

ICGN Statement to the 21st Council of Experts
Follow-up of Japan's Stewardship Code and Japan's Corporate Governance Code
Presented by Kerrie Waring, CEO, ICGN

18th November 2020

1. Introduction

Chair Kanda and Fellow Council Members,

Thank you for the opportunity to present ICGN opinion on the agenda items for the Council meeting today. My comments should be considered alongside ICGN's letter to the Council on 20th October whereby the following items were determined to form the basis of Council deliberations over the coming months:

1. Board effectiveness
2. Capital efficiency including cost of capital and cross-shareholdings
3. Sustainability
4. Annual general meetings
5. Ensuring confidence in audits
6. Governance of group subsidiaries
7. Other including human capital management and digital transformation

Today, I have been invited to talk specifically about item 1 regarding 'board effectiveness'. ICGN will provide comment on other items above when tabled at future Council meetings.

2. About ICGN

Led by investors responsible for assets under management of USD\$54 trillion, ICGN is a leading authority on global standards of corporate governance and investor stewardship. Our members include corporate leaders and institutional investors who have a shared interest - and thus a shared responsibility - in promoting the success of companies to preserve and enhance long-term value, contributing to strong economies and healthy societies.

ICGN's mission supports this shared responsibility, as advocated in the ICGN Global Stewardship Principles¹ and the ICGN Global Governance Principles², the latter of which is currently subject to Member consultation as part of a three-year review cycle. My comments today are therefore guided by ICGN Principles and largely drawn from the perspective of the global institutional investor community.

¹ ICGN Global Stewardship Principles, 2020: https://www.icgn.org/sites/default/files/ICGN%20Global%20Stewardship%20Principles%202020_0.pdf

² ICGN Global Governance Principles, 2017: http://icgn.flpbks.com/icgn_global_governance_principles/

3. Board effectiveness

The subject of 'board effectiveness' can encompass many aspects of corporate governance practice and we have been requested to focus our commentary on the following key matters:

- 3.1 Board leadership
- 3.2 Board diversity
- 3.3 Board independence and quality
- 3.4 Board appointments

3.1 Board leadership

3.1.1. Clear division of leadership

ICGN recommends that there should be a clear division of responsibilities between the role of the chair of the board and chief executive to avoid unfettered powers of decision-making in any one individual.

We recommend that the Japan Corporate Governance Code clarifies the difference between these roles and the distinct skills and experience for each. Companies should disclose the responsibilities of the chair, chief executive, lead independent director and committee chairs in their annual report to shareholders. If the CEO and board chair roles are exercised by the same individual, companies should explain how they balance power on the board.

3.1.2 CEO succession to Board Director or Chair

ICGN discourages the practice of a company's retiring CEO remaining on the board as a director and/or becoming chairman, regardless of any interim break period.

In the event this practice does take place, the retiring CEO should not serve on board committees that require independent representation. If, exceptionally, the board decides that a retiring CEO should succeed to become chair, the board should consult with shareholders in advance setting out a convincing rationale and provide detailed explanation, particularly in terms of succession planning, in the annual report. Unless there are extraordinary circumstances, there should be a break in service between the roles.

3.1.3 CEO selection, dismissal and succession

ICGN recommends that the Nomination Committee, comprised of a majority of independent directors, be responsible for the recruitment and dismissal of the CEO and ensure adequate succession planning for the role of CEO. Companies should provide better disclosure in English around these processes.

Succession planning for the role of the CEO is critically important to ensure an orderly transition and the long-term health of the company. Best practice in succession planning is for the Nomination Committee to commence planning upon the hiring of a new CEO and to formally document a 'succession plan' which should be reviewed annually. A succession plan will serve as guidance for the board in the event of either unplanned or planned succession and include a description of the roles and responsibilities of the CEO, recruitment specifications and key contact points.

Furthermore, the lack of consultation with independent directors or use of external recruitment consultants in the appointment of a CEO sets Japan at odds with other markets. ICGN would encourage wider use of Nomination Committees, comprised of a majority of

independent directors to be responsible for succession planning as well as take a firmer responsibility for CEO appointment, performance evaluation and (if necessary) dismissal.

3.1.4 Role of the Board Chair

ICGN recommends that the board should be chaired by an independent director who should be independent on the date of appointment.

The chair is responsible for leadership of the board and ensuring its effectiveness in holding the CEO to account for the strategic direction and risk management of the company, while inspiring a shared commitment to the company's vision, mission and purpose.

The Chair is responsible for setting the board agenda, ensuring that independent directors have sufficient and timely information and can constructively challenge and debate managerial proposals. Additionally, the chair should regularly hold meetings with the independent directors without management present. A culture of openness on the board should be encouraged to allow a range of views to be expressed and adequate time made available for discussion of all agenda items.

3.1.5 Lead Independent Director

ICGN recommends that the board should appoint a Lead Independent Director (LID) even when the company chair is independent.

ICGN acknowledges that the concept of a LID is mentioned in the Japan Corporate Governance Code, however we suggest that the role of the LID should also be explained. The LID can provide a valuable leadership role and can act as a point of communication with other independent directors and shareholders if any contentious issues arise relating to the chair or significant shareholders (in the case of controlled companies).

3.1.6 Constructive dialogue

ICGN strongly encourages companies to respond to requests for constructive engagement from investors, whether individually or collectively.

Such dialogue should encompass all matters of material relevance to a company's strategic direction, risk management and performance as well as governance, environmental and social policies and practices. All board directors should be willing and able to engage with investors however the board Chair and / or LID should be most commonly available for dialogue.

3.2 Board diversity

3.2.1 Diversity and inclusion

ICGN recommends that boards should disclose and report against both a board policy and a wider company policy (particularly managerial positions) on diversity which should include specific goals, measurable targets for attaining such goals and a time period over which this is achieved. The report should include an explanation of the rationale for the diversity policy, progress achieved and how diversity is considered as part of succession planning on the board and throughout the company.

ICGN does not have a position on an optimal level of female representation on boards but we observe that a minimum threshold of 30%/33% is commonly referred to as being a helpful starting point for realising the benefits of more diversity on boards.

Boards, and the workforce as a whole, should be comprised of a diverse group of individuals, reflective of the company's key stakeholders, to ensure effective and inclusive decision-making in alignment with the company's purpose, strategy and commercial objectives. This includes individuals from different genders, nationalities, professional backgrounds, social and economic origins, and personal attributes.

In Japan, and in many other countries, an ageing population and acute gender disparities in the workplace exacerbate pressures on productivity. Improving gender parity is therefore a significant economic opportunity for companies, investors and society. Corporate disclosure is key to achieving this and Annex 1 provides a list of information that is useful to investors.

ICGN welcomes initiatives which help to provide more information about a company's approach to diversity and how this contributes to attracting and retaining talent, improving problem solving and enhancing interaction with customers. We do not advocate a position on whether this should be achieved by mandatory or voluntary measures. However, a requirement for time-bound aspirational targets in a national code of corporate governance can be helpful. Annex 2 provides examples of initiative being taken in different markets.

Crucial to achieving diversity is inclusion, i.e. creating a culture in which diversity can flourish and people of different backgrounds and views feel valued. Inclusion is harder to assess by focusing only on numbers and percentages. Therefore, it is vital for companies to provide greater disclosure on what is done to create an inclusive environment and support its employees' different requirements.

3.3 Board independence and quality

3.3.1 Independence ratio

ICGN advocates that, as an international standard, corporate boards should comprise a majority of independent directors. In Japan, we advocate that there should be a majority of independent directors on the prime market and at least one-third independent directors on other segments. For listed subsidiary companies, there should be a majority of independent directors serving on the board to mitigate infringements to minority shareholder interests.

Independent directors play a crucial role in constructively challenging management, free from external influence. They can help offset the domination of decision-making by any single individual (such as the CEO). By drawing on their personal competencies and experience, they can contribute a diversity of perspectives to generate healthy debate in the boardroom and are well placed to represent the interests of minority long-term shareholders.

3.3.2 Definition of independence

ICGN recommends that there is a clear definition of what it means to be an independent director in Japan's Corporate Governance Code.

We acknowledge that there is a definition of 'independence' in TSE Listing Rules however we believe that this should be included in the Japan Corporate Governance Code to provide further clarity to boards in their independent director appointment processes, strengthen awareness of independence criteria and lead to greater consistency of approach by all companies.

The board should identify in the annual report the names of the directors considered by the board to be independent and who are able to exercise independent judgement free from any

external influence. Annex 3 provides a list of conditions which might impair a director's independence.

3.3.3 Independent director training

The board should have a formal process of induction for all new directors so that they are well-informed about the company as soon as possible after their appointment.

ICGN encourages the introduction of high-quality training for all directors in Japan to help build an understanding of what their role entails, particularly in relation to strategy, monitoring management and public disclosures. We also stress the importance of financial literacy to ensure that independent directors can challenge management on issues such as capital efficiency, the use of cross shareholdings and CEO remuneration.

We acknowledge that under Principle 4.11 Preconditions for Board and Kansayaku Board Effectiveness, the Code outlines the need for individuals to have knowledge of finance, accounting and law in order to be appointed as kansayaku. However, we would advocate that all kansayaku members should have sufficient expertise on finance and accounting to ensure effective decision-making.

3.4 Board appointments

3.4.1 Appointment of independent directors

ICGN recommends that board appointments and succession planning should be subject to a formal procedure based on objective criteria and led by the Nomination Committee, comprised of a majority of independent directors. The rationale for individual director appointments should be publicly disclosed, including any factors that may affect a director's independence and how the director's experience aligns with company's diversity policy and strategy.

ICGN observes scant disclosure by companies around how independent directors are nominated and appointed to boards in Japan and we recommend more information be disclosed around the process including whether any consultants were used.

To ensure accountability to shareholders, all incumbent directors should stand for re-election on an annual basis, alongside the appointment of new individuals for election. Boards should disclose the rationale for each resolution and shareholders should have a separate vote on the re-election/election of each director, with each candidate approved by a simple majority of shares voted. Annex 4 provides information which is helpful to be disclosed about board candidates.

In terms of appointments to board committees, there to be a diversity of members in each committee with the requisite skills, experience and knowledge aligned with the committee's purpose. There should also be periodic evaluation and refreshment of committee membership.

3.4.2 Director tenure

ICGN recommends that companies disclose specific term limits for director tenure on boards and annual re-election be contingent on individual performance based on satisfactory evaluations of the director's contribution to the board.

More generally, ICGN advocates that independent directors should serve for an appropriate length of time to ensure they bring an objective perspective to the board without compromising the independence of the board.

3.4.3. Evaluation

ICGN recommends that companies undertake a rigorous review of the performance of the board (as a collective body, including kansayaku boards), committees and individual directors prior to being proposed for annual re-election. The board should periodically (preferably every three years) engage an independent external consultant to undertake such evaluations.

Board evaluation should be conducted to review composition as appropriate for the needs of the company. In this regard, we encourage companies to develop and disclose a skills matrix of board composition to identify how key skills, experience and knowledge are aligned with the company's long-term strategic needs, diversity policy and succession planning. This review of performance would allow for long-standing directors to step down, thus unlocking vacancies to enable appropriate board diversity and independence.

The independent directors, led by the LID, should be responsible for performance evaluation of the chair, taking account the views of executive officers.

The board should disclose the process for evaluation and, as far as reasonably possible, any material issues of relevance arising from the conclusions and actions taken as a consequence.

3.4.4 Nomination Committee

ICGN recommends that all listed companies in Japan (not just those with a three-committee structure) should establish a Nomination Committee comprised of an independent chair and majority of independent directors. The terms of reference and responsibilities for the committee along with the committee membership should also be disclosed.

ICGN observes that only around 50% of 1st Section JPX listed companies have opted to establish Nomination and Remuneration Committees comprised of a majority of independent directors. We therefore recommend that the Japan Corporate Governance Code be strengthened to encourage the outstanding 50% of 1st Section JPX listed companies to improve the independence and effectiveness of Nomination and Remuneration Committees.

Nomination Committee responsibilities include:

- a) determining the process for board evaluation, implementation of any actions arising and impact on board composition aligned with the required skills, knowledge, independence and experience aligned with company strategy;
- b) the development of the board (and workforce) diversity and inclusion policy aligned with the company strategy, and oversee it's implementation and reports on progress towards achieving objectives;
- c) leading the process for board appointments and putting forward recommendations to shareholders on directors to be elected and re-elected;
- d) proactively leading and being accountable for the development, implementation and continual review of succession planning for the board and CEO.

- e) ensuring appropriate director independence by addressing real and potential conflicts of interest among committee members and between the committee and its advisors during the nomination process;
- f) appointing any independent consultants for recruitment or evaluation advice including their selection and terms of engagement and publicly disclosing their identity and consulting fees; and
- g) entering into dialogue with shareholders on the subject of board nominations either directly or via the board.

3.4.5 Remuneration Committee

ICGN recommends that all listed companies in Japan (not just those with a three-committee structure) should establish a Remuneration Committee, comprised wholly of independent directors. The terms of reference and responsibilities for the committee along with the committee membership should also be disclosed.

Remuneration Committee responsibilities include:

- a) determining and recommending to the board the company's remuneration philosophy and policy which should take into account pay and employment conditions within the context of the company as a whole and its human resource strategy;
- b) designing, implementing, monitoring and evaluating short-term and long-term share-based incentives and other benefits schemes including pension arrangements;
- c) ensuring that conflicts of interest among committee members and between the committee and its advisors are identified and avoided;
- d) appointing any independent remuneration consultant including their selection and terms of engagement. This includes scrutiny of the rationale for consultancy proposals (particularly if levels appear industry benchmarked). The consultant's identity and fees should also be publicly disclosed;
- e) considering sustainable capital allocation in developing remuneration structures through the use of metrics which take account of shareholder and stakeholder interests; and
- f) maintaining appropriate communication with shareholders on the subject of remuneration either directly or via the board.

Thank you for this opportunity to provide commentary for the Council meeting and we look forward to the continued deliberations.

Yours faithfully,



Kerrie Waring
Chief Executive Officer

Annex 1: Information generally relevant to diversity and useful to investors.

Disclosures that are relevant in general to investors on diversity include:

- Turnover rates for all employees
- Number of hires by gender and by job category
- Percentage of female directors and officers promoted within the company
- Percentage of women in senior executive positions and targets to improve this metric
- Percentage of employees taking paid holidays and parental leaves by gender
- Policies to facilitate flexible working by both genders
- Policies to subsidise childcare
- Mentoring schemes and employee networks which give marginalized groups support
- KPIs related to diversity and inclusion for senior management, linked to pay
- Disclosure on percentage of staff given training around issues such as sexual discrimination and harassment
- High-level figures on use and outcomes of whistle-blower complaints system.

With quantitative reporting alone, there is a risk that investors assess companies solely on their 'numbers'. It is easy to see how this can create perverse incentives for companies to simply 'hire in' diversity to improve their diversity perception on paper. However, this is an ineffective approach that simply leads to greater turnover.

Annex 2: Examples of initiative which helps to improve diversity taken in different markets

- In the UK, there is a focus on the gender pay gap and regulations³ require companies to publish figures comparing the average pay of male and female employees. Disclosures that go beyond the numbers and examine drivers of the pay gap and remedies to address this over a specific time frame are particularly insightful. Importantly, companies also report the board's oversight role stating that the gender pay gap reporting has been analysed and discussed at board level. Many companies have also linked the gender pay gap reporting to UN Sustainable Development Goal 5 – gender equality and empowering women and girls.
- At a European level, the EU Non-Financial Reporting Directive⁴ requires a company to describe how the diversity policy is applied to administrative, management and supervisory bodies with regard to aspects such as: age, gender, or educational and professional backgrounds. Companies must also describe the objectives of the diversity policy, how it has been implemented and the results in the reporting period. Importantly, if companies do not have such a policy, they must issue a statement explaining why that is the case.
- In the US, the Equal Employment and Opportunity Commission (EEOC)⁵ requires companies to report workforce composition by ethnicity and gender, by job category (EEO-1 Report). Publicly disclosing this report is not mandatory, but US companies are increasingly disclosing workforce demographic data. More recently the US Securities and Exchange Commission⁶ changed its reporting rules to require companies to report 'material' human capital objectives for the first time.

³ <https://gender-pay-gap.service.gov.uk/>

⁴ <https://eur-lex.europa.eu/legal-content/EN/TXT/HTML/?uri=CELEX:32014L0095&qid=1588075789600&from=EN>

⁵ <https://www.eeoc.gov/>

⁶ <https://www.sec.gov/comments/4-711/4-711.htm>

Annex 3: List of conditions which might impair independence

Conditions which might impair a director's independence include, whether a director:

- is or has been employed in an executive capacity by the company or a subsidiary and there has not been an appropriate period between ceasing such employment and serving on the board;
- is or has within an appropriate period been a shareholder, partner, director or senior employee of a provider of material professional or contractual services to the company or any of its subsidiaries;
- receives or has received additional remuneration from the company apart from a director's fee, participates in the company's share option plan or a performance-related pay scheme, or is a member of the company's pension scheme;
- has or had close family ties with any of the company's advisers, directors or senior management;
- holds cross-directorships or has significant links with other directors through involvement in other companies or bodies;
- is a significant shareholder or cross-shareholder of the company, or an officer of, or otherwise associated with, a significant shareholder or cross-shareholder of the company;
- is or has been a nominee director as a representative of minority shareholders or the state;
- has been a director of the company for such a period that his or her independence may have become compromised. There is no fixed date that automatically triggers lack of independence; the norm can differ in varying jurisdictions between 8-12 years after which a non-executive director may no longer be deemed independent.

Annex 4: Useful disclosure about board candidates:

The following information should be disclosed about board candidates:

- identity of the director
- rationale for how the appointment aligns with the company strategy
- core competencies, qualifications, and experience
- recent and current board and management mandates at other companies, as well as significant roles on non-profit/ charitable organisations
- factors affecting independence, including relationship/s with controlling shareholders
- length of tenure
- board and committee meeting attendance
- any shareholdings in the company

**第 21 回スチュワードシップ・コードおよびコーポレートガバナンス・コードの
フォローアップに関する有識者会議への ICGN 意見書
(ケリー・ワリング、ICGN CEO による発表) <要約版、暫定訳>**

2020 年 11 月 18 日

1. はじめに

神田座長およびフォローアップ会議メンバーの皆様

本日は、有識者会議の議題について ICGN の意見を述べる機会をいただきありがとうございます。私のコメントは、以下の事項が今後数ヶ月にわたる審議のベースになると決定された 10 月 20 日の第 20 回会議において提出しました ICGN の意見書と共に考慮頂くべきであります。

1. 取締役会の実効性
2. 資本コストと株式持ち合いを含む資本効率
3. サステナビリティ
4. 年次株主総会
5. 監査の信頼性の確保
6. グループ子会社のガバナンス
7. 人的資本管理やデジタルトランスフォーメーションを含むその他

本日は、「取締役会の実効性」に関する項目 1 について具体的にお話させていただきます。上記の他の項目については、ICGN は今後の有識者会議において、それぞれ審議の際にコメントを提供致したく存じます。

2. ICGN について

(省略)

3. 取締役会の実効性

「取締役会の実効性」のテーマは、コーポレートガバナンスの慣行の多くの側面を網羅するものでありますが、以下の主たる事項にフォーカスして意見を求められています。

3.1 取締役会のリーダーシップ

3.2 取締役会の多様性

3.3 取締役会の独立性と質

3.4 取締役会の任命

3.1 取締役会のリーダーシップ

3.1.1 リーダーシップの明確な分離

ICGN は、取締役会議長と経営幹部の役割の間で責任が明確に分離され、1 人の個人が自由気儘に意思決定する事を回避するよう推奨します。

(省略)

3.1.2 取締役または議長への CEO の承継

ICGN は、退任した CEO が、暫定的な休止期間にかかわらず、取締役として取締役に残留したり、議長に就任することを推奨しません。

(省略)

3.1.3 CEO の選任、解任および承継

ICGN は、過半数が独立社外取締役に占める指名委員会が CEO の採用、解任に責任を持ち、CEO の役割の十分な承継の計画を確保するよう推奨します。企業はこれらの過程についてより良き開示を提供すべきです。

(省略)

3.1.4 取締役会議長の役割

ICGN は、取締役会の議長を、その指名日において独立である社外取締役に務めることを推奨します。

(省略)

3.1.5 筆頭独立社外取締役

ICGN は、会社の議長が独立社外取締役である場合でも、取締役に筆頭独立社外取締役 (LID) を指名することを推奨します。

(省略)

3.1.6 建設的な対話

ICGN は、企業が投資家からの個別の、または集団的な建設的対話の要請に対応することを強く奨励します。

(省略)

3.2 取締役会の多様性

3.2.1 多様性と包摂性

ICGN は、取締役会が、多様性に関し特定の目標、そうした目標を達成する為の測定可能な目標、およびこれを達成する為の期間を含む取締役会の方針とより広範な企業方針の両方を開示し、報告することを推奨します。報告には、多様性に関する方針の論理的根拠と、達成された進展状況および取締役会の後継者育成および会社全体の計画の一部として多様性がどのように考慮されているかについての説明を含むべきです。

(省略)

3.3 取締役会の独立性と質

3.3.1 独立者の比率

ICGN は、国際的な標準として取締役会は過半数の独立社外取締役で構成されるべきであることを提唱しています。日本においては完全に独立した委員会を設置できるようにする為、少なくとも 3 分の 1 の独立社外取締役が必要であると提唱します。上場子会社の場合、少数株主の利益に対する侵害を軽減するために、取締役会に過半数の独立社外取締役が就任すべきです。

(省略)

3.3.2 独立性の定義

ICGN は、日本のコーポレートガバナンス・コードに独立社外取締役の意味を明確に定義することを推奨します。

(省略)

3.3.3 独立社外取締役のトレーニング

取締役会は、選任後できるだけ早く会社について十分な情報を得られるように、すべての新任取締役の正式な導入教育プロセスを持つ必要があります。

(省略)

3.4 取締役の選任

3.4.1 独立社外取締役の選任

ICGN は、取締役の選任と後継者育成計画は、客観的な基準に基づいた正式な手続きに従い、独立社外取締役が過半数を占める指名委員会で主導されることを推奨します。個別の取締役の選任理由は、取締役の独立性に影響を与える可能性のある要因や、取締役の経験が会社の多様性の方針および戦略とどのように一致するかを含め、公に開示すべきであります。

(省略)

3.4.2 取締役の任期

ICGN は、企業が取締役任期についての限度を開示し、取締役会への取締役の貢献の十分な評価に基づく個人の業績により毎年再任されることを推奨します。

(省略)

3.4.3 評価

ICGN は、毎年再任が提案される前に、企業が取締役会（集合体として、監査役会を含む）、委員会、および個々の取締役の業績を厳密にレビューすることを推奨します。取締役会は定期的に（できれば3年ごとに）独立した外部コンサルタントを雇ってそのような評価を行うべきです。

(省略)

3.4.4 指名委員会

ICGN は、日本のすべての上場企業（指名委員会等設置会社だけでなく）が、独立した議長と過半数の独立した取締役で構成される指名委員会を設置することを推奨します。委員会の構成とともに、委員会の委任事項と責任も開示すべきであります。

(省略)

3.4.5 報酬委員会

ICGN は、日本の全てのの上場企業（指名委員会等設置会社だけでなく）が、独立社外取締役のみで構成された報酬委員会を設置することを推奨します。委員会の構成とともに、委員会の委任事項と責任も開示すべきであります。

(省略)

有識者会議にコメントを提供させていただける機会に感謝し、引き続きの審議を楽しみにしております。

敬具



ケリー・ワリング

最高経営責任者