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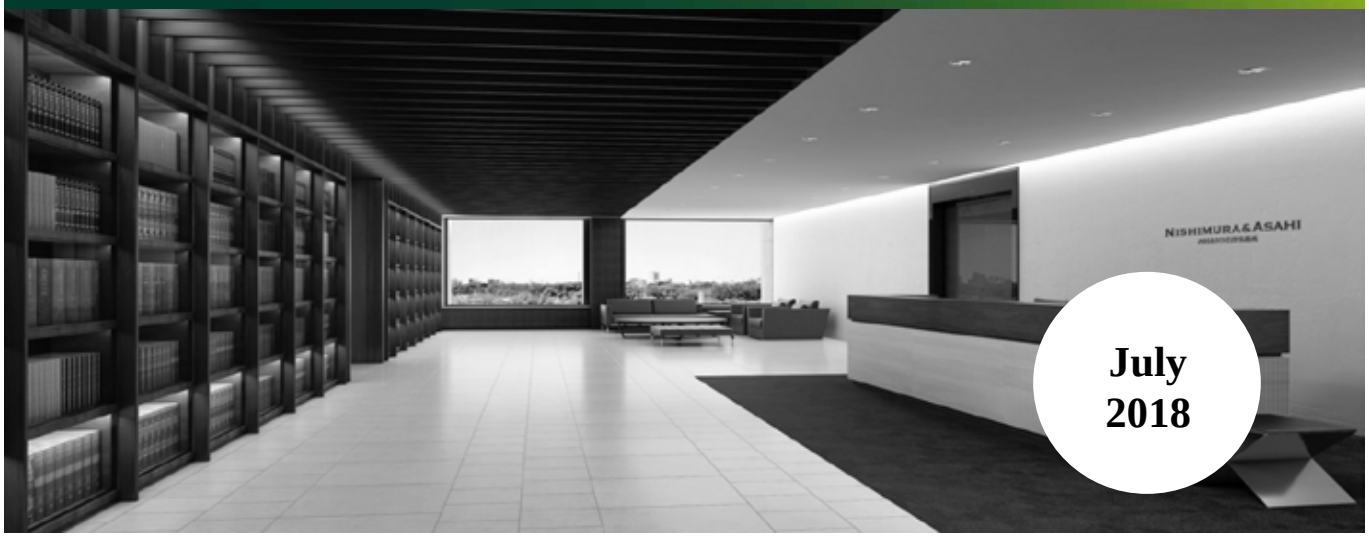

The Revision of the Corporate Governance Code and the Establishment of the Engagement Guidelines — Based on the Answers to the Public Comments

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1. Introduction

In response to the proposition in the "Council of Experts Concerning the Follow-up of Japan's Stewardship Code and Japan's Corporate Governance Code," in which the Financial Service Agency and the Tokyo Stock Exchange are the secretariats (the "**Follow-up Council Meeting**"), and in order to deepen the corporate governance reform more substantially through dialogue between companies and investors, the Tokyo Stock Exchange revised the Corporate Governance Code as of June 1, 2018 (the Corporate Governance Code after the revision referred to as the "**Revised Code**"), and the Financial Services Agency newly formulated the "Guidelines for Investor and Company Engagement" (the "**Engagement GL**") as of the same date.

Each of the original draft of the Revised Code and the Engagement GL was published late in March 2018[1], the details of which we discussed in the Financial Regulation Newsletter published in April 2018[2], and were both finalized with details nearly the same as the original draft, after receiving public comments. The only matter that was amended was in the "Notes" in the beginning of "Section 3 Ensuring Appropriate Information Disclosure and Transparency" of the Revised Code, namely, "financial standing, business strategies, risks, and ESG

[1] After the original draft of the Engagement Guidelines was published on March 26, 2018, the original draft of the Revised Code was published on March 30, 2018.

[2] https://www.jurists.co.jp/sites/default/files/news_pdf/en/newsletter_en_201804_finance.pdf

(environmental, social and governance) matters" are added as examples of "non-financial information" that is noted as "often boiler-plate and lacking in detail, therefore less valuable." As such, the Code Revision Draft clarifies that information including ESG matters should be appropriately disclosed and proactive provision of information should be carried out (Public Comment Answers for the Code: No. 295 to 303, Public Comment Answers for the Engagement GL: No. 149 and 150).

In this issue, we summarize the points to consider in practice focusing on the ideas relating to the public comments of the Tokyo Stock Exchange[3] (the "**Public Comment Answers for the Code**") and of the Financial Services Agency[4] (the "**Public Comment Answers for the Engagement GL**"; together with the Public Comment Answers for the Code, the "**Public Comment Answers**").

2. General Revision of the Corporate Governance Code — Position of the Governance Report and the Engagement Guidelines

(1) Governance Report

Listed companies are required to submit the Report Concerning Corporate Governance that describes the matters in relation to the Revised Code (including the reasons for not complying with each principle of the Revised Code) (Rule 419, Item 1 of the Securities Listing Regulations, the "**Governance Report**") "immediately after the preparation of the revised version thereof, but no later than the end of December 2018" (Supplementary Provisions of the Securities Listing Regulations).

Major Public Comment Answers regarding the Governance Report are as follows:

(i) If it is difficult to comply with each principle of the Revised Code by the end of December 2018, although the company intends to do so, a possible solution is to include the schedule of implementation activities in the future and the outlook of the timing of the implementation in the explanation of "non-compliance with each principle of the Revised Code" in the Governance Report (see Public Comment Answers for the Code: No. 20 to 22, Public Comment Answers for the Engagement GL: No. 17).

(ii) If any change has occurred in the information in the Governance Report by the end of December 2018, it would be also acceptable to submit a report pursuant to the old Code (Public Comment Answers for the Code: No. 23). However, from the perspective of consideration for the investors, when renewing the Governance Report, whether the description is based on either of the old or new code expected to be specified (Public Comment Answers for the Code: No. 24).

(iii) Regarding the idea that there are cases where companies proactively explain the reason why they do not comply with a certain principle and that these kinds of explanatory efforts are preferable to superficial compliance

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[3] The English version is not available as of July 19, 2018. While the Japanese original can be viewed via the following link: https://www.jpx.co.jp/rules-participants/public-comment/detail/d1/nlsgeu0000031fnd-att/nlsgeu0000034w98.pdf

[4] The English version is not available as of July 19, 2018. While the Japanese original can be viewed via the following link: https://www.fsa.go.jp/news/30/singi/20180601/02.pdf

(Responses to the Council of Experts Concerning the Follow-Up No. 1 published as of October 20, 2015), the Tokyo Stock Exchange will make efforts to broadly publicize the idea to deepen the understanding of both listed companies and investors (Public Comment Answers for the Code: No. 27).

(2) Position of the Engagement GL

The Engagement GL provides agenda items for engagement that institutional investors and companies are expected to focus on.

The Engagement GL is positioned as a "supplemental document" of the Corporate Governance Code and the Stewardship Code, and the Engagement GL itself would not require companies and institutional investors to take any measures to comply therewith or explain the reasons for non-compliance.

The summary of major Public Comment Answers regarding the position and usage of the Engagement GL and the description in the Engagement GL is as follows:

(i) companies are expected to consider the contents of the Engagement GL when they comply with any principles of the Corporate Governance Code, including principles calling for disclosure, or, if not, explain the reasons why they are not doing so (introduction of the Engagement GL, Public Comment Answers for the Code: No. 25, Public Comment Answers for the Engagement GL: No. 11 to 13);

(ii) in order to enhance constructive engagement between institutional investors and companies, even when a company complies with a principle, it is beneficial for the company to proactively explain its specific implementation activities (introduction of the Engagement GL and footnote 1); and

(iii) it is not appropriate to use the Engagement GL's agenda as a mechanical checklist, and it is important to have "effective engagement" that takes into consideration each company's specific circumstances and corporate group status (introduction of the Engagement GL and footnote 2, and Public Comment Answers for the Engagement GL: No. 16).

3. Management Decisions in Response to Changes in the Business Environment and Investment Strategy and Financial Management Policy

(1) Formulation and disclosing of business strategies and business plans: Principle 5.2 — accurate identification of the "cost of capital"

In the Corporate Governance Code, business strategies and business plans have been the subjects of disclosure in **Principle 3.1 (i)**; in **Principle 5.2** in the Revised Code, it was clarified that establishing and disclosing business strategies and business plans should be carried out after "accurately identifying the company's cost of capital." The emphasis on the "cost of capital" is one of the notable characteristics in the Revised Code and the Engagement GL, and there were many public comments, including the concept and calculation method thereof.

In the Public Comment Answers, the "cost of capital" is "generally the cost along with fund-raising fairly reflecting the business risk of the company, and considered as the rate of return expected by the provider of the fund," and explained that "cost of shareholders' equity and WACC (weighted average cost of capital)" are often used,

depending on each case (Public Comment Answers for the Code: No. 35, Public Comment Answers for the Engagement GL: No. 18 and 19).

Also, while **Principle 5.2** in the Revised Code does not require disclosure of the numerical values of the cost of capital themselves, based on the Engagement GL 1.2, in "setting targets on profitability and capital efficiency" it is required to clearly explain to the investors the company's idea regarding the cost of capital and the usage thereof in the business management (Public Comment Answers for the Code: No. 35 and 36, Public Comment Answers for the Engagement GL: No. 18 to 23).

(2) Investment strategy and financial management policy: Principle 5.2 — "Basic Strategy for Capital Policy" and "Allocation of Management Resources"

In relation to the "Basic Strategy for Capital Policy" that has been required to be disclosed in **Principle 5.2** from the previous version, the Public Comment Answers states that the "capital policy" largely refers to the policy for maintenance of capital, such as procuring capital and liabilities necessary for the listed company to perform its business, returns to shareholders, ratio of capital and liabilities, and measures therefor, including, for example, target leverage and investment plans for procuring capital (Public Comment Answers for the Code: No. 37 and 38).

Additionally, it was clarified that in the Revised Code "the allocation of management resources," which has also been required to be explained in **Principle 5.2** from the previous version, includes "reviewing their business portfolio and investments in fixed assets, R&D, and human resources" (Public Comment Answers for the Code: No. 31 to 34, Public Comment Answers for the Engagement GL: No. 18 to 23).

4. Appointment/Dismissal of the CEO and Responsibilities of the Board

(1) Appointment/dismissal of the CEO and succession plan

The major points of the Revised Code and the Public Comment Answers regarding appointment/dismissal of the CEO and the succession plan are as follows.

Subjects of disclosure

Explanations for "policies and procedures in the appointment of the senior management" and "individual appointments" have been the subjects of disclosure, but in the Revised Code, "appointment" is amended to "appointment/dismissal" and dismissal is also required to be a subject for disclosure (Principle 3.1 (iv) and (v)).

Responsibilities of the board regarding appointment/dismissal of the CEO

Supplementary Principles regarding roles and responsibilities of the board are newly established, and the board should appoint a qualified CEO through "objective, timely, and transparent procedures", deploying sufficient time and resources (Supplementary Principle 4.3.2).

Additionally, it is provided that "objective, timely, and transparent procedures" should be established such that a

CEO is dismissed when it is determined that the CEO is not adequately fulfilling the CEO's responsibilities (Supplementary Principle 4.3.3)[5].

(i) "[O]bjective, timely, and transparent procedures" are, for example, denying an appointment of a CEO through "unclear procedures that only prioritize internal ethics" (Public Comment Answers for the Code: No. 56 and 57): "timely" includes flexibly appointing a new CEO depending on the situation (Public Comment Answers for the Code: No. 54 and 57) and making it possible to flexibly dismiss a CEO without rigid procedures (Public Comment Answers for the Code: No. 58 to 60, Public Comment Answers for the Engagement GL: No. 42 to 44 and 49 to 54).

(ii) In appointment/dismissal of a CEO through such procedures, the policy on CEO qualifications is required to be clarified. Further, it is desirable to review such policy on qualifications as occasion demands through the procedures of appointment/dismissal of a CEO, based on the change in the business environment, etc. (Public Comment Answers for the Code: No. 53, Public Comment Answers for the Engagement GL: No. 35 to 41)

Roles and responsibilities of the board regarding succession plan for the CEO

The board should "proactively engage" in the establishment and implementation of "a succession plan for the CEO and other top executives" and "appropriately oversee" the systematic development of succession candidates, deploying sufficient time and resources (Supplementary Principle 4.1.3).

(i) Regarding the board "proactively engag[ing]" in the establishment and implementation of a succession plan, there were several critical and skeptical opinions in the procedure of the public comments; however, in the Public Comment Answers, it was emphasized that it was pointed out in the Follow-up Council Meeting that a succession plan for the CEO is particularly important to realize sustainable growth and mid- and long-term increase in corporate value of a listed company, and it is explained that, for example, "not leaving it to the discretion of the current CEO" but the board's proactive engagement is required (Public Comment Answers for the Code: No. 65 to 67, Public Comment Answers for the Engagement GL: No. 45 and 46).

(ii) In proactive engagement of the board, substance rather than formality is important. It is not necessarily required to formulate a succession plan in a document form, but from the perspective of enhancing the efficiency of the succession plan, each listed company is required to make an effective plan, such as writing the important portion of the plan in a document (Public Comment Answers for the Code: No. 71).

(iii) The subject of the succession plan is the "CEO, etc.," namely, the top executives the screening of whose successors is considered to be important among other matters. Depending on the situation of each listed company, the COO and others may be included in the subject of the succession plan, and at the discretion of each listed company, the company could extend the scope of the subject of the succession plan to the entire board when implementing the succession plan (Public Comment Answers for the Code: No. 77 and 78).

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[5] It is based on the argument pointing out that the appointment/dismissal of the chief executive officer (the "**CEO**"), in particular, can be thought as the most important strategic decision to realize sustainable growth and mid- and long-term increase in corporate value of a listed company, found in the Responses to the Council of Experts Concerning the Follow-Up No. 2 dated February 18, 2016.

(iv) **Principle 3.1** of the Revised Code does not stipulate any disclosure regarding a succession plan, but from the perspective that these disclosures should add value for investors[6], at the discretion of each listed company, it is possible to provide information regarding succession plans, etc. (Public Comment Answers for the Code: No. 74 to 76)

Effective use of optional and independent advisory committees

If the organizational structure of a company is either a company with *kansayaku* board or a company with supervisory committee and independent directors do not compose a majority of the board, the company should seek appropriate involvement and advice from independent directors by establishing "optional" and "independent" advisory committees, such as a nomination committee and a remuneration committee, to which independent directors make significant contributions (Supplementary Principle 4.10.1). The old Code has only provided an example of measures, which is to establish such advisory committees, but the Revised Code clarifies that companies should establish an advisory committee.

(i) An "optional" committee is an advisory committee that is not required to be established under the Companies Act (Public Comment Answers for the Code: No. 104 to 112).

(ii) Regarding the meaning of "independence," based on the purport that the independent directors are required to fulfill their roles and responsibilities from "a standpoint independent of the management and controlling shareholders"[7], it is explained that the meaning of "independence" should be "substantially determined from the perspective that whether the director is unlikely to have conflicts of interest with general investors" and reasonably determined from such perspective including whether the CEO, etc. should compose the committee (Public Comment Answers for the Code: No. 113 to 115).

(iii) It is not sufficient only to formally establish an advisory committee and, in order to effectively gain involvement and advice from independent directors, it is considered that "it is important for each listed company to take measures, such as clarifying specific roles of an advisory board" (Public Comment Answers for the Code: No. 104 to 112, Public Comment Answers for the Engagement GL: No. 60 to 64).

(2) Determination of the remuneration of the management

In the Revised Code, the board[8] "should design management remuneration systems […] and determine actual remuneration amounts appropriately through objective and transparent procedures" (Supplementary Principle 4.2.1).

(i) Under the current Companies Act, the amount of the remunerations of directors shall be fixed by the articles

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6 See **Supplementary Principle 3.1.1**.

7 See **Principle 4.7 (iv)**.

8 As in the preamble 14 of the Final Proposal of the Corporate Governance Code of June 2015, each principle will be applied by making necessary adjustments in accordance with their form of company organization; therefore the "board" in **Supplementary Principle 4.2.1** in the Revised Code is adjusted to "remuneration committee" in a company with nominating committee, etc. (Public Comment Answers for the Code: No. 84 to 90).

of incorporation or resolution of a shareholders meeting in a stock company other than a company with nominating committee, etc. (Article 361, paragraph 1 of the Companies Act). However, in practice, for example, a company with a board of company auditors only provides the maximum total amount of the remunerations of all directors by resolution of a shareholders meeting, delegate to the board the determination of distribution of the remuneration for each director within such amount, only determine the policy and calculation method of remuneration for directors at the board, and re-discrete the determination of the specific amount of remuneration to the representative directors, etc., which is often the case. In the Public Comment Answers, it is explained that such re-discretion "in practice is not denied, but in such cases, it is important for each listed company to take measures in procedures under the responsibility of the board so that enough objectiveness and transparency are secured" (Public Comment Answers for the Code: No. 84 to 90, Public Comment Answers for the Engagement GL: No. 55).

The remunerations for directors, from the perspective of operating them as an incentive (Public Comment Answers for the Code: No. 84 to 93, Public Comment Answers for the Engagement GL: No. 59), is discussed in "Interim Proposal Regarding Review of Corporation Laws (related to corporate governance, etc.)" (an interim proposal)[9] by Corporation Laws (related to corporate governance, etc.) Division of Legislative Council, and we need to continuously keep an eye on the trend of the revision of the Companies Act.

(3) Responsibilities of the Board

In the Revised Code, it is clarified that "diversity" in the constitution of the board should "includ[e] gender and international experience," and it is required to constitute the board in a manner to achieve both diversity and appropriate size (Principle 4.11) (Public Comment Answers for the Code: No. 127 to 134, Public Comment Answers for the Engagement GL: No. 69 to 74). Further, the board is required to have a "view" on diversity and appropriate board size, and disclosure thereof (Supplementary Principle 4.11.1).

(i) Regarding "international experience," the Revised Code does not require all listed companies to appoint foreign directors, but for example, listed companies that broadly and internationally expand their business may be required to appoint foreign directors (Public Comment Answers for the Code: No. 135, Public Comment Answers for the Engagement GL: No. 75 and 76).

(ii) From the perspective that it should add value for investors, at the discretion of each listed company, for example, it may be possible to disclose "specific goals and activities" towards securing the diversity of the board (Public Comment Answers for the Code: No. 136 to 139).

(4) Appointment of independent directors and their responsibilities

In the Revised Code, (i) maintaining the description that a listed company should appoint "at least two" independent directors (the first paragraph of **Principle 4.8**), (ii) it is stated that "if a company believes it needs to

[9] An interim proposal was published on February 18, 2018 and the public comment period ended on April 13, 2018. Regarding the remunerations of directors, accountability in the case a "policy for deciding the details of remunerations of the directors" is established, treatment of re-discretion, disclosure in business report, etc. are discussed. The proposal the of outline will be provided within 2018 at the earliest, and it is possible that the reform bill will be submitted to the Diet in 2019.

appoint at least one-third of directors as independent directors […], it should appoint a sufficient number of independent directors" (the second paragraph of **Principle 4.8**).

(i) The subject of the new requirement is "a company [that] believes it needs to appoint at least one-third of directors as independent directors." In the previous Code, such listed company should "disclose a roadmap for doing so," but in the Revised Code, it is stated that it should not only disclose a roadmap but also "appoint a sufficient number of independent directors" as actually decided by the company (Public Comment Answers for the Code: No. 159 to 174, Public Comment Answers for the Engagement GL: No. 91).

(ii) On the other hand, under the Revised Code, a listed company that does not "believe it needs to appoint at least one-third of directors as independent directors" is not required to comply or explain[10].

(iii) The method of counting "at least one-third" should strictly be based on the proportion of the number of directors as independent directors only, from among the "total number of the directors" and *kansayaku* are not included in this number (Public Comment Answers for the Code: No. 175 and 176, Public Comment Answers for the Engagement GL: No. 92).

5. Cross-Shareholdings

(1) Assessment of the appropriateness of cross-shareholdings (Principle 1.4) and relations with cross-shareholders (Supplementary Principle 1.4.1 and 1.4.2)

Cross-shareholdings were disciplined at a certain level in the previous Code, and the names, numbers, amounts reported on the balance sheets and purposes were disclosed in companies' annual securities reports. In the Revised Code, disclosure of a company's policies, etc. for "reduction" is clearly required for the first time. The board should assess "individual" cross-shareholding, including the perspective of the cost of capital. Further, discipline towards a party who causes cross-shareholding was newly established, as shown in the table below.

	Previous Code	**Revised Code**
Assessment of the appropriateness (Principle 1.4)		
(i) Disclosure of the policy	Disclosure of "the policy with respect to cross-shareholdings"	Disclosure of "their policy with respect to [cross-shareholdings], including their policies regarding the reduction of cross-shareholdings"
(ii) Assessment of the appropriateness	(a) regarding "major cross-shareholdings" (b) examine economic rationale and	(a) regarding "individual cross-shareholding" (b) "assess whether or not to hold each individual cross-

[10] However, the Engagement GL 3.8 provides whether "a sufficient number of […] independent directors [is] appointed", and constructive engagement between investors and listed companies is expected (Public Comment Answers for the Code: No. 159 to 174, Public Comment Answers for the Engagement GL: No. 91).

	future outlook (c) "detailed explanation" of the objective and rationale behind cross-shareholdings	shareholding," specifically examining whether the purpose of the holding is appropriate and whether the benefits and risks from each holding cover "the cost of capital" (c) disclose the results of this assessment
(iii) disclosure of standards with respect to the voting rights	Establish and disclose "standards" with respect to the voting rights	(a) establish and disclose "specific standards" with respect to the voting rights (b) "vote in accordance with" such "standards"
Relations with Cross-Shareholders (Supplementary Principle 1.4.1 and 1.4.2)		
(iv) discipline towards a party who causes cross-shareholding (issuing company)	-	(a) When cross-shareholders (i.e., shareholders who hold a company's shares for the purpose of cross-shareholding) indicate their intention to sell their shares, whether or not a company hinders the sale of the cross-held shares by, for instance, implying a possible reduction of business transactions. (b) Whether or not a company engages in transactions with cross-shareholders which may harm the interests of the companies or the common interests of their shareholders by, for instance, continuing the transactions without carefully examining the underlying economic rationale.

(2) Assessment of the appropriateness of cross-shareholdings (Principle 1.4)

Cross-shareholding

"Cross-shareholding" in **Principle 1.4** not only includes (i) the shares held by a listed company for a purpose other than net investment, but also (ii) shares that are substantially assessed as cross-shareholding although the listed company does not directly hold them, such as shares "regarded as holding shares" in the Cabinet Office Ordinance on Disclosure of Corporate Affairs (footnote 3 of the Revised Code), and (iii) not only the case of interlocking shareholding, but also the case of a listed company unilaterally holding the shares of another listed company

(Public Comment Answers for the Code: No. 210 to 213, Public Comment Answers for the Engagement GL: No. 113).

Disclosure of "policies regarding the reduction of cross-shareholdings" - (i) in the table above

Disclosure of "their policy with respect to [cross-shareholding]" was required in the previous Code, and in the Revised Code it was amended to disclosure of "their policy with respect to [cross-shareholding], including their policies regarding the reduction of cross-shareholdings." If "their policies regarding the reduction of cross-shareholdings" are not disclosed, it is regarded as non-compliance with the Principle, and the company is required to fully explain the reason (Public Comment Answers for the Code: No. 247).

It is explained that specific details of "their policies regarding the reduction of cross-shareholdings" depend on the individual circumstance of each listed company; for example, in which case companies hold shares of other listed companies as cross-shareholdings, how to deal with a case that does not fall under the standards of holding based on the result of the assessment, and the like (Public Comment Answers for the Code: No. 247).

Assessment of the appropriateness - (ii) (a) in the table above

Assessment of the appropriateness of "major cross-shareholdings" was required in the previous Code, and in the Revised Code the board itself is required to assess the appropriateness of "individual cross-shareholding." Even in the case the executives make preparations to a certain level in order to assess the appropriateness of holding shares of other listed companies as cross-shareholdings, "substantially, the board itself" is required to "assess individual cross-shareholding." If a listed company does not assess certain holdings in the board, as an explanation for **Principle 1.4**, the company is required to fully explain the reason, and for the holdings assessed, to disclose the detail of the assessment by the board (Public Comment Answers for the Code: No. 216 to 220, Public Comment Answers for the Engagement GL: No. 116 and 117).

A uniform reduction in the cross-holdings is not necessarily required under the Revised Code, but it is considered that, as a result of the assessments, there will be many cases that require reduction (Public Comment Answers for the Code: No. 237 to 245, Public Comment Answers for the Engagement GL: No. 126 to 130). Further, when increasing the cross-shareholdings, assessment of the appropriateness of such holding is required as a matter of course (Public Comment Answers for the Code: No. 247).

Disclosure of the results of the assessment - (ii) (c) in the table above

Regarding the disclosure of "the results of the assessment," it is considered that a company is not necessarily required to disclose the results of assessments for each individual cross-holding, including the appropriateness of the holding. On the other hand, the disclosure is expected to be specific, regarding, for example the (i) particular perspective of the assessment and established standards, (ii) details of the discussion, and (iii) conclusion of the appropriateness of the holding, but not to be general or abstract such as simply stating "as a result of the assessment, all of the holdings are approved as appropriate" (Public Comment Answers for the Code: No. 221 to 233, Public Comment Answers for the Engagement GL: No. 118 to 123).

Relations with cross-shareholders - (iv) in the table above

In **Supplementary Principle 1.4** of the Revised Code, discipline towards a party who causes cross-shareholdings (issuing company) is introduced for the first time.

Regarding the (iv) (a) **Supplementary Principle 1.4.1** in the table above, in light of there being agreements between the parties and contracts (so called cooperation by holding capital) in which long-term cross-shareholding is assumed as a precondition of such as business collaboration in practice, there were several opinions that requested for the revision of the original draft during the procedure of public comments, including discriminating such case from an arm's length general business relationship as an exception to the Revised Code. However, in the Public Comment Answers, while it does not necessarily prohibit such agreements and contracts, in the case a listed company with cross-shareholdings indicates its intention to sell its shares, any measures that further hinder the company from selling the cross-held shares by, for instance, implying a possible reduction of business transactions should not be taken, and the original draft remained to be finalized in the Revised Code (Public Comment Answers for the Code: No. 251 to 255, Public Comment Answers for the Engagement GL: No. 132 to 134).

The (iv) (b) **Supplementary Principle 1.4.2** in the table above indicates the importance of examining the underlying rationale in transactions conducted by a listed company with cross-shareholders, and, in view of the current situation that "maintaining transactions," etc. are often listed as reasons for cross-shareholding, it directly stipulates that such transactions should not harm the interest of the company or the common interests of the shareholders (Public Comment Answers for the Code: No. 260). "Economic rationale underlying in a transaction" includes the perspective of validity and fairness of a transaction; for example, an important perspective is why a transaction that is conducted with the party who is a cross-shareholder is recognized as reasonable compared to the terms of transactions with other similar parties that are not cross-shareholders (Public Comment Answers for the Code: No. 257 to 259, Public Comment Answers for the Engagement GL: No. 135 to 137).

6. Asset Owners

The role of asset owners who are positioned closest to the ultimate beneficiaries and who encourage and monitor asset managers of corporate pension funds that are the direct counterparties in engagement with companies is important in order to deepen corporate governance reform and promote the smooth functioning of the investment chain. However, among asset owners, actions, especially regarding corporate pension funds, have not necessarily been adequate compared to other similar asset managers, even after the revision of the Stewardship Code in May 2017. Such issues should essentially be dealt with by the corporate pension fund itself, but pension fund sponsors are required to fully recognize that the investment management of corporate pension funds impacts asset formation for the employees and companies' own financial standing and to take measures on their own initiative in order to improve human resources and operational practices, thus making sure that corporate pension funds fulfill their roles as asset owners and to disclose such measures, which led to the new establishment of **Principle 2.6** in the Revised Code.

The subject of **Principle 2.6** of the Revised Code is corporate pension funds and does not further cover employees of a share ownership plan, etc. (Public Comment Answers for the Code: No. 294). Additionally, the "corporate pension funds" in the Principle basically assume a fund-type and contract-type defined benefit plan and an

employees' pension fund, and, generally speaking, in occasions where selecting asset managers and products of corporate pension funds and implementation of education for asset management to employees, it is expected to be an appropriate measure in the listed company as a pension fund sponsor (Public Comment Answers for the Code: No. 285 to 287, Public Comment Answers for the Engagement GL: No. 145).

Some possible examples of "measures to improve human resources and operational practices" can be assigning qualified persons to corporate pension fund offices and asset management committees and developing those persons, providing necessary support in engaging in stewardship activities with management trustee organizations that such organization implements, and the like, but not limited thereto, and appropriate measures depending on the situation of each listed company. Further, regarding the means to "disclose," such measures is expected to be a disclosure to stakeholders such as investors and employees, essentially by a corporate governance report, the same as the other Principles of the Revised Code that requires disclosure (Public Comment Answers for the Code: No. 291).

7. Matter that should be noted in addition to the Revised Code and the Engagement GL

For matters regarding disclosure in the Revised Code, it is repeatedly mentioned as an explanatory note that "currently the disclosure working group of the Financial System Council of the Financial Services Agency has been examining it" in the Public Comment Answers, and listed companies need to continuously keep an eye on the trend of the revision of the systems in addition to the Revised Code and the Engagement GL regarding the manner of disclosure. Further, particularly regarding the remunerations for directors, the listed companies need to continuously keep an eye on the trend of the revision of the Companies Act.

Revised Corporate Governance Code (Draft) **(Note: Underlined portions are the portions revised from the previous Code, and the framed portions are related to disclosure.)**	**Related Major Engagement Guidelines**
Principle 1.4 Cross-Shareholdings When companies hold shares of other listed companies as cross-shareholdings, they should disclose their policy with respect to doing so, including their policies regarding the reduction of cross-shareholdings. In addition, the board should annually assess whether or not to hold each individual cross-shareholding, specifically examining whether the purpose is appropriate and whether the benefits and risks from each holding cover the company's cost of capital. The results of this assessment should be disclosed. Companies should establish and disclose specific standards with respect to the voting rights as to their cross-shareholdings, and vote in accordance with the standards.	**Engagement GL 4.1 and 4.2**
Supplementary Principles 1.4.1 When cross-shareholders (i.e., shareholders who hold a company's shares for the purpose of cross-shareholding) indicate their intention to	**Engagement GL 4.3 and 4.4**

sell their shares, companies should not hinder the sale of the cross-held shares by, for instance, implying a possible reduction of business transactions. 1.4.2 Companies should not engage in transactions with cross-shareholders which may harm the interests of the companies or the common interests of their shareholders by, for instance, continuing the transactions without carefully examining the underlying economic rationale.	
Principle 2.6 Roles of Corporate Pension Funds as Asset Owners Because the management of corporate pension funds impacts stable asset formation for employees and companies' own financial standing, companies should take and disclose measures to improve human resources and operational practices, such as the recruitment or assignment of qualified persons, in order to increase the investment management expertise of corporate pension funds (including stewardship activities such as monitoring the asset managers of corporate pension funds), thus making sure that corporate pension funds perform their roles as asset owners. Companies should ensure that conflicts of interest which could arise between pension fund beneficiaries and companies are appropriately managed.	**Engagement GL 5.1**
Principle 3.1 Full Disclosure In addition to making information disclosure in compliance with relevant laws and regulations, companies should disclose and proactively provide the information listed below (along with the disclosures specified by the principles of the Code) in order to enhance transparency and fairness in decision-making and ensure effective corporate governance: i) Company objectives (e.g., business principles), business strategies and business plans; ii) Basic views and guidelines on corporate governance based on each of the principles of the Code; iii) Board policies and procedures in determining the remuneration of the senior management and directors; iv) Board policies and procedures in the appointment/dismissal of the senior management and the nomination of directors and *kansayaku* candidates; and v) Explanations with respect to the individual appointments/dismissals and nominations based on iv). **Supplementary Principle** 3.1.1 These disclosures, including disclosures in compliance with	**Engagement GL 1.1, 1.2, 3-5, 3.7 and others**

relevant laws and regulations, should add value for investors, and the board should ensure that information is not boiler-plate or lacking in detail.	
Principle 4.1 Roles and Responsibilities of the Board (1) **Supplementary Principle** 4.1.3 Based on the company objectives (business principles, etc.) and specific business strategies, the board should proactively engage in the establishment and implementation of a succession plan for the CEO and other top executives and appropriately oversee the systematic development of succession candidates, deploying sufficient time and resources.	**Engagement GL 3.1, 3.2, 3.3 and 3.4**
Principle 4.2 Roles and Responsibilities of the Board (2) **Supplementary Principle** 4.2.1 The board should design management remuneration systems such that they operate as a healthy incentive to generate sustainable growth, and determine actual remuneration amounts appropriately through objective and transparent procedures. The proportion of management remuneration linked to mid- to long-term results and the balance of cash and stock should be set appropriately.	**Engagement GL 3.5**
Principle 4.3 Roles and Responsibilities of the Board (3) **Supplementary Principles** 4.3.2 Because the appointment/dismissal of the CEO is the most important strategic decision for a company, the board should appoint a qualified CEO through objective, timely, and transparent procedures, deploying sufficient time and resources. 4.3.3 The board should establish objective, timely, and transparent procedures such that a CEO is dismissed when it is determined, via an appropriate evaluation of the company's business results, that the CEO is not adequately fulfilling the CEO's responsibilities.	**Engagement GL 3.1, 3.2, 3.3 and 3.4**
Principle 4.8 Effective Use of Independent Directors Independent directors should fulfill their roles and responsibilities with the aim of contributing to sustainable growth of companies and increasing corporate value over the mid- to long-term. Companies should therefore appoint at least two independent directors that sufficiently have such qualities. Irrespective of the above, if a company believes it needs to appoint at least one-third of directors as independent directors based on a broad consideration of factors such as the industry, company size, business characteristics, organizational structure and circumstances surrounding	**Engagement GL 3.8 and 3.9**

the company, it should appoint a sufficient number of independent directors.	
Principle 4.10 Use of Optional Approach **Supplementary Principle** 4.10.1 If the organizational structure of a company is either Company with *Kansayaku* Board or Company with Supervisory Committee and independent directors do not compose a majority of the board, in order to strengthen the independence, objectivity and accountability of board functions on the matters of nomination and remuneration of the senior management and directors, the company should seek appropriate involvement and advice from independent directors in the examination of such important matters as nominations and remuneration by establishing independent advisory committees under the board, such as an optional nomination committee and an optional remuneration committee, to which independent directors make significant contributions.	**Engagement GL 3.2 and 3.5**
Principle 4.11 Preconditions for Board and *Kansayaku* Board Effectiveness The board should be well balanced in knowledge, experience and skills in order to fulfill its roles and responsibilities, and it should be constituted in a manner to achieve both diversity, including gender and international experience, and appropriate size. In addition, persons with appropriate experience and skills as well as necessary knowledge on finance, accounting, and the law should be appointed as *kansayaku*. In particular, at least one person who has sufficient expertise on finance and accounting should be appointed as *kansayaku*. The board should endeavor to improve its function by analyzing and evaluating effectiveness of the board as a whole.	**Engagement GL 3.6, 3.7, 3.8, 3.9, 3.10 and 3.11**
Principle 5.2 Establishing and Disclosing Business Strategies and Business Plans When establishing and disclosing business strategies and business plans, companies should articulate their earnings plans and capital policies, and present targets for profitability and capital efficiency after accurately identifying the company's cost of capital. Also, companies should provide explanations that are clear and logical to shareholders with respect to the allocation of management resources, such as reviewing their business portfolio and investments in fixed assets, R&D, and human resources, and specific measures that will be taken in order to achieve their plans and targets.	**Engagement GL 1.1, 1.2, 1.3, 2.1 and 2.2**

(Source) Prepared by the authors, based on "Japan's Corporate Governance Code ― Seeking Sustainable Corporate Growth and Increased Corporate Value over the Mid- to Long Term" published by the Tokyo Exchange Group, Inc. on June 1, 2018, which is currently in effect, and "Guidelines for Investor and Company Engagement" published by the Financial Services Agency on June 1, 2016.

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