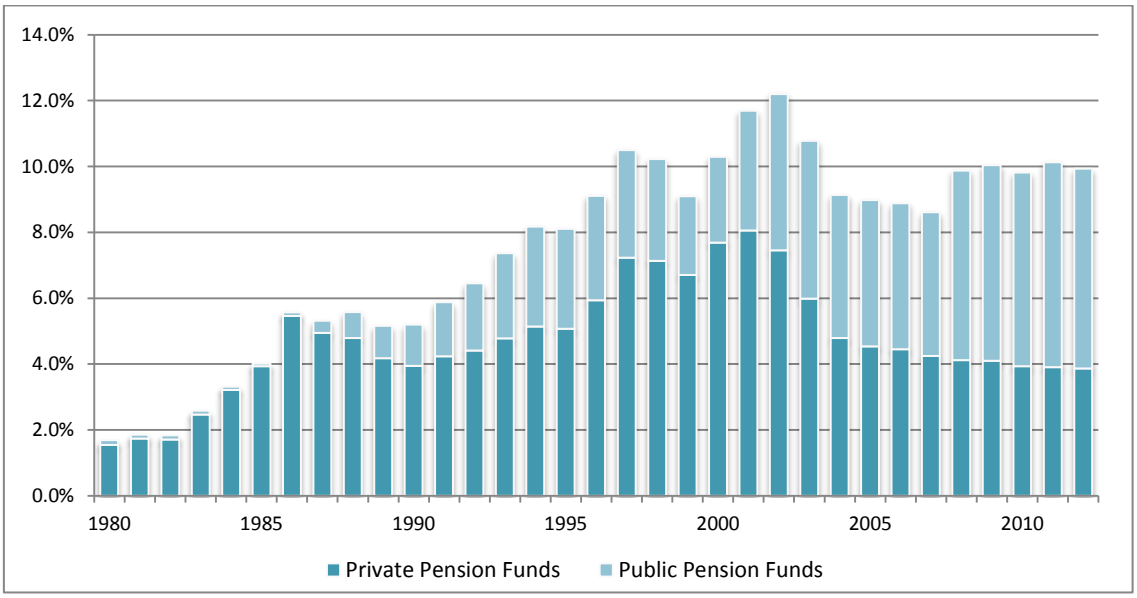
Against this background, in March 2010 the Financial Services Agency (FSA) revised the "Cabinet Office Ordinance on Disclosure of Corporate Information etc.," to enhance the disclosure of listed companies' shareholdings (to be described in detail later); note that the revisions did not apply to holdings made for net investment purposes (holdings for policy purposes). Consequently, information on key cross-shareholding is now provided in securities reports.

1.1.4 Increase in shareholdings by pension funds

In 1980, less than 1.7% of shares in Japan's securities markets were held by corporate pensions and public pensions, but by 2012 this had increased to 9.9%. In particular, public pension funds increased their shareholdings from just 0.1% in 1980 to 6.1% by 2012.

In the mid-1990s, regulations that required pension funds to operate an asset allocation policy with a 5:3:3:2 split (bonds, equity, foreign currency denominated securities, and real estate respectively) were abolished, and this saw an increase in equity investment by pension funds.

Figure 2. Pension funds' shareholding in Japan's securities markets



Source: Bank of Japan

The Pension Funds Association initiated the exercise of voting rights for in-house operations from 2003 onwards, and in 2007 it also asked fund managers to adopt the Association's voting guidelines and exercise voting rights. Furthermore, in 2004 the Pension Fund Association for Local Government published the "Principles of Corporate Governance and Guidelines on the Exercise of Voting Rights" and requested that these be adopted by fund managers.
Thus pension funds play a major role in Japan's corporate governance. Moreover, as described below, it is expected that pension funds will have even greater involvement following the enactment of Japan's Stewardship Code in 2014.

1.2 Increase in number of listed companies

Figure 3, compiled from 1950 onwards, showed 713 listed companies, but this figure increased significantly with the expansion of Japan's economy and its capital markets, so that by the end of

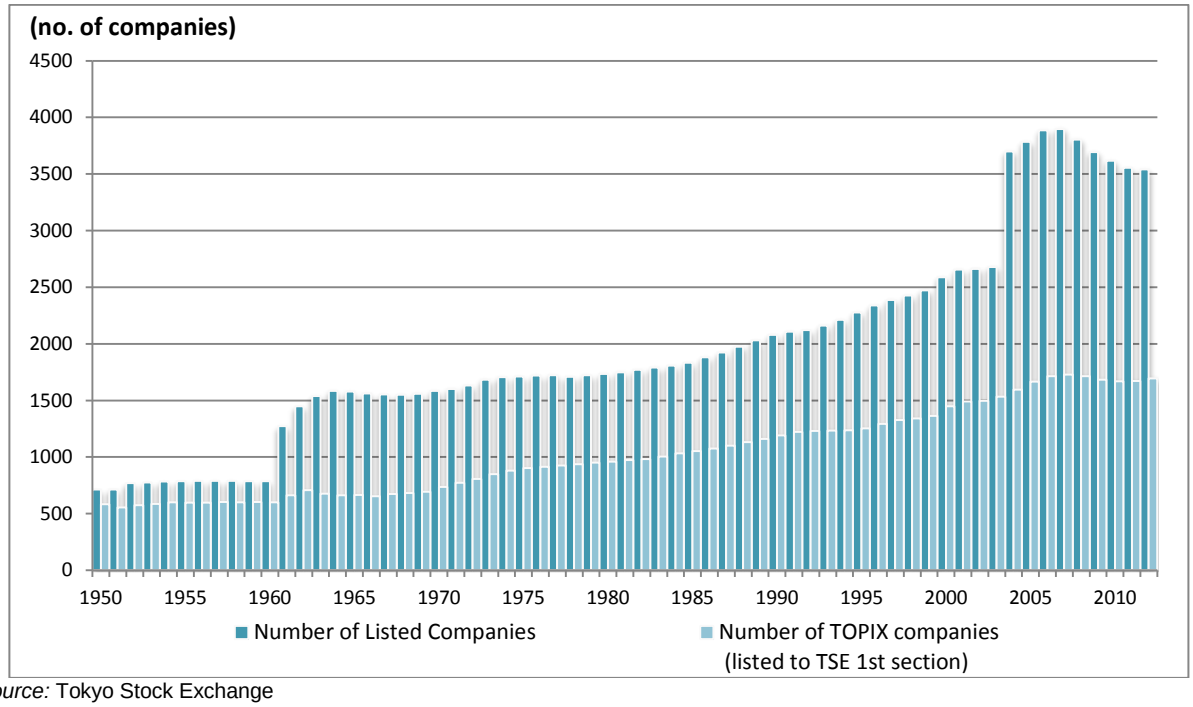
2012 there were 3 540 publicly traded companies. There were particularly large increases in the number of listed companies between 1960 and 1961, when figures jumped from 785 to 1 274; and between 2003 and 2004, when the number of listings rose from 2 679 to 3 698.

The early 1960s was the first period of high economic growth, a period of reconstruction that followed World War II, when both industry and the capital markets had grown significantly. It seems that the number of listed companies rose as capital needs in the industrial sector increased. At that time, the market was not divided and only two types of trading were available: the stock exchange and the over-the-counter (OTC) market. However, speculative trading in the OTC market increased with the post-war market development. This led to a reform of the system in 1961, when the 2nd Section of the Tokyo Stock Exchange was established, incorporating around 500 companies from the OTC market.

Subsequently, stability in the Japanese economy and market infrastructure was accompanied by a gradual expansion in OTC trading of new, unlisted securities, as a preparation for entry into the 2nd Section of the Tokyo Stock Exchange. These were called OTC-registered issues, but later the name was changed and they become known as JASDAQ-registered issues; by around 2004 the number of such issues had increased to approximately 1 000.

In the 2000s, Japan aimed to activate its capital markets and increase the number of new listings, and the country developed one new market after another. In 2001 the Tokyo Stock Exchange founded the emerging market "Mothers." Furthermore, stocks registered on JASDAQ were one-on-one transactions managed by the Japan Securities Dealers Association and were at a distinct disadvantage compared with those listed on the securities exchanges in terms of clearing/settlement, credit transactions and so on. Consequently, in 2004, it was decided to upgrade the JASDAQ market as a securities exchange. Thus, the JASDAQ Securities Exchange was born. Close to 1 000 stocks that were registered on JASDAQ at that time were added to the figures used in the calculation of listed companies, and it seems that this accounted for the sudden increase in the number of listings.

Figure 3. Number of Japanese listed companies



Source: Tokyo Stock Exchange

The number of listings on the 1st Section of the Tokyo Stock Exchange also increased from 585 companies in 1950 to 1 695 by the year 2013. All Japanese companies listed on the 1st Section of the Tokyo Stock Exchange are incorporated in the TOPIX stock price index. Many institutional investors use TOPIX as their benchmark. Therefore, companies listed on the 1st Section have a relatively high percentage of shares held by institutional investors.

Since 2007, the Tokyo Stock Exchange has been working to improve its listing mechanism and has been undertaking a comprehensive system review to ensure that the exchange functions properly as a trading market and to support improvements in the corporate value of listed companies and international competitiveness, while achieving the protection and respect of shareholders and investors.[2] The implementation plan also reflects the opinions of institutional investors both at home and abroad and refers to issues of corporate governance such as ensuring independence of the board of directors. Additionally, in 2013 the Tokyo Stock Exchange and the Osaka Securities Exchange integrated and, under the auspices of the Osaka Securities Exchange, the JASDAQ market also become part of the same group; this meant a significant expansion in the markets targeted in the implementation plan.

As a result, both international companies and local companies are to be subject to the same system and rules; an “international” company being one that develops its business internationally and that attracts considerable interest from (and has a high percentage of) institutional and foreign investors, while a “local” company has its business based mainly in Japan, attracts relatively low interest from (and has a lower percentage of) institutional and foreign investors and, on the whole, has Japanese shareholders. Local companies also include a fair number of family-owned companies.

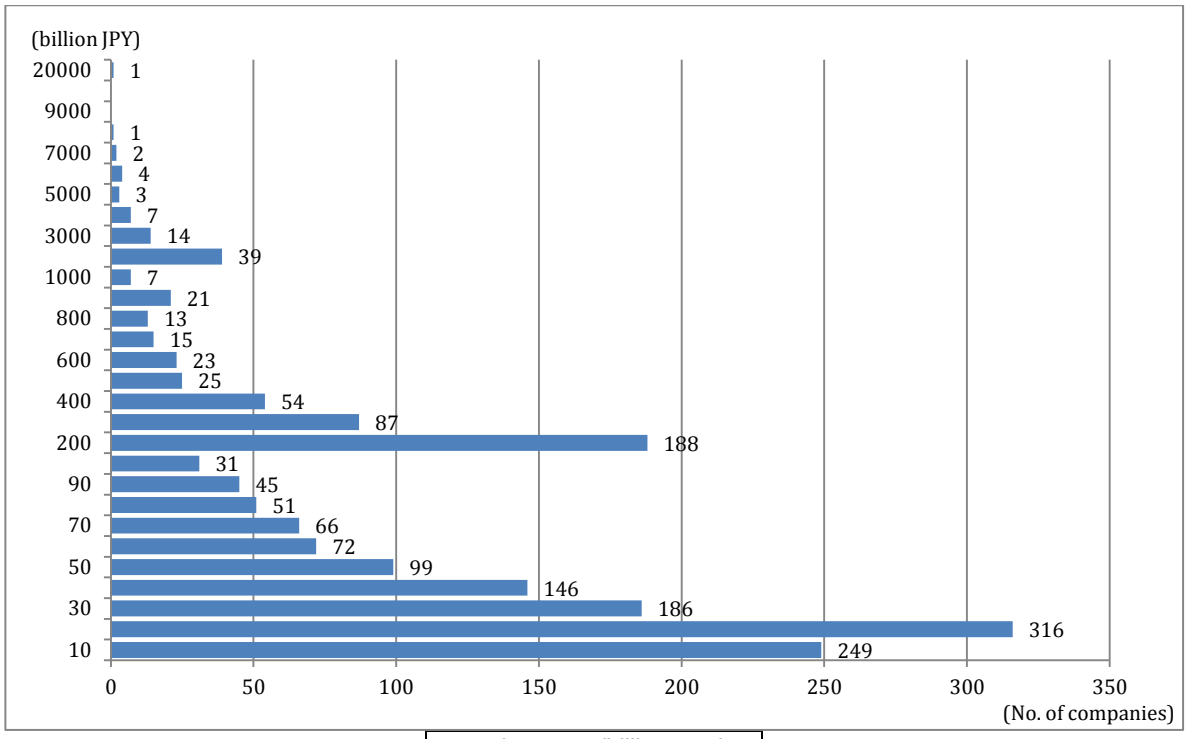
Whether a company is local or international, it is equally important that, as a listed company, its transparency and efficiency is ensured. However, the weight of the obligation to ensure the employment of outside directors in the development of a company's management regime varies depending on the size of the company. Assuming that many international companies are large in scale, they will have the organisational structure and human resources to respond to such a system and assume the obligation relatively easily. In contrast, many local companies will not have a sufficiently developed organisational structure or enough staff to respond to international trends and for these companies the obligation to respond to such a system would be onerous. In addition, there are not many institutional and foreign investors in local businesses to begin with; this means that, in some cases, the benefits do not adequately match the cost of complying with the system.

Furthermore, even though companies listed on the 1st Section of the Tokyo Stock Exchange are automatically incorporated into TOPIX and become targets for investment, there is a significant difference in the size of these companies; consequently, there are times when a single, uniform set of evaluation criteria cannot be used to analyse their finances and corporate governance.

In some instances the content of the UK Corporate Governance Code differs between FTSE 350 companies and other small-scale firms. In Japan too, it has been pointed out that there is a need to categorise listed companies to allow a flexible response to the actual business conditions and scale of smaller companies. Therefore, it is thought that the new JPX400 index described below may be useful.

[2] Tokyo Stock Exchange,” Listing System Improvement Action Plan 2009”(2009).

Figure 4. Distribution of companies listed on TSE 1st Section by market capitalisation



Market Cap. (billion JPN)	
Average	203.9
Highest	16757.3
Lowest	1.6
Median	38.8

Source: Tokyo Stock Exchange

1.3 New initiatives for Japanese markets to attract international investors: JPX400 Index

As mentioned above, TOPIX is the most common share index for the Japanese market. TOPIX covers all the companies listed on the 1st Section of the Tokyo Stock Exchange and consequently, there are large disparities between individual companies. Therefore, it was necessary to create a framework within the Japanese stock market for a group of listed companies that are suitable for international investors.

In November 2013, the Japan Exchange Group[3] and the Nihon Keizai Shimbun announced the formation of a new index, "JPX Nikkei 400 Index" (hereafter referred to as the JPX400). The new index is composed of "companies that have great appeal for investors"; i.e. companies that meet the conditions required for global investment criteria in terms of efficient use of capital and management that gives due consideration to investors. The aim is to activate the stock market[4] by promoting improvements in sustainable corporate values, while also fostering the appeal of Japanese companies at home and abroad. Japan Exchange Group, Tokyo Stock Exchange and Nikkei will start to calculate the "JPX400" from 6 January 2014.
The process below was used to select 400 companies for the JPX400:

[3] Japan's largest group of exchanges, formed by the integration of the management of the Tokyo Stock Exchange and the Osaka Securities Exchange.

[4] Japan Exchange Group, Tokyo Stock Exchange and Nikkei, “New Index, JPX-Nikkei Index 400”, 2013.11.6

1. Screening based on eligibility criteria (excessive debt, operating losses, final deficits etc.) and market liquidity (trading values; market capitalisation)

2. Scoring based on quantitative indicators (ROE; cumulative operating income; market capitalisation etc.)

3. Additional points awarded for qualitative factors (independent, external directors; adoption of IFRS; disclosures in English)

The productivity of capital is an important factor for companies whose appeal to investors lies in sustainable corporate values. A comparison of the ROE of JPX400 companies and that of other companies is shown below.

Figure 5. 3-year simple average ROE (based on the selected issues for FY 2013)

JPX400 constituents	11.1%
TOPIX constituents	5.7%
non-JPX400 constituents	3.9%

Source: Tokyo Stock Exchange

It was highly likely that listed companies of a comparatively large scale would be chosen, given the fact that market capitalisation, cumulative operating income and trading value were included in the selection criteria. In addition, points were added for qualitative factors from an international perspective, such as the use of two or more independent, external directors in corporate governance, as well as the adoption of international accounting standards (IFRS) and the implementation of disclosure in English. Consequently, this meant that the companies selected met international management standards and were suitable for global investors.

PART II. CORPORATE GOVERNANCE DEVELOPMENTS WITHIN LISTED COMPANIES

2.1 Corporate governance legislation

2.1.1 Corporate governance system in Japan

a) Overview

In Japan, the corporate governance system is defined in the Companies Act. Japan's Companies Act can be traced back to the Commercial Code which came into force in 1890. At that time the Commercial Code, enacted as law, was based on business practices existing since the earlier Edo period, and was influenced by Europe, primarily Germany. Subsequently, in the wake of World War II, the influence of the American system led to reforms, such as the introduction of boards of directors. In 2005, the part of the Commercial Code that dealt with companies was established as a separate, independent law and was established as the new Companies Act. Against this historical backdrop, Japan's corporate structure has evolved in its own, unique way.

In Japan, there are no laws and regulations that define corporate governance in listed companies. The Companies Act applies to two types of company; namely closely-held companies and publicly-held companies. Under the Companies Act, there are cases where the provisions of the Act apply to separate categories of company to reflect differences in the scale and number of stakeholders, with companies classed as "large companies" or "non-large companies". A large company is one that has capital of JPY 500 million or more, or one that has total liabilities of JPY 20 billion or above.

As detailed below, under the Companies Act it is possible to create 39 formats for corporate governance systems, depending on the categories of publicly-held company/closely-held company, and large company/non-large company. Within this framework, companies are allowed to select the most appropriate format.

Figure 6. Formats for corporate governance systems available under Japan's Companies Act

Transfer Restriction Applicable/Not Applicable	Non-large Companies	Large Companies
Closely-held Company	・ Board of Directors + Company Auditor (in some instances only with authority to audit accounts; in other instances this may not apply) ・ Board of Directors + Board of Company auditors ・ Board of Directors + Company Auditor + Accounting Auditor ・ Board of Directors + Board of Company Auditors + Accounting Auditor ・ Board of Directors + three Committees + Accounting Auditor ・ Board of Directors + Accounting Advisor * ・ Director + Company auditor (in some instances only with authority to audit accounts; in other instances this may not apply)	・ Board of Directors + Company Auditor + Accounting Auditor ・ Board of Directors + Board of Company Auditors + Accounting Auditor ・ **Board of Directors +** three **Committees + Accounting Auditor** ・ **Director +** Company A**uditor + Accounting Auditor**
Publicly-held Company	・ Board of Directors + Company auditor ・ Board of Directors + Board of Company auditors ・ Board of Directors + Company Auditor + Accounting Auditor ・ Board of Directors + Board of Company Auditors + Accounting Auditor ・ Board of Directors + three Committees + Accounting Auditor	・ **Board of Directors + Board of Company Auditors + Accounting Auditor** ・ **Board of Directors +** three **Committees + Accounting Auditor**

Note: All forms of accounting (with the exception of *), may or may not have accounting advisors included.
Source: Masao Kishida, *A Seminar: Introduction to the Companies Act (7th Edition)*, Nikkei Publishing, p. 185.

Many listed companies are large companies, and the current Companies Act lays out the corporate governance systems described below for large companies.

First are "companies with a board of company auditors," which exist in Japan's traditional systems. In these companies, there is no obligation to have external directors on the board of directors; but at least 50% of the board must be comprised of external auditors on a board of company auditors with supervisory functions.

Second are "companies with committees," which were introduced in 2003 from the perspective of global management. These companies are required to establish three committees; namely a nominating committee, a remunerations committee, and an audit committee.

In addition, the Revised Companies Act enacted in 2014 introduced a third system, "companies with audit and supervisory committees" as an intermediate format between "companies with company auditors" and "companies with committees." From April 2015, it will form a third system of corporate governance.

Note that in Japan external auditors and external directors do exist, but their definition stops at "external". There is no legal definition placed on their "independence" in terms of business ties with a company and so on. Meanwhile, many institutional investors, both in Japan and abroad, place great emphasis on independence being secured. Consequently, many companies have formed their own standards of independence.

Furthermore, many foreign investors tend to prefer companies with a committee system of governance that is similar to global corporate governance systems. However, the law does not

discriminate between the system used in companies with a board of company auditors and that used in companies with committees. A company is able to design the best possible system of corporate governance appropriate to the circumstances surrounding its own business and shareholders.

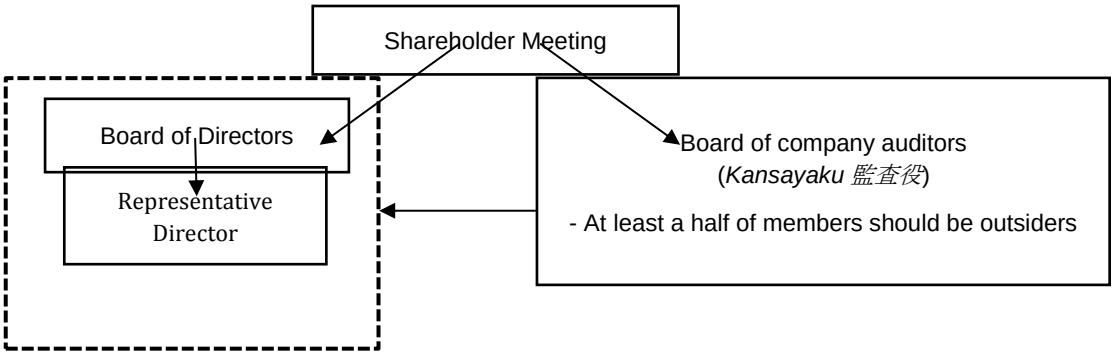
b) Companies with a board of company auditors

The system of “company auditors” *(Kansayaku)* is a traditional system of corporate governance unique to Japan. Company auditors are responsible for auditing and supervising the executive functions of the board of directors. There is no requirement for external directors in companies with a board of company auditors. Instead, the board of auditors should consist of at least three members, at least half of whom must be external auditors. Over 90% of listed companies still currently use this system.

The definition of “outside company auditors” is as follows (Companies Act §2.16);
“Those of any Stock Company who has neither ever served in the past as a director, Accounting Advisor (or, in cases where the accounting advisor is a juridical person, any member thereof who was in charge of its advisory affairs) or executive officer, nor as an employee, including a manager, of such Stock Company or any of its Subsidiaries”.

The following criticisms have been made of the current requirements for auditors to be from "outside". First, former employees and directors of subsidiaries cannot take up future appointments as auditors to the parent company. This fact means that despite the increasing need for outside auditors, the pool of such human resources is shrinking, leading to the criticism that it has become increasingly difficult to secure high-quality staff. Second is the acceptance of directors and employees of the parent company as being from "outside". Management in parent/subsidiary companies and group corporations often targets the group as a whole, and although a company may be an individual legal entity, in economic terms it is integrated as part of the whole. Thus, many institutional investors are critical of and vote against candidates for outside company auditors from the parent companies.

Figure 7. Companies with a board of corporate auditors



Consequently, the Revised Companies Act enacted in 2014 sets a 10-year cooling-off period for the determination of what constitutes “outside”, so that anyone who has not been a director or employee of a subsidiary during the past 10 years is able to be appointed as an outside auditor. In addition, directors and employees from parent companies will no longer be able to be appointed as outside auditors.

It should be noted that the requirement for outside directors in companies with a board of company auditors has not been included in the current amendments to the Companies Act. However, once the current amendments take effect, if a company with a board of company auditors (i.e. any such company classified as both "large" and "publicly-held") does not install outside directors, then its directors will have to explain at a general shareholder meeting the "reasons why it is not appropriate to appoint outside directors". (The Revised Companies Act Article 327-2)

Furthermore, the Legislative Council of the Ministry of Justice has declared as a supplementary resolution[5] that "the regulations of financial instruments exchanges need to include a rule to the effect that listed companies should seek to secure at least one independent official as a director". As a result, the Tokyo Stock Exchange decided to demand that listed companies secure at least one, highly independent, outside director.

There is strong demand from investors for the mandatory appointment of outside directors to companies that operate the company auditor system and 65% of the companies listed on the TSE 1st Section have already voluntarily done so. It is likely to be very difficult to convince shareholders of the argument that "there are reasons why the appointment of outside directors is not appropriate" when it comes to the issue of such directors improving corporate governance. As a result, companies with a board of company auditors are also expected to proceed with the introduction of outside directors in future.

c) Companies with committees

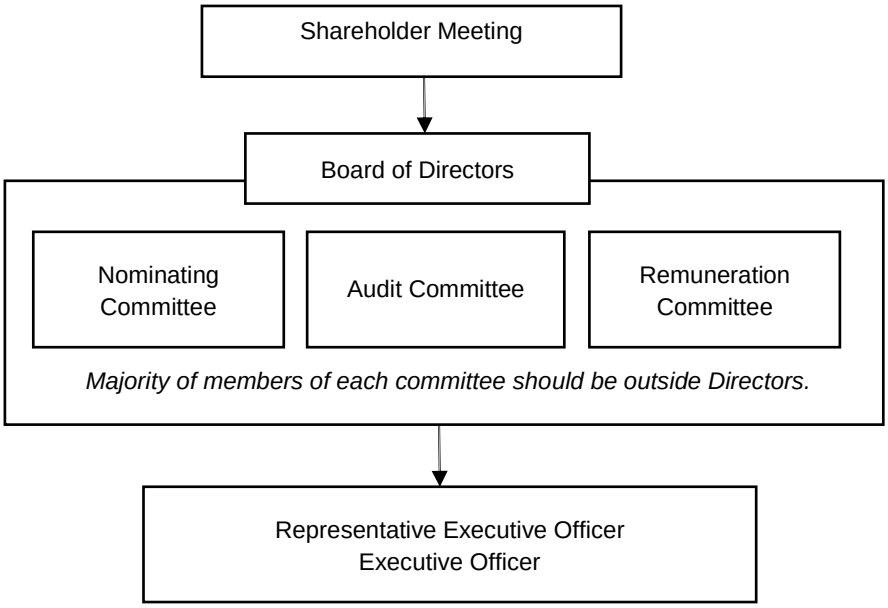
The system of "companies with three committees" was introduced in 2003 with the aim of achieving global management structure and harmonisation with overseas' systems. However, it has only been adopted by a few percent of listed companies, including Sony, Hitachi, Toshiba and Nomura. Companies using this system must set up three committees; namely a Nominating Committee; an Audit Committee; and a Remuneration Committee. It is mandatory that each of the three-committees consists of a majority of outside directors.

The definition of “outside director” is as follows (Companies Act §2.15);

“A director of any Stock Company who is neither an Executive Director nor an executive officer, nor an employee, including a manager, of such Stock Company or any of its Subsidiaries, and who has neither ever served in the past as an executive director nor executive officer, nor as an employee, including a manager, of such Stock Company or any of its Subsidiaries”.

[5] TSE “Revisions to Listing Rules concerning Securing Highly Independent Outside Directors”; November 29, 2013.

Figure 8. Companies with committees



The requirements for outside directors have been subject to similar criticisms as those mentioned above concerning outside auditors. Consequently, the Revised Companies Act amends the Act to include a 10-year cooling off period and bar parent company employees/directors from being appointed as outside directors. In addition, the Revised Companies Act stipulates that any newly established companies with audit committees etc., as shown below, will be renamed and referred to as "companies with nominating committees etc." rather than the traditional title of "companies with committees".

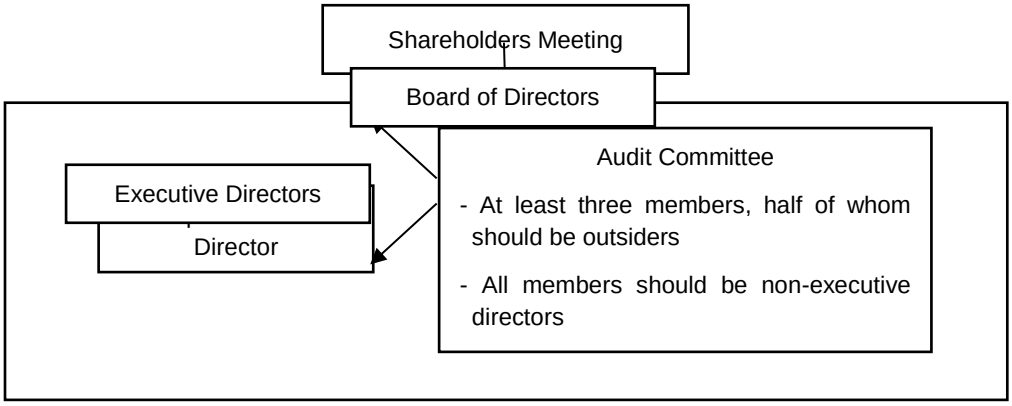
d) Companies with an audit committee

The system of “companies with an audit committee” is a new structure of corporate governance introduced under the Revised Companies Act adopted in June 2014.

This system is expected to adopt a position midway between the system that uses a board of company auditors and the three-committee system. Companies with a board of company auditors have auditors from independent audit firms and an audit board; consequently, in formal terms, they can be expected to have a strong audit regime that is independent and objective. However, in these companies the auditors are not members of the board of directors and cannot participate in the resolutions reached by this board; as such, the criticism has been made that auditors are in a weak position to intervene in the decisions made by the board of directors. Meanwhile, it is mandatory to establish three committees (nominating, remuneration and audit committees) in companies using the committee system and this creates a rigid organisation. It makes it impossible to legally establish an organisation such as that used by US listed companies where there is one committee (for example a "corporate governance committee") that combines nomination and remuneration functions, and another committee that deals with the real-life conditions facing the company and incorporates the risk management panel etc. In addition, the executive authority of the board of directors is stronger in Japan's corporate culture, and because the decisions of individual committees take precedence over resolutions reached by

the board of directors, there is criticism that the three-committee system gives too much authority to committees that are comprised of a majority of outside directors.

Figure 9. Companies with an audit committee



It was decided to introduce a new system of "companies with an audit committee" to combine the characteristics of the system used in traditional Japanese corporate culture (i.e. a board of auditors) with the features of the committee system of governance, in order to compensate for the respective shortcomings of "companies with a board of auditors" and "companies with three committees."

The transition process from the company auditor system to the audit committee system turns Japan's traditional auditors into directors, and transforms the board of auditors that was an outside agency into an audit committee within the board of directors. In so doing, internal auditors become non-executive directors in charge of audit and supervision; and external auditors become outside, non-executive directors. As a result this also leads to an advance in the appointment of outside directors. Moreover, supervision is expected to become more effective as former auditors are allowed to participate in resolutions made by the board of directors in their new role as directors.

2.1.2 "Study Group on the Internationalization of Japan's Financial and Capital Markets" - A report by the Financial Services Agency.

In the late 1990s, reforms were made to the financial system in Japan. As a result, the country's financial system continued to transform from one that relied on the banks to take risks, to one where the focus was transferred to a market-based financial system.

This transformation of the financial system allows us to understand how the corporate governance regulations imposed under the "main bank" system were replaced by regulations imposed by the markets and shareholders. Under the watchful eye of shareholders and investors, companies achieved high-quality management and created worth, which was then returned to shareholders and investors; this ultimately led to Japan's economic growth and the expansion of the country's national wealth. Consequently, developments in the legal system and stock exchange regulations have also evolved in this context. Meanwhile, there have been questions raised as to whether the measures advanced to improve corporate governance have met expectations.

Against this background, the "Study Group on the Internationalization of Japan's Financial and Capital Markets" (a Financial System Council working group), was set up within the Financial Services Agency to study issues related to the corporate governance of listed companies. The findings of the study group's deliberations were published in June 2009 in "A Report by the Study Group on the Internationalization of Japan's Financial and Capital Markets - Toward Stronger Corporate Governance of Publicly Listed Companies."[6]

The study group's report discusses three main issues and the separate questions pertaining to each; and recommends ways for the necessary system responses etc. The three main challenges are (i) issues surrounding the procurement of funding etc. in the market; (ii) issues surrounding governance mechanisms; (iii) issues surrounding the exercise of voting rights by investors etc. Figure 10 summarises the report.

Figure 10. Main recommendations of the study group's report

Issues surrounding the procurement of funding in the market	Issues surrounding governance mechanisms	Issues surrounding the exercise of voting rights by investors etc.
1. Optimisation of increased third party allocations 2. Dealing with Cash Out 3. Governance in corporate groups Subsidiary listings 4. Treatment of cross-shareholdings	1. Board of Director Models 2. Strengthening auditors' functions 3. Independence of outside directors/auditors 3. Proposing auditor appointments/ deciding remuneration 4. Disclosure of directors pay	1. Appropriate exercise of voting rights based on the fiduciary duties of institutional investors - Preparation and publication of guidelines on the exercise of voting rights - Publication of voting results 2. Publication by listed companies of the results of votes made on resolutions at shareholder meetings 3. Improving the environment for the exercise of voting rights - Providing an environment that allows dates of shareholder general meetings to be spread out and convocation notices to be promptly dispatched. - Promoting the use of electronic voting platforms - Submitting securities reports etc. to shareholder general meetings Enhancing shareholder/investor dialogue with management

Source: Yuuki Kimura "Verification of enhanced disclosure of information pertaining to corporate governance - Current Status as of Fiscal Year 2011", *Shojihomu* , Vol. 1964 - 1966 (2012).

In addition, based on the recommendations made in the study group's report, the Financial Services Agency, the Ministry of Justice and the securities exchanges began to develop a system that included disclosure rules, legislation such as the Companies Act, and listing regulations. Figure 11 shows the status of the systems initiated by policy makers in response to the report's recommendations.

[6] Financial Services Agency "A Report by the Study Group on the Internationalization of Japan's Financial and Capital Markets - Toward Stronger Corporate Governance of Publicly Listed Companies"; June 2009 – English version available.

Figure 11. Current status of responses to the recommendations in the study group's report

(as of February 2014)

Issues surrounding the procurement of funding in the market

Stronger governance on capital policies of listed companies etc. in order to prevent funding procurement etc. likely to seriously damage the interests of minority shareholders

1. Dealing with the issue of new shares etc.
- Dealing with the allocation of new shares to third parties, including those that would dilute the major control ratios/ the issue of MSCB. [TSE] Regulation amendments (effective 24 August 2009).
- Development of delisting criteria in case of new share allocation to a third party; and implementation of procedures etc. for schemes similar to MSCB. [JSDA] Regulation amendments (effective 14 July 2009)
- Implementation of procedures for schemes similar to MSCB. [FSA] Revisions to the Cabinet Office Ordinance on Disclosure of Corporate Information (effective 1 February 2010)
- Improving the description of third party allocation of new shares and MSCB
- Improving co-operation/enhancing enforcement in the authorities and exchanges [FSA; Local Finance Bureau; SESC; Exchanges] Joint Meetings (effective 21 October 2009; 31 March 2010)
- An exchange of views was held on issues with third party allocation of new shares etc., and the current status of procedures to deal with such issues

2. Cash Out
- Exchanges should monitor whether there are any undue restrictions on the rights of shareholders and should take strict action, including delisting, if any problems are found. [TSE] Regulation amendments (effective 24 August 2009)
- Criteria for delisting in the event of reverse stock splits etc. are being developed.
- Plans for cash outs accompanying the allocation of new shares to third parties and disclosure on their specific details [FSA] Revisions to the Cabinet Office Ordinance on Disclosure of Corporate Information (effective 1 February 2010)
- Mandatory requirement for companies to disclose plans/details of cash outs accompanying new third party allocations

3. Governance in Corporate Groups
[TSE] Regulation amendments (effective 30 December 2009)
+ Formulation of regulations on honoring the principles of corporate governance
+ Governance principles should include the fact that governance of a corporate group should be implemented for the group as a whole.
+ Management decisions made by a subsidiary company should be appropriately disclosed, together with the opinion of the parent company's management team.
[Bill on the Companies Act]（Submitted to the National Assembly in November 2013)
+ establishes a system to allow multiple class actions

4. Practices for Subsidiary Listings
[TSE] Publication of a summary of investigations (effective 3 March 2010)
+It is appropriate to develop rules to prevent the abuse of authority by controlling shareholders.

5. Procedures for Crossholdings of Shares
[FSA] Revisions to Cabinet Office Ordinance on Disclosure of Corporate Information (effective 31 March 2010)
+Filing companies must disclose their purpose for holding shares that fall into the category of investment securities if such securities are held for any strategic purpose. This applies to either (i) the top 30 largest stock held on the balance sheet (top 10 stock as to end-March 2010); or (ii) individual stocks whose amounts reported on the balance sheet account for more than 1% of the filing company's capital. *1 *2

Note 1: Holding company must include subsidiaries' holdings in its figures (from end-March 2011)
Note 2: Phased rollout from end-March 2010 of the requirement for disclosure in banking/insurance; sectors not previously subject to disclosure

Figure 11. Current status of responses to the recommendations in the study group's report (as of February 2014) (cont.)

Issues surrounding governance structures

The nature of governance structures is extremely important to achieve high quality of management in listed companies and from the perspective of ensuring investor confidence

1. Board of Directors
   - 3 suggestions for boards of directors
     [TSE] Regulation amendments (effective 30 December 2009)
     ○ Formulate regulations on honouring the principles of corporate governance
     ○ List the 3 types of SG report models as reference for governance principles
     ○ Disclose the governance structure of individual companies and the reasons for choosing the structure in the governance report
     [FSA] Revisions to the Cabinet Office Ordinance on Disclosure of Corporate Information (effective 31 March 2009).
     Disclosure of the structure of corporate governance in each company (presence or absence of outside directors) and reasons for adopting such a structure

2. Strengthening the functions of corporate auditors
   - Securing human resources and systems to support corporate auditors in performing audits
     i) Appointment of highly-independent outside auditors ii) Appointment of auditors with financial and accounting knowledge
     These should all be given priority as matters desirable for listed companies, and each listed company should disclose the status of initiatives taken in regard to each matter
     [TSE] Regulation amendments (effective 30 December 2009)
     ○ Formulate regulations on honouring the principles of corporate governance
     ○ List various recommendations for the improvement of SG report auditors' functions in the governance principles
     ○ Disclose the current status of initiatives aimed at strengthening auditors' functions in the governance report
     [FSA] Revision to the Cabinet Office Ordinance on Disclosure of Corporate Information as regards point iii) (effective 31 March 2010)
     (Note that descriptions of the current status of i) and ii) are already included in existing items for disclosure)

3. Independence of outside directors and auditors
   Enhanced disclosure of a company's opinions on the relationship between the company and outside directors/auditors, and the independence of such officials (the case for subsidiary listings is noted separately).
   [TSE] Regulation amendments
   + companies should disclose their opinions on the relationship between the company and outside directors/auditors and the independence of such officials in their governance reports (effective 30 December 2009)
   + formulation of a rule that companies should secure at least one independent official (i.e. an outside director/auditor that is at no risk of having a conflict of interest with general shareholders) (effective 30 December 2009)
   + publication of study summary on the role that independent officials should play (Effective 31 March 2010)
   + Review of the listing system with regard to ensuring highly independent outside directors (available for public comment 29 November 2013)
   [FSA] Revisions to the Cabinet Office Ordinance on Disclosure of Corporate Information (effective 31 March 2010)
   + Disclosure of a filing company's opinions etc. on the function/role of outside directors/auditors (including concepts of independence)
   [Bill on Companies Act] (Submitted to the National Assembly in November 2013)
   + Disclosure of grounds for non-appointment of outside directors in companies that operate a board of company auditors system
   + The exclusion of officers from the parent company; and the creation of a 10 year cooling off period with regard to the conditions placed on outside directors/auditors

4. Accounting auditors: authority for appointments and remuneration
   - Promotion of a study on whether authority for the appointment and remuneration of (accounting) auditors should lie with a company's company auditors
   [FSA] A request to the relevant authorities to promote the study

5. Enhanced disclosure of senior management remuneration
   - Disclosure of policies used to determine senior management remuneration and a detailed breakdown of categories of remuneration.
   [FSA] Revisions to the Cabinet Office Ordinance on Disclosure of Corporate Information (effective 31 March 2010)
   + Disclosure of the policies used to determine senior management remuneration, a breakdown of total remuneration by type and position; with separate disclosure of any officials earning JPY 100 million or more.

Figure 11. Current status of responses to the recommendations in the study group's report (as of February 2014) (cont.)

Issues surrounding the exercise of voting rights by investors

Accurate monitoring of management by investors via the market in order to raise standards of governance in listed companies

1. Appropriate exercise of voting rights based on the fiduciary responsibilities of institutional investors
- Preparation and publication of voting policies of domestic institutional investors and the 4 major associations
  1) Mutual Funds ; self-regulations enacted (March 2003)
  2) Trust Banks; Notice issued by Association/publications by major trust banks
  3) Investment Advisory Companies; self-regulations revised (December 2009)
  4) Life Insurance - publication by the major companies (November 2009)
- Publication of the voting results of domestic institutional investors/the 4 major associations
  1) Investment Trust Funds; self-regulations amended （March 2010）
  2) Trust Banks; Association has issued a notice requesting trusts to make publication
  3) Investment Advisory Companies; self-regulations amended (January 2010)
  4) Life Insurance; publication of voting result highlights by the major companies

[FSA] Publication of Japan's Stewardship Code (February 2014)

2. Publication by listed companies of the voting results on resolutions made at shareholder meetings
- Publication of the final number of votes for and against each resolution
  [TSE] Request made to all companies (effective 29 October 2009)
  [FSA] Revisions to the Cabinet Office Ordinance on Disclosure of Corporate Information (effective 31 March 2010)
- Disclosure of the final number of votes for and against each resolution and the ratio of resolutions passed (including resolutions on the appointment of individual senior officials).

3. Promotion of the use of electronic voting platforms

[TSE] Publication of a summary of investigations into the matter (published 31 March 2010)
+ It is appropriate for TSE and ICJ (Inc.) to continue to work toward promoting the use of such platforms
+ The idea of improving the voting environment for substantial shareholders is not made obvious in current codes of business conduct; a fact which needs to be suitably addressed

Methods of enforcing compliance with regard to corporate governance

- It is the stock exchange's mission to ensure high standards of corporate governance.

[TSE] As described above, TSE has implemented revisions to its regulations

- Enhanced disclosure requirements to try and improve corporate governance under the watchful eye of the markets

[FSA] Implementation of revisions etc. to the Cabinet Office Ordinance on Disclosure of Corporate Information, as described above

- Further extensive study is needed on the nature of legislation surrounding the corporate governance of listed companies

Note: The following exchanges are all implementing revisions to their regulations - Osaka (now integrated with Tokyo); Nagoya; Fukuoka; and Sapporo.

Source: Yuuki Kimura "Verification of enhanced disclosure of information pertaining to corporate governance", *Shojihomu*, vol. 1931 and 1932 (2011). Updated by Ryoko Ueda.

2.1.3 Disclosure regarding corporate governance

Based on the recommendations of the study group report mentioned above, the Financial Services Agency amended the Cabinet Office Ordinance on Disclosure of Corporate Information etc., in order to enhance disclosure on corporate governance.[7] The amendments took effect on 31 March 2010.

The details of the amendments are listed below. The two main points were (i) enhanced disclosure on corporate governance to be included in the annual securities report; and (ii) disclosure of shareholder voting results to be included in extraordinary reports.

Both points addressed calls for enhanced disclosure of information from shareholders, including institutional investors, who were making stronger demands than previously on issues of corporate governance. In addition, the latter point, on the disclosure of voting results, addressed recommendations made by the Financial Services Agency Working Group Report of 2009 on the disclosure of regulations.

Key features of the March 2010 amendments to the Cabinet Office Ordinance on Disclosure of Corporate Information

1. Enhanced disclosures related to corporate governance in the securities report.
a) Corporate governance system
   i. Systems of corporate governance
   ii. Audit organisation, personnel, procedure
   iii. Outside directors/outside auditors
b) Executive remuneration
   i. Total remuneration by management category and type of remuneration
   ii. Total remuneration for individual officers (in the event that this exceeds JPY 100 million; consolidated basis)
   iii. Strategies for determining remuneration amounts/calculation methods
c) Disclosure of voting results from general shareholder meetings

d) Status of shareholdings
   i. Shares held for strategic purposes
   ii. Shares held for purely investment purposes

2. Disclosure of voting results in extraordinary reports

1. Enhanced disclosures related to corporate governance in the securities report

a) Corporate governance system

i. Systems of corporate governance

Prior to the amendments, companies were obliged to include matters of corporate governance in their annual securities reports, whether they adopted the system of a “company with a board of company auditors” or that of “a company with committees.”

The new amendments made it compulsory to provide an overview of the system of corporate governance used and disclose the specific reasons that the system was adopted; the purpose being to disclose information on the de-facto status of a company’s management regime.

[7] FSA, ”Outline of Disclosure concerning Corporate Governance”,（2012.2）.

"Corporate governance system" meant a voluntary system established by a company, such as a committee system of management advisory boards for example, or similar.

ii. Audit organisation, personnel and procedures

Prior to the amendments, it was mandatory to include in the annual securities report details of the organisation, personnel and procedures used in internal audits and audits conducted by company auditors, as well as any links between audits (i.e. between internal audits, audits conducted by company auditors and accounting audits).

The new amendments demanded the disclosure of any company auditors, or audit committee members, with a substantial amount of expertise in finance or accounting (certified public accountants etc.)

Disclosure of financial and accounting expertise within the audit function is required in some other countries, such as in the UK Corporate Governance Code, and this has also contributed to the demand for the disclosure of such expertise in Japanese securities reports.

iii. Outside directors/outside company auditors

Prior to the amendments, it was mandatory to describe any ties between outside directors/outside auditors and a company in the annual securities report; such ties included personal connections, capital ties, trading relationships and any other mutual interests.

The new amendments, in addition to requiring the disclosure of any external relationships between outside directors/auditors and the company as mandated in the past, were also intended to improve the explanation of matters relating to the evaluation of their actual effectiveness.

The specific details were as follows:

First, the new amendments considered (i) function and role of outside directors/auditors, including the issue of independence therein; and (ii) conditions surrounding the appointment of outside directors/auditors, which are meant to follow the company's concepts for targeting balance and structure between internal and external officers.

Second, the amendments called for enhanced descriptions of how monitoring/audits by outside directors/auditors were co-ordinated with the company’s audit department (internal audits; audits conducted by company auditors; accounting audits), and the relationship between such outside officials and the company’s department in charge of internal controls. The aim was to improve effectiveness by promoting co-operation between outside directors/auditors and other parties with supervisory functions.

Third, the new amendments required companies not appointing outside directors/auditors to disclose, in their annual securities report, the alternative system they were using and their grounds for the selection of the said system (i.e. the system where no outside directors or outside auditors were appointed). This demanded that companies not employing outside officers explain their reasons for not doing so and describe their alternative governance procedures, and was based on the assumption that the presence of outside directors/auditors is critical to ensure objectivity in the supervisory function.

b) Executive remuneration

i. Total remuneration by management category and type of remuneration

Remuneration paid to senior management should be disclosed as overall total remuneration by management category and total figures for each type of remuneration.

Management categories are classified as (i) directors (excluding outside directors); (ii) company auditors (excluding outside company auditors); (iii) executive officers; (iv) outside officials. Remuneration is categorised into the following types: (i) base salary; (ii) stock options; (iii) bonuses; (iv) retirement benefits.

The format in which companies make disclosure is not prescribed, unlike the descriptions given in US proxy statements. As a result, companies have used different ways of describing outside officials, such as calculating a combined total that includes both outside directors and outside auditors; or separately classifying such officials as either “outside directors” or “outside auditors.” Moreover, in Japan the term "stock options" is generally understood to include both options and actual shares. It is worth bearing this point in mind, as it differs from the classification method used in US proxy statements, which separates stock options into "option rights" and "stock awards".

ii. Total remuneration of executive officers (JPY 100 million and above, on a consolidated basis)

The disclosure of information on high-earning executives (in receipt of remuneration of JPY 100 million or more, on a consolidated basis), is mandatory and must include total remuneration amounts for individual officials and the total amount of each type of remuneration.

As described later, the remuneration paid to senior management in Japan is relatively low compared with the United States In terms of corporate governance, many view the disclosure of individual officers' remuneration figures with scepticism. Consequently, the standard was set at JPY 100 million, with the mandatory requirement that remuneration at, or above, this level be disclosed as important information on corporate governance.

iii. Strategies for determining remuneration amounts/calculation methods

While specific payment amounts are an important element of executive remuneration, it is company attitudes toward remuneration issues such as payment methods and calculation techniques that are important in terms of corporate governance. Many shareholders, including institutional investors, are more concerned with the issue of whether remuneration payments are linked to performance, than with how much is paid to whom (an issue that is the object of public interest at times). To this end, it is necessary to secure predictability for shareholders on the issue of executive compensation. The new amendments were expected to promote the formulation of remuneration strategies.

c) Disclosure of voting results from general shareholder meetings

The exercise of voting rights by shareholders is an important factor in improving corporate governance. As a result, it has been made compulsory for listed companies to submit extraordinary reports disclosing the results of resolutions made on proposals submitted at shareholder meetings.

Specifically, the items listed below should be disclosed:

1. Date of the general shareholder meeting

2. Matters for resolution

3. The number of voting rights cast for and against each matter and the number of abstentions; terms of approval pertaining to the said matters; resolution results.

4. If applicable, the reason for not including certain voting rights of shareholders present at a general meeting in the number of voting rights mentioned in 3 above. (Such reasons may include the fact that the resolution has already been legally established under the Companies Act due to its terms of approval having been met by voting rights exercised the previous day, or by the aggregate number of votes exercised by majority shareholders in attendance on the day in question.)

In addition, disclosure is required on the number of votes obtained by each individual nominee in resolutions on the election of directors or company auditors.

d) Status of shareholdings

i. Shares held for strategic purposes

As mentioned above, cross-shareholdings are an issue in terms of corporate governance in Japan. In the past, there was much criticism of banks etc. holding shares in operating companies as part of the “main bank” system. However, in recent years the number of share cross-holdings between operating companies with business ties has increased in order to ensure shareholder satisfaction.

“Shares held for strategic purposes” are investment grade, marketable securities classified as “investment stock” that are held for any purpose other than pure investment. Under the amendments to the Cabinet Office Ordinance on Disclosure of Corporate Information, companies are obliged to disclose the number of such stocks held and the total amounts recorded for each on the balance sheet.

Furthermore, companies must disclose any listed shares they hold for strategic purposes that have voting rights attached. Such disclosure includes the number of shares of each issue whose amount on the balance sheet accounts for more than 1% of the holding company's equity capital; balance sheet amounts; and specific reasons for holding the stock. In the event that the number of issues accounting for more than 1% of equity capital is less than 30, the company must disclose the top 30 largest issues on its balance sheet, including the number of shares held; balance sheet amounts; and the specific reasons for holding the stock.

ii. Shares held purely for investment purposes

From the perspective of efficiently utilising shareholder capital, transparency is also necessary for shares held purely for investment purposes.

Companies must separately classify any shares held purely for investment purposes into listed stock and unlisted stock, and disclose balance sheet amounts; amounts of dividends received; gains/losses on sales; gains/losses on valuation.

In addition, when the purpose for which a stock is held changes from “pure investment” to “strategic”, or vice versa, stockholdings should be reclassified and a list of issues, the number of shares in each issue and their amounts shown on the balance sheet must be disclosed.

2.2 Corporate governance developments within Japanese companies

2.2.1 Shareholder meetings

a) Shareholder rights in relation to corporate governance

Key shareholder rights, as stipulated in Japan’s Companies Act, are detailed in Figure 12 below. In terms of corporate governance, voting rights are a key right, and the principle adopted is one-share-one-vote.

Shareholders are entitled to file proposals if they have held 1% or more of total shareholder voting rights (or 300 voting rights or more) for a period of six months prior to exercising such entitlement. In this case, they are allowed to submit proposals and objectives for general shareholder meetings in writing or by electronic means up to eight weeks in advance.

Figure 12. Shareholder rights under the Companies Act

	Voting Right Requirements	Holding Period Requirements	Cases (Company Act Articles)
right to self-interest	-	-	Dividend rights on retained earnings(461); residual asset claims (504)
right to common-interest	-	-	The right to vote at general shareholder meetings (308); the right to submit written questions (314); the right to demand cancellation of shareholder meeting resolutions (381); the right to claim nullification of incorporation (828 II); cumulative voting claims (342); rights of injunction against the issue of shares for subscription (210 etc.)
		6 month holding period prior to execution	representative litigation rights (847); rights of injunction against misconduct by directors and executive officers (360, 422)
	1%+ of total shareholder voting rights; or 300+ such voting rights	6 month period prior to execution	Right to file shareholder proposals（303・305）
	1%+ of total shareholder voting rights	6 month period prior to execution	Right to demand appointment of a shareholder meeting inspector（306）
	3%+ of total shareholder voting rights; or 3%+ of total outstanding shares	-	Right to inspect the books (433); right to demand appointment of an inspector (358)
	3%+ of total shareholder voting rights	-	Right of objection to reductions in directors’ responsibilities etc. (426V)
	3%+ of total shareholder voting rights; or 3%+ of total outstanding shares	6 month period prior to execution	Right to demand dismissal of directors etc.（854・479）
	3%+ of total shareholder voting rights	6 month period prior to execution	Right to convene a general meeting (297）
	10%+ of total shareholder voting rights; or 10%+ of total outstanding shares	-	Right to demand a corporate dissolution（833）
	Ordinance of the Ministry of Justice (Rule 197 etc.)	-	Right of objection to simple mergers etc. (796 IV etc.)

Note:
1. Total outstanding shares excludes treasury stock
2. The 6 month requirement only applies to publicly held companies
3. The terms of Articles of Incorporation can be relaxed in the case of all companies
Source: Hideki Kanda, *Companies Act - 8th Edition*, Kobundo, p.117.

b) Matters for resolution by a general shareholder meeting

Article 295 of the Companies Act stipulates the matters for resolution by a general shareholder meeting. In Japan, the scope of matters that can be resolved by a general shareholder meeting is comparatively wide, and in companies with no board of directors general meetings can pass resolutions on organisational issues, operations, management and all other matters related to an incorporated company. Moreover, authority for matters that are legally mandated by the resolution of a general shareholder meeting cannot be delegated to a board of directors.

Under the Companies Act, publicly held companies are obliged to have a board of directors; this also includes listed companies. In companies with a board of directors, the matters that can be resolved by a general shareholder meeting are limited by the Companies Act and under the articles of incorporation; this is done to separate ownership from management. General shareholder meetings are responsible for resolutions on the following 5 matters under the Companies Act.

1. Matters relating to fundamental changes in the company (amendments to articles of incorporation; mergers and splits; dissolutions etc.)
2. Matters relating to appointments to/dismissals from institutions etc. (directors, company auditors, accounting advisors, accounting auditors etc.)
3. Matters relating to accounting (approval of accounts etc.)
4. Matters concerning vital shareholder interests (appropriation of retained earnings; treatment of losses; preferential issue of new shares/stock acquisition rights etc.)
5. Matters relating to the risk of abuse of power by directors etc. (determination of directors' remuneration; subsequent establishment etc.)

c) Proposals to general shareholder meetings

According to a survey of companies (March results) listed on the 1st Section of the Tokyo Stock Exchange (see Figure 13), on average 3.4 proposals per company were submitted at general shareholder meetings held in June 2013. There was even one company that had no proposals filed in terms of the reportable items.

In general, there is an increasing trend in the number of proposals submitted if proposals on corporate restructuring such as mergers etc. are included. From around 2012 onwards, with regard to proposals on the appointment of directors and auditors in the event of a merger (categorised into pre-merger proposals and post-merger proposals), there is an increase in the number of companies suggesting proposals in both respective categories. When companies merge there may be a temporary increase in the number of directors and auditors, or cases where there is a change in the structure of outside officers. Meanwhile, many institutional investors look closely at proposals made on appointments for directors and auditors, as this is an important issue for corporate governance. As a result, companies are submitting more detailed proposals to try to gain shareholder approval.

In Japan, directors of publicly held companies are generally elected for a term of two years, but in some articles of incorporation this is shortened to one year (companies with committees are an exception, making one-year appointments for directors). However, as mentioned below (in Figure 14), there is an increase in the number of companies reducing the term of office for directors, and in 2013 1 250 companies out of 1 337 (93.5%) submitted proposals on the appointment of directors.

The term of office stipulated for auditors is four years, due to the need for such officers to play an effective supervisory role from a position of stability. The number of proposals submitted on auditor appointments fell to 718 (with 1 123 nominees) in 2013, down from 949 such proposals (and 2003 nominees) in 2012. This reflects that 2011 and 2012 were periods when many companies re-elected their auditors. In these circumstances the obligations placed on institutional investors to exercise their voting rights increase. With regard to proposals on the appointment of senior officials, many institutional investors carry out instructions for each nominee (in practice, they handle such proposals as "sub-proposals" using each nominee's candidate number); this applies even more so in the election of outside auditors whose appointment is mandatory under the Companies Act, as such elections are subject to particularly strict scrutiny by many institutional investors.

In addition, there has been an increase in the number of proposals related to new or updated anti-takeover measures; from 78 such proposals in 2012, to 135 in 2013. Many companies have an effective term of around three years for anti-takeover measures and so 2014 is also expected to see the submission of many proposals on such measures.

Figure 13. Proposals submitted to general shareholder meetings

	June 2013	**June 2012**	**June 2011**	**June 2010**	**June 2009**	**June 2008**	**June 2007**	**June 2006**
No. of companies	1337	1326	1329	1330	1359	1368	1381	1366
Appropriation of retained earnings	961	957	952	928	930	1010	1036	1321
Election of Directors	1250	1202	1232	1185	1256	1206	1279	1161
Election of Company Auditors	718	949	988	640	753	1021	1044	640
Partial amendments to articles of incorporation	392	326	284	278	1365	459	546	1404
Payment of retirement benefits	185	252	293	269	417	563	748	799
Revision of directors' compensation	108	149	123	127	132	210	392	450
Share warrant issuance (granting of stock options)	46	48	65	81	90	103	106	217
Election of accounting auditors	11	8	29	19	40	39	284	85
Restructuring (M&A)	29	25	16	22	26	25	26	34
Other proposals by companies	41	32	31	19	30	35	53	52
Shareholder proposals	99	111	86	85	60	74	74	49
Payment of bonuses to directors	170	187	218	197	172	322	503	35
Election of alternate auditors	358	352	342	355	313	325	302	333
Buyback of own shares	7	5	6	9	10	11	11	18
Anti-takeover defense measures	135	78	140	130	99	156	172	64
Average no. of proposals per company	3.4	3.5	3.6	3.3	4.2	4.1	4.8	4.9

Note 1 : Applies to companies listed on the 1st Section of TSE (March results)
Note 2 : The figures in the table above do not represent the number of companies, but rather the total number of individual proposals

d) Amendments to the articles of incorporation

The 2005 Companies Act enhanced the principle of private autonomy through the articles of incorporation in Japanese corporate law. As a result, by determining articles of incorporation a company is able to adopt a management regime concurrent with its real-life circumstances. For this reason, in Japan many companies submit proposals on amendments to their articles of incorporation to a general shareholder meeting. On the other hand, the increase in this trend also leads to greater authority of boards of directors. This in turn increases the need for shareholders to monitor directors and raises the importance of proposals on the election of directors being submitted to general shareholder meetings.

Figure 14 summarises which of the proposals submitted to general shareholder meetings on alterations to articles of incorporation are of greatest interest to institutional investors in terms of corporate governance.

i. A Breakdown of proposals on amendments to articles of incorporation

In 2013, 392 proposals on amendments to articles of incorporation were submitted. This number includes the proposals by seven companies that divided into different categories, which enables shareholders to look at the proposals submitted under each category separately. Previously, most companies submitted amendments to articles of incorporation in one single proposal, even if the amendments included multiple issues. However, in June 2005 there were several cases where general shareholder meetings rejected partial amendments to articles of incorporation, including even formal amendments in response to the amendment of the Companies Act enacted in 2005. For example, proposals on amendments to articles of incorporation were rejected at general shareholder meetings in each of the following cases: June 2005 - FANUC, Yokogawa Electric Corporation, Tokyo Electronics; June 2006 - Nintendo; June 2007 - Fujifilm Holdings. These companies all had high ratios of foreign shareholders and good global ratings in terms of performance and operating activities; and the effect of the proposal rejections affected many listed companies.

In the wake of these cases, many listed companies became increasingly aware of the risk of proposals being rejected. Consequently, the number of companies submitting more than one proposal increased, as proposals were separated into different categories, depending on content; i.e. (i) formal amendments such as those stipulated in the Companies Act; and (ii) substantive amendments such as the introduction of anti-takeover measures.

ii. Increase in total number of shares for issue (authorised shares)

Many institutional investors make decisions on increases in the total number of authorised shares on a case by case basis, after duly considering if such increases are appropriate in terms of current funding requirements, or the introduction of anti-takeover measures. When defenses against hostile takeovers became the topic of conversation in June 2005, a significant number of companies tried to implement such defenses by allowing increases in the total number of authorised shares, and tightening the requirements for resolutions on the dismissal of directors etc., rather than by introducing a regime of anti-takeover measures. In fact, in June 2005, 154 companies proposed an increase in the total number of authorised shares. A significant number of shareholders, mainly institutional investors from Japan and overseas, voted against these measures and in some cases the proposals were rejected. As a result, there was a downturn in the use of authorised share increases as an anti-takeover defense strategy, and proposals for such increases were limited to companies in need of funding.

iii. Term of office for directors

As mentioned previously, in principle, the term of office for directors in companies with company auditors is two years. However, this can be shortened to one year under the terms of articles of incorporation. From the perspective of corporate governance, the annual re-election of directors can be seen as a way for shareholders to more easily exercisesupervision. Since 2005, 438 companies (32.8%) listed on the 1st Section of the Tokyo Stock Exchange have submitted proposals on amendments to articles of incorporation to shorten directors' terms of office (as of March 2013 results). If the number of companies making such proposals prior to 2005 is included, it can be assumed that a considerable number of companies have reduced their directors' terms of office to one year.

Figure 14. Proposals for amendments to articles of incorporation submitted to general shareholder meetings

No. of Companies	June 2013	June 2012	June 2011	June 2010	June 2009	June 2008	June 2007	June 2006	June 2005
Multiple proposals for amending articles of incorporation	7	10	6	3	20	12	42	26	
Total no. shares	10	7	10	7	20	23	32	99	154
Increase authorised for Reduction	1	3	4	3	1				
issuance									
Shortening of term of office for directors	23	13	18	14	40	7	83	167	73
（incl.）board of directors to determine	6	1	2	1	2	3	7	87	
allocation of retained earnings									
Revisions to resolution conditions									
（incl.）stricter conditions on resolutions	0	0	0	0	0	0	0	53	8
to dismiss directors									
Changes in prescribed number of directors									
Reduction	14	21	21	13	25	42	52	255	222
Increase	16	20	9	9	14	-	-	-	-
Exemption of duties of senior officials									
Directors and company auditors	74	54	16	60	44	55	62	676	50
Including insiders	7	15	12	12	11	18	18	227	
Only outsiders	67	39	4	47	34	37	44	449	
Accounting auditors	1	0	0	1	0	0	11	136	
Allocation of retained earnings by									-
resolution of the board of directors	11	12	5	6	2	8	11	320	
（incl.）abolition of AGM rights	6	4	3	1	1	5	6	240	
Anti-takeover measures									
Introduced/amended	3	0	2	12	23	63	55	-	-
Abolished	0	1	0	0	1	1			

Note: Companies listed on 1st Section of TSE (March results)

The 2005 Companies Act (Article 459) allowed companies that had shortened their directors' terms of office to one year to amend their articles of incorporation so that resolutions on the allocation of retained earnings could be made by the board of directors; a fact that contributed to the growing trend for companies to shorten directors' terms of office. As a result in June 2006, immediately after the 2005 Companies Act came into force, 167 companies shortened directors' terms of office, with more than half (87 companies) amending their articles of incorporation to allow the board of directors to determine the allocation of retained earnings. Similarly in 2006, just after the enactment of the Companies Act, 320 companies amended their articles of incorporation so that the allocation of retained earnings was decided by the board of directors; of these, 240 companies abolished the rights of general shareholder meetings to determine such matters (indicating, in no uncertain terms, in their articles of incorporation that "such matters are to be resolved by the board of directors, not the general shareholder meeting"). However since 2007, there has been an abrupt decline in companies submitting such proposals. This is due to the fact that the delegation of authority for the allocation of retained earnings to the board of directors met with fierce criticism, mainly from investors dissatisfied with companies' capital policies and financial strategies, and led to many investors voting against the proposals.

Instead, in recent years there has been a tendency for companies planning to introduce anti-takeover measures to secure shareholders' supervisory functions and to reduce the term of office of their directors to one year to make it easier to gain shareholder support (further details to follow).

e) Shareholder proposals

i. Large number of shareholder proposals in certain companies

As mentioned earlier, in Japan, shareholders can submit proposals relatively easily, provided that they meet certain criteria (i.e. in the six-month period prior to the exercise of rights they have held 1% or more of the total number of shareholder voting rights, or 300 such voting rights or more). Companies are not allowed to reject shareholder proposals unless the content of the proposal is inappropriate for a general shareholder meeting, or the same shareholder proposal was made the previous year and failed to reach 10 votes of approval. As a result, in Japan there are many shareholder proposals from individual shareholders (either single individuals or groups of individuals). Many of these are directed at the company's current management team and come from shareholders such as those harbouring some personal dissatisfaction; trade unions (decreasing recently); or environmental organisations opposed to nuclear power plants etc.

Shareholder proposals in Japan often feature the submission of large numbers of proposals in certain companies. In June 2013, 16 companies received 99 proposals from shareholders (see Figure 15). Recently there has been an increasing trend for the same shareholder to submit a multitude of proposals. For example in Toshiba, one single shareholder submitted a total of 60 proposals of which only one was adopted as containing matters worthy of consideration, with the rest invalidated by blank balloting (i.e. votes that gave no indication of a "for" or "against" intention). Toshiba's Notice of Convocation described this issue as follows: "As in the past years, the Board of Directors of the Company has no choice but to consider the shareholder proposals as being inappropriate to be submitted to the General Meeting of Shareholders, and believes that the current exercise of the shareholder's right to propose can be considered to be an abuse of the shareholder's right." HOYA also faced the ongoing submission of numerous proposals from particular shareholders and filed a suit to cancel the resolutions of the general shareholder meeting, refusing to adopt any of the measures proposed by shareholders in previous general shareholder meetings. This suggests that in reality companies are struggling to deal with the increasingly active exercise of rights by shareholders.

ii. Shareholder proposals on nuclear power

Since the incident at TEPCO's Fukushima Dai-Ichi Nuclear Reactor at the time of the Great East Japan Earthquake in 2011, the prospects for nuclear power have been a huge topic of controversy at general shareholder meetings. Consequently, the number of shareholder proposals submitted to power companies in 2013 was as follows: Tokyo Electric Power (15); Chubu Electric Power (7); Kansai Electric Power (29); Chugoku Electric Power (6); Tohoku Electric Power (3); Shikoku Electric Power (3); Kyushu Electric Power (7); Hokkaido Electric Power (2). Although suggested by different proponents, some of these shareholder proposals have almost the same content (see Figure 15; proposals no. 28 and 31 at Kansai Electric Power). There was even a case in which shareholders overstepped their role as investors in a private-sector company to involve themselves in issues of national energy strategy (demanding the closure of nuclear power plants; see Figure 15). Foreign investors often express the opinion that it is difficult to exercise their voting rights because many similar shareholder proposals are submitted to a single company.

iii. The attitude of institutional investors towards shareholder proposals

Many institutional investors judge shareholder proposals in terms of whether they contribute to the common interests of shareholders in the long term.

In its "Voting Guidelines for Shareholders," the Pension Fund Association for Local Government Officials stipulates that "shareholder proposals should be scrutinised in terms of whether or not they will improve long term share values and decisions should be made on a case-by-case basis. However, proposals likely to pursue the interests of only certain shareholders should, in principle, be rejected." In its "Criteria for the Exercise of Shareholder Voting Rights," the Pension Fund Association also concludes "as a general rule, proposals should be studied individually, but the fundamental standard that should be employed in reaching a decision is whether or not the shareholder proposal in question contributes to long term growth in shareholder worth. However, it is not possible to reach a positive decision if it is found that a proposal is being used predominately as a means to resolve a specific social or political issue." Based on the opinions of such financial sponsors, many trust banks and investment advisory companies that act as investment institutions have also developed similar criteria.

In light of this, many institutional investors will decide whether to vote “for” or “against” a shareholder proposal as outlined below. Many institutional investors and foreign investors are accountable to their own financial sponsors, and consequently they will often reach a decision on a proposal based solely on its content, regardless of the identity of the shareholder submitting the proposal.

Shareholder proposals that often receive “for” votes from institutional investors:

- Proposals on the disclosure of individual remuneration
- Proposals seeking the abolition of restrictions on the number of Japanese characters submitted in shareholder proposals
- Proposals on blank voting (exercise of votes that do not indicate any intention “for” or “against”)
- Other proposals related to disclosure of information, transparency and improvements in corporate governance

Shareholder proposals that often receive “against” votes from institutional investors:

- Proposals leading to the benefit of specific stakeholders
- Proposals based on political beliefs
- Proposals related to a particular case
- Proposals affected by government policies such as energy issues etc.

Furthermore, minimum investment units are being standardised in Japan at the request of the stock exchanges, so that one unit will equal 100 shares. When this happens, a company whose minimum investment unit is 1 000 shares will have the number reduced (according to the TSE website, this applies to 859, or 37.2% of the 2 303 companies listed on the exchange as of 31 May 2013). Consequently, the requirements on shareholder proposals will have to be substantially relaxed. As a result, submitting shareholder proposals may become easier in the future.

Figure 15. Shareholder proposals submitted to general meetings in 2013

Company (Ticker)	Resolution No.	Content	Details	Votes in favour (%)
Japan Tobacco（2914）	4	Allocation of retained earnings	Dividend of JPY120 per share	20
	5	Acquisition of treasury stock	Acquisition of 1 million shares of treasury stock at JPY 350 billion	22
	6	Partial amendment of articles of incorporation	Retirement of treasury stock	23
	7	Other	Retirement of treasury stock	-
Oji Holdings (3861）	4	Dismissal of directors	Dismissal of 2 directors due to failings in a Chinese company (both are currently retired)	7.34
Mitsui Mining & Smelting（5706）	5	Dismissal of directors	Dismissal of 1 director on the grounds of cadmium contamination	7.91
	6	Allocation of retained earnings	All net income to go to dividend distribution	1.35
Toshiba（6502）	2	Partial amendment of articles of incorporation	Treatment of voter forms that do not contain descriptions of pros and cons as invalid	18.24
HOYA（7741）	2	Partial amendment of articles of incorporation	Individual disclosure of director and executive remuneration	39.55
	3	Partial amendment of articles of incorporation	Increase in the maximum number of Japanese characters allowed in the description of proposals submitted by shareholders to 1000 characters.	6.36
	4	Partial amendment of articles of incorporation	Prohibition of the practice of allowing blank ballots for proposals submitted by a company, but disallowing the same for proposals submitted by shareholders.	41.89
	5	Partial amendment of articles of incorporation	Obligation to hold management meetings that do not include executive officers	2.95
	6	Partial amendment of articles of incorporation	Separation of the roles of Chairman of the Board and Chief Executive Officer	27.04
	7	Partial amendment of articles of incorporation	Establishment of a complaints desk in the audit committee	4.98
	8	Partial amendment of articles of incorporation	Establishment of legal counsel to the board of directors	3.44
	9	Partial amendment of articles of incorporation	Creation of a budgetary allowance that can be used by the committee without the approval of executive officers	3.73
	10	Election of directors	Appointment of 1 director	2.68
Mizuho Financial Group（8411）	6	Partial amendment of articles of incorporation	Ceiling of JPY 30 million set for executive remuneration	9
	7	Partial amendment of articles of incorporation	Proposed financing of train operators for in-train security camera installation	8
	8	Partial amendment of articles of incorporation	Exercise of voting rights for strategically held shares	28
	9	Partial amendment of articles of incorporation	Officer training policy and disclosure of financial results	31
	10	Partial amendment of articles of incorporation	Shareholder meeting resolutions on internal reserves	9
	11	Partial amendment of articles of incorporation	Disclosure requirements for actions to nullify shareholder meeting resolutions taken by investee or borrowing companies	9
	12	Partial amendment of articles of incorporation	Individual disclosure of director and executive remuneration	27
	13	Partial amendment of articles of incorporation	Disclosure of IPO valuation documents	9
	14	Partial amendment of articles of incorporation	Hosting investor seminars	8
Daito Bank（8563）	3	Partial amendment of articles of incorporation	Issue of preference shares	9.41
	4	Partial amendment of articles of incorporation	Appointment of 2 or more full time outside directors	9.69
	5	Payment of retirement benefits	Payment of retirement benefits to officers who have retired in the past	8.82

Figure 15. Shareholder proposals submitted to general meetings in 2013 (cont.)

Company (Ticker)	Resolution No.	Content	Details	Votes in favour (%)
East Japan Railway （9020）	5	Partial amendment of articles of incorporation	Enhancement of the authority granted to AGM in the Articles of Incorporation (related to the Great East Japan Earthquake.)	7
	6	Other	Establishment of a committee for reconstruction project planning	7
	7	Partial amendment of articles of incorporation	Enhancement of the authority granted to general shareholder meetings in the Articles of Incorporation (compliance) (the issue of illegal water intake at the Shinano River power plant)	8
	8	Other	Establishment of a special compliance supervisory committee (the issue of illegal water intake at the Shinano River power plant)	8
	9	Partial amendment of articles of incorporation	Individual disclosure to shareholders of directors' remuneration	34
	10	Partial amendment of articles of incorporation	Mandatory appointment of 3 or more outside directors	27
	11	Dismissal of directors	Dismissal of 5 directors	7
	12	Revision to Executive Remuneration	20% reduction in executive remuneration	7
	13	Allocation of retained earnings	JPY 60 billion loss reserve fund for disaster reconstruction projects related to the Great East Japan Earthquake; JPY 20 billion reserve fund for local line mergers	7
Tokyo Electric Power (9501）	2	Partial amendment of articles of incorporation	Additional operating objectives (Fukushima No. 1 Nuclear Power Plant Incident)	3.26
	3	Partial amendment of articles of incorporation	Transfer of Head Office	3.22
	4	Appointment of directors	Appointment of 1 director	withdrawn
	5	Other	Dismissal of accounting auditor	3.05
	6	Partial amendment of articles of incorporation	Accounting auditor's attendance at AGM & statements of opinion	3.11
	7	Partial amendment of articles of incorporation	Ensuring management transparency (proposed by Tokyo municipal authorities)	5.24
	8	Partial amendment of articles of incorporation	Decommissioning of Fukushima No. 2 Nuclear Power Plant	3.19
	9	Partial amendment of articles of incorporation	Decommissioning of the Kashiwazaki-Kariya Nuclear Power Plant	3.06
	10	Partial amendment of articles of incorporation	Establishment of a new headquarters for the decommissioning of nuclear power plant	3.17
	11	Partial amendment of articles of incorporation	Establishment of the power generation division as an independent company	3.08
	12	Partial amendment of articles of incorporation	Study into the responsibilities of the constructors in the Fukushima No. 1 Power Plant incident	3.16
	13	Partial amendment of articles of incorporation	Individual disclosure of remuneration etc.	6.15
	14	Partial amendment of articles of incorporation	Reductions in director/executive remuneration etc.	3.31
	15	Partial amendment of articles of incorporation	Reduction in employee salaries and corporate pensions	3.26
	16	Partial amendment of articles of incorporation	Publication of general shareholder meeting proceedings	3.30

Figure 15. Shareholder proposals submitted to general meetings in 2013 (cont.)

Company (Ticker)	Resolution No.	Content	Details	Votes in favour (%)
Chubu Electric Power（9502）	3	Partial amendment of articles of incorporation	Changes in management strategy (withdrawal from nuclear power generation)	6.3
	4	Partial amendment of articles of incorporation	Withdrawal from nuclear power generation	6.3
	5	Partial amendment of articles of incorporation	Restrictions of loan guarantees on investments in Japan nuclear power /Japan nuclear fuel	6.4
	6	Partial amendment of articles of incorporation	Disclosure of information on donations, co-operative funds and compensation	7.2
	7	Partial amendment of articles of incorporation	Establishment of a committee for the decommissioning of nuclear power plant facilities	6.3
	8	Partial amendment of articles of incorporation	Prohibitions on the production, use and sale of plutonium and storage management	6.2
	9	Partial amendment of articles of incorporation	Decommissioning of the Hamaoka nuclear power plant	6.3
Kansai Electric Power（9503）	3	Partial amendment of articles of incorporation	Reduction of thermal fuels	3.3
	4	Partial amendment of articles of incorporation	Statement of social obligations (withdrawal from nuclear power generation)	16.7
	5	Partial amendment of articles of incorporation	CSR based management (withdrawal from nuclear power generation)	17.4
	6	Partial amendment of articles of incorporation	AGM transparency (withdrawal from nuclear power generation)	18.6
	7	Partial amendment of articles of incorporation	12 Directors (withdrawal from nuclear power generation)	0.8
	8	Partial amendment of articles of incorporation	6 company auditors; all on secondment from environmental protection NGOs	3.3
	9	Partial amendment of articles of incorporation	CSR based operational management	17.6
	10	Partial amendment of articles of incorporation	CSR based operational management	3.5
	11	Partial amendment of articles of incorporation	CSR based operational management	3.2
	12	Partial amendment of articles of incorporation	CSR based operational management	3.3
	13	Dismissal of directors	Dismissal of one director	3.4
	14	Partial amendment of articles of incorporation	Halt to nuclear power generation at Oii	16.9
	15	Partial amendment of articles of incorporation	Avoidance of exposure	17.4
	16	Partial amendment of articles of incorporation	Individual disclosure of remuneration	20.1
	17	Partial amendment of articles of incorporation	Halt to nuclear power re-running operations	16.6
	18	Partial amendment of articles of incorporation	Prohibitions on reprocessing	16.7
	19	Partial amendment of articles of incorporation	Ban on loan guarantees for investments in Japan nuclear power/Japan nuclear fuels	16.7
	20	Partial amendment of articles of incorporation	Ensuring management transparency	33.1
	21	Partial amendment of articles of incorporation	Individual disclosure of directors' remuneration (proposed by Osaka and Kyoto municipal authorities)	29.1
	22	Partial amendment of articles of incorporation	Reduction in directors' responsibilities (proposed by Osaka municipal authorities)	40.6
	23	Partial amendment of articles of incorporation	Securing alternative sources of power (proposed by Osaka and Kyoto municipal authorities)	17.3
	24	Partial amendment of articles of incorporation	Reforms to business structure (proposed by Osaka and Kyoto municipal authorities)	17.2
	25	Partial amendment of articles of incorporation	Measures to control power demands and the development of new services (proposed by Osaka and Kyoto municipal authorities)	26.4
	26	Partial amendment of articles of incorporation	Restrictions on accepting re-employment (proposed by Osaka municipal authorities)	16.7

Figure 15. Shareholder proposals submitted to general meetings in 2013 (cont.)

Company (Ticker)	Resolution No.	Content	Details	Votes in favour (%)
	27	Partial amendment of articles of incorporation	10 directors (proposed by Osaka municipal authorities)	14.2
	28	Partial amendment of articles of incorporation	Decommissioning nuclear power and ensuring safety (proposed by Osaka municipal authorities)	16.5
	29	Partial amendment of articles of incorporation	Fostering a culture of safety (proposed by Osaka municipal authorities)	17.4
	30	Election of directors	Appointment of 1 director	26.4
	31	Partial amendment of articles of incorporation	Reliance on nuclear power decommissioning and ensuring safety (proposed by Kyoto municipal authorities)	21.6
Chugoku Electric Power (9504)	4	Partial amendment of articles of incorporation	Halt to operations of nuclear power plants and ban on constructing new ones	9.15
	5	Partial amendment of articles of incorporation	Decommissioning work on nuclear power plants	9.12
	6	Partial amendment of articles of incorporation	Ban on the payment of advertising expenses, co-operative funds, donations etc.	9.27
	7	Partial amendment of articles of incorporation	Conclusion of a disaster prevention accord on nuclear power	9.23
	8	Partial amendment of articles of incorporation	Conclusion of an agreement on nuclear damage lawsuits	9.07
	9	Partial amendment of articles of incorporation	Promotion of renewable/natural energy	9.28
Tohoku Electric Power (9506)	5	Partial amendment of articles of incorporation	Decommissioning of Onogawa nuclear power plant	6.71
	6	Partial amendment of articles of incorporation	Decommissioning of Totsu nuclear power plant	6.79
	7	Partial amendment of articles of incorporation	Unification of the national grid	7.91
Shikoku Electric Power (9507)	4	Partial amendment of articles of incorporation	Addition of a code of ethics	6
	5	Partial amendment of articles of incorporation	Development & promotion of environmentally-friendly energy	6.4
	6	Partial amendment of articles of incorporation	Cancellation of nuclear power re-starts and establishment of a committee to investigate decommissions	6
Kyushu Electric Power (9508)	5	Partial amendment of articles of incorporation	Reduction in salary and numbers of directors/auditors and abolition of consultants/advisors	6.74
	6	Partial amendment of articles of incorporation	Withdrawal from professional thermal power generation, Rokkasho-mura reprocessing operations	6.19
	7	Partial amendment of articles of incorporation	Establishment of a preparatory committee for decommissioning	6.22
	8	Partial amendment of articles of incorporation	Establishment of an aid organisation for the victims of the Fukushima Nuclear Incident	5.86
	9	Partial amendment of articles of incorporation	Promotion of IGCC	6.13
	10	Partial amendment of articles of incorporation	Declaration on the Kawauchi nuclear power plant	5.96
	11	Election of directors	Appointment of 1 external director	5.66
Hokkaido Electric Power (9509)	3	Partial amendment of articles of incorporation	Withdrawal from nuclear power generation	6
	4	Partial amendment of articles of incorporation	Individual disclosure of executive remuneration	15

Note: Applies to TOPIX companies (March results)

2.2.2 Directors and company auditors

Of the 1 337 TOPIX companies (March results), 1 300 (97.2%) were companies with company auditors, while 37 (2.8%) were companies with committees (Figure 16). The number of companies with committees has stayed more or less the same since 2010 and at general shareholder meetings held in June 2013, the Monex Group was the only company to transfer to the committee system.

Figure 16. Directors and company auditors

	June 2013	June 2012	June 2011	June 2010	June 2009	June 2008	June 2007	June 2006	June 2005
All TOPIX Companies	1337	1326	1329	1330	1359	1368	1381	1366	1348
Average no. of directors	8.9	9.0	9.1	9.2	9.3	9.6	9.8	9.9	10.1
Average no. of outside directors	1.2	1.1	1.0	1.0	0.9	0.9	0.9	0.8	0.8
Companies with over 20 directors	5	5	10	13	13	17	21	24	41
Companies with company auditors	1300	1290	1292	1294	1315	1323	1333	1322	1303
Average no. of directors	8.7	9.0	9.1	9.2	9.3	9.6	9.8	9.9	10.2
Average no. of outside directors	1.1	1.0	0.9	0.9	0.8	0.8	0.7	0.7	0.6
Companies without outside directors	472	574	633	678	716	737	774	811	819
Average no. of directors	8.2	8.3	8.6	8.8	8.9	9.3	9.5	9.7	9.9
Companies with outside directors	828	716	659	616	599	586	559	511	484
Average no. of directors	9.3	9.4	9.5	9.7	9.7	10.0	10.3	10.3	10.5
Average no. of outside directors	1.8	1.8	1.8	1.8	1.8	1.8	1.8	1.7	1.7
Companies with committees	37	36	37	36	44	46	48	44	45
Average no. of directors	9.4	9.2	9.4	9.3	9.1	9.5	9.2	9.5	9.0
Average no. of outside directors	4.6	4.4	4.4	4.4	4.3	4.5	4.5	4.5	4.2

Note: Refers to TOPIX Companies (March Results)
Note: Figures refer to number of companies/number of persons as applicable

Characteristically many companies that have chosen to adopt the committee system operate in a global environment and are aiming to achieve international harmonisation due to their shareholder profiles which include foreign investors and major shareholders. In addition, as scandals and social issues have led to increasing recognition of the need for transparency and accountability, some companies have chosen to adopt the committee system as it provides greater separation of management and supervisory functions.

Figure 17. Companies with committees

Toshiba, Hitachi	Hitachi Construction Machinery	Hitachi Medical Corporation
Japan Exchange Group	Resona Holdings	HOYA
Sony, Orix	Monex group	18Bank
NSK	Miraca Holdings	Ichiyoshi Securities
Mitsubishi Electric	S.T. Corporation	kabu.com Securities
Daiwa Securities Group Inc.	Fuji Seal International	Hitachi Transport System
Eisai	Fukui Bank, Ltd.	Hitachi Cable
Konica Minolta	Hitachi Chemical	Hitachi High-Technologies
Nomura Holdings	Nippon Sheet Glass	Hitachi Capital
FIDEA Holdings	Hitachi Metals	Hitachi Kokusai Electric
TEPCO	Daikyo	Kuroda Electric Co., Ltd.
LIXIL group	Eiken Chemical Co., Ltd.	

Note 1: As of 31 December 2013.
Note 2: Applies to TOPIX companies (March results)

a) Composition of boards of directors

A characteristic feature of Japan's corporate governance is that more emphasis is placed on the operational executive function of a board of directors, than on its supervisory function; as a result a significant number of companies have dozens of directors. Furthermore, in Japan's corporate culture many directors come from the ranks of ordinary employees and it is generally accepted

that the goal of many employees joining the company as a new recruit is to someday be appointed as a director.

Meanwhile, with regard to institutional investor voting, standards[8] have been developed on the size of boards; these standards tend to view the effectiveness of excessively large boards of directors as a problem. As a result, given the opinions of such financial sponsors, a fixed standard of, for example, 20 directors may be established. Any board that employs more than this number may face criticism from a considerable number of institutional investors that it is too large. Reflecting shareholder attitudes, Japan's corporate culture has also changed with regard to directors and boards. Many companies are promoting reforms in corporate governance such as the introduction of an executive officer system, reducing their number of directors and working to ensure the supervisory function and effectiveness of their boards. Figure 18 compares data for 2005 and 2013 and shows how Japan's corporate boards of directors are becoming more streamlined.

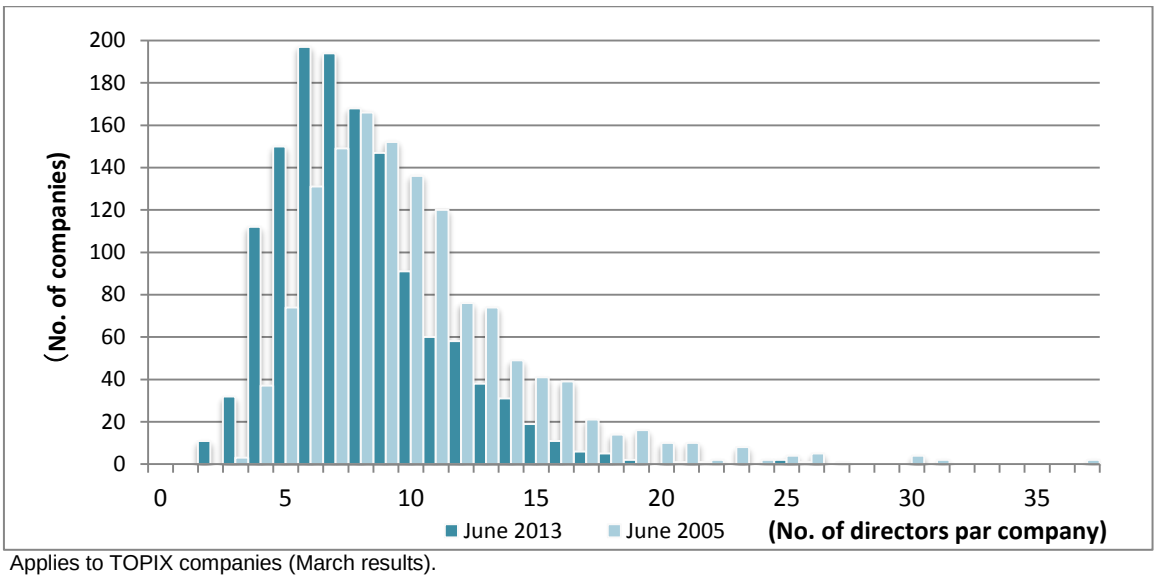
The number of companies with more than 20 directors (this being the standard set by many institutional investors) stood at 41 in June 2005 but has dropped to five since June 2012 (Figure 19). And the streamlining continues with the average number of directors per company falling from 10.1 in June 2005 to 9 in June 2012 (Figure 16). As well as an overall trend for fewer directors on boards, there has been a considerable reduction in the number of companies employing more than 20 directors.

On the other hand, although there were many companies that reduced their number of directors up to 2011, from 2012 some companies increased the number (there were 16 such companies as of June 2013; see Figure 14). These cases are at odds with prior trends for many companies to downsize their number of directors with the objective of allowing boards to operate flexibly in terms of corporate governance. In some cases, the increases have occurred because a certain number of directors have been needed for the expansion of business or re-development of business sectors; and in other cases, the employment of outside directors has necessitated an increase in numbers. However, companies that increase their number of directors must give detailed reasons for doing so, as there are institutional investors who will vote against it[9].

[8] In its voting guidelines, the Pension Fund Association for Local Government Officials stipulates that it would vote in favor of boards of directors that are comprised of a reasonable number of members in comparison with competitors, taking into account the sector and scale of the company, so as to allow full and frank discussion to ensure effective operations. On the other hand, as a general rule, it would oppose boards with noticeably large numbers of directors.

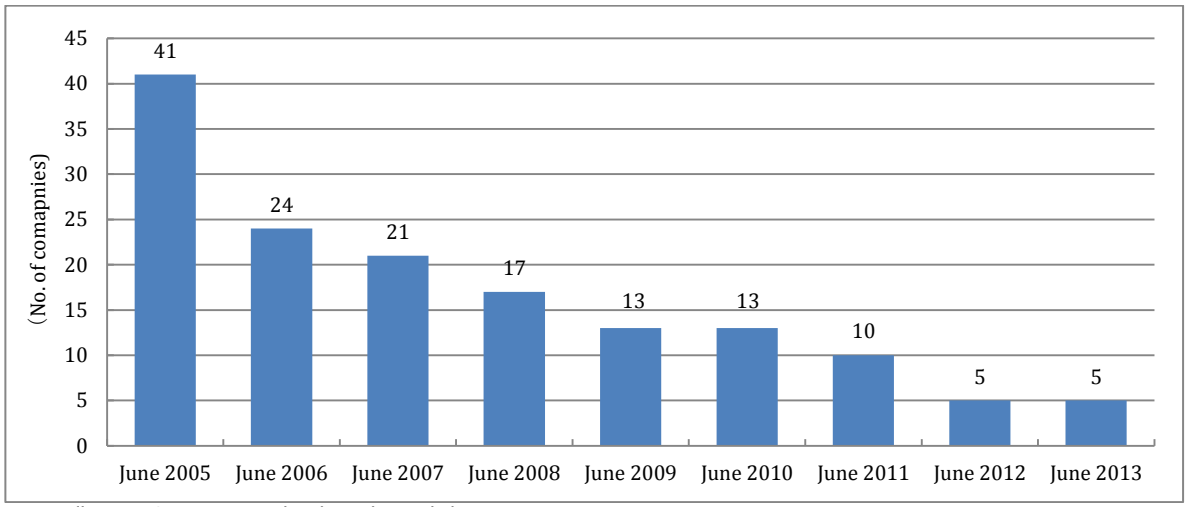
[9] In its voting guidelines, the Pension Fund Association for Local Government Officials stipulates that "with the exception of outside directors, a reduction in the number of directors should be judged positively; whereas, in principle, any increase should be opposed unless a clear and reasonable explanation is given."

Figure 18. Distribution of number of directors per company



Note: Applies to TOPIX companies (March results).

Figure 19. Companies with more than 20 directors



Note1: Applies to TOPIX companies (March results).
Note 2: The 5 companies with more than 20 directors since June 2012 are: Nipro (27), Toray (26), Toppan Printing (26), Shin-etsu Chemicals (23), Kadokawa Group Holdings (22).

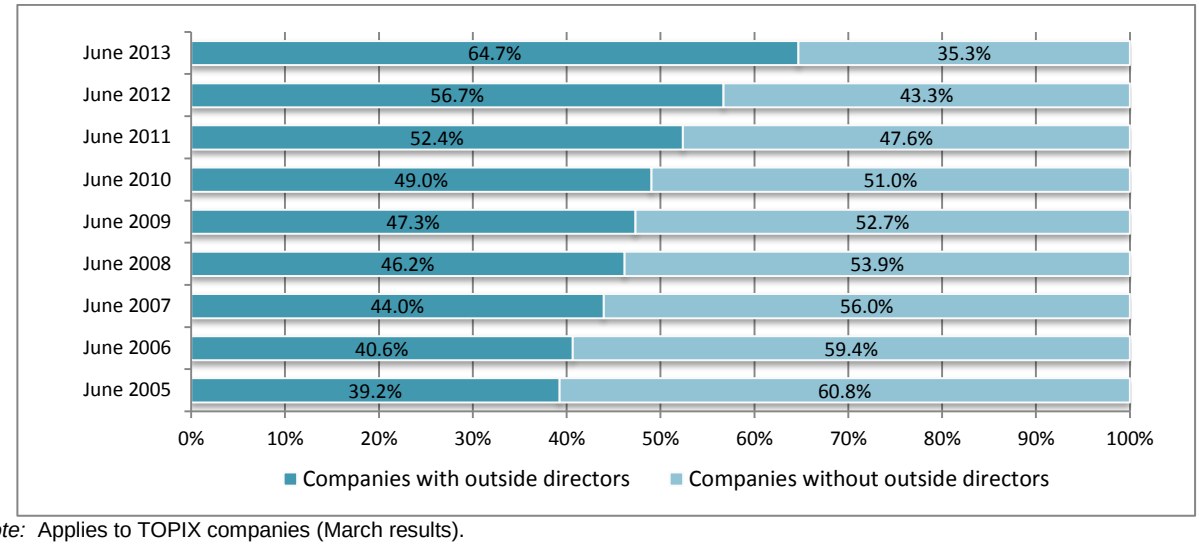
b) Appointment of outside directors

According to the 2014 Revised Companies Act, the directors of any "company with company auditors" (qualifying as both "large" and "publicly-held") that does not install outside directors must explain at the shareholder meeting "the reason that it is not appropriate to install outside directors" (post-amendments Article 327-2 of the Act). Furthermore, the Legislative Council of the Ministry of Justice has declared as a supplementary resolution that "the regulations of financial instruments exchanges need to include a rule to the effect that listed companies should seek to secure at least one independent official as a director." As a result, the Tokyo Stock Exchange decided to demand that listed companies secure at least one highly independent, outside director. Reflecting these revisions to the Companies Act and listing regulations, there was a rise in the number of companies giving new consideration to the use of outside directors. As shown in

Figure 20, as of June 2013, 64.7% of TOPIX companies posting March results had employed outside director(s). Since 2005, there has been an ongoing annual increase in the percentage of companies using outside directors; in 2011 it was 52.4%, more than half; and year-on-year figures for 2013 also showed an 8% increase in the rate of employment.

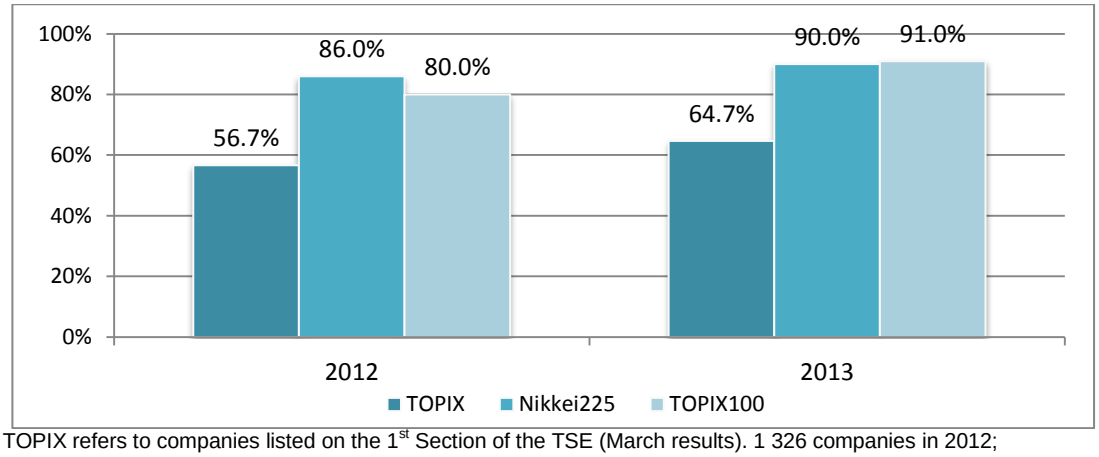
In addition, Figure 21 shows that the bigger the scale of the company （TOPIX < Nikkei 225 < TOPIX100), the greater the percentage of companies employing outside directors. It is assumed that the underlying reason for this is that such companies run global operations, and have high ratios of Japanese and foreign institutional investors etc.

Figure 20. Companies appointing outside directors



Note: Applies to TOPIX companies (March results).

Figure 21. Employment of outside directors by company scale



Note 1: TOPIX refers to companies listed on the 1st Section of the TSE (March results). 1 326 companies in 2012; 1 337 companies in 2013.
Note 2: NIKKEI 225 refers to the 225 companies listed on the Nikkei stock average index.
Note 3: TOPIX100 refers to the top 100 companies on the 1st Section of the TSE in terms of market capitalisation.

c) Independence of outside directors and outside auditors

Figure 22 shows the results of investigations into the attributes and origins of candidates for outside directors (1 500 nominees) and outside auditors (690 nominees) put forward at general shareholder meetings in June 2013.

i. TSE requirements for independent officers

Tokyo Stock Exchange prescribed a provision to the effect that a listed company must, for the purpose of protecting general shareholders, secure at least one independent director/auditor (i.e. an outside director/auditor who is unlikely to have conflicts of interest with general shareholders) as "Matters to be Observed" in the Codes of Corporate Conduct. Listed companies are required to submit "Independent Director/Auditor Notifications" to confirm compliance with the Codes of Corporate Conduct related to securing independent directors/auditors.

According to Figure 22, 66.7% of outside directors and 61.9% of outside auditors have been reported, or are scheduled to be reported, as "independent officers" as defined by stock exchanges. Furthermore, the percentage of outside directors with ties that could compromise their independence (such as ties with shareholders, business affiliations, creditors, banks, insurers, lawyers, certified accountants and so on) is lower than that of outside auditors. This indicates that there is a relatively higher degree of independence ensured for outside directors.

ii. Capital ties

In particular, any capital or business ties between a company and the organisation to which an outside director/auditor previously belonged may influence objective decisions and raise doubts on the independence of such officers. Yet there is a significant number of nominees for outside director/auditor posts who come from the ranks of shareholders or business partners.

With regard to capital ties, 33.1% of nominees for outside directors, and 35.8% of nominees for outside auditors come from within the ranks of a company's top ten shareholders. As the officers who hold these outside positions are able to make quantitative decisions such as shareholding ratios etc., some institutional investors may decide to implement their own criteria on the issue of independence and capital ties when casting their votes such as "no more than 10% of outside officers should be sourced from the ranks of shareholders". In addition, the amendments to the Companies Act prohibit officers from a parent company becoming outside directors/auditors of a subsidiary, as they are not seen as satisfying the requirement to come from “outside”.

iii. Business ties

A total of 42.7% of outside directors and 44.6% of outside auditors have business ties with the company, whether it be some kind of capital business alliance, or product supply relationship etc. In Japan, there is a strong manufacturing presence in industry, and consequently there are many business relationships along the supply chain. Meanwhile, there are a number of companies that require management advice from their outside directors and in this respect, they want to attract managers from other companies to these posts. However, top firms and regional blue-chip companies have developed wide business networks and it is very difficult for them to appoint outside directors/auditors with whom they have absolutely no business ties. Some form of relationship already exists in many cases.

As there are no guidelines on "best practice" on the independence of outside directors/auditors in Japan, many companies have dealt with the issue by establishing their own criteria for independence in line with the different situations they face. For example, a leading regional bank appointed as an outside director a professor from a national university located in the same region. At that time, it was pointed out that the professor had a mortgage loan from the bank. However, the monetary amounts involved were not disclosed from the point of view of privacy. In Japan, it is normal to take out a mortgage loan when building a house, and there are many regions in Japan where local banks are the only lenders of mortgage loans. Therefore, even though the information disclosed does indicate the existence of a business relationship between the bank and the newly appointed outside director, the size of the financial transaction was not large enough to impair independence or objectivity of oversight by the director. It would not be appropriate to identify the existence of business relationship in such a case.

Consequently, the matter of independence should be judged not solely by the existence of business ties but by the materiality of them.

iv. Banks & insurance companies

Furthermore, one of the historical features of Japan's corporate governance is the "main bank" system, under which banks exercised influence over company management through loans, shareholdings and the nomination of officers and employees. However, the percentage of outside directors/auditor nominees from banks is relatively low compared with nominations from the ranks of shareholders or business partners, standing at just 5.3% for outside directors and 11.7% for outside auditors. In contrast, the percentage of nominees coming from the ranks of creditors is 9.7% for outside directors and 15.1% for outside auditors; this includes non-bank creditors such as insurance companies and group parent companies.

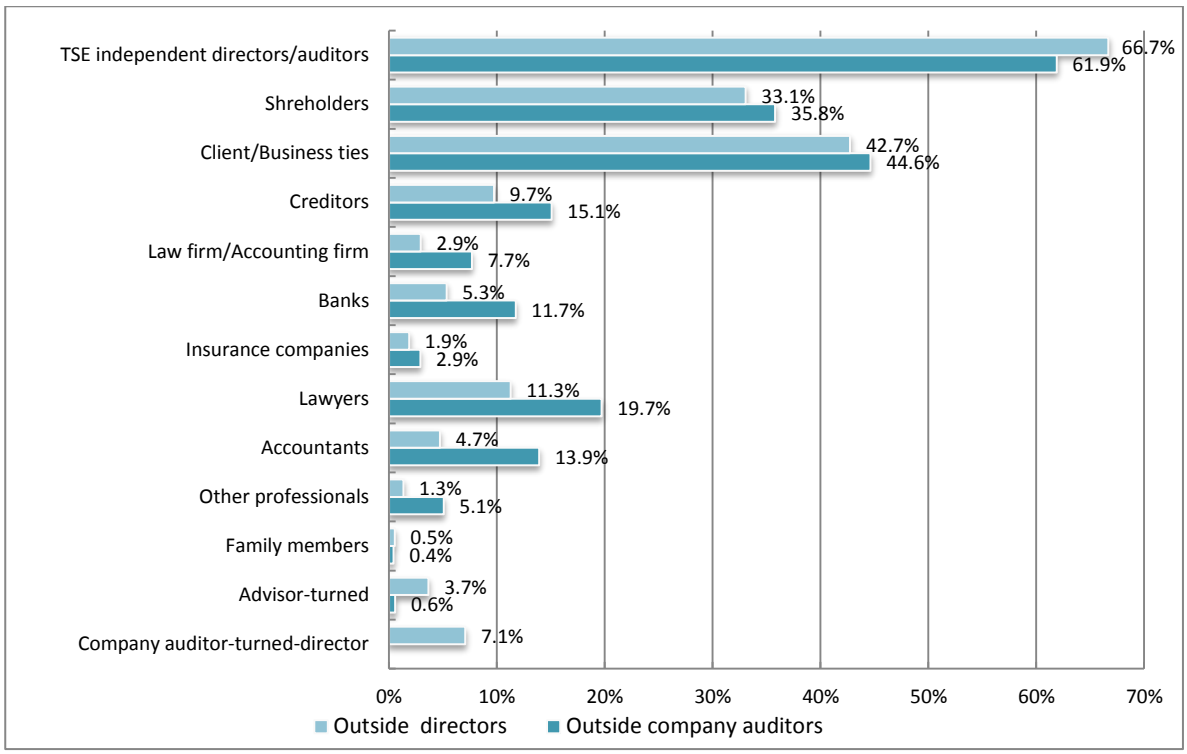
v. Compliance and accounting experts

There are many qualified people nominated for the role of outside auditor such as lawyers (19.7%) or certified public accountants (13.9%). The underlying concept is that the role of auditor requires experience, knowledge and expertise in compliance, finance and accounting.

On the other hand, there is a relatively low percentage of compliance and accounting professionals employed as outside directors, with lawyers accounting for 11.3% and certified public accountants 4.7%. This is thought to reflect assumptions that outside directors will fulfil a broad range of executive management and supervisory functions.

In the event that a nominee for outside director/auditor is a lawyer or certified public accountant and there is an advisory agreement or audit contract in place between the individual, or the firm to which he/she belongs, and the company ("advisory relationship" in Figure 22), the independence of the nominee may be called into question. In Japan, companies that are having difficulty in finding candidates for outside director/auditor may in some cases hold talks with accounting firms or law firms with whom they hold advisory contracts. And on occasion the accounting firm or law firm may introduce a retired employee or a colleague who has no direct links to the company. In these circumstances, there is not sufficient independence between the company and the candidate, which becomes a problem in terms of corporate governance.

Figure 22. Backgrounds of outside directors and outside company auditors



Note 1: Applies to TOPIX companies (March results).
Note 2: The chart shows candidates for outside directors and outside auditors at general shareholder meetings in June 2013 (1500 nominees for outside directors and 690 nominees for outside auditors).
Note3: Definition of attributes is as follows. Each attribute overlaps.
・The information on business relationships, creditors, and advisory relationships (legal advisory contracts, and appointments to accounting auditor) is that disclosed in the general shareholder meeting convocation notices and attached documentation.
・Shareholders: This refers to nominees from the ranks of the company's top 10 largest shareholders.
・Banks /Insurance Companies: This refers to nominees from banks and insurance companies within the ranks of the top ten largest shareholders.
・Family Members: Nominees with family members inside the company up to three generations removed.

d) Diversity

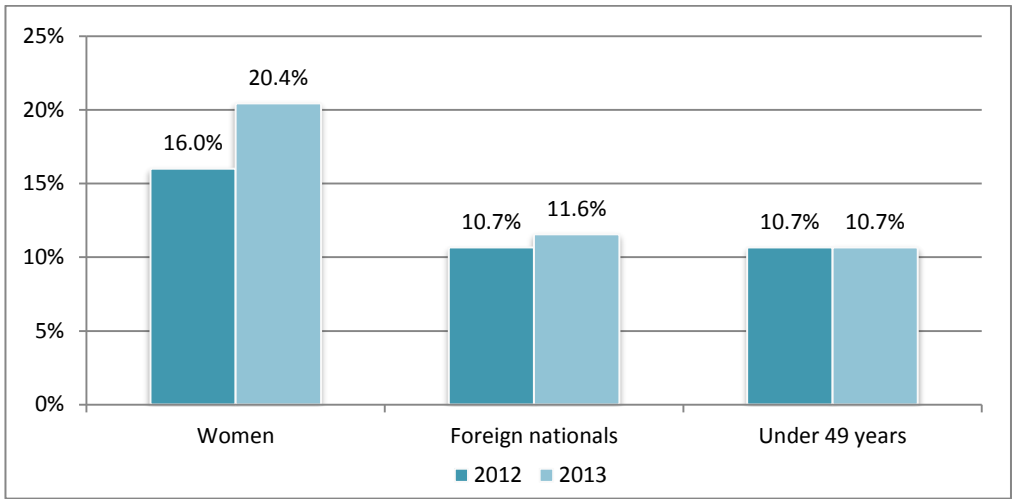
Traditionally in Japan, the duties of a director have focused more on operational execution than on supervision. In addition, it is well recognised that under a corporate culture of seniority and lifetime employment, it is the goal of employees within the company to be promoted to the title of director. Historically, many women left work after marriage or the birth of a baby, and so inevitably men became the major human resource. As a result, in many cases directors are middle-aged men.

However, there has more recently been an increase in the number of women and foreign nationals actively involved in the workplace and their presence is growing. In addition, there is diversification among stakeholders, as the environment in which Japanese companies operate becomes increasingly global. A growing number of companies are also recognising the need for diversity on their boards of directors to reflect these changes in the business environment and society.

Figure 23 shows the percentage of companies employing female directors, foreign directors and young directors aged 49 or under. In 2013 it shows 20.4% of companies employed female directors. Meanwhile, a little over 10% of companies had foreign or young directors. This may

indicate that the employment of women is at the forefront of the promotion of diversity on boards of directors.

Figure 23. Companies employing directors with diverse attributes



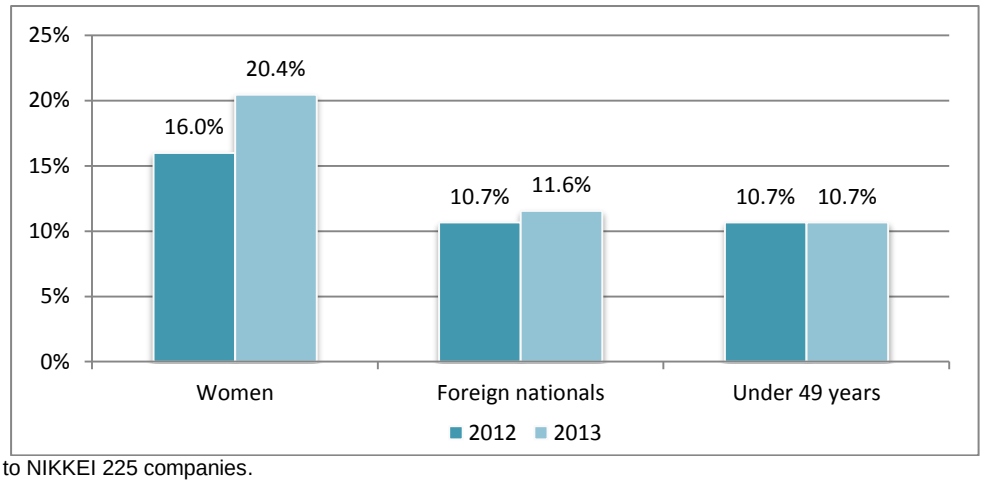
Note: Applies to NIKKEI 225 companies.
Source: Eiji Kato "Current Status of Diversity on Boards of Directors and Implications for Performance", Capital Market Research Vol. 30 (2014).

However, Figure 24 shows that the percentage of directors with these diverse attributes makes up no more than around 2% of all directors. Meanwhile, as of 2013, TOPIX companies (March results) had no more than 64.7% of the members within their boards made up of outside directors (Figure 21). Consequently, the current situation in Japanese companies means that prioritising the appointment of outside directors is the first step to ensuring diversity within boards.

According to these studies, 68.0% of companies (153 out of the NIKKEI 225 companies) have a board of directors that is entirely comprised of Japanese men, aged over 50.[10] It seems that the traditional corporate culture remains to be preserved in Japan, where the ultimate goal of the employees is to promote to be a member of the board.

[10] Eiji Kato, "Current Status of Diversity on Boards of Directors and Implications for Performance", *Capital Market Research*, vol. 30 (2014), p.192.

Figure 24. Diversity of directors in Japanese companies



Note: Applies to NIKKEI 225 companies.
Source: Eiji Kato "Current Status of Diversity on Boards of Directors and Implications for Performance", Capital Market Research Vol. 30 (2014) .

i. Gender

According to Figure 23, 20.4% of NIKKEI 225 companies have appointed a female director (a total of 51 such directors). However, 46 of these 51 female directors (90.2%) are outside directors. Moreover, of the five women legally appointed as internal directors, four are either from outside the company, or members of the founder's family. Only one female director at Takashimaya (retail sector: department store) has risen through the employee ranks to oversee executive operations as an internal director. Underlying this is the fact that women's employment potential is respected in Japan's retail sector.

A characteristic of female directors is that they often concurrently serve as directors in more than one company; this applies to seven of the female directors in the NIKKEI 225 companies. At present, there is not a sufficiently large pool of female nominees for directorships with the skills and experience sought by companies; hence requests for women to take up positions as directors are concentrated among a few individuals.[11]

Among NIKKEI 225 companies, the sectors with a higher tendency to employ women directors are insurance (four out of six companies; 66.7%); foodstuffs (six out of 11 companies; 54.5%); and trading companies (three out of seven companies; 42.9%). These sectors have a high ratio of female employees, as well as large numbers of female customers, which is the reason that a lot of their companies proactively employ women.
By contrast, no female directors were employed in the automotive, iron & steel, non-ferrous metals, construction or real estate sectors.[12]

ii. Nationality

According to Figure 23, 11.6% of NIKKEI 225 companies have appointed foreign directors. The ratios in Figure 24 show a drop from 2.2% to 2.0%, however this was due to the retirement of six

[11] Kato, supra note 14, p.187

[12] Kato, supra note 14, p.187.

foreign directors at Aozora Bank following a change in the overseas fund that was one of the Bank's largest shareholders. Taking this into consideration, on the whole there has been an increase in the number of companies employing foreign directors.

With the exception of companies with a foreign parent company, or major overseas shareholders (such as Chugai Pharmaceuticals and Roche; Showa Shell Oil and Shell; Nissan and Renault etc.) companies often appoint foreign directors on a voluntary basis in order to globalise their management structures and business environments. There are particularly high percentages of companies with foreign directors in the pharmaceuticals sector (three out of eight companies; 37.5%) and the electrical equipment sector (five companies out of 29; 17.2%).[13] These companies make more than 50% of their sales overseas, and they have a higher proportion of non-Japanese employees.

By contrast, there were no foreign directors in sectors led by domestic demand such as foodstuffs, construction, real estate and railways. Although trading companies conduct business globally, the fact that they use a unique Japanese business model means that they do not employ foreign directors.[14]

iii. Age

According to Figure 25, 49.7% of directors in Japanese companies are in their 60s, and 37.4% are in their 50s. If we define a young director as being 49 years of age or under, only 0.1% are in their 30s and no more than 1.6% in their 40s; comprising merely 1.7% in total. Furthermore, only 10.7% of companies employ young directors aged 49 or under.

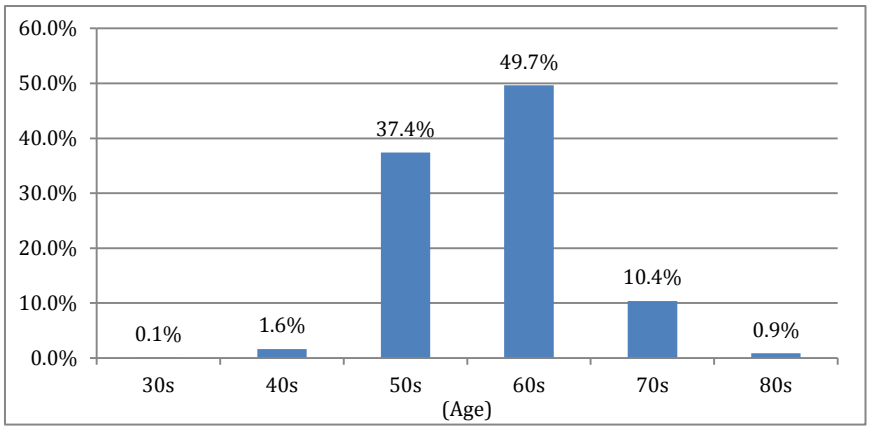
Sectors where the appointment of young directors is relatively high are communications (three out of six companies; 50%); service industry (three out of seven companies; 42.9%); and insurance (two out of six companies; 33.3%). Young directors are appointed in sectors that deal with relatively new areas of technology and service industries.

By contrast, there are no young directors appointed in the key industrial sectors such as machinery, chemicals, iron and steel, non-ferrous metals, ceramics and so on.

[13] Kato, supra note 14, p.189.

[14] Kato, supra note 14, p.189.

Figure 25 Distribution of directors by age



Note: Applies to NIKKEI 225 companies.
Source: Eiji Kato "Current Status of Diversity on Boards of Directors and Implications for Performance", Capital Market Research Vol. 30 (2014).

2.2.3 Remuneration

a) Remuneration and companies law

i. Remuneration of directors

Article 361-1 of the Companies Act stipulates that the following matters related to salaries, bonuses, and other financial benefits that directors receive from a stock company as consideration for the performance of duties (hereinafter, remuneration), when not prescribed by the articles of incorporation, shall be determined by resolution of the general shareholder meeting.

1. The amount of any fixed remuneration.
2. The specific method for determining any variable remuneration.
3. The specific content of any non-monetary remuneration.

A director submitting to the general shareholder meeting a proposal for deciding or revising the second and third items above shall explain to the general shareholder meeting the reasons why the proposal is reasonable (Article 361-2).

In this case, the resolution of the general shareholder meeting is an ordinary resolution.

Fixed remuneration is rarely prescribed in articles of incorporation. In general, an upper limit on the total amount of remuneration is determined by resolution of the general shareholder meeting. In companies with boards of directors, actual pay is determined within the upper limit by resolution of the board of directors.

Remuneration is broadly defined to include not only director salaries and bonuses, but also other financial benefits received from a stock company in consideration of the performance of duties.

Remuneration can be categorised as follows based on the timing of payment.

i. Remuneration paid regularly while employed (e.g. monthly and annual salaries).
ii. Remuneration paid irregularly based on performance while employed (e.g. bonuses).

iii. Remuneration paid in the future during retirement (e.g. retirement bonuses).

Remuneration can be categorised as follows based on the content of payment.

A. Monetary remuneration.
B. Non-monetary remuneration (e.g. stocks, stock options, and products).

Remuneration can be categorised as follows based on the calculation method.

a. Fixed remuneration (e.g. monthly and annual salaries).
b. Variable remuneration (e.g. bonuses and stock options as performance-based remuneration).
c. Remuneration including both fixed and variable components (e.g. retirement bonuses that include a qualitative evaluation component, such as incentive and merit pay).

Accordingly, a variety of remuneration plans can be designed by combining the aforementioned items.

ii. Remuneration of company auditors

Article 387-1 of the Companies Act stipulates that company auditor remuneration (salaries, bonuses, and other financial benefits received from a stock company in consideration of the performance of duties), when the amount is not prescribed by the articles of incorporation, shall be determined by resolution of the general shareholder meeting. Additionally, in the case of two or more auditors, when the remuneration for each auditor is not prescribed in the articles of incorporation or determined by resolution of the general shareholder meeting, said remuneration shall be determined within the scope of remuneration in the preceding clause through consultation with the auditors (Article 387-2). Auditors are allowed to state their opinions about auditor remuneration at the general shareholder meeting (Article 387-3).

Article 387 only covers the amount of auditor remuneration. Some auditors also receive performance-based remuneration, including bonuses and stock options. In these cases, the provisions on director remuneration in Article 361 could be applied by analogy.[15]

However, the duty of auditors is to supervise directors in the performance of their duties. Auditors are not in a position to contribute directly to a company's profits through the performance of their duties. There is concern that the receipt of performance-based remuneration could prevent auditors, who are supposed to serve as a check on management, from fulfilling their supervisory function. Consequently, there is widespread opposition from institutional investors, as discussed below.

For auditors, the purpose of regulations is to ensure adequate remuneration and protect their independence.[16]

iii. Purpose of remuneration regulations

The relationship between a company, its executives (directors, accountants and auditors), and the accounting auditor is governed by mandate provisions. Article 648-1 of the Civil Code, which covers mandatory remuneration, stipulates that, in the absence of any special agreements, mandatories are unable to claim remuneration from mandators. Consequently, mandatories are,

[15] Kenjiro Egashira, *Laws of Stock Corporations,* 4th ed., Yuhikaku Publishing (2011), p.501.

[16] Egashira, supra note 22, p. 500.

in principle, not compensated. In practice, however, directors, auditors, and other executives are generally paid remuneration.

Decisions on director remuneration can be considered part of the performance of duties, but if these decisions are left entirely to the board of directors, there is a risk that the board of directors could act arbitrarily and harm the interests of shareholders. Consequently, in the interest of avoiding self-reward, the Companies Act stipulates that director remuneration must be determined by the articles of incorporation or by resolution of the general shareholder meeting.

iv. Remuneration of employee directors

When a director is also an employee (hereinafter, employee director), the employee portion of their remuneration is provided as consideration for their work as an employee, rather than as consideration for their duties as a director. Legal precedents and the established view consider that the employee portion of remuneration for employee directors is not subject to director remuneration regulations in the Companies Act because it is separate to director remuneration.[17]

The employee portion of remuneration has fewer restrictions than the director portion, including the calculation method, decision-making process, and disclosure method. This allows the employee portion to be used flexibly as a means of adjusting for the director portion. However, the lack of transparency is an issue. Should the employee portion be higher than the director portion, it would certainly be possible to effectively pay director remuneration while avoiding remuneration decision procedures through the general shareholder meeting. Consequently, when determining the director portion of remuneration for employee directors through a resolution of the general shareholder meeting, some think it should be made clear that the resolution amount does not include consideration of the duties performed as an employee director.[18] In practice, a statement is generally added to the reference materials provided at the general shareholder meeting to make clear that the employee portion of remuneration for employee directors is not included.

b) Changes to total amount of remuneration through resolutions at shareholder meetings

Since the enactment of the 2005 Companies Act, many companies in Japan have revised remuneration amounts as part of a review of their executive compensation packages. There was a particularly sharp rise in the number of such companies in 2006 and 2007, immediately after the Act came into force. According to Figure 26, there were 426 TOPIX companies that changed remuneration amounts in 2006, and 310 in 2007. Since then around 100 companies each year have been carrying out similar reviews.

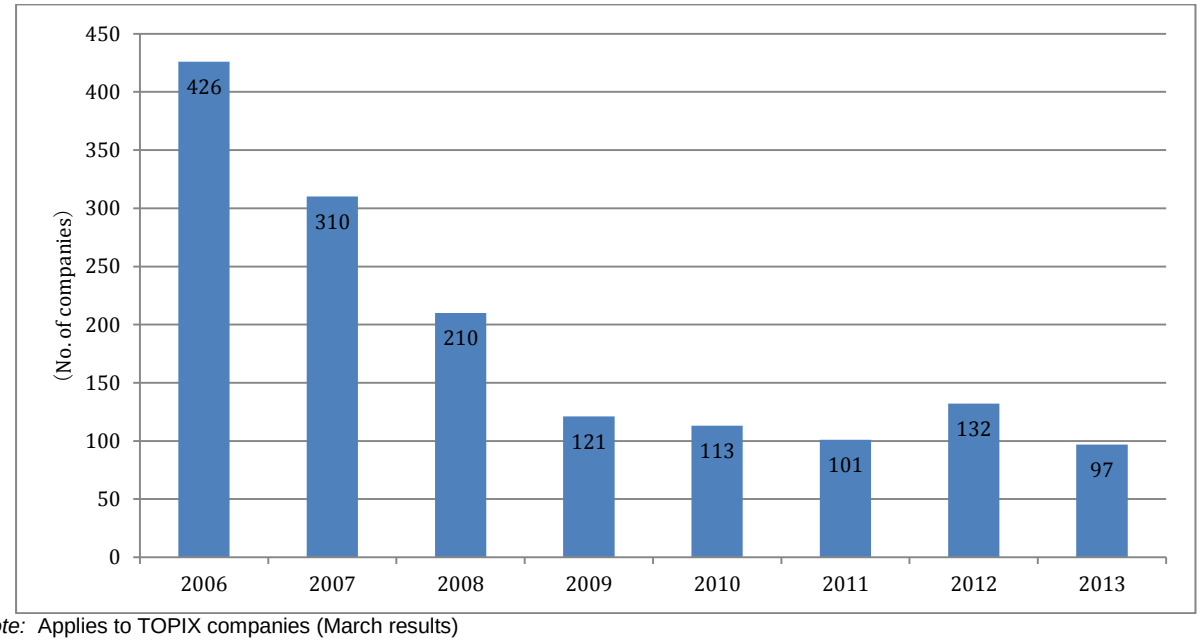
In Japan, the design of the remuneration packages is determined under the framework of the determination of the total amount of remuneration (i.e. “changes to total amount of remuneration”). The remuneration packages can include cash and/or stocks, depending on the form of remuneration, and fixed portions and/or performance-related portions depending on the nature of the compensation scheme. Figure 27 suggests that many companies have made changes to increase remuneration amounts. Meanwhile, 8% of companies have decreased amounts, but in many cases such changes have accompanied a significant reduction in the number of directors, as companies have adopted executive officer systems as part of reforms in their corporate governance.

[17] Supreme Court Reports (Civil Cases), no. 144, p. 247, March 26, 1985; Toshio Sakamaki and Yasuhiro Osaki, *Important Precedents in Corporation Law,* new ed., (Seibundoh), p. 172.

[18] Egashira, supra note 22, p. 423.

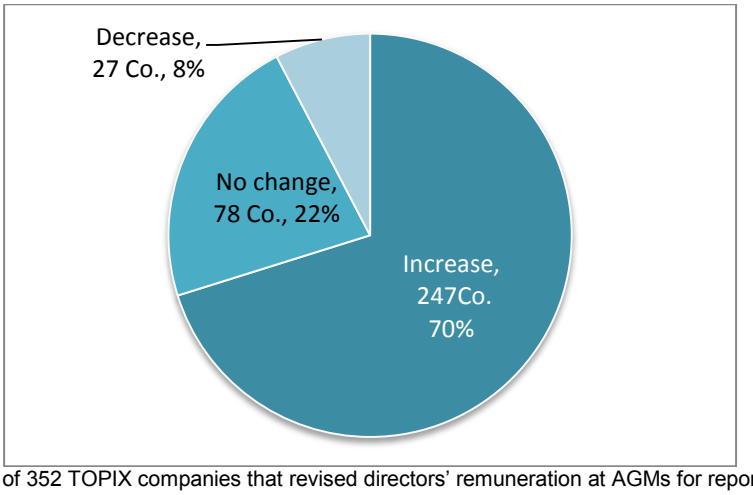
In addition, the provisions of Article 361 of the 2005 Companies Act, which stipulate revisions to the treatment of executive bonuses, have led to changes in the methods used to describe bonuses. Previously bonuses were described as "xx yen per month" but following the changes this has become "xx yen per year." Prior to the enactment of the 2005 Companies Act, executive bonuses had been included in proposals on the appropriation of profits and were deemed expenditures to be taken from final profits; with the enforcement of the Act they were clearly defined as being included in remuneration etc. This caused some problems processing bonuses, which were annual performance-related remuneration, in companies that only had monthly remuneration systems in place. Therefore, many companies revised the way they reported remuneration amounts from a monthly basis to an annual basis. As a result, in some companies, the method of reporting remuneration simply changed from 12 monthly figures to one yearly figure a change that was not accompanied by any actual revision in real amounts. According to Figure 27, this applied to 78 of the 352 companies (22%) that revised directors' remuneration amounts.

Figure 26 Changes in executive remuneration totals



Note: Applies to TOPIX companies (March results)

Figure 27 Increases/decreases in director remuneration



Note: Taken from a survey of 352 TOPIX companies that revised directors' remuneration at AGMs for reporting periods FY 2010 - FY 2012.

c) Retirement benefits

i. Increases in the cancellation of retirement plans

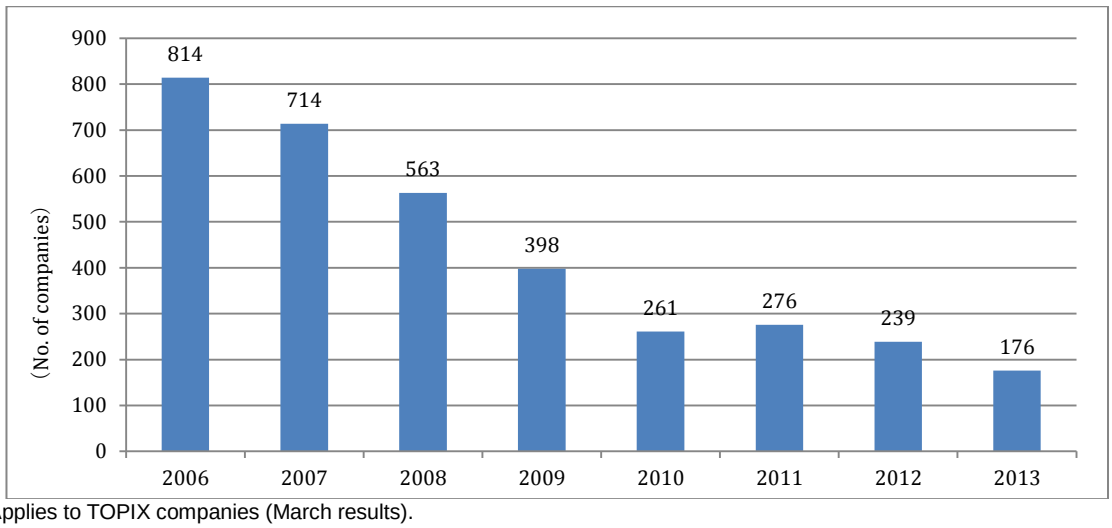
As mentioned earlier, executive retirement plans are a well-established business practice in Japan, and are a means of providing social security after retirement. They are subject to preferential tax treatment under the Income Tax Act in the same way as employee pension plans. However, some have pointed out that because retirement benefits are, by nature, deferred remuneration, they are not suitable for executives; unlike employees. There has also been criticism that retirement benefits are calculated by multiplying an executive's term of office by a constant factor and, as such, the grounds for payment and calculations lack transparency.

The objective of a director should be to improve the company's performance while he/she is in office, and in terms of corporate governance the adoption of a performance-based remuneration system is a preferable method of ensuring motivation and awareness to that end. In most traditional retirement plans, payouts increase with length of tenure and as a result executives are incentivised to prolong their term in office rather than improve company performance; a practice subject to criticism by foreign institutional investors in particular.

Moreover, outside directors and auditors (both internal and external) are expected to monitor operating officers objectively from an independent standpoint. In this respect, there has been criticism that the payment of retirement benefits as deferred remuneration upon retirement risks influencing their objectivity and independence during office.

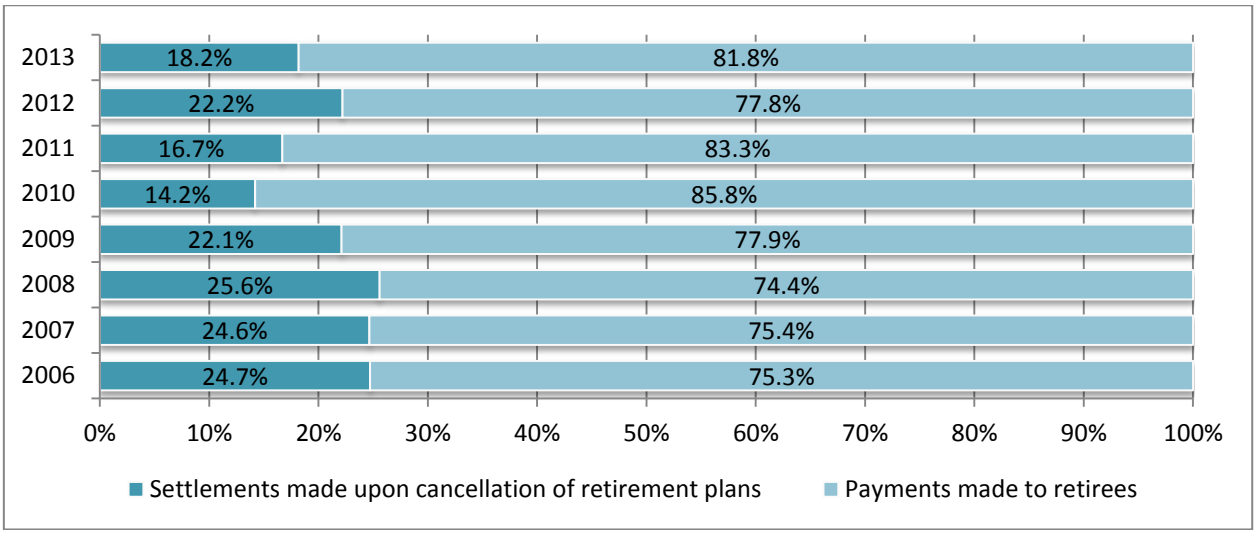
From this perspective, an increasing number of companies are ceasing to offer retirement plans, or stopping their payment. Figure 28 shows a significant downtrend in the number of companies submitting retirement plan proposals at general shareholder meetings since 2006. According to Figure 29, of the companies submitting proposals on retirement plans around 20% involved the adjustment of payments for beneficiaries of traditional retirement plans that were being discontinued, with the adjusted payments calculated according to the term of office held until discontinuation. Note that payments may be made in one lump sum at the time the plan is annulled, or paid out to the beneficiary upon retirement in an amount commensurate with the historical payment period in effect prior to and up until the plan's annulment.

Figure 28 Proposals raised at general shareholder meetings on the payment of retirement benefits



Note: Applies to TOPIX companies (March results).

Figure 29. Breakdown of retirement benefits paid (settlements made upon repeal of retirement plans and payments made to retirees)



Note: Applies to TOPIX companies (March results).

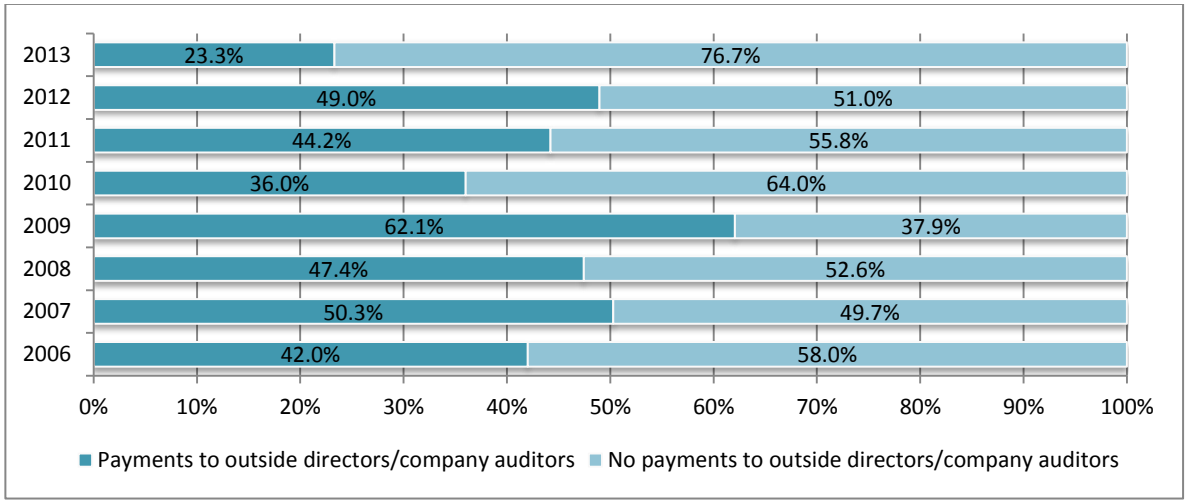
ii. Increase in the number of companies revoking retirement plans

There has been criticism of retirement plans for outside directors and auditors (both internal and external) in terms of ensuring the objectivity and independence of their supervisory functions. On the other hand, there is also an argument against treating employees who have risen through the ranks differently and awarding/not awarding retirement benefits depending on whether they are appointed to the executive post of director, or that of internal auditor. In light of such conditions, there is a trend among many Japanese institutional investors to oppose the payment of retirement benefits to external officers (i.e. outside directors and outside auditors) who need to maintain particularly high levels of objectivity and independence.

As a result, fewer companies are offering retirement plans to newly appointed outside officers. Meanwhile, in some cases, companies with commitments to pay retirement benefits to outside officers under current terms of appointment are making these payouts when the officers retire, while in other cases they are paying out appropriately adjusted amounts as retirement plans are discontinued.

Figure 30 analyses the recipients of retirement benefit payouts. It shows considerable variations in the benefit payments made to outside officers from year to year. In 2013, 23.3% of companies made payments to outside officers, lower than any of the previous surveys.

Figure 30. Recipients of retirement benefit payouts



Note: Applies to TOPIX companies (March results).

d) Stock options

i. Stock option categories (general stock options and equity remuneration stock options)

Remuneration in the form of stock acquisition rights is paid in order to provide performance-linked incentives. Stock options can be broadly classified into two categories that are related to terms of issue of the subscription rights; namely, "general stock options" (subject to restriction on issuance under favourable terms) and "equity remuneration stock options" (not subject to restriction).

General stock options (subject to restriction on issuance under favourable terms)

The former Commercial Code (Article 280-1) stipulated that stock options granted to third parties other than shareholders under favourable terms of issue required a special resolution of a general shareholder meeting. Consequently, this was taken to mean that a resolution was not needed for issues made as director remuneration.[19] The current Companies Act treats the granting of stock options to employees as favourable issuance to third parties and subjects such options to regulation. In the event that similar schemes are used for directors, they are also subject to the regulations on favourable issuance.

[19] Masamitsu Shiseki, ed., *Q&A on the Amended Commercial Code of 2002*, Shojihomu (2003), p. 33.

This type of stock option that was used traditionally is often called a “general stock option” or simply a “stock option.”

Equity remuneration stock options (not subject to restriction)

When it is understood that stock options are granted to directors as compensation for the execution of their duties, or to offset their claims for remuneration from the company, then the subscription rights are allocated at a price that corresponds to a given economic value. As a result, the offer of such rights is not recognised as a method subject to restriction regarding favourable terms of issue under the Companies Act. This new form of stock option is commonly referred to as an “equity remuneration stock option.”

In principle, in publicly-held companies the Companies Act allows a resolution by the board of directors to determine the process by which subscription rights are issued; this does not apply to favourable issuance that requires the resolution of a general shareholder meeting (Companies Act Articles 240-1 & 238-3.) Consequently, stock options that are not granted favourable terms of issue can be issued by a resolution of the board of directors. However, it is considered inappropriate to interpret the granting of stock options as not requiring a shareholder resolution on remuneration, as per the former Commercial Code. Such an interpretation would make it impossible to achieve the purpose of regulation, which is to prevent directors making their own self-approved remuneration plans. If a special resolution by a general shareholder meeting is not required on the basis of favourable terms of issue, then a resolution by the same should be required on the basis of remuneration regulations.

Proposals on revisions to executive remuneration submitted at general shareholder meetings specifically look to change the monetary amounts or the details of remuneration packages. At general shareholder meetings held in June 2013, around half of such proposals were related to revisions to allow the use of equity remuneration stock options (see Figure 31.)

Moreover, Figure 32 shows that companies using equity remuneration stock options had higher levels of remuneration in comparison with companies not using them. In this regard, under the Companies Act stock options qualify as “remuneration in a fixed amount” (Article 361-1) and “non-monetary remuneration” (Article 361-3) assuming that they are granted to confer economic benefits in consideration for the execution of duties, and that a fair price can be calculated at the time of the options’ issue. [20] Accordingly, when a company grants stock options to directors, the specific amount and details must be decided by a resolution of the general shareholder meeting (Article 361-1, 361-3). Furthermore, a director who submits a stock options proposal must provide the general shareholder meeting with an adequate reason for the proposal (Article 361-2). As a result, the granting of stock options demands two procedures; namely decisions on director remuneration and the issue of subscription rights. Any stock options that are not subject to restrictions regarding favourable terms require an ordinary resolution by a general shareholder meeting on the basis of remuneration regulations.[21]

[20] Tetsu Aizawa and Yusuke Ishii, *Institutions other than General Meetings of Shareholders, Part 1*, Shojihomu no.1744 (2005), p.102..

[21] Ibid., p.103.

Figure 31. The use of equity remuneration stock options in proposals for revisions on equity remuneration amounts

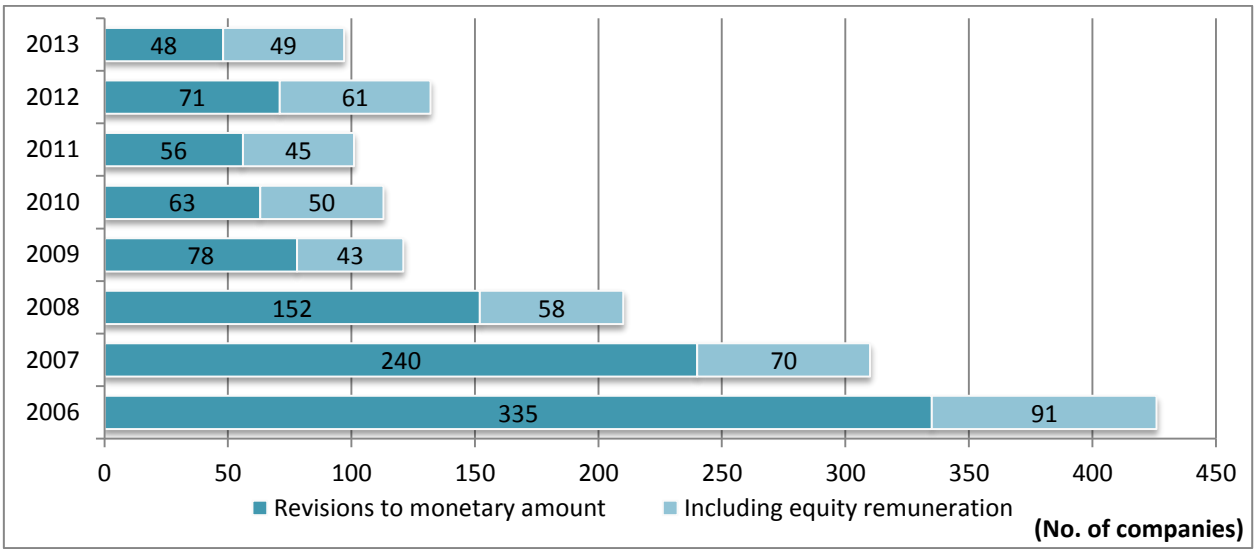
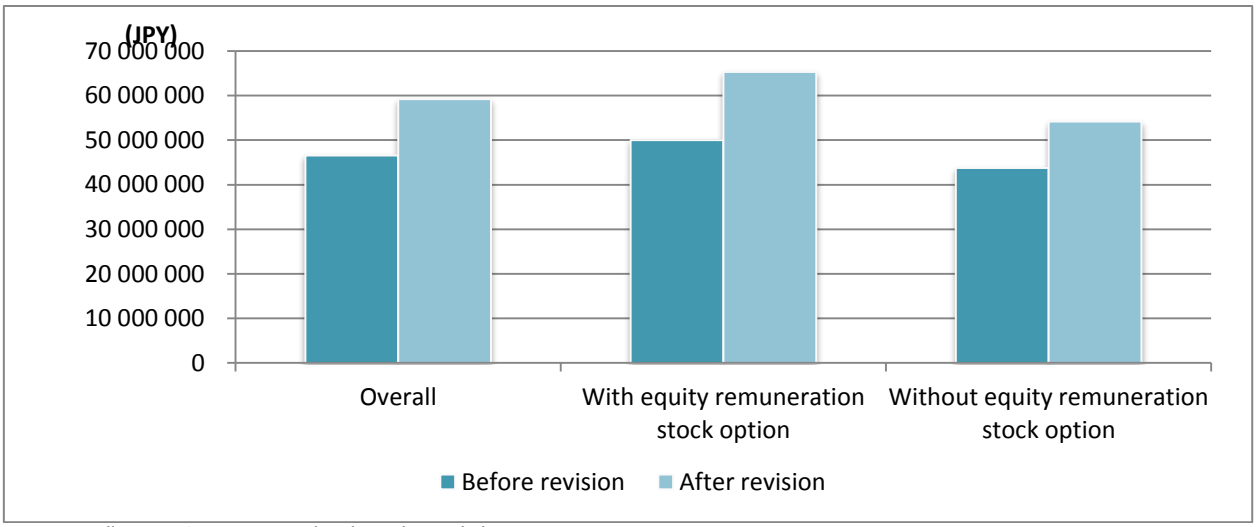


Figure 32. Changes to monetary amounts and the adoption/non-adoption of equity remuneration stock options before and after revisions to executive remuneration



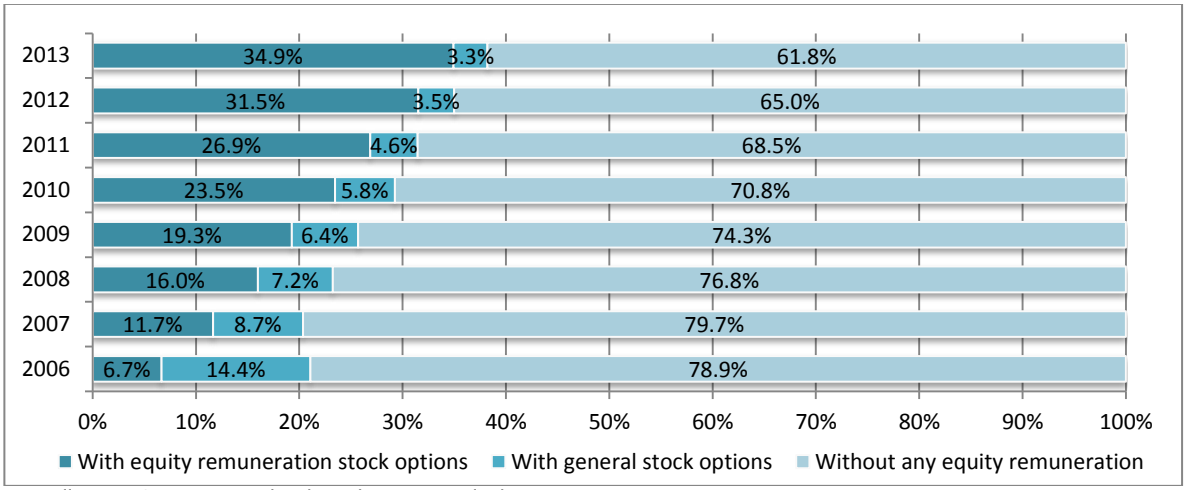
Note: Applies to TOPIX companies (March results).

Increase in remuneration packages utilising equity

Since the amendments to the Companies Act, many companies have introduced remuneration systems that use an equity element in response to strong recommendations by institutional investors for the adoption of performance-related remuneration for directors. In addition, a number of companies have adopted equity remuneration stock options as an alternative to retirement plans.

Figure 33 shows the results of a study into the current status of the introduction of stock options at general shareholder meetings, with around 40% of companies making progress in this regard. A cumulative total of 467 companies have introduced equity remuneration stock options since 2006, and such options have, in practice, become a form of remuneration.

Figure 33. Introduction of stock options



Note: Applies to TOPIX companies (March remuneration)

ii. Stock dilution

The use of equity in remuneration systems leads to the dilution of stock. Consequently, many institutional investors will return harsh verdicts if too much equity is granted under such systems. Therefore, companies need to consider the issue of stock dilution if they are planning stock options. Due to fears that stock dilution will directly harm the interests of shareholders, there are institutional investors who cast their votes in accordance with fixed numerical criteria and who will vote against proposals above the appropriate limit. Generally, there is a tendency for a sharp increase in the proportion of votes cast against stock option proposals submitted to general shareholder meetings when the dilution rate rises above 5%.

For general stock options, the general shareholder meeting passes a resolution fixing the upper limit on the amount of stock that can be issued under a given stock option plan. However, equity remuneration stock options can be granted every year for the life of the remuneration system, once the limit on the annual number of issuable shares has been established. As a result, some investors take a negative view of such equity remuneration stock options as “evergreen plans” that can lead to perpetual dilution.

Figure 34. Dilution caused by stock options

Average	0.52%
Minimum	0.002%
Maximum	6.87%
No. of Companies exceeding 1%	10 Companies（12.2%）

Note: Applies to TOPIX companies (March results).

iii. Recipients of the stock options granted

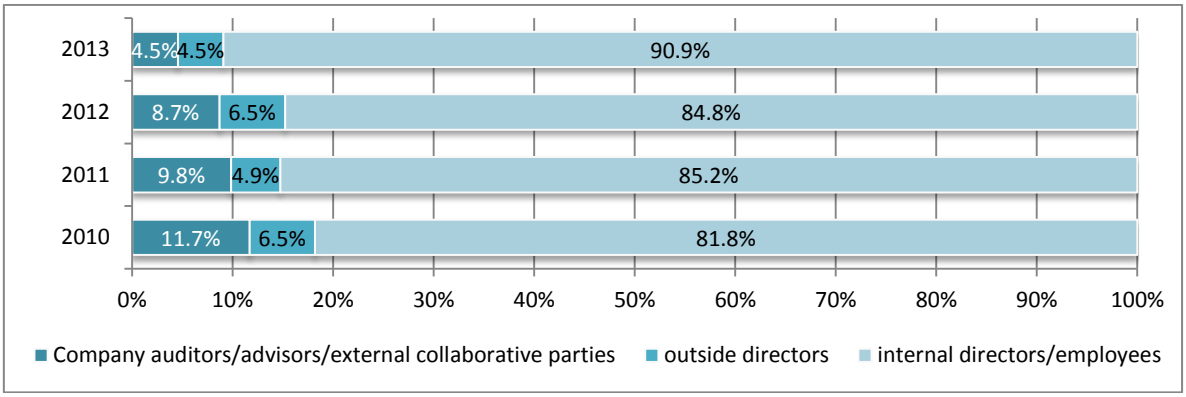
Many institutional investors believe that stock options should only be granted to those in a position to contribute to business performance such as (internal) directors, employees and executive officers. This is due to the fact that the nature of stock options, both general and equity remuneration, means the amount of remuneration a party can obtain rises or falls in line with fluctuations in the stock price. Apart from such operating officers, or those under their command, many institutional investors are opposed to granting stock options to other parties who are

expected to fulfil a supervisory function, in other words outside directors and auditors (both internal and external), as it is more important to ensure their supervisory capacity from an objective standpoint than have them contribute to improving business performance as represented by the stock price.

There is also the criticism that when stock options are granted to external collaborative parties, such as counsel and advisor agencies etc., it not only increases dilution of the stock, but it is also difficult to evaluate the involvement of such parties in enhancing business performance. As a result, many institutional investors are opposed to the granting of stock options to such external, collaborative parties.

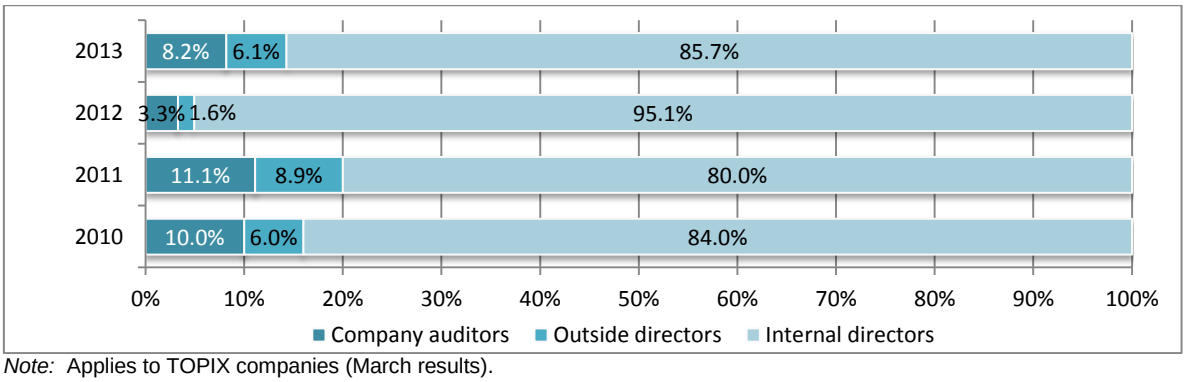
Figures 35 and 36 analyse the recipients of general stock options and equity remuneration stock options respectively, in terms of those recipients that many institutional investors view as problematic. Sometimes general stock options are granted to external, collaborative parties, but many companies limited the recipients of equity remuneration stock options to internal directors and auditors, as these stock options are designed as part of executive remuneration schemes that include retirement plans.

Figure 35. Recipients of general stock options (option rights)



Note: Applies to TOPIX companies (March results).

Figure 36. Recipients of equity remuneration stock options (equity remuneration)



Note: Applies to TOPIX companies (March results).

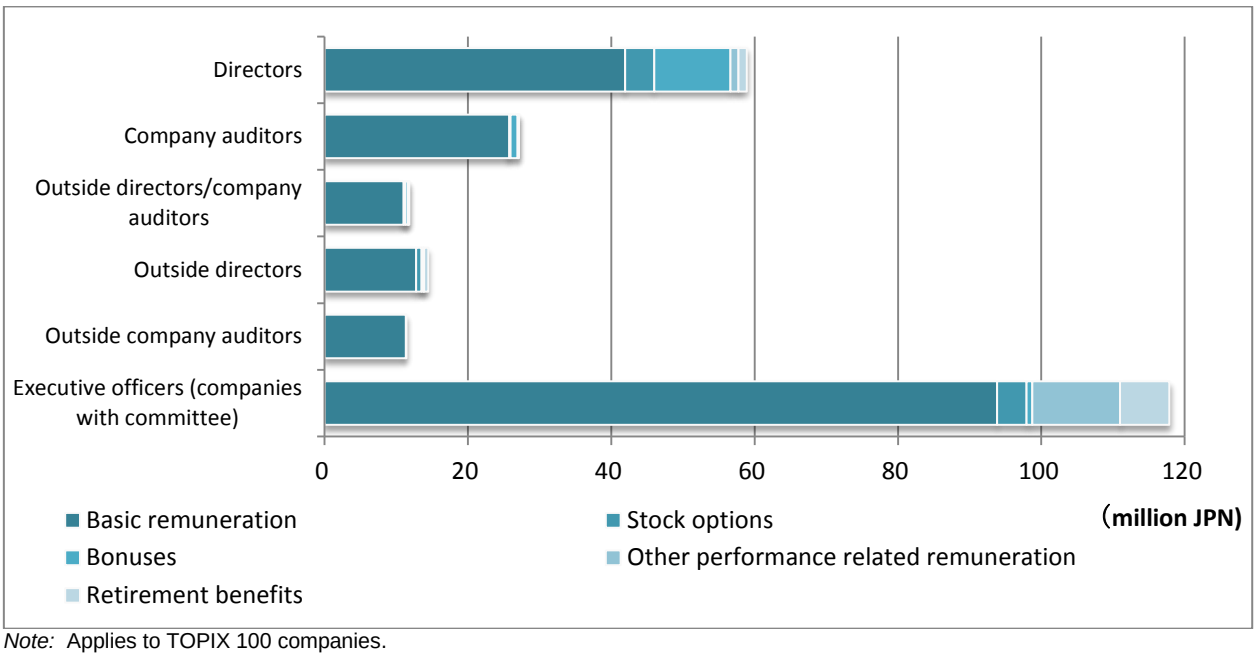
e) Management remuneration in Japanese companies

i. Levels of management remuneration in Japanese companies

The disclosure of executive remuneration shown in securities reports classifies senior management into four categories; namely (i) directors (excluding outside directors); (ii) company auditors (excluding outside auditors); (iii) executive officers; and (iv) outside executive officers (outside directors and outside auditors). It also breaks remuneration down into four types; namely (i) basic remuneration; (ii) stock options; (iii) bonuses; and (iv) retirement benefits. The below analysis shows the level and breakdown of remuneration for each management category in TOPIX 100 companies.

According to Figure 37, the highest level of remuneration of JPY 117.82 million is found among executive officers in companies with committees; next is that for (internal) directors at JPY 58.9 million; followed by (internal) auditors at JPY 27.1 million, outside directors at JPY 14.47 million and outside auditors at JPY 11.43 million. Compared with remuneration levels for (internal) auditors and outside officers (outside directors and outside auditors) who are expected to fulfil a supervisory function, levels for executive officers and (internal) directors with an executive function are higher. This implies that remuneration is determined in accordance with the level of contribution made to business performance. Furthermore, within the same job description of "director" or "auditor", internal officers receive more generous compensation than outside officers.

Figure 37. Management remuneration in Japanese companies



Note: Applies to TOPIX 100 companies.

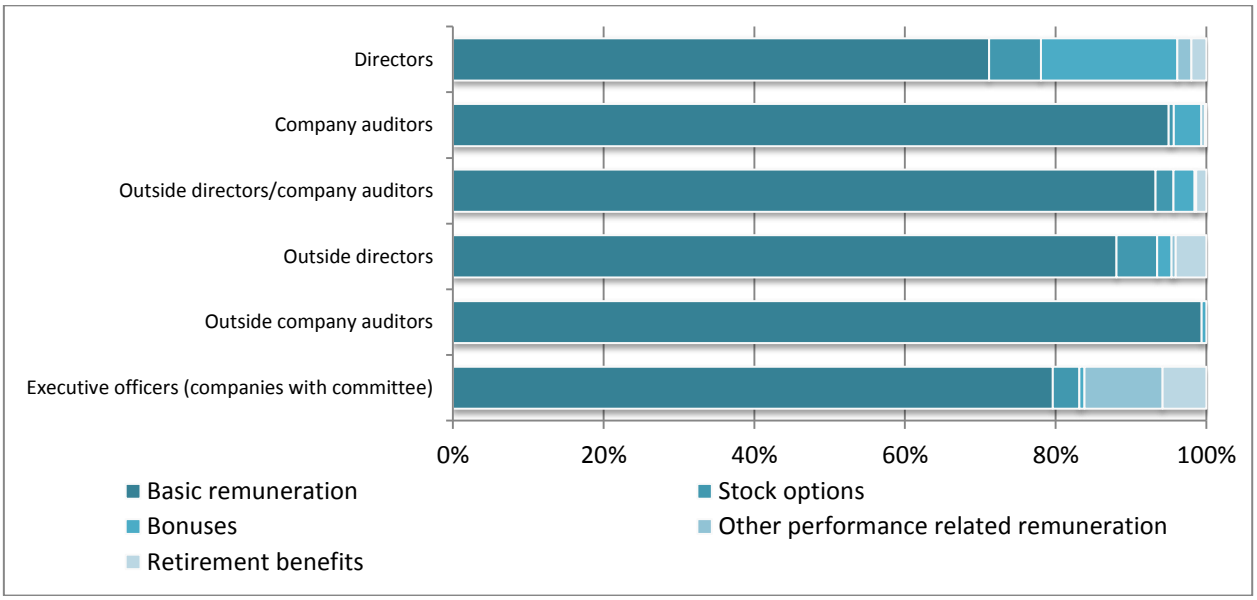
ii. Breakdown of management remuneration in Japanese companies

Executive officers (in companies with committees) and internal directors are expected to fulfil an executive function and a breakdown of their remuneration shows a higher percentage of performance-related remuneration and a lower percentage of fixed, basic remuneration than officers with a supervisory function; i.e. company auditors and outside officers (outside directors and outside auditors). On the other hand, around 90% or more of the total remuneration received by company auditors and outside officers is made up of fixed remuneration. Executive

officers and internal directors bear the responsibility and role of the executive body of operations and as such there is an ongoing tendency to adopt remuneration systems that are linked to the business performance resulting from their execution of operations, with companies offering remuneration packages designed to make these officers aware of their responsibilities and provide them with incentives to improve business performance.

Figure 38 shows directors as the category of executive with the lowest basic remuneration at 71.1%, followed by executive officers at 79.6%. Meanwhile the percentage of fixed compensation for officers expected to fulfil a supervisory function is substantially higher, with basic remuneration standing at 95.0% for company auditors, 88.1% for outside directors, and 99.4% for outside auditors. At 6.9%, the ratio of stock options is highest for directors, followed by 5.4% for outside directors. Bonuses are also highest among directors, accounting for 18.1%. This shows that the use of performance-related remuneration systems such as stock options and bonuses is relatively advanced among directors. Retirement benefits are highest among executive officers; accounting for 5.8%. The underlying reason for this is thought to be that executive officers are appointed by the board of directors via a nominating committee, rather than by a general shareholder meeting. This means less involvement on the part of shareholder meetings, where retirement plans for directors and auditors are criticised by many shareholders, mainly institutional investors, and the provision of such plans is on the downturn. In addition, many companies, such as Hitachi, Toshiba and Mitsubishi Electric, pay a certain percentage of executive officers' remuneration (varying from around 30% to around 40-50%) in the form of performance-related compensation, which is paid according to the outcome of the company's business performance, or the business area that the executive officer oversees. At 99.4%, virtually all the compensation of outside auditors is made up of basic remuneration, with bonuses accounting for 0.6%. There are thought to be two reasons for the use of reward schemes with such an extremely high percentage of fixed remuneration; one being that auditors are employed as full time supervisory entities and the other that they are also outside officers.

Figure 38. Breakdown of management remuneration in Japanese companies



Note: Applies to TOPIX 100.

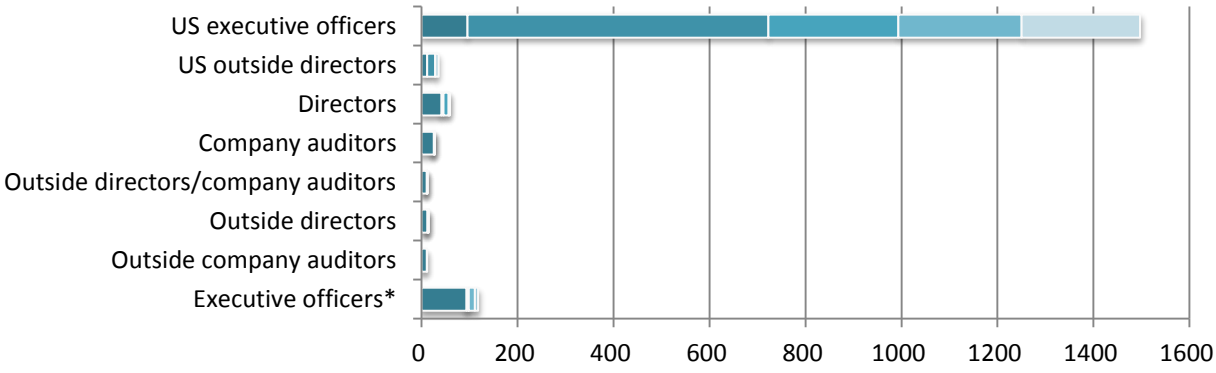
iii. Comparison of management remuneration in Japan and the United States

Levels of remuneration in Japan and the United States

In the United States, most boards are comprised of independent outside directors, with a few internal officers such as the CEO and CFO also normally serving as directors. The board of directors primarily functions in a supervisory capacity, with executive officers (managers such as the CEO or CFO etc.) having the greater authority for executive operations. The remuneration methods applicable to the latter party in charge of executive operations are discussed when referring to the issue of management remuneration overseas. From this perspective, remunerations for individual operational executives are described in the general shareholding meeting proxy statement, including the method used to determine rewards, as well as detailed amounts and breakdowns. Performance-related compensation is subject to peer group analysis, which is also carried out in detail on performance evaluation.

According to Figure 39, the average remuneration for operational executives is JPY 1.49 billion (exchange rate USD 1: JPY 100), over 40 times that of outside directors, which stands at JPY 35.88 million. For this reason, high levels of executive compensation are often cited as a concern.

Figure 39. A comparison of managers' remuneration in Japan and the United States



	Executive officers*	Outside company auditors	Outside directors	Outside directors/company auditors	Company auditors	Directors	US outside directors	US executive officers
Basic remuneration	94	11	13	11	26	42	12	96
Stock options	4	0	1	0	0	4	17	627
Bonuses	1	0	0	0	1	11		271
Other performance related remuneration	12	0	0	0	0	1		257
Retirement benefits	7	0	1	0	0	1		
Other remuneration							8	247

Note 1: Executive officers in companies with three committees.
Note 2: Applies to TOPIX 100 companies and DOW 30 companies.

The following two points are features of remuneration levels that both Japanese and US companies share in common. First, remuneration levels are higher among officers with executive operational functions than among supervisory officers. Second, remuneration levels among outside directors who function in a supervisory capacity are comparable in both Japan and the United States.

Meanwhile, there is a huge difference between the overall amounts of remuneration paid to operational executives in Japan and the United States. The average total remuneration of US executives is more than 10 times that of Japanese internal directors and executive officers.

Breakdown of management remuneration in Japan and the United States

The boards of US listed companies are comprised of independent, outside directors, with the exception of certain top management members such as CEOs, and CFOs who serve jointly as directors. Operational executive authority lies with the CEO, who is the top member of management, and the key role of the board of directors is to monitor the CEO. As a result, the remuneration paid to outside directors is made up of a large proportion of fixed remuneration and a small proportion of performance-related rewards; and the total amount is small in comparison to that paid to management officers, where a significant proportion is comprised of performance-related compensation.

According to Figure 39, cash remuneration, which is fixed compensation, is 32.6%, while equity remuneration is 46.3%. Stock option remuneration, which is a typical form of performance-related compensation, is not granted to outside directors.

A feature of remuneration packages common to both Japan and the United States is that a higher percentage of performance-related remuneration is paid to those with operational executive functions than those with supervisory functions. Meanwhile, those in a supervisory capacity are paid a high percentage of fixed remuneration.

Moreover, the ratio of fixed remuneration is relatively high in Japan, while in the United States the ratio of performance-linked compensation is higher.

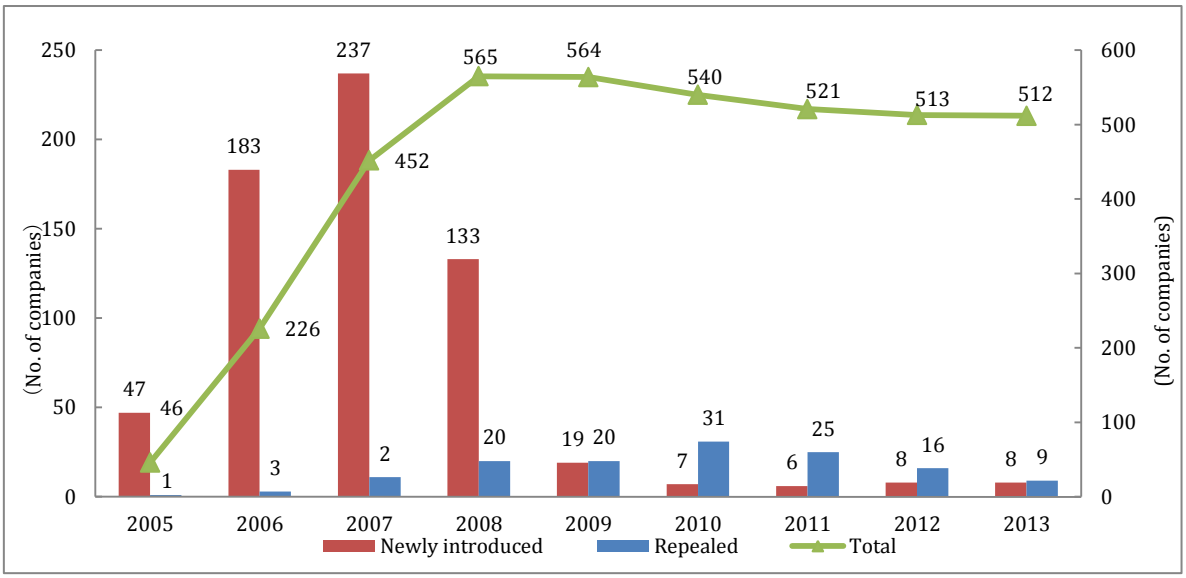
2.2.4 Anti-takeover measures

a) Companies introducing anti-takeover measures

According to a survey of listed companies, the number of companies introducing anti-takeover measures peaked at 565 at the end of FY 2008, and has since declined to 512 companies as of FY 2013. Moreover, there has been an increase in the cancellation of such measures since FY 2008. In the face of strong opposition from institutional investors and uncertainty as to the effectiveness of anti-takeover measures, companies have been slow to introduce new mechanisms.

Figure 40 shows a summary of the number of companies that have introduced takeover defenses since their launch in FY 2005.

Figure 40. Companies introducing anti-takeover measures



Note: Applies to all listed companies in Japan.

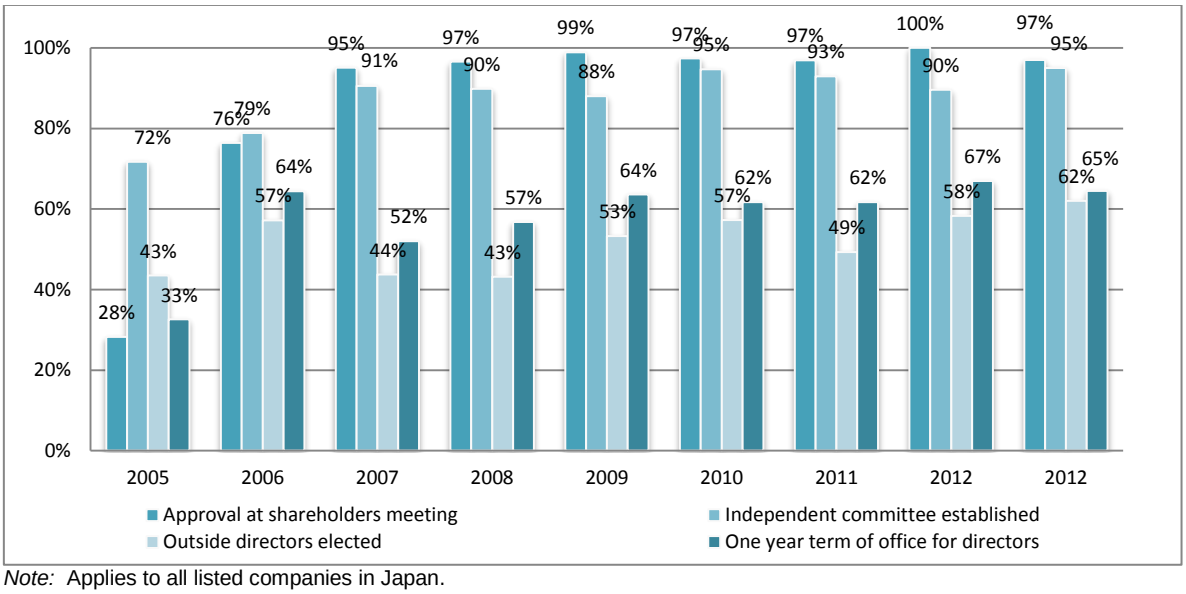
b) Details of anti-takeover measures

Institutional investors determine the validity of anti-takeover measures mainly in terms of whether shareholder interests are respected and whether the transparency and objectivity of the decision to activate the measures are ensured.

Many institutional investors believe that the items listed below are the minimum criteria necessary to judge anti-takeover measures as appropriate. Figure 41 shows how companies introducing defenses have addressed these items.

- Approval from general shareholder meeting
- Establishment of an independent committee
- Installation of outside directors
- One-year term of office for directors

Figure 41. Details of anti-takeover measures



Note: Applies to all listed companies in Japan.

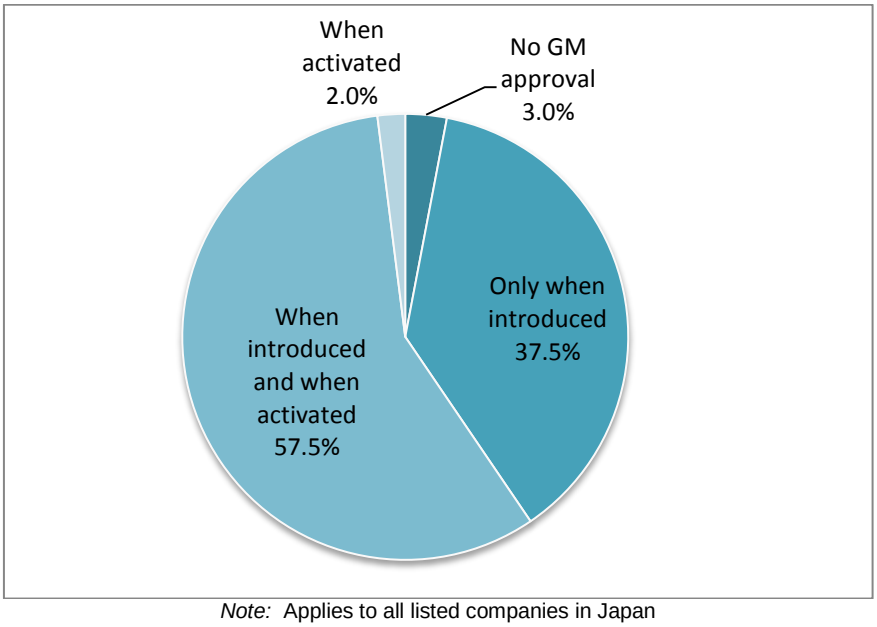
Shareholders lose acquisition opportunities when anti-takeover measures are activated; consequently there is the potential for such measures to have a significant impact on their rights and interests. As a result, many institutional investors demand the approval of a general shareholder meeting as a means of reflecting shareholder opinion whenever takeover defenses are introduced or renewed. In addition, it is necessary to ensure objectivity and independence in the decision-making process used to implement anti-takeover measures, because fair and objective judgments are needed in terms of shareholder interests. Consequently, some investors expect the board of directors to establish separate, independent committees comprised solely of members who are independent from management discussions and consultations on the activation of defenses, and to install outside director(s) to guarantee the objectivity of decisions taken by the board. Furthermore, some investors also request that the term of office for directors be reduced to one year in order to enhance shareholder monitoring; this is due to fears that current management regimes may possibly exploit anti-takeover measures as a means of self-protection and forego opportunities to improve corporate value. In addition, the external environment, such as ownership structure, is sometimes taken into account in determining the validity of takeover defenses.

c) Shareholder approval for anti-takeover measures

According to Figure 41, in FY 2013, 97% of the companies introducing new takeover defenses, or updating such measures, required the approval of a general shareholder meeting. Figure 42 is a summary of whether resolutions of general shareholder meetings were taken at the point defenses were introduced, as well as the points in time that resolutions of general shareholder meetings were deemed necessary. It shows that in 37.5% of cases resolutions were only passed at the time defenses were introduced (including renewals), in 57.5% of cases resolutions were passed at the time of introduction and the time of activation, and in 2% of cases resolutions were only passed at the time of activation. The fact that over half of all companies required the approval of general meetings of shareholders at both the point of introduction and the point of activation seems to indicate that companies are becoming increasingly shareholder-friendly. However, when a resolution of a general shareholder meeting is also required at the time

defenses are activated, it presents a contradiction, as it attenuates the need for independence in the company management structures in the form of independent committees and outside directors etc. Nevertheless, the fact that many companies are installing these independent committees and outside directors indicates that they wish to retain the option of activating anti-takeover measures if urgent circumstances so require, without having to obtain a resolution of a general shareholder meeting.

Figure 42. Shareholder approval for anti-takeover measures



Note: Applies to all listed companies in Japan

d) Conditions necessary for the activation of anti-takeover measures

Anti-takeover measures are considered necessary from the standpoint of eliminating a hostile bidder. However, there are fears that if decisions to activate defenses are widely accepted as being taken at the discretion of the board of directors, managers may act in their own self-interests and prevent takeovers that would be advantageous in terms of increasing shareholder value. As a result, a major issue of concern is the conditions under which the activation of anti-takeover measures is permitted. Institutional investors are interested in this issue and study it in detail.

On 23 March 2005, a ruling by the Tokyo High Court (in the case of Nippon Broadcasting) noted four types of takeover that qualified as "attempts to prey on a company" and a “coercive two-step acquisition” (five types in total) in terms of the conditions necessary to trigger takeover defenses. Some institutional investors will only allow the activation of takeover defenses if a bid satisfies these conditions. The four types of acquisition that the Tokyo High Court ruling stipulated as "attempts to prey on a company" are listed below.[22]

1. Cases where shares are acquired with no intention of actually participating in the management of a company, simply for the purpose of driving up stock prices and forcing a company's stakeholders to buy the shares back at an inflated price (so-called “greenmailing”).

[22] METI “Corporate Value Report - Proposal toward establishment of rules for a fair business community” May 27, 2005. Page 30

2. Cases where shares are acquired for the purpose of so-called "scorched earth" management, whereby the acquirer takes temporary control of the target company's management to force the transfer of certain essential elements of its management operations to the acquiring party or one of its group companies. Such elements include intellectual property rights, business know-how, secret corporate information, major suppliers and customers etc.

3. Cases where shares are acquired with plans to dominate the target company management and then divert the target company's assets to act as debt collateral or repayment funds for the acquiring party or one of its group companies etc.

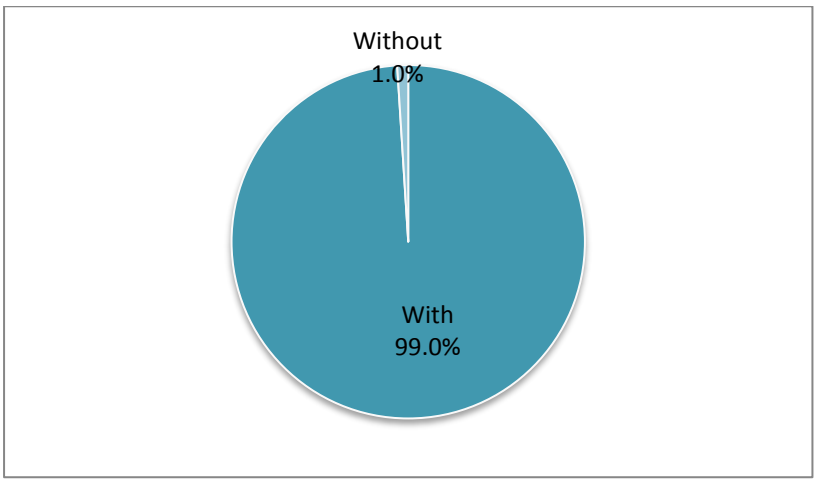
4. Cases where shares are acquired for the purpose of resale at a high stock price. A high stock price that is realised by the acquiring party taking temporary control of the target company's management and forcing the disposal by sale etc. of high value assets such as real estate and marketable securities that are not immediately connected with the target company's business, then using the proceeds of such disposal to temporarily effect a high dividend, or alternatively to create the opportunity for a sudden rise in stock prices as a result of the temporarily high dividend.

Coercive two-step acquisition refers to the practice of establishing two different sets of acquisition terms, with advantageous terms offered at the first stage and disadvantageous (or ambiguous) terms on offer if the bid goes to the second stage. This creates a situation where the target will suffer a disadvantage if it does not agree to the takeover during the first stage, and is a takeover method that forces shareholders to sell quickly.[23]

On the other hand, as shown in Figure 43, only 1% of companies that employed anti-takeover measures in FY 2013 determined the non-activation of such measures on the basis of compliance with their own rules on large-scale purchases (e.g. rules on the disclosure of information pertaining to the offering party). Conversely, in addition to the five types of takeover mentioned above, 99% of companies have adopted provisions that permit the activation of takeover defenses if there are concerns that "damage to the common interests of shareholders" or "damage to corporate value" will occur (i.e. comprehensive provisions). However, a significant number of investors are troubled by the fact that the details of such provisions are ambiguous and that company management has considerable discretion in determining the suitability of takeover proposals. As a result, many investors will negatively judge the establishment of such comprehensive provisions for the activation of anti-takeover measures.

[23] Ibid. Pages 25 & 32

Figure 43. Comprehensive provisions for the activation of anti-takeover measures



Note 1: Applies to all listed companies in Japan.
Note 2: "Without" only applies to 2 companies; Akebono Brake, and Neturen.

PART III. CORPORATE GOVERNANCE AND THE ROLE OF INSTITUTIONAL INVESTORS

3.1 Systems pertaining to the role of institutional investors in corporate governance

3.1.1 "Study Group on the Internationalization of Japan's Financial and Capital Markets" – A report by the Financial Services Agency

a) Disclosure of institutional investors' voting results

i. Recommendations of the study group

The report published by the FSA in June 2009 entitled "Study Group on the Internationalization of Japan's Financial and Capital Markets"[24] called for accurate monitoring of management by investors in order to improve the corporate governance of listed companies via the market. To that end, it demanded the appropriate exercise of voting rights by institutional investors, based on their fiduciary responsibilities.

In order for voting rights to be properly exercised under market supervision, it was necessary to publish appropriate guidelines and voting strategies for institutional investors to use as standards. Since 2003, the Investment Trusts Association, Japan has led the way in formulating industry rules on the creation and disclosure of voting strategies. Meanwhile, it is recommended that other institutional investors, besides investment trusts, also develop and publish their voting strategies in a similar fashion.

Furthermore, the publication of institutional investors' actual voting results will increase transparency by allowing objective evaluation of whether or not such investors are properly exercising their voting rights. In Japan, some public pension funds in the Pension Fund Association have been disclosing their voting results on a voluntary basis. The aim is to expand such disclosure to all institutional investors in order to improve governance through the exercise of voting rights. Consequently, it is recommended that various institutional investor organisations should summarise voting results and construct rules on their publication.

ii. Responses to the recommendations

Since 2003, the Investment Trusts Association, Japan has been developing voluntary regulations on the creation and publication of voting strategies, and in March 2010 developed the same on the publication of voting results.

The Japan Investment Advisers Association developed voluntary regulations on the creation and publication of voting strategies in December 2009, and the same on the publication of voting results in January 2010.

[24] Ibid 6 / FSA "Study Group on the Internationalization of Japan's Financial and Capital Markets"

The Trusts Association has issued their member companies with notices on the creation/publication of voting strategies and the publication of voting results, and the major trust banks that are members of the association are addressing the issues.

Therefore, since 2010 Japan's major institutional investors (investment trusts, investment advisers, and trust banks) have been publishing information on their voting strategies and results, which can be viewed on their individual websites. In addition, each association collects information from individual member companies and publishes a summary of their voting results.

With regard to the publication of voting results, virtually all institutional investors publish more than just their overall ratios of "for" and "against" votes, and disclose the ratios for individual categories of proposal. However, in Japan it is recognised that disclosing the voting results on individual proposals made in individual companies may risk affecting the relationship of trust between companies and investors.

In 2013, the FSA started to produce Japan's Stewardship Code in order to further enhance the role of institutional investors in corporate governance and make Japan's markets more attractive. In February 2014, the FSA published "Principles for Responsible Institutional Investors - Japan's Stewardship Code" (described in more detail later).

b) Listed companies' disclosure of voting results

i. Recommendations of the study group report

Improvements were also recommended in the transparency and disclosure of information on voting results in listed companies. Prior to 2010, many listed companies simply disclosed in a "Notice of Resolutions" whether the general shareholder meeting resolutions had resulted in approval or rejection of a proposal. In order to fulfill their accountability to shareholders and increase transparency, it would be necessary for listed companies to disclose the number of votes for and against each proposal.

There were strong demands for the systematic disclosure of voting results in listed companies, particularly from foreign institutional investors whose objective was to evaluate the effectiveness of their own voting behaviour.

As a result, the study group's report recommended that the regulators and securities exchanges develop a system for the disclosure of voting results.

ii. Responses to the recommendations

The FSA amended the "Cabinet Office Ordinance on Disclosure of Corporate Information etc." with effect from 31 March 2010[25] on the basis of the study group report (described above). It became mandatory for listed companies to issue an extraordinary report to disclose the results of resolutions made on proposals submitted to the general shareholder meeting.

The resolution results were to include the number of votes "for" and "against" each proposal, as well as the number of abstentions, and the conditions of approval for the matters to be resolved. In addition, it was decided that for proposals on the election of directors and auditors, the number of votes for each individual candidate had to be disclosed.

[25] FSA, "Outline of Disclosure concerning Corporate Governance".

3.1.2 Japan's Stewardship Code[26]

a) Background

Japan's Stewardship Code originated with a statement from the Prime Minister, acting as the head of the "Headquarters for Japan's Economic Revitalization" established within The Cabinet. The statement indicated that "in terms of promoting sustainable corporate growth, we should examine the type of principles that allow a wide range of institutional investors to properly fulfill their fiduciary responsibilities".[27]

In June 2013, The Cabinet approved the "Japan Revitalization Strategy"[28], which defines the growth strategy, or "the third arrow" of the current administration's economic policy. The Strategy states that "principles (Japan's Stewardship Code) for institutional investors to fulfil their fiduciary responsibilities, e.g. by promoting medium-to long-term growth of companies through engagements," that is, "the principles for a wide range of institutional investors to appropriately discharge their stewardship responsibilities, with the aim of promoting sustainable growth of investee companies, through constructive dialogue with them" should be discussed and drafted by the end of the year.

In light of this background, the FSA set up a study group of experts on Japan's Stewardship Code in August 2013. This study group held a number of discussions and in February 2014 it published "Principles for Responsible Institutional Investors [Japan's Stewardship Code] －To promote sustainable growth of companies through investment and dialogue."

b) Key concepts in Japan's Stewardship Code

i. Stewardship responsibilities

In Japan's Stewardship Code, "stewardship responsibilities" refers to the responsibilities of institutional investors to enhance the medium-to long-term investment return for their clients and beneficiaries (including ultimate beneficiaries) by improving and fostering the investee companies' corporate value and sustainable growth through constructive engagement, or purposeful dialogue, based on in-depth knowledge on the companies and their business environment.

ii. Objectives of the Stewardship Code

Japan's Stewardship Code defines principles to help responsible institutional investors fulfill their stewardship responsibilities with due regard to both their clients and beneficiaries, and to investee companies. By fulfilling their stewardship responsibilities properly in line with this code, institutional investors will also be able to contribute to the growth of the economy as a whole.

[26] FSA, "Principles for Responsible Institutional Investors ≪Japan's Stewardship Code≫ －To promote sustainable growth of companies through investment and dialogue".

[27] 6th meeting of the Headquarters for Japan's Economic Revitalization (2 April 2012)

[28] The Cabinet Office, "the Japan Revitalization Strategy" (13 June 2013).

Figure 44. The value chain of Japan's Stewardship Code

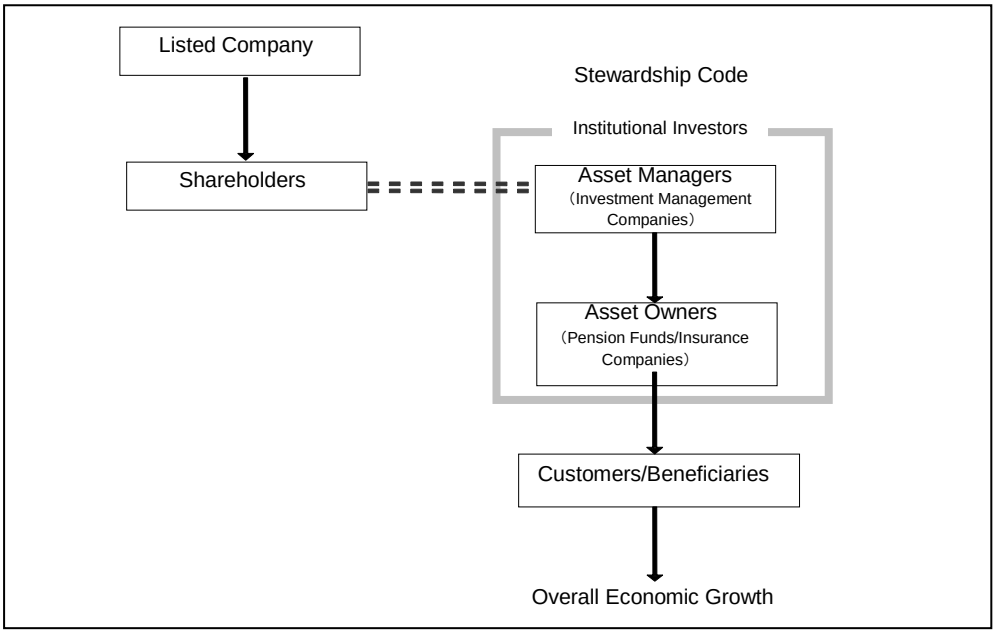


Figure 44 shows the flow of value improvements that is the aim of Japan's Stewardship Code. In the Stewardship Code, each investor is required to be aware of the role to be fulfilled (code guidelines 1-2) in light of his individual position within the investment chain (i.e. the flow of investment funds from customers and beneficiaries towards investee companies).

iii. Principles-based approach

A "rules-based approach" that defines laws and regulations in detail has traditionally been used in Japan. However, the Stewardship Code has adopted a "principles-based approach" which allows institutional investors to appropriately fulfill their own stewardship responsibilities in line with their individual circumstances (Background to the Code: Paragraph 10).

The Code puts a "principles-based approach" into practice for the first time in Japan, and initially some confusion is to be expected in a country that is familiar with a "rules-based approach". However, one of the characteristics of a "principles-based approach" is that once institutional investors understand the Code's underlying ethos, they are allowed to respond in specific, individual ways within its framework, in line with their individual circumstances. Under this process, investors should respect the ethos behind the Code and be able to embrace it as far as possible, rather than deciding whether or not to use all of the terms contained therein. As a result, this should lead to the Code's adoption by a wide range of institutional investors and so increase its effectiveness.

iv. The "comply or explain" approach

The Code is "principles-based" as mentioned above and is quite clearly not a legally binding set of regulations. Institutional investors who support the Code and are prepared to accept it are expected to disclose (publically express) their intention (Background to the Code: Paragraph 11). Moreover, the Code adopts the so-called "comply or explain" approach.

v. Disclosing the adoption of the Code

Institutional investors who adopt the Code are expected to publish a statement to such effect on their websites and review/update the statement every year, notifying the FSA of the website address (Background to the Code: Paragraph 14).

The statement should include disclosure of the investor's intention to accept the Code (acceptance disclosure) along with the items of information that need to be publically disclosed under the individual principles of the Code, such as the strategies in place to fulfill stewardship responsibilities (including an explanation of the reason for any non-compliance with the Code's principles).

c) Seven principles in Japan's Stewardship Code

Principle 1: Institutional investors should have a clear policy on how they fulfill their stewardship responsibilities, and publicly disclose it.

Institutional investors should aim to enhance the medium-to long-term return on investment for their clients and beneficiaries by improving and fostering investee companies' corporate value and sustainable growth through constructive engagement based on in-depth knowledge of the companies and their business environment (Code Guidance 1-1).

Moreover, institutional investors should have a clear policy on how they plan to fulfill their stewardship responsibilities and on their role in the investment chain on the basis of their position within the chain; and this policy should be publically disclosed (Code Guidance 1-2).

Principle 2: Institutional investors should have a clear policy on how they manage conflicts of interest in fulfilling their stewardship responsibilities, and publicly disclose it.

Institutional investors need to manage any conflicts of interest properly and adequately, so as to achieve value growth in the investment chain. On the other hand, there will be occasions when conflicts of interest inevitably arise, such as when voting on matters affecting both the business group the institutional investor belongs to and a customer or beneficiary. The Code recognises that such conflicts of interest are sometimes unavoidable, but stipulates that it is vital for institutional investors to manage such conflicts appropriately (Code Guidance 2-1).

Furthermore, institutional investors should put the necessary measures in place to ensure the interests of customers and beneficiaries come first, and publicly disclose a clear policy on how they will manage key types of potential conflicts of interest (Code Guidance 2-2).

Principle 3: Institutional investors should monitor investee companies so that they can appropriately fulfill their stewardship responsibilities and support the sustainable growth of the companies.

Principle 3 stipulates the importance of institutional investors monitoring investee companies. It is vital that institutional investors accurately monitor conditions in investee companies to allow them to properly exercise their stewardship responsibilities with the aim of enhancing medium-to long-term corporate value and capital efficiencies, and supporting sustainable growth of the companies (Code Guidance 3-1). Institutional investors should also monitor conditions in

investee companies on an on-going basis and review the effectiveness of the monitoring as appropriate (Code Guidance 3-2).

In terms of specific monitoring details, a number of factors may be considered, such as how an investee company addresses governance, corporate strategy, performance, capital structure and risk (including risks related to social and environmental issues). However, institutional investors need to make their own decisions on which specific factors they focus on in light of their own stewardship responsibilities, as investment policies will vary from investor to investor, and the importance placed on the items to be monitored will also differ according to the investee company. In addition, investors should endeavor to identify at an early stage any issues that pose a risk of material loss in the corporate value of an investee company (Code Guidance 3-3).

Principle 4: Institutional investors should seek to arrive at an understanding in common with investee companies and work to solve problems through constructive engagement with them.

Institutional investors should endeavor to improve common understanding with investee companies through constructive dialogue (engagement). Moreover, if it is felt there is a risk of a loss in corporate value, institutional investors should endeavor to obtain an even deeper common understanding by requesting further detailed explanation from the investee company and make every attempt to solve the problem (Code Guidance 4-1). To this end, institutional investors should have clear, pre-prepared policies in place on the dialogue they hold with companies (Code Guidance 4-2).

In addition, institutional investors should treat any undisclosed material facts obtained during the course of such dialogue with caution (Code Guidance 4-3).[29]

Principle 5: Institutional investors should have a clear policy on voting and disclosure of voting activity. The voting policy should not only be comprised of a mechanical checklist: it should be designed to contribute to the sustainable growth of investee companies.

The exercise of voting rights is a typical example of stewardship activity and is one of the most important acts of stewardship responsibility; it should be carried out in light of the outcome of dialogue (engagement) between the institutional investor and the investee company. As mentioned earlier, investment trusts, investment advisers and trust banks have been developing and publishing voting rights policies, as well as disclosing voting results, based on the recommendations of the 2009 study group report by the FSA. On the other hand, asset owners such as pension funds and insurance companies disclose very little information on their voting polices and results, although there are certain public pensions that make disclosures such as the Government Pension Investment Fund, the Pension Fund Association for Local Government Officials, and the Pension Fund Association.

The Code states that institutional investors should seek to vote on all shares held, and should decide on a vote in light of conditions in the investee company and the result of dialogues held with the company (Code Guidance 5-1).

[29] "OECD Principles of Corporate Governance" and the TSE's "Principles of Corporate Governance for Listed Companies" (based on the OECD principles) establish the fundamental principle of equitable treatment of shareholders which applies to the handling of a company's undisclosed material facts.

Institutional investors should establish a clear policy on voting and publicly disclose it. Moreover, they should be careful that the policy does not result in decisions being taken mechanically (Code Guidance 5-2).

Institutional investors should respect the practices established in Japan on the disclosure of voting results and should publish the results in an organised manner, aggregated into the main categories of proposal (Code Guidance 5-3, first paragraph). The Code points out that should an institutional investor feel that an alternative method of disclosing voting results, other than this aggregated summary, would allow a better understanding of its own stewardship activities overall, then the investor may explain the reasons and publish the voting results using the alternative method (Code Guidance 5-3, second paragraph).

In Japan, asset managers normally reach their own decisions on voting in-house, on the basis of their own voting policy. As a result, many analysts are swamped with voting-related work during June, which is the most common period for general shareholder meetings. Consequently, although Japanese asset managers investing in Japanese equities may refer to information provided by proxy advisors, only a minority will automatically rely on the recommendations of such advisors. However, asset managers with foreign affiliations, such as those with foreign equity voting rights, or those involved in global voting processes, often commission the services of proxy advisors in their work. Consequently the Code deems that when institutional investors use the services of a proxy advisor, they should disclose the fact and also how such services are utilised (Code Guidance 5-4).

Principle 6: Institutional investors should, in principle, report periodically on how they fulfill their stewardship responsibilities, including their voting responsibilities, to their clients and beneficiaries.

Stewardship activities, including the exercise of voting rights, are very important with regard to entrusted assets; consequently, institutional investors are expected to regularly explain such activities to fund contributors who are higher up the investment chain.

Asset managers should, in principle, report periodically to their clients on how they fulfill their stewardship responsibilities through their stewardship activities (Code Guidance 6-1). Similarly, asset owners should, in principle, report at least once a year to their beneficiaries on the policies they have in place to allow them to fulfill their stewardship responsibilities, and on how such policies are actually implemented (Code Guidance 6-2).

Such reports should be devised to function in an effective and efficient manner, and should respect the wishes of the client/beneficiary (Code Guidance 6-3). In addition, institutional investors should keep a record of their stewardship activities, such as the exercise of voting rights etc., to the extent so required (Code Guidance 6-4).

Principle 7: To contribute positively to the sustainable growth of investee companies, institutional investors should have in-depth knowledge of the said companies, their business environment and capabilities to appropriately engage with them and make proper judgements in fulfilling their stewardship activities.

Institutional investors should develop sufficient capabilities to effectively enhance their engagements with investee companies (Code Guidance 7-1) and should implement the necessary internal structure to the same end (Code Guidance 7-2).

Unlike Principle 5 of the UK Stewardship Code, Japan's Stewardship Code does not define any distinct principle on collective engagement. This is due to the fact that the Japanese environment is not one where institutional investors act together to perform stewardship activities; consequently, to adopt such a principle into the Code at this point in time would potentially cause confusion in practice. However, the Code suggests that it may be beneficial for institutional investors to exchange views with other investors as necessary and have a forum for such a purpose (Code Guidance 7-3), which implies there is room for collective engagement in future.

d) Differences between Japan's Stewardship Code and the UK Stewardship Code

Japan's Stewardship Code makes reference to the ethos behind the UK code in the way it recognises the importance of dialogue and engagement in stewardship activities and the way it adopts the "comply or explain" approach. However, Japan's Stewardship Code incorporates items that are uniquely Japanese, in light of the background to its development and the nature of stewardship activities relevant to the investment environment and practices in Japan.
Overall, Japan's Stewardship Code provides detailed descriptions using terms and relationships already familiar in Japan's legal system and customary practices. For example, it uses definitions and explanations that are easy to understand such as "stewardship responsibilities", "engagement", "comply-or-explain", and "investment chain".

The following differences have been pointed out with regard to the content of the principles in Japan's Stewardship Code as compared to the UK Stewardship Code[30]

1. Emphasis is placed on the importance of promoting the "sustainable growth of companies".

2. The importance of "constructive dialogue" between institutional investors and companies is highlighted.

3. The principle of supporting collective engagement is not adopted.

4. A description of the efforts that institutional investors should make to ensure that dialogue is useful for the company is included.

Hence, the aim was to create a code appropriate for the Japanese market that could be promoted for use by a large number of investors in the future, thereby increasing its effectiveness.

3.2 Promoting institutional investors' participation in general shareholder meetings in Japan

3.2.1 General shareholder meeting schedules

In Japan, 80% or more of listed companies use a fiscal year that runs from April to March. Companies must file a securities report within three months of the fiscal year-end; consequently such companies must hold their general shareholder meeting by the end of June. Furthermore, there are companies that use the system of setting a "base date" to determine which shareholders will be able to vote at the shareholder meeting, and in such cases the shareholder meeting must be held within three months of the base date. In practice, most companies set the final day of the fiscal year as the base date. This means that if 31 March is the fiscal year end,

[30] Motoyuki Yufu "Trends in Disclosure and Corporate Accounting etc.", *Shojihomu*, vol. 2021 (2014), p.56.

the shareholder meeting must be held by 30 June. As a result, many companies in Japan have their shareholder meetings in the latter half of June.

Furthermore, at one time many companies worried about corporate raiders disrupting shareholder meetings. As a result, many companies held their shareholder meetings on the same day, as a defensive measure against such raids. Although corporate raiders have virtually disappeared these days, their influence still remains in today's shareholder meeting schedules and practices.

As shown in Figure 45, 27 June (Thursday) was the peak day for shareholder meetings related to the fiscal year ending March 2013, with 551 companies (41.2%) holding their shareholder meetings on this day. In 2006, 56.3% of all companies held their shareholder meetings on the same day, but since 2010 the percentage has been no more than 40-45%. The trend seems to be for a dispersal of dates, rather than concentrating all the meetings on one particular day.

On the other hand, looking at the week that includes the peak day, the number jumps to 75.5% of companies holding their shareholder meetings during that week (i.e. 24-28 June 2013). This shows that even now many shareholder meetings are still concentrated within a specific period.

Figure 45. General shareholder meeting schedule (June 2013)

Date		Date Convocation Notice Issued																									No. of Co.	%
		May												June														
		2	2	22	23	24	25	26	27	28	29	30	31	1	2	3	4	5	6	7	8	9	10	11	12	13		
		M	T	W	T	F	S	S	M	T	W	T	F	S	S	M	T	W	T	F	S	S	M	T	W	T		
6/7	F	1																									1	0.0
6/8	S					1																					1	0.0
6/9	S																										0	0.0
6/10	M																										0	0.0
6/11	T					1			1																		2	0.1
6/12	W				1	1				3																	5	0.3
6/13	T									3	5																8	0.6
6/14	F					3			1	1	3	6															14	1.0
6/15	S					1			1			1	2														5	0.3
6/16	S				1								2														3	0.2
6/17	M										1		1														2	0.1
6/18	T								2	4	5	2	4			3											20	1.5
6/19	W					2				6	4	4	5			10	2										33	2.4
6/20	T										3	9	6			18	4	9									49	3.6
6/21	F		1						2	1	2	27	31			26	21	28	31								170	12.
6/22	S					1							4			1		1	3	2							12	0.9
6/23	S																	1		2							3	0.2
6/24	M										1	1	7			4	1	1	3	3							21	1.5
6/25	T											1	11			60	28	17	14	46			28				205	15.
6/26	W					1							4			15	53	26	22	44			39	26			230	17.
6/27	T					1					1		6			17	24	11	68	98	1		85	72	64		551	41.
6/28	F																									2	2	0.1
No. of Co.		1	1	0	2	12	0	0	7	18	25	51	83	0	0	154	133	197	141	195	1	0	152	98	64	2	1337	100

Note: Applies to TOPIX companies (March results).

There are virtually no investors with shares in their own name who actually attend the general shareholder meeting, with the exception of so called "activist" investors. Instead, it is common practice for institutional investors to issue asset managers with their voting instructions up to five business days prior to the date of the shareholder meeting. The deadline for institutional investors to issue voting instructions on many of the companies is five days before the busiest shareholder meeting date; this is to allow for the scheduling of work related to the voting instructions. On the other hand, once a convocation notice has actually been received from a company, the investors can start to determine their voting instructions. Hence, if convocation notices are obtained promptly, institutional investors can spread out the work related to their voting instructions, which will ensure that they have plenty of time to reach their decisions. In this sense, only 183 companies (13.7%) sent their convocation notices on the legal deadline (the interpretation of the law is there must be two weeks or more between the date the notice is sent and the date of the shareholder meeting, which means in practice the deadline is 15 days prior to the date of the shareholder meeting), and since 2010, on average, convocation notices have been sent 19 days in advance (see Figure 46).

In addition, Figure 47 shows that although the deadline for the convocation notice to be sent is 15 days prior to the event, the majority of companies send it one week earlier than this – 22 days before the date of the shareholder meeting.

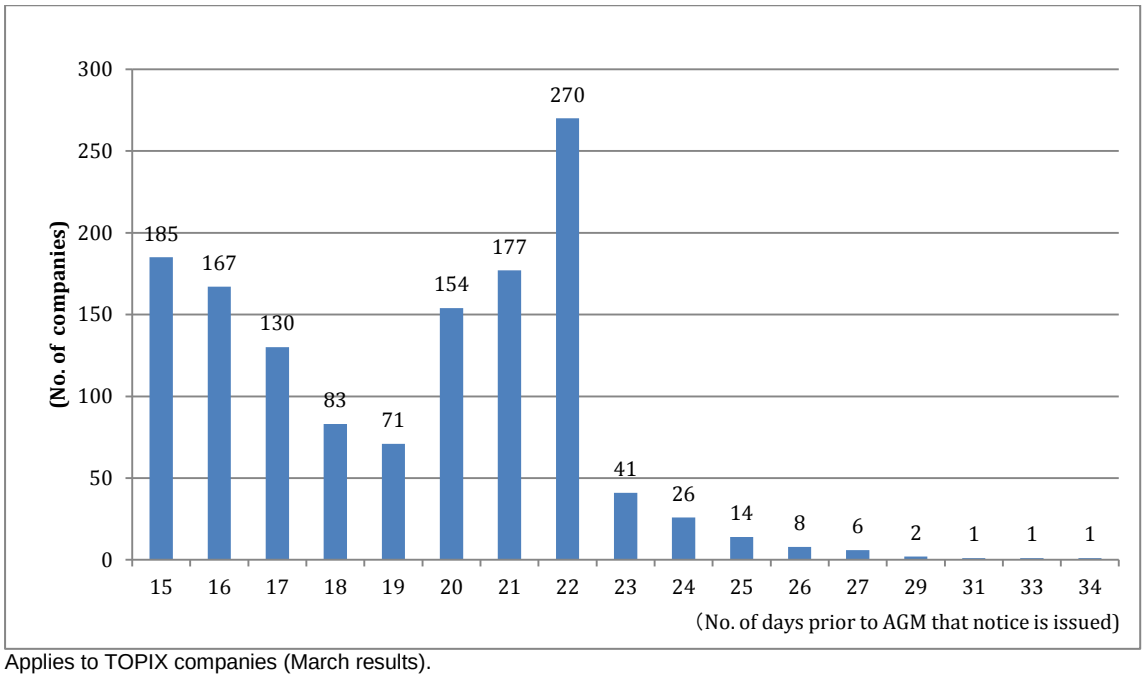
Moreover, the revisions to the TSE rules in July 2009 meant that as of June 2010 general shareholder meetings, companies had to submit copies of the shareholder meeting convocation notice and any attachments to the exchange for publication on the TSE website. Developing this system has allowed investors to obtain the information contained in the notices sooner than waiting for the hard copy of the notice, ensuring further time for them to make their deliberations.

Figure 46. Schedule of general shareholder meetings and issue of convocation notices

	June 2013	June 2012	June 2011	June 2010	June 2009	June 2008	June 2007	June 2006
Date of Convocation Notice (Av. No. of Days Prior to general shareholder meeting)	19.2	19.3	19.2	19.0	18.4	18.4	18.1	17.9
Av. No. of Days between end of fiscal year and announcement of results	38.0	38.1	39.0	39.0	39.6	39.6	40.3	42.0
% of general shareholder meetings held on peak date (peak date)	41.2% (13/6/27)	41.7% (12/6/28)	41.7% (11/6/29)	43.7% (10/6/29)	50.3% (09/6/26)	49.1% (08/6/27)	53.5% (07/6/28)	56.3% (06/6/29)
% of general shareholder meetings held in peak week (week with the peak day)	75.5%	72.9%	56.9%	45.0%	87.4%	86.7%	78.8%	77.3%

Note: Applies to TOPIX companies (companies posting March results).

Figure 47. Schedule of issue of convocation notices



Note: Applies to TOPIX companies (March results).

3.2.2 Institutional investors' holding structures

Under the Companies Act of Japan, nominal owners are not given legal shareholder rights, such as the right to attend general shareholder meetings etc. In particular, in the event that multiple beneficiary owners use a joint account, the agreement of all such owners is necessary for the nominal owner to be allowed to exercise rights. As a result, there are legal and practical barriers to the exercise of rights by institutional investors. In Japan, there was a case of large-scale pension funds from the Pension Fund Association etc. heading up a lawsuit against Seibu Railway when it was delisted due to a breach of conduct. However, such action by institutional investors is very limited.

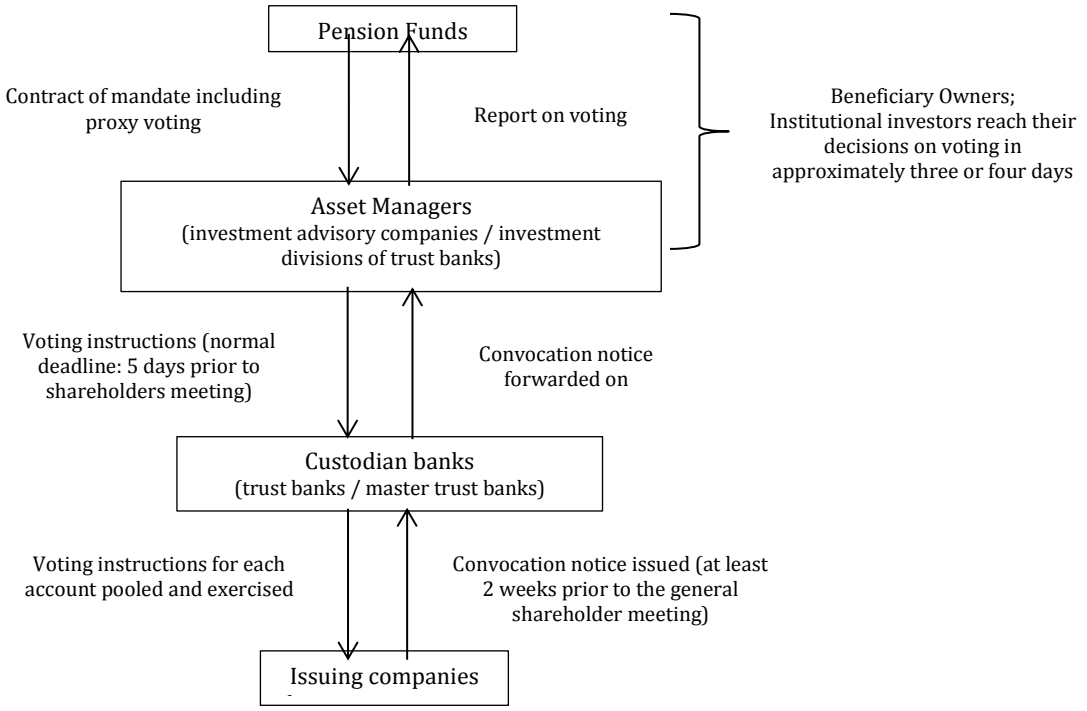
Figure 48 provides an overview of the flow of the exercise of voting rights in Japan's listed companies by Japanese investors. The convocation notices dispatched by the issuing company are sorted by asset management organisations, the shareholders on the register, and forwarded on to the investment trust agencies (management companies such as investment advisory companies etc.) June is the peak time for Japanese companies' general shareholder meetings and it is also a month when asset management organisations are extremely busy with administrative tasks. Also, when schedules span the weekends, the process may take longer. As a result, once the convocation notice has been sent by the issuing company, it may take several days for it to arrive in the hands of the management company that actually makes the voting decisions due to administrative and mailing processes. Many capital sponsors, such as pension funds etc., leave the exercise of voting rights to the discretion of the investment trust agencies. However, some pension funds provide voting criteria and demand that the investment trust agencies vote specifically in accordance with such criteria. The investment trust agencies then report the voting results to the pension funds after the fact. It is investment trust agencies and capital sponsors such as pension funds that constitute the beneficiary owners of listed companies.

Meanwhile, once they have decided how to vote, the beneficiary owners return their instructions to the asset management organisations by the deadline, which is normally about five days before the date of the general shareholder meeting.

In this event, assuming that the company issues the convocation notice two weeks before the general shareholder meeting (in line with the legal deadline), the beneficiary owners may only have a few days to carry out their review of the proposals between receiving the notice and the deadline for their voting instructions. In addition, if any holidays etc. fall during the period in which the owners are reviewing the proposals, this further restricts the time available in terms of business days. As a result, in practice institutional investors often exercise their voting rights under severe time constraints. Moreover, recent years have seen an increase in the number of proposals requiring individual consideration – proposals that are not the run-of-the-mill, such as M&A and takeover defenses or shareholder proposals.

As mentioned above, it was decided to publish convocation notice files on the stock exchange website, starting with the notices for general shareholder meetings held in June 2010. This has made it possible to obtain information earlier than waiting for the convocation notice to be forwarded from asset management organisations, and it is felt that it has vastly improved investor access to information on bill proposals.

Figure 48 Institutional investor voting process in Japan



3.2.3 Electronification of general shareholder meetings

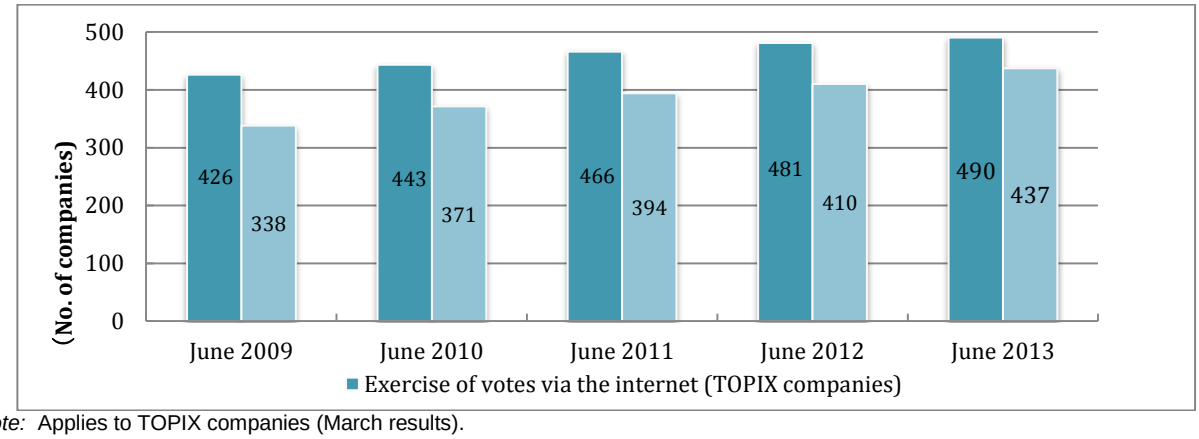
As described earlier, steps are being taken to electronify shareholder meetings, e.g. the disclosure of convocation notices on the stock exchange website etc. Additionally, advances are

also being made in electronic voting, specifically the use of electronic voting platforms and methods of voting via the Internet.

By issuing each shareholder with a user ID and password, it is possible to conduct Internet voting. The principal objective is to extend the methods by which individual shareholders can exercise their votes. As of June 2013, 490 TOPIX companies had adopted Internet voting (Figure 49). However, many companies have found that, in actual fact, the percentage of votes cast via the Internet is not particularly high and in practice the bulk of voting continues to be done in written format, specifically via the use of voting slips.

ICJ Inc. is a joint venture by the Tokyo Stock Exchange, the Japan Securities Dealers Association and Broadridge, a US supplier of operating systems (investment in ICJ: TSE – 50%; Broadridge - 50%) set up to build an electronic voting platform, with issuing companies as its target clients. Its objective is to improve the efficiency and reliability with which institutional investors exercise their votes. For foreign investors in particular, there are various obstacles, time-wise and procedurally, to exercising their votes in Japanese companies. Therefore, such investors will find the ICJ platform very useful, as it allows them to cast their votes via the Internet up until just before the date of the general shareholder meeting, and also allows them to make changes to the content of their votes within the permitted timeframe. As a result, many companies with a high ratio of foreign shareholders are taking part in the initiative; with the number of participating companies standing at 437 as of June 2013 (Figure 49). However, despite an increasing number of companies participating in the platform, at present by no means all companies have adopted its use. As a result, domestic investors still need to exercise their votes in the conventional manner using asset management organisations for those companies that, for whatever reason, are non-participants. Consequently, the use of electronic platforms by domestic investors is a topic for future consideration.

Figure 49 Electronification of general shareholder meetings



Note: Applies to TOPIX companies (March results).

3.2.4 Disclosure of voting results

a) Disclosure of voting results by institutional investor organisations

i. The Investment Trusts Association

Every year, the Investment Trusts Association publishes the findings of its questionnaire on voting results to member investment trust management companies (Figures 50 & 51).

According to the survey, the ratio of opposition votes cast (i.e. the proportion of votes cast against proposals, or abstentions) rose from 15% in 2012 to 16% in 2013. Moreover the ratio of opposition votes on proposals related to retirement benefits shows an upward trend in the years surveyed, with a substantial year-on-year increase from 31% in 2012 to 38% in 2013.

The proportion of votes cast in favour of shareholder proposals related to the disclosure of executive remuneration was high, standing at 45% in 2013. As mentioned earlier, in Japan only executive remuneration of JPY 100 million or more needs to be disclosed in securities reports. However, the high proportion of votes shown in the survey reflects the demands of many shareholders for all, or at least all the main, executives to disclose the amount and breakdown of their remuneration on an individual basis from the perspective of corporate governance.

In terms of the decision-making structure used for general shareholder meeting proposals, a high percentage of those responsible for making the decisions (80%) did so in consideration of in-house voting criteria; while a relatively low percentage (29%) based their decisions on the advice of advisory agencies. This shows that those exercising the votes make decisions at their own discretion, with the help of in-house resources.

Figure 50. Voting results of investment trust management companies (on company proposals)

	For (A)	Against (B)	Abstained (C)	Total "Against" + "Abstained"(D) (B)+(C)	Total No. Proposals(E) (A)+(B)+(C)	Ratio of Opposition Votes (D)/(E)
Allocation of retained earnings	28,479	895	35	930	29,409	3%
Election of Directors	75,298	12,854	65	12,919	88,217	15%
Election of Auditors	23,782	8,279	28	8,307	32,089	26%
Partial Amendments to Articles of Incorporation	11,729	403	20	423	12,152	3%
Payment of Retirement Benefits	2,907	2,188	13	2,201	5,108	43%
Revisions to Executive Remuneration	6,071	371	23	394	6,465	6%
Issue of new share subscriptions rights	2,630	688	17	705	3,335	21%
Appointment of accounting auditors	247	14	0	14	261	5%
Restructuring-related	660	98	0	98	758	13%
Other company proposals	5,292	3,277	18	3,295	8,587	38%
Total	157,095	29,067	219	29,286	186,381	16%

Note: Unit = No. of Proposals.
Source: The Investment Trusts Association "Findings of the Survey on the Voting Results of Investment Trust Management Companies" (October 2013), p.6.

Figure 51. Voting results of investment trust management companies (on shareholder proposals)

	For (A)	Against (B)	Abstained (C)	Total No. Proposals(D) (A)＋(B)＋(C)	Ratio of "For" Votes (A)/(D)
Dividend increases	23	130	3	156	15%
Treasury stock acquisition	13	51	0	64	20%
Disclosure of Executive Remuneration etc.	123	148	3	274	45%
Issues with (Board of) Directors	117	555	7	679	17%
Issues with (Board of) Auditors	2	13	0	15	13%
Reduction in retirement benefits etc.	0	12	0	12	0%
Other – Partial amendments to Articles of Incorporation	158	2,766	14	2,938	5%
Other shareholder proposals	111	585	162	858	13%
Total	547	4260	189	4,996	11%

Note: Unit = No. of Proposals.
Source: The Investment Trusts Association "Findings of the Survey on the Voting Results of Investment Trust Management Companies" (October 2013) , p.7.

Figure 52. Decision-making structures used for general shareholder meeting proposals

The decision maker voted on the basis of in-house criteria	80%
Decisions were reached by setting up a committee for the purpose	51%
The decision maker used the recommendations of advisory agencies	29%
Other	14%

Note: Respondents could give more than one answer.
Source: The Investment Trusts Association "Findings of the Survey on the Voting Results of Investment Trust Management Companies" (October 2013), p.7.

ii. Investment Advisers Association

The Investment Advisers Association also conducts a survey of its members' (investment companies) voting practices (Figures 53 & 54). According to this survey, the bills proposed at general shareholder meetings that had the highest ratio of opposition votes were those concerning (i) payment of retirement benefits – 34.8%; (ii) other company proposals – 33.1%; and (iii) issue of new share subscription rights – 23.6%. The high ratio against retirement benefits is thought to reflect the fact that many investors are opposed to paying such benefits to outside officers. "Other company proposals" may include proposals pertaining to takeover defenses, with the high ratio reflecting the opposition of investors to such defenses.

With regard to shareholder proposals, the ratio of votes in favour of executive remuneration disclosure was 37.5%. As with the Investment Trusts Association, this suggests that many investors are in favor of such proposals, as they improve the transparency of remuneration which is a very important issue in terms of corporate governance.

In 2013, 53% of investors used the services of a proxy voting agency. Of the investment management companies that used such agencies, 63% did so for both domestic and foreign stocks, while 22% only used such services for foreign stocks. The use of proxy voting agencies was down from 2012, when it stood at 62%. The underlying reason for this is that, in Japan, many investment management companies carry out their own voting, and in reality few of them use the recommendations of proxy voting agencies for reference. As a result, the exercise of voting rights has not been outsourced to proxy agencies to any great degree.

Figure 53. Voting results of discretionary investment advisers（company proposals）

	For	Against	Abstained	Carte Blanche	Total	% of "against" & "abstained"
Allocation of retained earnings	16,450	643	21	0	17,114	3.9%
Election of directors	51,570	7,031	133	0	58,734	12.2%
Election of auditors	15,418	4,329	97	0	19,844	22.3%
Partial amendments to Articles of Incorporation	6,874	189	41	0	7,104	3.2%
Payment of retirement benefits	1,912	996	25	0	2,933	34.8%
Revisions to executive remuneration	3,440	190	36	0	3,666	6.2%
Issue of new share subscription rights	1,287	381	16	0	1,684	23.6%
Appointment of accounting auditor	169	4	2	0	175	3.4%
Restructuring-related	404	32	1	0	437	7.6%
Other company proposals	3,164	1,547	15	0	4,726	33.1%
Total	100,688	15,342	387	0	116,417	13.5%

Note: Unit = No. of Proposals.
Source: Investment Advisers Association "Questionnaire on Voting Instructions pertaining to Discretionary Investment Contracts" (September 2013) , p.1.

Figure 54. Voting results of discretionary investment advisers (shareholder proposals)

	For	Against	Abstained	Carte Blanche	Total	% of "against" & "abstained"
Allocation of retained earnings	11	116	2	0	129	8.5%
Acquisition of Treasury Stock	10	43	0	0	53	18.9%
Disclosure of executive remuneration etc.	63	103	2	0	168	37.5%
Issues with (Board of) Directors	66	445	3	0	514	12.8%
Issues with (Board of) Auditors	3	11	0	0	14	21.4%
Reductions in retirement benefits etc.	0	7	0	0	7	0.0%
Other	176	2,052	0	0	2,240	7.9%
Total	329	2,777	19	0	3,125	10.5%

Note: Unit = No. of Proposals.
Source: Investment Advisers Association "Questionnaire on Voting Instructions pertaining to Discretionary Investment Contracts" (September 2013) , p.3.

Figure 55. Use of proxy voting agencies:

Q1. Have you used proxy agencies in connection with voting instructions?

	No. Companies Responding in 2013: 78	No. Companies Responding in 2012: 69
Yes we have used them	41 （53%）	43（62%）
No we have not used them	37（47%）	26（38%）
○We intend to use them in future	1	0
○We are currently investigating their future use	2	1
○We have no plans to use them in future	34	25

Q2. If you answered "Yes we have used them" in response to Q1, did you use the proxy agency for domestic stocks, or foreign stocks?

	No. Companies Responding in 2013: 41	No. Companies Responding in 2013: 43
Both domestic and foreign stock	26（63%）	22（51%）
Domestic stock only	6（15%）	10（23%）
Foreign stock only	9（22%）	11（26%）

Note: Unit = No. of Companies
Source: Investment Advisers Association "Questionnaire on Voting Instructions pertaining to Discretionary Investment Contracts" (September 2013), p.4.

b) Analysis of the disclosure of voting results by companies

i. The percentage of votes exercised at general shareholder meetings

The following is an analysis of general shareholder meeting results conducted using the information disclosed in companies' extraordinary reports (applying to NIKKEI 225 companies.) Figure 56 puts the average number of votes exercised at general shareholder meetings at around 75%, which is almost equal with the figure obtained by subtracting the percentage of individual shareholders. A high percentage of institutional investors tend to exercise their voting rights in light of their fiduciary responsibilities, and corporate investors are often shareholders with a close connection to the investee in terms of cross-shareholdings and capital ties; for this reason they always exercise their votes. However, it has been pointed out that, in general, individual shareholders often tend not to exercise their votes.

These tendencies are more markedly expressed in Figure 57. The percentage of votes exercised is high amongst parent companies and companies that form the main shareholders. On the other hand, when the ratio of individual shareholders is high, the proportion of votes exercised tends to be low, even if the ratio of foreign shareholders is high.

Figure 56. Average exercise ratios of voting rights

		2013	2012	2011	2010
Average Exercise Ratio（%）		75.7	75.3	75.3	74.9
Shareholder Composition （%）	Other Corporates	13.9	13.8	14.0	15.0
	Financial Institutions	33.5	35.0	34.8	35.3
	Foreign Shareholders	26.2	24.9	25.4	24.0
	Individual Shareholders (Other)	23.0	22.8	22.5	22.5

Note 1: Applies to companies on the NIKKEI 225 average stock price index (225 companies).
Note 2: Figures for 2010 apply only to NIKKEI 225 companies posting March results.
Source: Tatsuya Furukawa "An Analysis of Voting Results at 2013 General Shareholder Meetings - Focusing on Institutional Investors' Trends." Capital Market Research Issue Vol. 29 (2013).

Figure 57. Exercise of voting rights at general shareholder meetings
Top 10 companies & bottom 10 companies

Top 10 Companies in terms of Ratio of Votes Exercised (%)

No	Ticker	Company Name	Sector	Exercise Ratio	Shareholder Composition				Parent Company/Controlling Shareholder
					Other Incorporates	Financial Institution	Foreign Shareholders	Individual Shareholders	
1	4689	Yahoo Japan	Service	92.6	42.7	5.3	46.0	5.7	Yes
2	8729	Sony Financial Holdings	Insurance	91.2	60.2	11.0	24.5	3.4	Yes
3	4519	Chuugai Pharmaceuticals	Pharmaceuticals	88.8	1.1	10.9	76.0	9.5	Yes
4	1605	Inpex Corporation	Mining	88.8	19.7	15.3	41.8	3.3	
5	7205	Hino Motors	Automotive	88.4	58.5	17.8	16.4	5.5	Yes
6	9437	NTT DoCoMo	Communications	88.3	64.5	9.0	12.5	12.7	Yes
7	7269	Suzuki	Automotive	88.1	13.5	31.4	48.6	5.1	
8	9412	Sky Perfect JSAT Holdings	Communications	87.8	50.2	23.8	13.6	11.7	
9	2914	Japan Tobacco Inc.	Foodstuffs	87.4	1.1	15.0	33.5	15.9	
10	6902	Denso	Electrical Equipment	87.2	36.8	20.6	23.1	18.4	

Bottom 10 companies in terms of ratio of votes exercised (%)

No	Ticker	Company	Sector	Exercise Ratio	Shareholder Composition				Parent Company/Controlling Shareholder
					Other Incorporates	Financial Institution	Foreign Shareholders	Individual Shareholders	
1	5202	Nippon Sheet Glass	Ceramics	51.1	5.1	20.0	22.2	49.3	
2	9202	ANA Holdings	Air Line	54.1	13.3	19.0	7.1	60.1	
3	6767	Mitsumi Electric	Electrical Equipment	56.8	0.9	33.9	28.5	29.0	
4	3103	Unitika	Textiles	58.0	3.9	24.6	11.0	57.6	
5	6773	Pioneer	Electrical Equipment	59.5	18.4	25.3	17.8	33.6	
6	6758	Sony	Electrical Equipment	59.9	3.4	22.9	32.7	38.2	
7	6703	Oki Electric Industry	Electrical Equipment	60.0	4.8	25.1	12.6	51.0	
8	8604	Nomura Holdings	Securities	60.0	5.4	20.6	33.2	37.9	
9	6701	NEC	Electrical Equipment	60.8	3.8	25.8	25.2	42.3	
10	8411	Mizuho Financial Group	Banking	63.8	12.6	26.5	22.3	33.2	

Note: Applies to companies on the NIKKEI 225 average stock price index (225 companies).

ii. Voting results by category of proposal

According to the breakdown of voting results by category of proposal (Figure 58), the category with the highest ratio of opposition votes was "introduction of takeover defenses" at 29.3%, followed by "payment of retirement benefits" at 15.6%. Takeover defenses were voted against by virtually all institutional investors, both domestic and foreign, accounting for the high opposition ratio. In addition, the fact that the opposition ratio was over 40% in some companies indicates significant shareholder opposition to takeover defenses (Figure 59).

With regard to retirement benefits, many institutional investors oppose payments to outside officers.

At 11.9%, the highest ratio of votes against the election of officials was against outside auditors. This is due to the fact that many investors scrutinise the independence of outside auditors, as the employment of such auditors is a mandatory requirement for companies with a board of company auditors.

Figure 58. Breakdown of opposition votes by category of proposal

	No. of Proposing Companies		No. of Proposals / No. of Elections		Average Ratio of Opposition Votes (%)	
	2013	2012	2013	2012	2013	2012
Allocation of Retained Earnings	170	168	170	169	1.0	0.8
Election of Directors (internal)	219	214	1,743	1,806	3.1	3.2
Election of Directors (outside)	192	163	470	431	5.1	5.1
Election of Auditors (internal)	79	109	86	133	3.3	2.3
Election of Auditors (outside)	100	128	140	195	11.9	10.3
Partial amendments to Articles of Incorporation	52	54	54	55	0.7	1.3
Payment of retirement benefits	10	11	14	12	15.6	18.6
Revisions to amount of executive remuneration	21	28	22	29	4.2	6.8
Issue of new share subscription rights	10	12	10	12	3.0	3.2
Restructuring-related	2	10	2	12	0.2	1.4
Other company proposals	8	6	9	6	3.7	0.9

Payment of executive salaries	47	48	47	48	3.0	2.8
Appointment of substitute auditor (internal)	3	5	3	5	3.0	2.8
Appointment of substitute auditor (outside)	49	43	49	43	3.6	4.6
Introduction of takeover defenses	28	16	28	16	29.3	26.2
Acquisition of treasury stock	1	0	1	0	0.8	―

Note: Applies to companies on the NIKKEI 225 average stock price index (225 companies).
Source: Tatsuya Furukawa "An Analysis of Voting Results at 2013 General Shareholder Meetings - Focusing on Institutional Investors' Trends." Capital Market Research Issue Vol. 29 (2013).

Figure 59. Companies with a significant percentage of votes against proposals related to takeover defenses

Ticker	Company	Sector	For (%)	Against (%)	Foreign Ownership (%)
4063	Shinetsu Chemical Co.	Chemicals	56.9	43.0	41.4
8802	Mitsubishi Estate	Real Estate	59.6	40.2	44.5
8830	Sumitomo Realty & Development	Real Estate	60.1	39.9	35.6
2871	Nichirei	Foodstuffs	62.7	35.5	16.6
7911	Toppan Printing	Other Manufacturing	63.7	35.1	17.6
4183	Mitsui Chemicals	Chemicals	63.9	35.1	30.6
9766	Konami	Service	65.0	34.7	32.9
5713	Sumitomo Metal Mining	Non-ferrous products	64.7	34.0	30.6
2282	Nippon Meatpackers	Foodstuffs	67.2	32.8	23.0
7951	Yamaha	Other Manufacturing	66.6	32.6	26.5
7733	Olympus	Precision equipment	66.9	32.5	33.9
5541	Pacific Metals	Iron & steel	68.6	31.4	20.7
6674	GS Yuasa Corporation	Electrical equipment	69.5	30.6	12.4
7762	Citizen Holdings	Precision equipment	69.2	30.5	24.4
9009	Keisei Electric Railway	Rail & bus	67.6	30.5	17.0
8803	Heiwa Real Estate	Real Estate	68.9	29.7	22.9
5711	Mitsubishi Materials	Non-ferrous products	68.9	29.1	20.6
7912	Dai Nippon Printing	Other Manufacturing	70.3	29.0	21.2
5801	Furukawa Electric Co.	Non-ferrous products	72.8	26.5	14.9
5332	TOTO	Ceramics	73.9	25.8	22.0
5411	JFE Holdings	Iron & Steel	75.1	23.6	20.7
3864	Mitsubishi Paper Mills	Pulp & paper	75.5	22.2	9.5
5703	Nippon Light Metal Holdings	Non-ferrous products	77.9	21.5	11.2
3865	Hokuetsu Kishu Paper	Pulp & paper	78.8	20.5	11.0
9008	Keio Electric Railway	Rail & bus	77.1	20.0	13.5
2531	Takara Holdings	Foodstuffs	74.3	19.3	9.1
5406	Kobe Steel	Iron & steel	79.3	17.5	15.0
2801	Kikkoman	Foodstuffs	82.2	16.6	14.1

Note: Applies to companies on the NIKKEI 225 average stock price index (225 companies).
Source: Tatsuya Furukawa "An Analysis of Voting Results at 2013 General Shareholder Meetings - Focusing on Institutional Investors' Trends.", Capital Market Research Issue Vol. 29 (2013).

There is a strong tendency for the ratio of opposition votes to increase for outside director/outside auditor election proposals if the question of independence is in doubt. Figures 60 and 61 analyse the relationship between these ratios and issues of independence for outside directors and outside auditors respectively. Of the two types of officer, outside auditors have the higher ratio of opposition votes. Presumably this is due to the fact that many investors analyse this issue in detail when voting, as it is a mandatory requirement for companies with boards of auditors to employ outside auditors. Moreover, for both outside directors and outside auditors, opposition rates are higher for candidates with business ties or from the ranks of major shareholders than for other candidates. This reflects the large number of investors who take into account the issue of independence when casting their votes on election proposals for outside directors/auditors.

Meanwhile, opposition rates are low for independent officials who have been registered with the Tokyo Stock Exchange. This suggests that, with regard to the independence of outside

directors/auditors, investors show respect for companies that have registered outside directors and auditors with the Tokyo Stock Exchange and reflect this respect in the exercise of their votes.

Figure 60. Independence of outside directors and rates of opposition

Business Ties (%)	2013	2012
With ties	7.8	8.9
Without ties	3.5	3.2
All Proposals	5.1	5.1
Highest rate of opposition for those “with ties.”	30.0	32.3

Originating from ranks of major shareholders	2013	2012
Applicable	8.7	9.9
Not applicable	4.0	3.8
All Proposals	5.1	5.1
Highest Rate of opposition for those “applicable”	29.6	41.0

TSE Registered Independent Officials	2013	2012
Not registered	10.9	8.7
Registered	4.1	4.4
All Proposals	5.1	5.1

(%)

Note: Applies to companies on the NIKKEI 225 average stock price index (225 companies).
Source: Tatsuya Furukawa "An Analysis of Voting Results at 2013 General Shareholder Meetings - Focusing on Institutional Investors' Trends.", Capital Market Research Issue Vol. 29 (2013).

Figure 61. Independence of outside auditors and rates of opposition

Business Ties (%)	2013	2012
With ties	20.9	17.3
Without ties	5.4	4.9
All Proposals	11.9	10.7
Highest rate of opposition for those “with ties.”	41.2	39.2

Originating from ranks of major shareholders	2013	2012
Applicable	23.4	21.1
Not applicable	7.8	6.7
All Proposals	11.9	10.7
Highest Rate of opposition for those “applicable”	41.2	36.3

TSE Registered Independent Officials	2013	2012
Not registered	18.1	13.6
Registered	9.9	9.6
All Proposals	11.9	10.7

(%)

Note: Applies to companies on the NIKKEI 225 average stock price index (225 companies).
Source: Tatsuya Furukawa "An Analysis of Voting Results at 2013 General Shareholder Meetings - Focusing on Institutional Investors' Trends.", Capital Market Research Issue Vol. 29 (2013).

CONCLUSION

Japan is approaching a crucial period as the country continues to reform its institutions and practices with regard to the issue of corporate governance.

On the institutional front, in March 2010 amendments to the Cabinet Office Ordinance on Disclosure of Corporate Information etc. enhanced the disclosure of issues related to corporate governance such as executive remuneration and voting results. November 2013 saw a bill for partial amendment of the Companies Act submitted to parliament that included issues related to corporate governance such as stricter requirements for outside directors and multiple derivative law suits. The bill was approved in June 2014 and most of the provisions related to corporate governance will come into force in 2015.

The Japanese version of the Stewardship Code was published in February 2014; it clarifies stewardship responsibilities and expands on the procedures to be used in the disclosure of voting policies and results, which have conventionally been handled under individual initiatives in the asset management sector.

In practical terms, Japanese companies are expected to address the demands of institutional investors to the best of abilities within the existing institutional framework. These demands include the structure of boards of directors, the design of executive remuneration packages, and the operation of general meetings of shareholders. This is also supported by the data examined in this paper, which relates to corporate governance over the past 10 years or so. In particular, there is an institutional issue that is a unique characteristic of Japan's corporate governance; namely that the system of company auditor boards used by most companies does not mandate the employment of outside directors. However, the majority of listed companies have made voluntary efforts to employ outside directors, also taking into consideration the issue of independence. It seems that with the globalisation of the business environment and the financial markets, an increasing number of companies are voluntarily and earnestly engaging in issues of corporate governance.

In institutional terms, as well as from a practical perspective, Japanese companies are putting their own take on the board of directors, the most important institution in corporate governance, enhancing the board's function by incorporating the best aspects of a one-tier system into the traditional two-tier system of company auditors.

In addition, institutional investors have become much more involved in issues of corporate governance. Since 2010 most of Japan's institutional investors have disclosed their voting policies and results, and many investors reach their voting decisions in-house rather than delegating the responsibility to outside agencies. In many cases, asset managers are already applying the majority of the principles in Japan’s Stewardship Code in practice.

Japan hopes to further develop its institutions and environment, reform its companies and encourage more investor activity, using improvements in corporate governance to promote sustainable growth in Japanese companies and expand growth in the Japanese economy as a whole.

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