

May 7, 2021

Institutional Investors Collective Engagement Forum

## Comments on the “Corporate Governance Code” (Draft Revision)

We submitted the following comments to the Tokyo Stock Exchange in response to its request for public comments on the draft revision of Japan’s Corporate Governance Code.

### Introduction

We understand that the draft revision of Japan’s Corporate Governance Code (hereinafter the “CG Code”) announced on April 8, 2021 includes a number of revisions that will contribute to the enhancement of corporate value in many aspects, based on changes in the international capital markets in recent years. These revisions aim, among others, to strengthen corporate initiatives for sustainability and their disclosure, to strengthen the functions of the board, to ensure diversity among core human resources of companies, and to promote constructive dialogue with shareholders in tandem with the revision of the Guidelines for Investor and Company Engagement. As a forum for institutional investors that engage in dialogue with companies, we support the goals that the CG Code intends to achieve.

In particular, the revision requires a higher governance discipline for the Prime Market, which is a new market category scheduled to start operation in April 2022 comprised of leading and first-class Japanese companies, aiming to make it an attractive market from an international perspective. In this respect, we believe that investors also have a high hope for the revision.

As above, we support the proposed draft revision of the CG Code as a whole. At the same time, we make the following comments to express institutional investors’ opinions and requests to further enhance corporate governance:

[Regarding Supplementary Principle 1.1.1] We request that the following paragraphs be added: “...should consider and disclose the need for shareholder dialogue and other measures. In additions, the board of a company that has a controlling shareholder should conduct the same analysis on the votes cast against a proposal by general (minority) shareholders excluding shares held by the controlling shareholder and should disclose whether there is a need for such measures.”

<Reason> Most companies claim that they comply with this principle, but few companies explain to shareholders about specific contents of their analysis or policies on their measures. We request that “disclosure” be added to the principle because we believe that it is an important first step of dialogue

with shareholders to disclose and explain results of analysis on proposals voted against by many shareholders in CG Report or elsewhere.

In addition, it is extremely important from the governance perspective for a company that has a controlling shareholder to actively engage in dialogue with general (minority) shareholders based on voting results of general (minority) shareholders other than controlling shareholders.

[Regarding Supplementary Principle 1.2.4] ~~“Bearing in mind the number of institutional and foreign shareholders, companies should take steps for the creation of an infrastructure allowing electronic voting, including the use of the Electronic Voting Platform, and the provision of English translations of the convening notices of general shareholder meeting...”~~

<Reason> We support the proposed revision to include a specific reference to the promotion of the use of the Electronic Voting Platform by companies to be listed on the Prime Market. However, as long as there are some listed companies not participating in the Electronic Voting Platform, institutional investors will continue to have to handle their administrative work in two different manners. Therefore, we expect that the Electronic Voting Platform will be made available for use for all listed companies. For this reason, we recommend that the phrase “Bearing in mind the number of institutional and foreign shareholders” be deleted from this principle to clearly indicate that all listed companies should strive to make electronic voting available to investors. In addition, we recommend that the provision of this principle about the English translation of convocation notices either be moved to Supplementary Principle 3.1.2 or be a separate principle as Supplementary Principle 1.2.5 (and the current 1.2.5 be changed to 1.2.6).

[Regarding Principle 1.4 Cross-Shareholdings] We request that “When the board has approved a plan to reduce cross-shareholdings, companies should promptly disclose it.” be added to this principle. We also request that the phrase “benefits and” be deleted from “...whether the purpose is appropriate and whether the ~~benefits and~~ risks from each holding...” and “it is inappropriate to require shareholdings as a condition for a commercial relationship” be added to this principle.

<Reason> As companies’ understanding and efforts on cross-shareholdings have been quite insufficient, we believe that it is necessary to revise the CG Code in a manner to further clarify its position on this matter.

First, given the current situation in which there are only a very few companies that disclose specific plans to reduce cross-shareholdings, investors would be able to ascertain the attitude of each company if it discloses a specific plans to reduce cross-shareholdings when the plan is approved by the board. Investors would also be able to surmise that a company without such disclosure has not formulated a specific plan and measures to reduce cross-shareholdings. This is expected to promote dialogue between companies and investors.

Next, regarding the holding purpose, Supplementary Principle 1.4.1 states that “...should not imply a possible reduction of business transactions when cross-shareholders indicate their intention to sell their shares.” Therefore, such a wording as “maintaining and strengthening the commercial relationship” presented by many companies as a reason for cross-holdings, i.e., the reason that shareholdings would strengthen the commercial relationship is clearly inconsistent with the spirit of Supplementary Principle 1.4.1. This should be expressly stated in Principle 1.4. Furthermore, as the notion that cross-shareholdings bring some “benefits” beyond ordinary shareholder rights contradicts the principle of “securing equal treatment of shareholders” set forth in General Principle 1, the use of the word “benefits” itself is inappropriate.

[Regarding Supplementary Principle 4.8.3] We request that it be modified as follows: “...appoint at least ~~one-third of their directors~~ (the majority of directors if listed on the Prime Market).”

<Reason> We support the idea that the CG Code requires higher discipline if both the parent company and its subsidiary are listed or if there is a controlling shareholder (holding 30% or more). There is no reason why the discipline applicable to a company with a controlling shareholder should distinguish between the Prime Market and the Standard Market because the controlling shareholder is often listed on the Prime Market. Therefore, we request that this Supplementary Principle be modified to require that the percentage of outside directors be more than 50% regardless of the market on which the company is listed.

[Regarding Supplementary Principle 4.11.1] We request that this Supplementary Principle be modified to “... When doing so, it is desirable for the board to include, for example, directors with management experience in other companies, those with knowledge of capital markets, and those with knowledge of latest technologies among independent directors.”

<Reason> We support the efforts to increase diversity among board members. In this context, it somewhat lacks a healthy balance to stipulate, in particular, that “director(s) with management experience in other companies should be included.” We understand that the purpose of the CG Code is to enhance corporate governance through dialogue with shareholders and other stakeholders and thereby to promote corporate management based on cost of capital. However, given that there were corporate executives in the past in Japan who did not consider the interest of shareholders and other stakeholders adequately, only stating inclusion of “management experience in other companies” as the ~~only~~ requirement could lead to such results that are not intended by the CG Code. Therefore, as shown above, we propose to add other requirements that are particularly expected as skills of future director candidates.

[Regarding Supplementary Principle 5.1.2] In view of Japan’s Stewardship Code Guidance 4-5 stating

that “it would be beneficial for them to engage with investee companies in collaboration with other institutional investors (collaborative engagement) as necessary,” we propose that “collaborative dialogue” be added to Supplementary Principle 5.1.2 iii) so that it is changed to “Measures to promote opportunities for dialogue aside from individual meetings and collaborative dialogue (e.g., general investor meetings and other IR activities)” in order to indicate that collaborative dialogue with shareholders is a beneficial means of dialogue also in the CG Code.

[Regarding Relationship between the CG Code and the Engagement Guidelines]

The proposed revision includes not only revisions to the CG Code, but also important revisions to the Guidelines for Investor and Company Engagement (hereinafter the “Engagement Guidelines”). The Engagement Guidelines “are intended to be a supplemental document to the Stewardship Code and the Corporate Governance Code,” and companies “are expected to consider the contents of the Guidelines” when they comply with a principle of the CG Code.

However, there is a risk that many companies and investors will not pay much attention to the revision of the Engagement Guidelines. Therefore, we request that the authorities provide such disclosure, explanation, and public relations that help them to understand the relationship between the CG Code and the Engagement Guidelines and that the items stipulated in the Engagement Guidelines are also what listed companies are expected to achieve.

[Regarding Disclosure Rules for CG Report]

Sufficient information disclosure is a prerequisite for dialogue between a company and its shareholders and investors. Investors want companies to disclose and explain how they are implementing specifically the governance principles with which they claim to comply. On the other hand, as the items that should be disclosed in CG Report are exhaustively prescribed, most companies currently understand that it suffices to disclose these prescribed items.

For this reason, we request that the Tokyo Stock Exchange send a message to the effect that “there is no problem if a company discloses and explains its efforts regarding not only the prescribed 11 items, but also other principles, and doing so is rather desirable in promoting dialogue with investors.”

[Regarding the scope of Material Proposals (Act of making important proposal) by a shareholder]

Lastly, for the effective instillation of the revised CG Code, the enhancement of dialogue between companies and investors would be indispensable. In engaging in such dialogue, large Japanese and foreign institutional investors that engage in collaborative dialogue and passive investment, in particular, have raised strong concerns in relation to the large shareholding reporting system that the scope of Material Proposal is unclear. If an investor makes a direct proposal for improvement to a

company whose governance awareness is insufficient, there is a risk that such a proposal will be regarded as a Material Proposal. As long as such a risk remains, investors' proposals would only result in ambiguous suggestions, which would limit the effectiveness of engagement.

We request that the scope of Material Proposal be clarified by stipulating, for example, that when an investor who clearly does not intend to acquire a controlling interest in a company, such as passive investor, refers to matters generally expected by investors from investees (e.g., better capital efficiency and improvement of corporate governance structure) in the course of dialogue, such a reference would not fall under Material Proposal. We strongly request that this point be taken into consideration.

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