

Interim Report on the Roles of and Support System for Non-
Executives including Outside Directors and *Kansayaku*

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Corporate Governance System Study Group

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1. The background of the study

1.1. The purpose of the establishment of the Study Group

As Japan's social and economic structure faces drastic changes including the development of globalization, a declining birth rate, and an aging population, it has become indispensable to discuss and deepen the study of an internationally understandable and socially and economically desirable corporate governance system on a consistent basis to ensure continuous growth and sustainable prosperity in the future.

In Japan, corporate governance came to be reinforced steadily. For instance, the Tokyo Stock Exchange (hereinafter referred to as "TSE") revised its Securities Listing Regulations in 2009. Following the revision, the adoption of independent officers was developed. However, triggered by misconduct at some listed companies, the Japanese corporate governance system has been subjected to criticism in Japan and overseas.

Given this situation, there was a discussion about the mandatory introduction of outside directors in the Japanese Ministry of Justice's Legislative Council Subcommittee on the Companies Act, and the TSE asked for a public comment concerning the independent officer system. With this background, the Corporate Governance System Study Group (hereafter, the Study Group) was established in March 2012, to realize the introduction of corporate governance rules based on the actual practice of the management of companies by making clear the roles expected to be played by non-executives including outside directors and Audit & Supervisory Board Members (*Kansayaku*)^{1,2}, as premises for the discussions above, and extensively studying how the corporate system should be.

¹ In this context, for the sound and sustainable growth of a company, needless to say, executives should carry out their duties appropriately first, and when studying supervisory organizations including non-executives, careful attention should be paid to the division of roles and cooperation with executives.

² [Translation Note : Many Japanese companies currently adopt the term "Corporate Auditor" as the English translation of "Kansayaku". However, use of the word "Auditor" may cause confusion with external accounting auditors or employees in charge of internal audit. In addition, (i)they not only audit financial reports but also check and monitor management activities in general, (ii)Each member can individually exercise his/her strong power of investigation of the company's activities and of enjoinderment of illegal acts, (iii) A member has the legal obligation of attending the board of directors meeting and expressing his/her opinion. Considering such functions and powers, we use the word "Audit & Supervisory Board Members (KANSAYAKU)"]

1.2. Development since the establishment of the Study Group

After the establishment of the Study Group, in June 2012 the Industrial Structure Council New Industrial Structure Subcommittee put together a report stating; “The implementation of effective corporate governance is the core of corporate activities. Therefore the roles currently played and tasks by non-executives including outside directors and Audit & Supervisory Board Members (*Kansayaku*) who constitute important elements of corporate governance will be made clear”. The report also stated that “The roles that essentially should be played by the non-executives will be put together.”

After the mandatory introduction of outside directors was discussed in the Japanese Ministry of Justice’s Legislative Council Subcommittee on the Companies Act, in September 2012 the Council adopted the resolution to the effect that companies with no outside director shall state, on its business report, the reason why it is not appropriate to have an outside director and set additional requirements for outside directors as being neither executives of the parent company or a fellow subsidiary of the relevant company, nor close relatives of the relevant company’s executives. A supplementary resolution required financial instrument exchanges to set a rule that a listed company should have at least one independent officer who also is a board member, and were immediately submitted to the Minister of Justice.

Responding to these, the Cabinet decided to approve the Bill for the Act for Partial Revision of the Companies Act in November 2013. In this Bill, directors of companies are required at annual shareholders’ meeting to provide explanations on the reason why it is not appropriate to have an outside director. Supplementary provisions were added to the effect that the corporate governance system is to be reviewed two years after the revised Act takes effect (taking into account the status of elected outside directors and other matters on social and economic transformations). According to such a review, some measures such as a requirement to secure outside directors are to be taken whenever deemed necessary. This Bill passed into law on June 20, 2014

Based on the above Supplementary Resolution, the provision, in which listed companies shall make effort to secure at least one independent director, was added to the Securities Listing Regulations in February 2014.

As a result of these measures, more companies than ever have appointed outside

directors. According to a press release by the TSE as of June 17, 2014³, as of June 16, 2014, the ratio of listed companies (the first section) with at least one outside director increased 11.9 percentage points (253 companies) year on year to 74.2% (1,345 companies).

³ http://www.tse.or.jp/english/news/09/20140617_a.html

1.3. Policies for the interim report

So far, the Study Group has conducted interviews mainly targeting members of the Group. As the members have pointed out that the roles expected to be played by non-executives including outside directors and Audit & Supervisory Board Members (*Kansayaku*) is the issue that should be put together, it was decided that the advance summary would be conducted centering on the roles expected to be played by non-executives including outside directors and Audit & Supervisory Board Members (*Kansayaku*) (hereafter, the interim report). In reaction to the point above, the interim report is intended to be referred to in cases where:

- (1) Non-executives including outside directors execute their duties
- (2) Companies, especially top managements, consider the election of outside directors
- (3) Companies consider the formulation of an effective corporate governance system utilizing non-executives including outside directors and Audit & Supervisory Board Members (*Kansayaku*) who have been or will be elected.

Moreover, the members also pointed out the significance of clear explanation and communication to other countries about Japan's corporate governance system, including the true pictures of the Audit & Supervisory Board and its member. It is expected to utilize main terms of the interim report as a tool to promote understanding of Japan's corporate governance system in other countries.

Excessively uniformed rules would prevent companies from advancing their creative ingenuity, and work negatively. In this regard, company should be left with how it deal in corporate governance based on its own needs and motive, and its diversity will be respected in principle.

This interim report is based on the practices of companies and non-executives including outside directors and Audit & Supervisory Board Members (*Kansayaku*) who aim to enhance corporate governance, and summarizes matters to be noted when each company and non-executives address their tasks on its own motive.

2. The process of the study

The Study Group has held eight meetings so far. At the first meeting, the overall problem of corporate governance in Japan was discussed. From the second to the sixth meeting members interviewed people in charge of corporate governance in companies, as well as experts, and held a discussion. The topics of the Study Group in the second and subsequent meetings are as below.

The second meeting: the current picture of corporate governance as practiced in companies with committees

The third meeting: the true situation of corporate governance in companies with Audit & Supervisory Board (*Kansayaku-kai*)

The fourth meeting: corporate governance system from the viewpoint of investors

The fifth meeting: comparison with systems of corporate governance in foreign countries

The sixth meeting: corporate governance system from the viewpoint of the theory of business administration

At the sixth and seventh meetings, discussions were also held about the orientation of the interim report, proposed by the secretariat.

2.1 The viewpoint of corporate governance

Corporate governance shall accomplish the following:

- (1) Achieve long-term performance,
- (2) Put in place a mechanism to prevent misconduct and unsound events at the company from occurring.

In addition, it is also important to

- (3) Present, in a transparent manner to investors, (1) and (2) above, so that they can understand them easily.

The Study Group decided to review corporate governance centering on (1) and (3) above, while paying attention to how to construct the compliance system to an extent as misconduct in some listed companies was one of the motivations of the study.

Especially regarding (3), from the viewpoint of understandability overseas, being aware of the comparison with the corporate governance systems in Europe and the United States, a study based on the historical development of Japan's corporate governance system and differences in social infrastructures in Europe and the United States will be conducted.

2.2 About the role of the board

(Difference between Japan and other countries)

- As a premise for the discussion of the role of non-executives including outside directors and Audit & Supervisory Board Members (*Kansayaku*), it was pointed out that the authority, obligation, and function of the board are important. Especially, when discussed in comparison with other countries, foreign institutional investors might misunderstand the function of the board of Japanese companies, which should be given special consideration.
- Specifically, there is a difference between the board specialized for supervision, as often seen in the UK and the United States (monitoring function) and one with a main role of decision on the execution of operation (operational function).
- In Europe and the United States, the former monitoring function is usual and seen as a premise, but in Japan, a company can choose one of these two functions of the board.

(Regarding the choice of structure of corporate governance)

- As a point related closely to the role of the board indicated above, there is the choice of structure of corporate governance. Under the current Act of Japan, a company can choose one of two structures of corporate governance:
 - A company with committees ,or,
 - A company with Audit & Supervisory Board (*Kansayaku-kai*).
- In the amendment to the Companies Act, a new structure of corporate governance of companies with the audit committee may also be selected.
- Companies with committees can usually be understood as the monitoring function oriented. On the other hand, companies with Audit & Supervisory Board (*Kansayaku-kai*) are thought to be operational function oriented in many cases, but depending on the choice of agenda of the board and the specific organizational layout (establishment of non-statutory nominating committee or compensation committee), it is possible to implement a monitoring-function board (so-called “hybrid of both function”).

(Securing supervisory feature in case of the operation function)

- In cases when the board belongs to the operation function, playing a supervisory roles, nomination and compensation can be issues. In interviews by the Study Group, some people from companies with an operation-function board remarked that Audit & Supervisory Board Members (*Kansayaku*) including outside members played supervisory roles for not only on legal issues but also on the appropriateness of the conduct of business. Regarding compensation for directors, there was a remark that a compensation committee, with more than half of its members consisting of outside members, was established, and compensation was decided at the board based on the report of the committee.

2.3 About a unified concept of non-executives

At the Study Group, about the distinction of officers between executives who execute operation and non-executives who play roles of supervision over executives, there were the following opinions:

- Whether by outside directors or by Audit & Supervisory Board Members (*Kansayaku*), it is important that audit and supervision are implemented in the proper way, so the unified concept of non-executive is supportable. On the other

hand, there was an opinion that it was uncomfortable to put directors and Audit & Supervisory Board Members (*Kansayaku*) in the same group, because they had clearly different functions.

- In companies that stress a more supervisory role, the difference of roles is not significant between outside directors and outside Audit & Supervisory Board Members (*Kansayaku*), because both supervise the execution of operations, making it possible to consider both as non-executives in common.
- In companies that stress the decision making on execution of operation, outside directors would be involved more directly, so the roles of outside directors and outside Audit & Supervisory Board Members (*Kansayaku*) who would not be directly involved in decisions by voting become quite different. Therefore, there exists an opinion that it is not appropriate to put them together as a unified concept of “non-executives.”

The interim report also covers inside Audit & Supervisory Board Members (*Kansayaku*) who are not outside members because they are non-executives. As stated above, there are various opinions about the unified concept of non-executives including outside directors and Audit & Supervisory Board Members (*Kansayaku*). Therefore, this report describes outside directors and (outside) Audit & Supervisory Board Members (*Kansayaku*) separately.

2.4 Corporate Governance Codes in European countries

- In European countries, including the U.K., France, and Germany, rules about the roles and support system of outside directors and Audit & Supervisory Board Members (*Kansayaku*) are taken in the form of soft law known as the Corporate Governance Code.⁴ It is useful for companies to follow the codes because they are offered not as a collection of ideal norms, but made based on actual best practices. As it is a collection of desirable common practices and not necessary to make mandatory law to respect the companies’ autonomy, the codes are presented as a soft law. Because these codes are prepared taking into accounts of opinions of institutional investors, some members pointed out that companies that declared they followed the codes attained higher approval rates for proposals in shareholder' meetings.

⁴ Among these codes in European countries, a few rules that were not found in the survey by the secretariat (see 3 below) or in open sources, and thought to be helpful to think about the roles and support system of non-executives including outside directors are introduced in the interim report.

2.5 Disclosure about corporate governance based on the interim report

- Companies shall develop their management strategies to improve corporate value according to their business models by taking into account the surrounding management environment including the situations and risks they face. In view of developed management strategies, companies shall consider, on an ongoing basis, corporate governance system including their structure of corporate governance and roles and membership of the board so as to improve corporate value.
- Therefore, it is not desirable that all companies follow the practices included in the interim report of the Study Group uniformly and externally. Each company should conduct sufficient review of the practices and disclose its corporate governance system in its business report or the report about corporate governance, and actively disseminate such information. (Comply AND Explain)

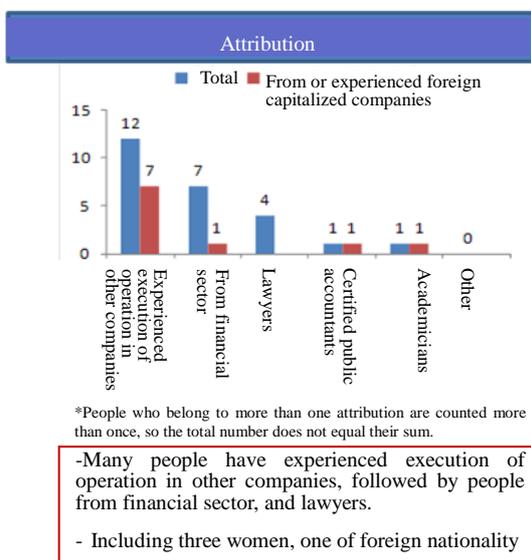
2.6 Corporate Governance Code in Japan and its announcement to overseas

- In addition to the cases of companies with good corporate governance systems, it is necessary to explain to countries outside Japan how to raise the level of companies that do not have sufficient corporate governance. To do that, some members suggested forming a code of best practices in order to better explain the direction of policies to other countries.

3. The survey by the secretariat

- The Study Group secretariat interviewed outside directors and Audit & Supervisory Board Members (*Kansayaku*) to obtain information about the points stated below (April to June 2012).
 - (1) Actions to be taken by outside directors and Audit & Supervisory Board Members (*Kansayaku*) in case they face the obligation stated in the Companies Act
 - (2) The role of outside directors and Audit & Supervisory Board Members (*Kansayaku*) to be understood as a premise of the discussion on the requirement to have outside directors
 - (3) Cases of success of Audit & Supervisory Board Members (*Kansayaku*) (inside and outside)

- Among interviews stated above, interviews were conducted on 25 outside directors (including people who had experience as outside Audit & Supervisory Board Members (*Kansayaku*), and former outside directors) centering on listed companies on a cross-industrial basis in cooperation with the Japan Corporate Governance Network (JCGN). The attribution of interviewees and the scale and structure of corporate governance of the companies where they took up the post are stated in the following table.



Scale and organizational structure of companies that appointed

	Large-scale companies	Medium-sized companies	Subtotal
Companies with Audit & Supervisory Board (<i>Kansayaku-kai</i>)	18	22	40
Companies with committees	9	0	9
Subtotal	27	22	49

Large-scale companies: 150 billion yen consolidated sales or more
Medium-sized companies: Less than 150 billion yen consolidated sales

*Excluding four companies without published information (non-listed companies and U.S. companies)

*Some people have experience in more than one company, so the total number of companies does not equal the number of interviewees.

- Interviews of Audit & Supervisory Board Members (*Kansayaku*) were conducted with 12 Audit & Supervisory Board Members (*Kansayaku*) (mainly full-time) centering on listed companies on a cross-industrial basis, in

cooperation with the Japan Audit & Supervisory Board Members Association.

- In addition, interviews were conducted with persons in charge in 18 companies to add and complement best practices of non-executives including outside directors and Audit & Supervisory Board Members (*Kansayaku*) (in December 2012).

4. The roles of non-executives including outside directors and *Kansayaku*

4.1. Problem to be addressed

There exist two kinds of problem to be addressed about the roles of non-executives including outside directors and Audit & Supervisory Board Members (*Kansayaku*).

One is to have a close look at the concrete image of the role of non-executives including outside directors and Audit & Supervisory Board Members (*Kansayaku*). The Companies Act has detailed rules about directors as executing persons and Audit & Supervisory Board Members (*Kansayaku*). But it does not necessarily contain sufficient rules about the roles of directors as supervisors. Article 362, paragraph (2), item (2) of the Companies Act states supervising the execution of the duties by directors, but there is no definite explanation about the content of the ‘supervision’. Therefore, except that a director, as a member of the board, should act in accordance with duty of care of a good manager and duty of loyalty, there are not enough legal rules about how to supervise specifically, and how to collaborate meaningfully with Audit & Supervisory Board Members (*Kansayaku*). Then, it is necessary to make the roles of the directors as supervisors clear. Furthermore, some members of the Study Group pointed out that it was necessary to show the best practices to companies where non-executives including outside directors and Audit & Supervisory Board Members (*Kansayaku*) do not function well in order to improve the level of corporate governance. Some members pointed out that it was difficult for investors in other countries to understand the Japanese system well, especially the system of Audit & Supervisory Board. As the roles of outside Audit & Supervisory Board Members (*Kansayaku*) may not have been properly recognized, it was important to send out information about the functions of not only outside directors, but also Audit & Supervisory Board Members (*Kansayaku*), especially outside members. Clarifying the role of non-executives including outside directors and Audit & Supervisory Board Members (*Kansayaku*) would contribute to the solution of these problems.

Another kind of problem to be addressed is to clarify the relationship between outside directors and other non-executives, including Audit & Supervisory Board Members (*Kansayaku*).

The summary of each of these is as follows.

4.2. Definite role of non-executives including outside directors and *Kansayaku*

4.2.1. The roles of non-executives including outside directors and *Kansayaku* in common

(1) The relationship between expected roles and the character of the company

Some members of the Study Group pointed out about the roles expected of non-executives including outside directors and Audit & Supervisory Board Members (*Kansayaku*) and the character of the company.

- The roles of non-executives including outside directors and Audit & Supervisory Board Members (*Kansayaku*) might differ between an independent board and centered on supervising operations and one centered on operational decision making.
- The necessity for outside directors and their roles are varying and can be different depending on companies. It is important to make this clear considering the difference.
- From the viewpoint of the theory of business administration, there is little empirical research on the relationship between outside and independent directors and business performance. However, research on this has increased in recent years based on various premises. For example, companies with strong cash and where management might waste money, might benefit from monitoring by outside directors. In a company which spend a large amount of cost in gaining information (with high ratio of R&D, where knowledge unique to the company is important), outside directors without adequate technical knowledge might not be effective. In a company with Japanese-style structure of governance (low ratio of foreign shareholders and high a ratio of cross share-holding), outside directors might contribute to the enhancement of performance.

Based on these points stated above and the diversity seen in practice, following implications can be developed.

- The structure of corporate governance of a company, the roles of its board, and the composition of the board to achieve the roles shall be selected not only from the viewpoint of compliance, but also based on the company's management strategy, after reviewing the risk and possibility of business. There is no fixed answer to this selection, and this issue should be reviewed constantly along with changes in the management environment and management strategy.

- The structure of corporate governance of a company and the roles and composition of its board are required to be selected in accordance with the management strategy of the company. As a result, the expected roles of non-executives including outside directors and Audit & Supervisory Board Members (*Kansayaku*) can be different in relation to the situation of the company, and its management strategy.
- A company is required to make the roles it expects of non-executives including outside directors and Audit & Supervisory Board Members (*Kansayaku*) clear to the officers themselves and shareholders. The officers themselves are required to execute their duties with the understanding of their roles.

(2) Commitment

<The provisions of code of foreign countries>

(The code of the U.K.⁵ B.3.2)

- Non-executive directors should undertake that they will have sufficient time to meet what is expected of them.

<Implications developed from the term above>

Non-executives shall secure ample time to fulfill the roles expected of them.

(3) Dialogues with shareholders

<The provisions of codes of foreign countries>

(The code of the U.K. E.1.1)

- Non-executive directors should be offered the opportunity to attend scheduled meetings with major shareholders and should expect to attend meetings if requested by major shareholders.

<Implications developed from the term above>

⁵ The UK Corporate Governance Code published as of September 2012 by the Financial Reporting Council in the U.K. (<http://www.frc.org.uk/Our-Work/Publications/Corporate-Governance/UK-Corporate-Governance-Code-September-2012.aspx>) In text, outlines of the relevant provisions are shown. The same shall apply hereafter.

In dialogues with shareholders who do not have enough time, knowledge, and experience, outside directors, as representatives for the interests of shareholders, should attend scheduled meetings with them and meetings requested by them.

On the other hand, in relation with shareholders who request dialogues about specific contents of management strategy and execution of operation, communication by executive directors who engage closely in those decisions is thought to be appropriate.

Some members of the Study Group pointed out that in some cases it was desirable that outside directors who represent the viewpoint of shareholders may communicate.

4.2.2. The roles of outside directors

The roles of outside directors are broken down into three aspects as follows, each of which are explained with specific practices.⁶

- (1) Negative check of proposals by executives (monitoring of the management)
- (2) Positive advice to the proposals by executives or given voluntarily (advice to the management)
- (3) Appraisal (nomination and compensation) of executives

About the other practices than provided in text, refer to the accompanying sheet.

(1) Monitoring of the management

In the Study Group, it was pointed out that the roles of outside directors had two aspects: one of which was to prevent “minuses” (that is, to prevent misconduct), and the other was to grow “pluses” (that is, to grow the sustainability of long-term performance), and they ought to be separately understood.

Based on the understanding as stated above, this term will be reviewed separately as follows:

- Monitoring from the viewpoint of compliance (preventing “minuses”), and
- Monitoring from the viewpoint of the enhancement of the corporate value (growing “pluses”)

⁶ In the Study Group, practices were shared through interviews and investigations conducted in the second and third meetings. Specific practices shown as follows were selected in information up to now, and it is possible that there exist other good practices than those. The words “best practices” are used because they are often used and easy to understand.

(1)-1. Monitoring from the viewpoint of compliance

<Best practices found in interviews>

A case of a company with Audit & Supervisory Board (*Kansayaku-kai*)⁷

(Electric equipment maker A)

- An outside director, who had experience of execution of operation in another company, strongly pointed out the problem of an act by the autocratic president, which might bring trouble from the aspect of compliance, and made it stop, while inside directors did not express their opinions.

Another case of a company with Audit & Supervisory Board (*Kansayaku-kai*)

(Precision equipment maker B)

- An outside director, who had experience of execution of operation in another company, actively exchanged opinions with an outside Audit & Supervisory Board Member (*Kansayaku*), and the member exercised the right to conduct an investigation as needed. Then, they found a problem and solved it.

Six other cases

<Implications developed from the term above>

Outside directors, obviously, need to monitor the execution of operation from the viewpoint of legality (compliance). In concert with Audit & Supervisory Board Members (*Kansayaku*), outside directors shall prevent illegal or grossly improper execution of operation. To that end, they shall look into facts suspicious of illegality, not only in relation to items brought onto the agenda of the board but also concerning information they gained through the internal auditing department, and express their opinion at the board on such matters or any other measure.

However, even if they cannot prevent an illegal execution of operation, there should be times when outside directors will not assume responsibility for the illegal actions of the company. A legal precedent⁸ stated that in a large-scale company, as far as monitoring

⁷ A company with Audit & Supervisory Board (*Kansayaku-kai*) that appointed two or more outside directors and established a nominating committee and a compensation committee voluntarily is recognized as an intermediate form between a company with Audit & Supervisory Board (*Kansayaku-kai*) and a company with committees (so-called hybrid type, refer to 2.1.2 above), which is stated in the notes in these cases.

⁸ The Tokyo High Court, May 21, 2008 (Yakult Honsha case)

is done over the execution of operation based on a proper risk management system, it is valid to trust the execution of operation by a director in charge is legal, in the absence of a specific reason to doubt that the execution might be illegal. Therefore, the conclusion of the case was that an outside director would not be accused of a breach of duty of care of a good manager, as a breach of obligation of monitoring. Not to make them assume too much responsibility, the monitoring expected of outside directors from the viewpoint of legality is thought to be based on the premise of the right to rely on others.⁹

(1)-2. Monitoring from the viewpoint of the enhancement of corporate value

<Best practices found in interviews>

(1)-2.1. Monitoring practices in management strategy

A case of a company with Audit & Supervisory Board (*Kansayaku-kai*) (with two or more outside directors and non-mandatory nomination and compensation committees)

(Manufacturing C)

(A case where an outside director with experience of execution of operation in another company pointed out a risk in the management strategy proposed based on his own experience, and improved its feasibility of the strategy.)

- With the development of global expansion, the company departed from its family-run operation, introduced a corporate officer system and more than one outside directors. The company also established committees comparable to a nominating committee and compensation committee in the board, with the aim of getting rid of the interdependence structure to secure the transparency of management to separate supervision and execution.
- The roles of the board, as representatives of stakeholders, include the decision of important matters, including management targets and strategy, as well as the supervision of the execution of operation. From the viewpoint of securement of the transparency of the management, prior management meetings are not held, and practical discussions are conducted at the board.
- Therefore, in election of outside directors, in addition to management experience, independence is considered important. There are unique criteria about independence. The company appointed ex-executive officers and management consultants as the

⁹ On p. 62 of “New Practices of Directors’ Responsibility” edited by Minoru Sawaguchi (Shoji Homu, 2012)

outside directors.

- As a result, outside directors with management experience pointed out problems of proposal from the executing side, including risks, and discussions in the board were activated, which contributed to the improvement of feasibility of the management target and strategy.

Two other cases

(1)-2.2 Monitoring practices in the decision of investment and M&A

A case of a company with committees

(Electric equipment maker D)

(A case where an outside director who had experience as a top management of a large-scale company pointed out a problem in an internal discussion from an outside viewpoint, and contributed to the prevention of unprofitable investment.)

- Against the background of the globalization of the management of the company, increased competition by the innovation of digital technology, and the increased ratio of foreign shareholders after dismantling of cross-shareholding, the company introduced the form of “companies with committees,” to strengthen the supervising function by separating supervision of management and execution, increase the transparency, soundness, and efficiency of management, and to speed up decision making by delegating the power to executive officers to a large extent. This is because the management at that time judged that the management and governance structure depending on such a system was more desirable than one relying too much on the ability of the individuals who happen to be in charge.
- The board delegated much power of decision making on the execution of operation to the representative executive officer (president), and focused on the fundamental terms of the execution of operation including the basic policy of the management, and the supervision of the execution of the management.
- Considering that the strengthening of supervision function is important from the viewpoint of general shareholders, the company elected outside directors with a high level of independence, in accordance with the criteria of independence set by the nominating committee, and elected the managements of various industrial sectors and specialties, in accordance with the management strategy of that time.
- As a result, in a case of decision of investment, an outside director specialized in business management, who had experience as a top management of a large-scale company, finally stopped an acquisition which would have brought a large impairment loss to the company, even after the discussion in internal meetings of management, by pointing out the problem from an outside viewpoint.

Another case of a company with committees

(Manufacturing E)

(A case where an outside director with experience of execution of operation in another company supported a proposal of M&A deal by the president after checking the process of business judgment.)

- The company Considered it should build a system where good management is ensured by structure, rather than a management solely relying on the personal capacity of managers (persons). Consulting the governance system of the U.S., the company appointed outside directors and transformed to a company with committees with the revision of the Commercial Code.
- Because the board is a place for discussions on the essential problems of management, with an important function of supervision of management, more than half of the board are outside directors, and the ex-CEO's or other type of persons who had experience of business executions were appointed.
- As a result, an outside director, with experience of business execution in another company, when the president had doubts about the success of an M&A deal, supported the president strongly, saying, "You should do things considering the growth strategy" after judging the appropriateness of the process of business judgment.

Twelve other cases

(1)-2.3. Monitoring practice in management and structure reformation

A case of a company with Audit & Supervisory Board (*Kansayaku-kai*)

(Information and communication company F)

(A case where an outside director with experience of business execution in another company, offered an opinion considering the profit of not only the founding family that is a large shareholder, but also general shareholders in selling the company, and summed up the discussion of the board.)

- In a case of reviewing the acceptance of a large-scale capital participation from another company to revive its business, an outside director, who had experience of execution of operation in another company, offered an opinion that not to pursue the interests of the founding family only, which is a large shareholder, but also for customers and general shareholders. With his opinion in the board, the opinions of inside directors, who could not make a judgment, were changed.

Another case

<Implications developed from the practices above>

Outside directors are required to monitor the execution of operation from a viewpoint of continuous enhancement of corporate value. Specifically speaking, outside directors offer honest opinions from their outside viewpoint with knowledge and experience, in important cases of execution of operation, such as decisions of management strategy,

execution of investment and M&A, and reform of management and structure of the company.

To expect these roles, the company should decide the criteria for electing outside directors, where the criteria is whether or not they are capable of monitoring in relation to the company's management strategies.

(2) Advice to the management

<Best practices found in interviews>

(2)-1 Best practices of advice on the making of management strategy

A case of a company with Audit & Supervisory Board (*Kansayaku-kai*)

(Transportation equipment maker G)

(A case where an outside director who knows the foreign situation well offers opinions based on the political situation of foreign countries)

- The company introduced outside directors when listed on a stock exchange in the U.S.
- The main aim of the introduction of outside directors is to bring in an outside viewpoint. The election of outside directors is not directly related to the particular content of the management strategy. A person who had experience of execution of operation of a bank was elected for supervision of finance, and another with knowledge of foreign situation was elected for supervision from a global viewpoint. However, their advice on management is expected as an additional effect.
- As a result, the outside director who knows the situation overseas well offers opinions about the future development of business, based on the political situation of the countries where the company is conducting or will conduct business. In the past, the outside director worked as a bridge to the local authority of an area targeted by the company, which resulted in success for the company.

Another case of a company with Audit & Supervisory Board (*Kansayaku-kai*)

(Energy company H)

(A case where an outside director who was an expert in related business, gave advice to the future business environment with special knowledge, and contributed to the making of management strategy.)

- The company conducted management reforms as a response to the situation that the expansion of sales became a business challenge after the transformation to a new business infrastructure, as well as a rise in the awareness of corporate governance in the economic community. The company introduced a corporate officer system and

elected more than one outside director.

- The roles of the board are decision making on important matters and supervision of the executing side. Specifically, because the company is engaged in semipublic business, it is expected to discuss how to grow stably, including from the viewpoints of outside, without conducting high-risk investments.
- Therefore, a lawyer who has a broad knowledge of corporate legal affairs, especially in the area of risk management, as well as an expert who has a good understanding of the viewpoint of energy users in order to address the management challenge of the expansion of sales based on the new business infrastructure, were elected as outside directors.
- As a result, the outside director who is an expert in energy and environment sectors gave advice on the middle- and long-term energy environment, including competition with electricity companies and the future change of energy sources, which contributed to the making of the management and investment strategies.

Two other cases

(2)-2. Best practices of advice on the decisions of investment and M&A

A case of a company with Audit & Supervisory Board (*Kansayaku-kai*) (with two or more outside directors and non-mandatory nomination and compensation committees)

(Service company I)

(A case where an outside director from the finance industry, leveraging his/her experience, contributes to the negotiation with a foreign country in an M&A case in which appropriateness of price was questioned.)

- Aiming at a management focused on the continuous enhancement of corporate value, by making the roles and responsibilities of the board, Audit & Supervisory Board (*Kansayaku-kai*), and executives clear and constructing a governance system that helped each of their function organically, the company introduced the current system (corporate officer system, with the majority of the board being outside directors, and a non-mandatory compensation committee).
- By the corporate officer system, corporate officers execute operations, and the board are dedicated to their supervision and important decision such as making of management policies, which would help realize efficient and sound management.
- About the election of outside directors, persons with knowledge and experience of finance are thought to be necessary, so persons from the financial industry were elected.
- As a result, in a case of assuming 100% ownership of a company through a share exchange, an outside director from the financial industry (a security company) made an independent committee, based on opinions of shareholders, and was involved in the

negotiation about the exchange ratio among the management, shareholders, and financial advisors, which resulted in an agreement with an advantageous ratio for the company.

Another case of a company with Audit & Supervisory Board (*Kansayaku-kai*) (with two or more outside directors and non-mandatory nomination and compensation committees)

(Trading company J)

(A case where an outside director who knows the foreign situation well offered an opinion to develop the acquisition case of an interest in a foreign country, considering the relationship with the foreign government, and contributed to the smooth achievement of the case.)

- In a time of bad performances including posting of loss, the company introduced a corporate officer system and elected outside directors, to consciously change the management system.
- Because the company's business covers a wide range of areas, as outside directors, not persons who can give advice in specific areas in accordance with the management strategy, but persons who can supervise the management from a wide viewpoint were elected.
- As a result, in a case of acquisition of an interest in a foreign country, the relationship with the government of which could worsen, an outside director who knows the situation of foreign countries well gave advice based on the movement of the government, and contributed to the smooth achievement of the case, while keeping the relationship with the government good.

Six other cases

(2)-3 Best practices of advice to the management and structure reforms

A case of a company with Audit & Supervisory Board (*Kansayaku-kai*) (with two or more outside directors and non-mandatory nomination and compensation committees)

(Retailing company K)

(A case where an outside director who had experience of execution of operation in another company promoted the withdrawal from a loss-making segment from the viewpoint of overall management and contributed to business structure reform.)

- Driven by the drastic deterioration in earnings that made radical structural reform necessary, the company introduced a corporate officer system and more than one outside directors, considering that it was difficult to conduct structural reform only by internal persons who were strongly related to existing businesses. The company did not choose to transform itself to a company with committees, because it was thought that a company with Audit & Supervisory Board (*Kansayaku-kai*) was better, as it may

establish non-statutory nominating and compensation committees. It maintained Audit & Supervisory Board Members (*Kansayaku*) with four-year-term, which is equipped with a function to stop, a very different from directors.

- The composition of the board is decided based on the idea that insufficient elements of inside directors are supplemented with outside directors from the viewpoint of each of business strategy, compliance, persons with the experience of management, and experts.
- From the viewpoint of promotion of structural reform, an outside director who could manage the company in an integrated manner and offer his opinion to the president based on his experience of business execution was thought to be necessary. Therefore, an outside director with executive experience of another company, was elected.
- As a result, the outside director offered an opinion to withdraw from a business segment that had been a source of earnings but had drastically deteriorated in its performance, and contributed to the company's structural reform by realizing the withdrawal.

Another case of a company with Audit & Supervisory Board (*Kansayaku-kai*)

(Electric equipment maker L)

(A case where an outside director had experience of execution of operation in another company. The director gave advice based on his knowledge and experience of business execution. The advice was about the production system of the company, and contributed to the reform of the system of the company in management crisis.)

- As a response to its deteriorated performance including an insolvency, the company reformed its management structure. The company introduced a corporate officer system to separate the management and supervision, and elected outside directors. The board is positioned as the organization for basic and strategic decision making, as well as the supervision of business execution. It deliberates on the fundamental policy and important matters of management and resolves them, as well as conducting inspection and supervision of the situation of business execution.
- For outside directors, persons with experience, track records, perspectives, and knowledge as experts are appointed to secure the effectiveness of supervising the function of management.
- As a result, an outside director with experience of execution of operation contributed to the reform of the production system at the manufacturing scene. The system had been difficult to reform only with internal opinions, because of existing past connections and ideas based on vested interests. The outside director gave advice based on his knowledge and experience of the business execution.

Two other cases

(2)-4. A best practice of advice to strengthen the internal system

A case of a company with Audit & Supervisory Board (*Kansayaku-kai*)

(Wholesaler M)

(A case where an outside director had experience of execution of operation in another company. The director contributed to the strengthening of the internal system in a time of revision of corporate law, utilizing his knowledge and experience.)

- In the wake of listing of its stock, the company elected outside directors to transform from management mainly by the founding family to management more conscious of general shareholders' viewpoint.
- The role of the board is to receive the report from the internal management meetings, and deliberate them. The discussion of the board is mainly led by indications by outside directors and Audit & Supervisory Board Members (*Kansayaku*). The board has a few members for the size of the company. All members except the president are non-executive directors.
- Persons with rich experience of management and financial experts are elected as outside directors.
- As a result, an outside director who had experience of execution of operation of another company contributed to the system reform. The reform includes the response to the revision of the Companies Act and the Financial Instruments and Exchange Act, and reform of internal control. The director utilized his knowledge and experience, which is helpful to the medium-sized company with only a few legal staff.

<Implications developed from the practice above>

Outside directors are expected to advise on the execution of operation as well. Utilizing their experience and knowledge as experts, they can contribute to the continuous enhancement of corporate value by bringing in knowledge and experience that did not exist in the company. Specifically, they are expected to advise on important occasions, including the construction of management strategy, the execution of investment and M&A, and implementing management & structural reforms. In small and medium-sized enterprises without rigid corporate system in place compared to large-scale companies, outside directors give advice to strengthen the system.

In that sense, the same as in (1)-2, the company should decide the criteria for electing outside directors, where the criteria is whether or not they are capable of advising in relation to the company's management strategies.

For advice to the management, some people point out that it is sufficient to contract with outside advisors, not as outside directors. On that point, companies that appointed outside directors offered opinions that outside directors knew the internal situation

better than advisors, because they are directors of the company. They also offered that outside directors would feel stronger sense of responsibility because they assume a duty of care of a good manager and a duty of loyalty defined in Companies Act.

(3) Appraisal (nomination and compensation) of executives

To evaluate performance of executives and to link it to their compensation is an important role expected of outside directors, because it is difficult for inside officers to evaluate objectively in some cases. This role is related to both (1) Monitoring of the management and (2) Advice to the management. So, this section was written independently from the last two sections.

<Best practices found in interviews>

A case of a company with committees

(Electric equipment maker N)

(A case where an outside director played an important role in the change of president.)

- At the time of listing on a stock exchange in the U.S., the company introduced outside directors. Considering the global standard of governance, and as per the revision of the Commercial Code, it divided the execution and supervision of business clearly, delegated powers to the execution side to a large extent, and transformed to a company with committees to speed up the execution. When the company was a company with Audit & Supervisory Board (*Kansayaku-kai*), because of the legal requirement, the company found it had too many agendas to be decided at the board, which prevented it from making agile decisions.
- The company required outside directors to supervise the management. The election is not based on the knowledge and experience of specific businesses, but on consciousness of diversity reflecting the diversity of the company's business.. On that basis, a discussion is held about what kinds of people were needed in the current board at the nomination committee every year.
- As a result, an outside director played an important role in the discussion at the board, in the change of president.

A case of a company with Audit & Supervisory Board (*Kansayaku-kai*) (with two or more outside directors and non-mandatory nomination and compensation committees)

(Information and communication company O)

(A case where an outside director had experience of execution of operation in a foreign capitalized company. The director utilized his experience of valuation and change of

presidents in the company and valued the performance of the president and character evaluation of the next president in non-mandatory nomination and compensation committees, from an independent standpoint.)

- An outside director, with experience as a representative of a foreign capitalized company, conducts character evaluation of the next president based on an interview, and valuation of the current president based on the quantitative criteria decided at the beginning of every fiscal year in the non-mandatory nomination and compensation committee.

Another case of a company with Audit & Supervisory Board (*Kansayaku-kai*) (with two or more outside directors and non-mandatory nomination and compensation committees)

(Precision equipment maker P)

(A case where an outside director had experience of execution of operation in another company. The director conducted an objective character evaluation in a non-mandatory nominating committee in cooperation with other outside directors. The director appointed a different person to the current president's choice as the next president.)

- The company appointed outside directors at the time it introduced anti-takeover measures. The current board is composed of the following types of members: (1) a director who is in full-time service at the holding company. He is in charge of the execution of operations of the holding company, concretization of target as a group, and monitoring of each operating subsidiary,
(2) a part-time director who knows each business well and works as a president of major subsidiaries, and
(3) two outside directors who check and supervise the management. They utilize their rich experience as top management and wide range of knowledge. They do their jobs, from their independent standpoint.

Also, the company voluntarily established a nomination committee and a compensation committee. The chairpersons and more than half of the members of the committees were outside directors.

- Outside directors are elected focusing on their rich experience as top managements, wide range of knowledge, as well as high-level knowledge and perspective of business finance and corporate law.
- As a result, in the election of the next president, an outside director utilize experience of execution of operation in another company. In cooperation with other outside directors, the director conducted an objective character evaluation based on interviews of inside directors and Audit & Supervisory Board Members (*Kansayaku*). Rather than just following the will of the president at that time, the director appointed a different person as the next president at the non-mandatory nomination committee. This

appointment of the next president by outside directors was seen as from an objective viewpoint. But for this nomination, conflicts around the appointment could have occurred in the company.

Another case of a company with Audit & Supervisory Board (*Kansayaku-kai*) (with two or more outside directors and non-mandatory nomination and compensation committees)

(Retailing company Q)

(A case where an outside director who had experience of execution of operation in another company contributes to the making of the human resource development plan.)

- An outside director with experience of execution of operation plays a central role in proposing about the making of a human resource development plan and contributes to the improvement of management.

Three other cases

<Implications developed from the practices above>

The ultimate measure to evaluate an executive is to remove her/him. In election and appointment of directors, especially the election of the representative director (president), it is important for outside directors to give advice. It is sometimes difficult for outside directors to conduct character evaluation itself, because they are from outside the company, but their participation can enhance the transparency of the election and appointment process.

Moreover, outside directors can make an evaluation of executives by evaluating performance of the company objectively and take it into account when they decide the compensation of the executives.

4.2.3. The role of (outside) *Kansayaku*

With respect to (outside) Audit & Supervisory Board Members (*Kansayaku*), there exist many rules about their duties and powers which include auditing the execution of duties by directors (Article 381, paragraph (1) of the Companies Act). Their duties are legally clearer than outside directors'.

Therefore, their important duties and powers are explained with best practices, as follows.

(1) Collection of information necessary for the audit

<Best practices found in interviews, etc.>

(Food maker A)

(A case where misconduct was found by the investigation by an Audit & Supervisory Board Member (*Kansayaku*).

- In the company, outside directors do not interfere in details of execution of operation, but offer opinions on the broad orientation. On the other hand, Audit & Supervisory Board Members (*Kansayaku*) focus on the prevention of misconduct.
- Therefore, persons who are familiar with this industry and have knowledge of accounting are elected for the post.
- An Audit & Supervisory Board Member (*Kansayaku*) questioned the numbers of the financial statement, conducted an investigation, and found misconduct in the company.

(A published case)

(A case where an Audit & Supervisory Board Member (*Kansayaku*) made the suggestion of an inappropriate deal with a company run by an ex-officer. Based on that, third-party committees including a lawyer conducted an investigation.)

<Implications developed from the practices above>

Audit & Supervisory Board Members (*Kansayaku*) have the power to investigate the situation of the company's business and property (Article 381, paragraph (2) of the Companies Act). They are required to gather necessary information by communicating with directors and accounting auditors, cooperating with internal audit and internal control units, and conducting site inspection.

In circumstance of emergency, there are some cases where they organize an investigation committee to look into the root cause of wrongdoing in coordination with people outside the company who have no interest.

(2) Opinion statement at meetings including the board

<Best practices found in interviews>

(2)-1. A Best practice of *Kansayaku*

(Information and communication company B)

(A case where Audit & Supervisory Board Members (*Kansayaku*) systematically warn of the risks of legal violation and cover-up of misconduct to the president.)

(A case where Audit & Supervisory Board Members (*Kansayaku*) state opinion about the appropriateness of investments from the viewpoint of shareholders.)

- Audit & Supervisory Board Members (*Kansayaku*) of the company are not incorporated in lines of execution of operation, and do not have to obey instructions from the president in the course of employment. Therefore, they can be upfront with the president himself on the risks of legal violation led by the president, or caused by the deficiencies in internal control, and cover-up of misconduct by the president.
- At the board, they ask questions about the appropriateness of investments, point out tasks to be addressed, and make sure that the investments are consistent with the management strategy. On this occasion, they conduct their duties based on the judgment criterion of the role they would expect of Audit & Supervisory Board Members (*Kansayaku*), if they were shareholders.

(2)-2. Best practices of outside *Kansayaku*

(Fishing and agriculture company C)

(A case where an outside Audit & Supervisory Board Member (*Kansayaku*) from the financial industry led the orientation of discussion about a proposal by the president at the board through communication with inside directors.)

- To speed up the decision making of the management and promote young human resources, the company introduced the corporate officer system. And to secure appropriate and transparent execution of operation, independent and fair-minded outside directors were elected, in addition to the supervision of the board by Audit & Supervisory Board (*Kansayaku-kai*).
- Persons who have rich knowledge and perspective of the financial industry and the management, and can give objective, accurate, and effective advice are elected as outside Audit & Supervisory Board Members (*Kansayaku*).
- As a result, when a proposal of acquisition by the president was brought up for discussion on very short notice, an outside Audit & Supervisory Board Member (*Kansayaku*) expressed a dissenting view as an Audit & Supervisory Board (*Kansayaku-kai*). This was because the acquisition could lead to a large deficit. His action helped postpone the resolution. After that when interviews of directors and business departments are conducted, the director in charge of the acquisition, other directors, and the R&D department pointed out the existence of risks, and expressed concerns. At the board later, the member opposed the acquisition again, from two aspects including the lack of third-party evaluation and the viewpoint as an expert; some inside directors also expressed their dissenting view, and the resolution was voted down. The resolution came close to be adopted before, but all directors had had

a dissenting view in their minds. The outside Audit & Supervisory Board Member's (*Kansayaku*'s) opinion brought out what they really thought.

(Electric equipment maker D)

(A case where outside Audit & Supervisory Board Members (*Kansayaku*) audit not only illegality but also appropriateness, and advice on PR and IR.)

- Two people with experience as top managements in other companies and one lawyer were appointed as outside Audit & Supervisory Board Members (*Kansayaku*).
- The company introduced outside directors for listing its ADR on the U.S. market. Requirement for outside Audit & Supervisory Board Members (*Kansayaku*) is not much different from outside directors, except legally decided duties for them, so they audit not only illegality but also appropriateness. Thus, they are expected to ask questions from the viewpoint of the third party and common sense, in addition to compliance.
- Specific cases include where they questioned the information management system when there had been a leak to a newspaper. They also offered an opinion about the way of expressing and explanation of financial results and IR from the viewpoint of investors, and contributed by making these easy to understand.

(Transportation equipment maker E)

(A case where outside Audit & Supervisory Board Members (*Kansayaku*) are checking the process of the business judgment)

- (According to the interviewed Audit & Supervisory Board Member (*Kansayaku*),) an important thing about the inspection of business execution is due process. It would be too much for an Audit & Supervisory Board Member (*Kansayaku*) to say, "Why don't you sell the goods at ¥110?", when they tell him they would sell it at ¥100. But, it would be his/her role to check if directors follow a proper procedure of the business judgment, including the price by competitors and after what kind of review they judged it at ¥100.
- Based on a recognition like this, outside Audit & Supervisory Board Members (*Kansayaku*) of the company focused on the check of the process of matters to be discussed with the board.

(Constructor F)

(A case where outside Audit & Supervisory Board Members (*Kansayaku*) do not hesitate to express their opinions about the appropriateness of decisions by the management, rather than just confirming them.)

- Outside Audit & Supervisory Board Members (*Kansayaku*) are elected to strengthen the

inspection function of management. As outside Audit & Supervisory Board Members (*Kansayaku*), persons with rich experience and knowledge about the main business of the company were elected.

- At the board, the decisions of the management meeting are not automatically approved. Directors explain to Audit & Supervisory Board Members (*Kansayaku*), especially outside members, and listen to their opinions. The opinions include not only ones about legality but also ones from the viewpoint of appropriateness, including the aim and intention of the proposal, risk analysis, financial analysis, and pros and cons. Even among decisions of the management meeting, some were voted down and some were accompanied with attached conditions based on these discussions.

(Machinery maker G)

(A case where an outside Audit & Supervisory Board Member (*Kansayaku*) who is a lawyer utilized his/her knowledge and experience and realized the improvement of the legal department.)

- In internal rules it is decided that outside Audit & Supervisory Board Members (*Kansayaku*) have to express their opinions actively at the board, and the board is positioned as a place for decision making about management policy and strategy, considering the interest of general shareholders.
- Therefore, a lawyer with rich legal knowledge and experience and without interest in the company was appointed as an outside Audit & Supervisory Board member (*Kansayaku*).
- As a result, the outside Audit & Supervisory Board member (*Kansayaku*) who is a lawyer gave specific advice to improve the operation of the legal department of the company, including contract procedures and complaints handling, which led to actual improvement.

<Implications developed from the practices above>

Audit & Supervisory Board Members (*Kansayaku*) have to participate in the board and express their opinions as needed (Article 383 paragraph (1) of the Companies Act). Needless to say, they are required to check the execution of duties performed by directors from the viewpoint of legality and express their opinions, which include the check of the existence of violation of duty of care of a good manager by directors. In addition, they are entitled to express their opinions and advice in terms of appropriateness.

In addition to the board, they are required to fulfill the same roles as above when they participate in important internal meetings, including management meetings.

(3) Indications by the audit report

<Best practices found in published cases>

(A published case)

(A case where the defectiveness of internal control system was pointed out in the audit report.)

(Another published case)

(A case where a business report was not approved in the audit report, because of doubt about compliance.)

<Implications developed from the practices above>

Audit & Supervisory Board Members (*Kansayaku*) have to prepare an audit report (Article 381, the second sentence of paragraph (1) of the Companies Act). The audit report constitutes an important document showing the result of the audit. They are required to point out irregularities as the case may be.

(4) Enjoinment of an illegal act

<A best practice found in a published case>

(A published case)

(A case where an outside Audit & Supervisory Board member (*Kansayaku*) filed a petition for provisional disposition with the illegal act against the extension of the repayment term and sellout of a company's property, because of the violation of duty of care of a good manager. The petition was approved.)

<Implications developed from the practice above>

If a director is engaged in an act that violates laws and articles of incorporation, or if such possibility exists, and if such act is potentially harmful to the company, Audit & Supervisory Board Members (*Kansayaku*) can demand the director to stop the act (Article 385, paragraph (1) of the Companies Act). This right to demand an injunction is a strong legal right, so it is necessary to review cautiously before the actual exercise,

including preliminarily demanding the director to rectify the illegal act. Still, there were some cases where the right was actually exercised.¹⁰

¹⁰ Except the case described above, examples where Audit & Supervisory Board Members (Kansayaku) exercise the right to demand an injunction include a published example where an Audit & Supervisory Board member (Kansayaku) filed a petition for provisional disposition with a censure motion against the member, which had been planned to be submitted to an ordinary general meeting of shareholders.

4.3. About division of roles between outside directors and (outside) *Kansayaku*

<Best practices found in interviews>

(Transport operator A)

- Audit & Supervisory Board Members (*Kansayaku*) express their opinions from the viewpoint that “this might be a problem” (they request reconsideration), on the other hand, outside directors express their opinions and propose active orientation, such as “you can do like this,” from the management perspective.

(Cosmetic company B)

- At the board, outside directors express their opinions from the viewpoint of how to make the business plan a success, assuming that the plan will be carried out; on the other hand, outside Audit & Supervisory Board Members (*Kansayaku*) express their opinions from every perspective, about if there is anything overlooked, illegality, and problem about risk management, from a neutral viewpoint about the execution of the matters to be discussed.

(Manufacturing C)

- At the board , outside Audit & Supervisory Board Members (*Kansayaku*) are also expected to make in-depth points about the appropriateness of the business, just the same as outside directors, and they really do.

<Implications developed from the practices above>

As stated in 4-2-3-(2) above, (outside) Audit & Supervisory Board Members (*Kansayaku*) are entitled to express their opinions and advice from the viewpoint of appropriateness. Actually there are many examples where they express their opinion without being concerned about the difference between illegality and appropriateness, just as outside directors do.

Among those examples, there exists a difference: outside directors express their opinions aiming at the upside (success of the business execution); on the other hand, (outside) Audit & Supervisory Board Members (*Kansayaku*) express their opinions to prevent the downside (failure of the business execution). Using these examples as a guide, when (outside) Audit & Supervisory Board Members (*Kansayaku*) express their

opinions, they could be conscious about the difference of orientation from outside directors' opinion.

About the difference between outside directors and (outside) Audit & Supervisory Board Members (*Kansayaku*), some pointed out that outside directors have less information than (outside) Audit & Supervisory Board Members (*Kansayaku*), for whom measures of information acquisition are legally defined. This point, however, is not an actual problem if the company constructs a sufficient support system to furnish outside directors with information, as stated in 5.3 below, and is not thought to be a problem of the outside director system itself.

5. Support system for non-executives including outside directors and *Kansayaku*

5.1. Introduction

There exist two kinds of questions concerning support systems of non-executives including outside directors and Audit & Supervisory Board Members (*Kansayaku*).

One is how to elect outside directors and Audit & Supervisory Board Members (*Kansayaku*) who can play expected roles. The election of outside directors and Audit & Supervisory Board Members (*Kansayaku*) is often discussed from the viewpoint of independence. But independence is the minimum condition for outside directors and Audit & Supervisory Board Members (*Kansayaku*) to play their roles, and discussion about how to secure more active conditions (strategic qualification) for them to play their roles is necessary.

Another question is what kind of internal system shall be implemented to support non-executives including outside directors and Audit & Supervisory Board Members (*Kansayaku*), and how to address the task. In general, information they have about the company and their relationship to people and systems inside the company are much weaker than inside officers. In order to avoid the situation where non-executives including outside directors and Audit & Supervisory Board Members (*Kansayaku*) are regarded as something in name only, adequate support is necessary. Some members of the Study Group pointed out that the roles of non-executives including outside directors and Audit & Supervisory Board Members (*Kansayaku*) could play were different depending on the support system for them, and as many listed companies tried to appoint them and make them effective, the study of what was lacking in the introduction and utilization of them was necessary. Moreover, some members pointed out that compared with Audit & Supervisory Board Members (*Kansayaku*) who can obtain information offered by full-time Audit & Supervisory Board Members (*Kansayaku*) and Audit & Supervisory Board, outside directors have much less information shared, and some measures to help appointed outside directors function effectively are necessary.

This report will discuss each point as follows.

5.2. About the selection and candidates for non-executives

(1) The selection of candidates

<Best practices found in interviews, etc.>

In interviews conducted by the secretariat, candidates for outside directors and Audit & Supervisory Board Members (*Kansayaku*) are often selected through private network with the top managements. On the other hand, in some companies the selection was conducted mainly by outside directors and Audit & Supervisory Board Members (*Kansayaku*). A published case shows a company defined specific criteria about the independence of outside directors and Audit & Supervisory Board Members (*Kansayaku*).

(Pharmaceutical company A)

- First, a nomination committee composed of outside directors lists candidates for outside directors. If not enough, other outside directors and inside directors also list names. After the check of independence, eventually the chairperson of the nomination committee, who is an outside director, asks for accession.

(A published case)

(A case where the criteria for the independence of outside directors and Audit & Supervisory Board Members (*Kansayaku*) were defined specifically and published, including “not someone from a main business partner.”)

<Implications developed from the practices above>

The company could call upon non-executives including outside directors and Audit & Supervisory Board Members (*Kansayaku*) to select candidates of other outside directors and Audit & Supervisory Board Members (*Kansayaku*) instead of asking executives to recommend some, to ensure high degree of independence from executives. Moreover, to ensure selecting independent outside directors and Audit & Supervisory Board Members (*Kansayaku*), the company could decide the specific selection criteria for independence of outside directors and Audit & Supervisory Board Members (*Kansayaku*) in addition to the legal requirements.

(2) Composition

<Best practices found in interviews, etc.>

(Cosmetic company B)

- Addition of diversified values to the board is regarded as important. Females and foreigners were elected as directors to diversify the composition of the board.

(Pharmaceutical company C)

- The company recognizes that supervision of management is more important than advice on the execution of operation as the roles of the board, and aims for the enhancement of profitability for stakeholders including shareholders, customers, and employees. For that reason also, the company pursues diversity in the composition of the board, and appointed foreigners and females.

Other examples of the election considering diversity of the board include the electric equipment maker N shown in 4-2-2-(3) above.

Some members of the Study Group offered an opinion that it should be watched closely that in the EU, proposals to improve corporate governance of companies in Europe (a green paper on the EU corporate governance framework) were published in 2011, and matters such as how to secure further diversity of the board were discussed now.

(Energy company D)

- Because the securement of resource interest overseas is an important management task, the company appointed outside directors who had experience of execution of operation and knew the situation of foreign countries well. As a result, they often pointed out the risks of foreign businesses, which led to more careful setting of the closure condition of foreign businesses.

<Implications developed from the practices above>

From the viewpoint of diversity of the board, the company could elect outside directors with various backgrounds, including women and foreigners to enable management advice and supervision over management based on diverse value.

On the other hand, when the company focuses on a specific area in relation to the management strategy, the company could appoint outside directors and Audit & Supervisory Board Members (*Kansayaku*) who have special knowledge of and experience in that area.

(3) Compensation

<The rules of code of foreign countries>

(The code of the U.K. D.1.3)

- Levels of remuneration for non-executive directors should reflect the time commitment and responsibilities of the role.

<Implications developed from the rule above>

To secure the appropriate level of incentive, the company should correlate the level of compensation of non-executives including outside directors and Audit & Supervisory Board Members (*Kansayaku*) with time that they spend on their duties and roles.

(4) Term of office

<A best practice found in interviews>

(Pharmaceutical company E)

- The longest tenure of outside directors is limited to three years in principle, because they have built relationships with people inside the company including the management from their appointment, and become insiders little by little.

<Implications developed from the practice above>

Although there is an opinion that with a longer term outside directors could know the business of the company well, which enables more effective supervision, the company could establish the longest tenure of outside directors, because they become insiders little by little from the moment of the appointment.

(5) Significance of cultivation and the securement of mobility of outside directors and *Kansayaku*

- If it had not been for the supply of potential candidates and the system of cultivation and education for candidates of outside directors and Audit & Supervisory Board Members (*Kansayaku*), there would be a concern that their existence would lack meaning, even if their number increases. It is necessary to

make the mechanism that includes the factors mentioned above.¹¹

- It is significant to realize the mobility of human resources to make easy the securement of good candidates for outside directors, and to secure the environment that outside directors and Audit & Supervisory Board Members (*Kansayaku*) can say what they want to say to executives without any restraint.

¹¹ Some people in economic associations consider making the filing of human resources of candidates for outside directors. This movement can be valued positively as a mechanism to realize appropriate securement of human resources by companies.

5.3. About support system

Management resources generally include people, goods, and capital. It is necessary to provide adequate internal information, support staff, and activity expenses and so on also for non-executives including outside directors and Audit & Supervisory Board Members (*Kansayaku*). Moreover, environmental consideration and other attempts are necessary for outside directors and Audit & Supervisory Board Members (*Kansayaku*) to feel at ease in offering their opinions in important meetings including the board and Audit & Supervisory Board.

Best practices about the support system for non-executives including outside directors and Audit & Supervisory Board Members (*Kansayaku*) are explained as follows.

A point that needs attention is that the support system required for each company is different depending on many factors, including the structure of corporate governance, size, management environment, and financial status, and a company is not obliged to construct all support systems shown as follows. What follows is understood as a reference for each company to review its support system.

However, items in the support system can be divided between recommended terms and terms that can be considered as an option. The former is expressed as “should” and the latter, as “could”

5.3.1. Support system for outside directors

(1) Provision and acquisition of company information

(1)-1 Preliminary provision of information about proposals to the board

<Best practices found in interviews>

(Energy company A)

- Materials are distributed on the company's intranet in the week before the board, and participants read them well preliminarily. Opinions and questions about the materials can be written on the intranet, and the secretariat answers before the date of the board meeting. As a result, a substantial discussion became possible at the meeting.

(Cosmetic company B)

- The secretariat sends materials to outside directors and outside Audit & Supervisory Board Members (*Kansayaku*) four to five days before the board is held, and they participate in the board after they read materials well.

(Energy company C)

- Before the start of the board, a briefing session is held for outside directors for about one hour. Preliminary sessions are essential, especially about complicated matters. Materials used in the session are sent the day before the board or distributed on that day.

<Implications developed from the practices above>

The company should deliver documents or explain about items brought onto the agenda of the board for discussion in advance enough to provide ample time for outside directors, so that they may express opinion, make indications, or raise questions in a meaningful manner.

Some members of the Study Group pointed out that information is important to support roles of outside directors and Audit & Supervisory Board Members (*Kansayaku*), especially outside directors, and a mechanism that enabled outside directors to obtain information regularly from their support staff and internal control department was necessary.

(1)-2 The way to obtain internal information

<Best practices found in interviews>

(Fishing and agriculture company D)

- An outside director, at his/her accession of office, negotiated with the president to obtain the same information as Audit & Supervisory Board Members (*Kansayaku*). When the internal audit department or internal control department finds misconduct, information from these departments is reported not only to the president, but also to outside directors. The outside director always checks it well.

(Electric equipment maker E)

- When problems including misconduct above a certain level of importance have occurred, the relevant information will be reported not only to the president but also to all directors including outside directors.

(Energy company F)

- Internal information of the company is supposed to be shared not only from inside officers, but also from the secretariat.

(Securities finance company G)

- One of the full-time inside director is in charge of providing information to the audit committee members, who are also outside directors. The inside director works as a link between outside directors and other inside directors.

<Implications developed from the practices above>

For outside directors to play their roles, it is necessary that internal information is adequately shared. Therefore the company should build a system to share information with outside directors. For that purpose, the company could assign this task to one of the full-time officer who knows well the inside situation of the company.

Especially concerning information about internal audit and internal control, the company should build a dual reporting structure, by which, the same information as is reported to the management is also reported to outside directors at the same time.

(1)-3 Collaboration with other non-executives including other outside directors and *Kansayaku*

<Best practices found in interviews>

(Pharmaceutical company H)

- Meetings composed only of outside directors are held once or twice in a year, where they discuss freely without the presence of the secretariat. The company believes that communication outside the board and committees deepens mutual understandings among outside directors, and passively contribute to active discussion in the board. Communications like this enhance awareness among outside directors about the management tasks, and make discussions at the board fruitful as a result.

(Precision equipment I)

- The outside directors exchanges opinions with outside Audit & Supervisory Board Members (*Kansayaku*), and when an investigation is necessary, sometimes commissions outside Audit & Supervisory Board Members (*Kansayaku*), who have investigatory authority, to conduct an investigation. There are examples where problems were found and resolved as a result.

<Implications developed from the practices above>

To conduct supervision of the management effectively, outside directors should hold regular meetings with other non-executives, mutually share information, and exchange opinions. (The company should arrange an environment adequate for such collaborations.)

Moreover, in relation to (outside) Audit & Supervisory Board Members (*Kansayaku*), outside directors should collaborate to enhance the effectiveness of the supervision of the management, including asking Audit & Supervisory Board Members (*Kansayaku*) to exercise their power of investigation, which is legally allowed for them as needed. (The company should arrange an environment adequate for such collaborations.)

(1)-4 Communication with the management

<Best practices found in interviews>

(company J)

- Depending on matters, outside directors ask the president to explain individually the matters to be discussed, and receive the explanation before the board is held. They participate in the board on that basis.

(Financial company K)

- As a factor to consider in officers appointment, the outside directors interview the president once or twice in a year.

<Implications developed from the practices above>

To conduct supervision of the management effectively, outside directors should communicate with the management concerning corporate management policies and items brought onto the agenda of the board. (The company should arrange an environment adequate for such communications.)

(1)-5 Training and education

<A best practice found in interviews>

(Pharmaceutical company L)

- The secretariat of the board conducts training sessions for newly appointed outside directors, in collaboration with an outside organization.

<Implications developed from the practice above>

For outside directors to understand their legal rights and obligations, and learn knowledge necessary to supervision on the management, a company should provide outside directors with training and education. Not only inside training and education, the company could provide them with a chance to receive training and education at organizations outside the company.

(2) Support staff

<A best practice found in interviews>

(Pharmaceutical company M)

- The secretariat of the board is supporting all the activities of outside directors generally,

and the internal audit department is supporting audit committee members. Employees who belong to the internal audit department are independent from the executive officer, and their personnel evaluation is conducted in the audit committee.

<Implications developed from the practice above>

The company should secure support staff for outside directors to help them fulfill their roles.

(3) The burden of expense

<A best practice found in interviews>

(Information and communication company N)

- When an independent committee was established about an M&A, mainly composed of outside directors, a financial advisor is appointed to check the calculation base of the price and the process of the calculation objectively.

<Implications developed from the practice above>

In the actual operation, a company should provide expenses to support the activities of outside directors, including the expenses to outsource or delegate such roles to an outside expert independent from company, for outside directors to fulfill their roles.

(4) Setting of the board

(4)-1 Setting of agenda

<Best practices found in interviews>

(Pharmaceutical company O)

- At the board, most matters to be resolved are legally defined matters, and decision making of execution of operation is delegated to the executive officers to a large extent.

(Electric equipment maker P)

- As a general rule, the board decides only matters of business strategy including M&A, that have a large impact on corporate value and shareholders' profit, in addition to

legally required matters in the Companies Act.

(Electric equipment maker Q)

- From the viewpoint of enhancement of supervising function of the board, authority is transferred to corporate officers within the bounds of law, increasing the limit of the money amount to be discussed in the board.

<Implications developed from the practices above>

The company should set the agenda of the board within the bounds of law, so that outside directors may participate in discussion actively.

Some members of the Study Group pointed out that it is important to consider how to select agendas to be discussed at the board. Such a consideration includes limiting matters submitted to the board where outside directors and Audit & Supervisory Board Members (*Kansayaku*) participate, and not submitting detailed matters about execution of operation.

(4)-2 Separation of the chairperson of the board and executive directors.

<A best practice found in interviews>

(Pharmaceutical company R)

- To make the supervising function on the management clear, the company separates the chairperson of the board and representative director (i.e. president or other executive director), and an outside director serves as the chairperson of the board.

According to the White Paper on Corporate Governance 2013 of the TSE, the ratio that a person other than the president serves the chairperson of the board is 21.1%, and the ratio that an outside director serves as the chairperson of the board is 0.3%.

<Implications developed from the practice above>

To divide the execution and supervision at the board and reinforce the supervising function of the board, the company could separate the chairperson and executive directors. Under such circumstance, an outside director could serve as the chairperson of the board.

(4)-3. The relationship between the chairperson of the board and non-executive directors

<The rules of code of foreign countries>

(The code of the U.K. A.3 Supporting Principles)

- The chairperson should promote a culture of openness and debate by ensuring constructive relations between executive directors and non-executive directors.

(The code of the U.K. B.6.3)

- The non-executive directors should be responsible for performance evaluation of the chairperson of the board.

<Implications developed from the rules above>

As the organizer of the board, the chairperson shall ensure a constructive relationship between executives and non-executives, and provide and promote an environment that allows open discussion.

At the company with the monitoring-function board, which is specialized in supervision, to secure the separation of execution of operation and supervision, evaluation of the chairperson of the board, that is the host of the supervising organization, could be carried out by outside directors, and not by executive directors.

(4)-4. Appointment of the senior independent director

<The rule of code of foreign countries>

(The code of the U.K. A.4.1)

- The board should appoint one of the independent non-executive directors to be the senior independent director to provide a sounding board for the chairperson and to serve as an intermediary for the other directors when necessary.

<Implications developed from the rule above>

The company could appoint one of the outside directors to be a sounding board for the chairperson and an intermediary for the directors.

5.3.2. Support system for the roles of (outside) *Kansayaku*

(1) Provision and acquisition of company information

(1)-1. The way to obtain internal information

(1)-1.1 About *Kansayaku* in general

<Best practices found in interviews>

(Securities finance company A)

- Staff of the internal control department submit reports to both the president and outside Audit & Supervisory Board Members (*Kansayaku*). Outside Audit & Supervisory Board Members (*Kansayaku*) offered opinions to the president when the improvement measures made by the internal control department have some problems.

(Insurance company B)

- Collaboration between the internal audit department of the execution side and Audit & Supervisory Board Members (*Kansayaku*) is important. Before conducting internal audit, Audit & Supervisory Board Members (*Kansayaku*) are always reported to about its focus from the internal audit department, and exchange their opinions with the department. Moreover, the result of the internal audit is shared before being reported at the management meeting, and Audit & Supervisory Board Members (*Kansayaku*) and the internal audit department discuss the point at issue and corrective strategy preliminarily.

(Electric equipment maker C)

- There are more than one routes of whistle blowing. One is to report to the legal department, and another is to Audit & Supervisory Board Members (*Kansayaku*). About once or twice a month there are cases of whistle blowing including the information about foreign subsidiaries directly reported to the Audit & Supervisory Board Members (*Kansayaku*). The contents of the whistle blowing are reported to outside Audit & Supervisory Board Members (*Kansayaku*) at the Audit & Supervisory Board.

(Trade company D)

- There is a system that people directly speak up (whistle blowing) to someone outside

the company, including directly contact to lawyers outside the company and outside Audit & Supervisory Board Members (*Kansayaku*).

<Implications developed from the practices above>

Audit & Supervisory Board Members (*Kansayaku*) should reinforce cooperation with internal audit and internal control units so as to provide more effective audit (and the company should arrange an environment to enhance such collaborations), and the company should build a dual reporting structure, by which, the same information on internal audit and internal control as is reported to the management is also reported to Audit & Supervisory Board Members (*Kansayaku*) at the same time.

Moreover, to find a clue of wrongdoing, the company could list Audit & Supervisory Board Members (*Kansayaku*) as the recipients of information from whistle-blowers.

(1)-1.2 About outside *Kansayaku*

<Best practices found in interviews>

(Energy company E)

- Inside Audit & Supervisory Board Members (*Kansayaku*) participate in management meetings, receive and check requests for approval, and participate in examination and site visits, and share information with all Audit & Supervisory Board Members (*Kansayaku*) including outside members by reporting the results to the Audit & Supervisory Board.

(Electric equipment maker F)

- There is a meeting with full-time Audit & Supervisory Board Members (*Kansayaku*) and their staff every week, and the members receive explanations about the situation of the audit. Not full-time Audit & Supervisory Board Members (*Kansayaku*) receive an explanation from full-time Audit & Supervisory Board Members (*Kansayaku*), and if necessary, staff of execution side also explains.

Note for translation: Normally in the Audit & Supervisory Boards of Japan, full-time members are inside, and non-full-time members are outside.

(Cosmetic company G)

- Not only internal Audit & Supervisory Board Members (*Kansayaku*), but also outside Audit & Supervisory Board Members (*Kansayaku*) participate in the management

meetings and collect information necessary for audit by themselves.

(Energy company H)

- Outside Audit & Supervisory Board Members (*Kansayaku*) often participate in site visits. Almost all site visits include at least one outside Audit & Supervisory Board member (*Kansayaku*).

<Implications developed from the practices above>

For outside Audit & Supervisory Board Members (*Kansayaku*) to play their roles, it is necessary that internal information be adequately shared. Therefore, the company should build a system to share information with outside Audit & Supervisory Board Members (*Kansayaku*), including information sharing through the meeting of full-time Audit & Supervisory Board Members (*Kansayaku*) and Audit & Supervisory Board. In addition, outside Audit & Supervisory Board Members (*Kansayaku*) could gain primary information by participating in site visits.

(1)-2. Collaboration with non-executives including other outside directors and *Kansayaku*

<Best practices found in interviews>

(Transportation company I)

- Outside Audit & Supervisory Board Members (*Kansayaku*) meet with outside directors at the board, and there are also formal meetings only for outside directors and Audit & Supervisory Board Members (*Kansayaku*) twice a year, where they discuss various management topics, including personnel evaluation.

(Food maker J)

- To share information, non-executives have an opportunity to have discussions.

<Implications developed from the practices above>

To conduct audit and supervise effectively, Audit & Supervisory Board Members (*Kansayaku*) should hold a regular meeting with other non-executives, mutually share information, and exchange opinions. (The company should arrange environment suitable for such collaboration.)

(1)-3 Communication with the management

<Best practices found in interviews>

(Information and communication company K)

- Inside Audit & Supervisory Board Members (*Kansayaku*) and the representative director have four meetings in a year. Two of them include outside Audit & Supervisory Board Members (*Kansayaku*).

(Trade company L)

- Audit & Supervisory Board Members (*Kansayaku*), including outside Audit & Supervisory Board Members (*Kansayaku*), hold a meeting with the president and the chairperson every month, where Audit & Supervisory Board Members (*Kansayaku*) exchange their frank opinions about various topics, including what they have felt through auditing.

(Information and communication company M)

- Audit & Supervisory Board Members (*Kansayaku*) have a meeting with the president once a year, where they express their opinions about tasks faced by the company, and management strategy.

<Implications developed from the practices above>

To conduct audit and supervise effectively, Audit & Supervisory Board Members (*Kansayaku*) should communicate with the management concerning corporate management policies and items brought onto the agenda of the board. (The company should arrange an environment adequate for such communications.)

(1)-4 Training and education

<A best practice found in interviews>

(Energy company N)

- The company holds regular study sessions for outside directors and Audit & Supervisory Board Members (*Kansayaku*).

<Implications developed from the practice above>

For Audit & Supervisory Board Members (*Kansayaku*) to understand their legal rights and obligations, and learn knowledge necessary to conduct audit and supervise, a company should provide them with training and education. Not only internal training and education, the company could provide them with a chance to receive training and education at organizations outside the company.

(2) Support staff

<Best practices found in interviews>

(Insurance company O)

- The company has a secretariat dedicated to Audit & Supervisory Board Members (*Kansayaku*), which conducts necessary investigations and collects data.

(Energy company P)

- There are a few dedicated staff for Audit & Supervisory Board Members (*Kansayaku*). Personnel evaluation of the staff is on the authority of Audit & Supervisory Board Members (*Kansayaku*), and independent from the execution of operation.

(Food maker Q)

- The company experienced misconduct. Back then, there was no staff for Audit & Supervisory Board Members (*Kansayaku*). The company learned from the experience and appointed staff to support the Audit & Supervisory Board Members (*Kansayaku*) after the incident.

<Implications developed from the practices above>

The company should secure support staff for Audit & Supervisory Board Members (*Kansayaku*) to help Audit & Supervisory Board Members (*Kansayaku*) fulfill their roles.

(3) The burden of expense

<Best practices found in interviews>

(Energy company R)

- Necessary expenses for audit, even out of initial budget, are covered. It does not happen

that Audit & Supervisory Board Members (*Kansayaku*) cannot conduct their duties because they worry about the expenses.

(Cosmetic company S)

- Necessary expenses are appropriately paid. There is no limit to the expenses, so the Audit & Supervisory Board Members (*Kansayaku*) experience no problem about the conduct of audit and supervision.

<Implications developed from the practices above>

For the execution of their duties, Audit & Supervisory Board Members (*Kansayaku*) can demand advance payment or reimburse expenses they disbursed (Article 388 of the Companies Act). In the actual operation, a company should provide expenses to support the activities of Audit & Supervisory Board Members (*Kansayaku*), including expenses of commission to the outside expert independent from company, for the members to achieve their roles.

(4) Setting of the board

<A best practice found in interviews>

(Trade company T)

- Materials about matters to be discussed at the board are sent one week before, to both directors and Audit & Supervisory Board Members (*Kansayaku*). The Audit & Supervisory Board meetings are scheduled right before the meetings of the board of directors, complicated matters are explained to Audit & Supervisory Board Members (*Kansayaku*) before the board meeting.

<Implications developed from the practice above>

The company should deliver documents or explain about items brought onto the agenda of the board for discussion in advance enough to provide ample time for Audit & Supervisory Board Members (*Kansayaku*), so that they, especially outside Audit & Supervisory Board Members (*Kansayaku*), may express opinions, make indications, or raise questions in a meaningful manner.

Exhibit (1): Attributes and Activity Areas of Outside Directors

	Experience of serving as an executive of another company(Domestic Company)
Investment decisions and M&A	<p>(Manufacturing A) Example: One outside director, who has had the experience of serving as an executive of another company, checked the process of management decision on an M&A deal before giving a boost to this plan of the president.</p> <p>(Energy company B) Example: One outside director familiar with the risk of overseas business, with the experience of serving as an executive, advised on overseas business and contributed to securing rights overseas in a smooth manner. Example: One outside director versed in overseas business, who served as an executive of another company, made the indication on the risk of overseas business, leading to minutely setting up conditions for exiting from overseas business.</p> <p>(Manufacturing C) Example: An outside director with the experience of serving as an executive of another company pointed out the risk on M&A and listing policies overseas that had not been envisioned at discussion within the company, thereby contributing to avoidance of the risk in advance. Example: An outside director who has had an experience of serving as an executive of another company suggested that business should be downsized, foreseeing change of environment in the future and the business of the company was actually downsized.</p> <p>(Housing D) Example: An outside director with the experience of serving as an executive of another company advised on labor management and also negotiating with the local authorities, and thus contributed to smooth development</p>

of overseas business.

(Manufacturing and sales such as daily consumables E)

Example:

The way to proceed with discussion proposed by one outside director who has served as an executive of another company brought into relief the opinion of objection, helping the company alleviate risk on an M&A deal.

(Manufacturing F)

Example:

One outside director, who has the experience of serving as an executive of another company, indicated issues on business customs practiced in the industry from the viewpoint of another industry.

(Trading company G)

Example:

One outside director, who has the experience of serving as an executive of another company, expressed candid opinion, and contributed to vibrant discussion at the board.

(Retailing company H)

Example:

An outside director, who served as an executive of another company, played a central role in ongoing deliberation on anti-takeover measures, and as a result, the company determined to discontinue its measures.

(Electronic equipment maker I)

Example:

One outside director, who has the experience of serving as an executive of another company, advised on cooperation with another industry to set up a new business, thereby contributing to its development.

(Wholesaler J)

Example:

One outside director with the experience of serving as an executive of another company advised that a mid-term management plan should be more aggressive. Based on this advice, the company invested in a domestic factory.

	(Precision equipment maker K) Example: One outside director, who has served as an executive of another company, pointed out the importance of due diligence in M&A deal, resulting in appropriate business judgment.
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	Female, Foreigner, or Academic
Investment decisions and M&A	(Trading company L) Example: One outside director familiar with overseas conditions expressed the opinion that the company should consider the relationship between foreign governments and should proceed with a deal of acquiring overseas interests, and helped the company fulfill its deal in a smooth manner.

	Experience of serving as an executive of another company (domestic company)
Management reform & structural reform	(Manufacturing M) Example: One outside director, who once served as an executive of another company, demanded the company's explanation for the reason for existing of a deteriorating business, instigating deepened discussion that might otherwise have been kept at bay.

	Female, Foreigner, or Academic
Nomination & Compensation	(Pharmaceutical Company N) Example: One outside director as academic voiced the opinion on the way to calculate executive officers' compensation.

Exhibit (2): Roles and Activity Area of an Outside Director

	Monitoring
Investment decisions and M&A	<p>(Manufacturing and sales such as daily consumables A) Example: The way to proceed with discussion proposed by one outside director who has served as an executive of another company brought into relief the opinion of objection, helping the company alleviate risk on an M&A deal.</p> <p>(Energy Company B) Example: One outside director versed in overseas business, who served as an executive of another company, made the indication on the risk of overseas business, leading to minutely setting up conditions for exiting from overseas business.</p> <p>(Manufacturing C) Example: An outside director with the experience of serving as an executive of another company pointed out the risk on M&A and listing policies overseas that had not been envisioned at discussion within the company, thereby contributing to avoidance of the risk in advance.</p> <p>(Energy Company D) Example: One outside director who is also an expert on related businesses checked items on the agenda from an expert's perspective.</p> <p>(Precision equipment maker E) Example: One outside director, who has served as an executive of another company, pointed out the importance of due diligence in M&A deal, resulting in an appropriate business judgment.</p> <p>(Manufacturing F) Example: One outside director, who has the experience of serving as an executive</p>

	<p>of another company, indicated issues on business customs practiced in the industry from the viewpoint of another industry.</p> <p>(Trading company G)</p> <p>Example: One outside director, who has the experience of serving as an executive of another company, expressed candid opinion, and contributed to vibrant discussion at the board.</p>
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	Advice
Investment decisions and M&A	<p>(Retailing company H)</p> <p>Example: An outside director, who served as an executive of another company, played a central role in ongoing deliberation on takeover defense measures, and as a result, the company determined to discontinue its measures.</p> <p>(Electronic equipment maker I)</p> <p>Example: One outside director, who has the experience of serving as an executive of another company, advised on cooperation with another industry to set up a new business, thereby contributing to its development.</p> <p>(Wholesaler J)</p> <p>Example: One outside director with the experience of serving as an executive of another company advised that a mid-term management plan should be more aggressive. Based on this advice, the company invested in a domestic factory.</p>

Appendix: Roster of the Corporate Governance System Study Group

As of June 30, 2014

Chairman	Hideki Kanda	Professor of Graduate Schools for Law and Politics/Faculty of Law, The University of Tokyo
	Yasuhisa Abe	Managing Director, Keidanren
	Nobuyuki Isagawa	Professor of Graduate School of Business Administration Division of Business Administration, Kobe University
	Takeyuki Ishida	Executive Director at Institutional Shareholder Services
	Akitsugu Era	Vice President, Head of Corporate Governance, BlackRock Japan Co. Ltd.
	Kenichi Osugi	Professor of Law School, Chuo University
	Junji Ota	Chairperson, Japan Audit & Supervisory Board Members Association
	Akiyoshi Oba	President & CEO, Tokio Marine Asset Management, Chairman, The securities Analysts Association of Japan
	Yasuhiro Osaki	Professor of Law, Waseda University
	Hiroyuki Kansaku	Professor of Graduate Schools for Law and Politics/Faculty of Law, The University of Tokyo
	Keizo Kuromi	General Manager, Corporate Legal & General Affairs Dept., Sumitomo Corporation
	Soichiro Sakuma	Representative Director and Executive Vice President, Nippon Steel & Sumitomo Metal
	Minoru Sawaguchi	Partner, Mori Hamada & Matsumoto
	Masaki Shizuka	Director & Senior Executive Officer, Tokyo Stock Exchange, Inc.
	Seiya Simaoka	Director, Member of the Audit Committee, Toshiba Corporation
	Takaya Seki	Managing Director, Corporate Practice Partners, Inc.
	Kazuhiro Takei	Partners, Attorney at Law, Nishimura & Asahi
	Yuichi Tashiro	General Manager, Transaction Legal Affair Div, Corporate Legal Center, CANON INC.
	Shirou Terashita	President and CEO, IR Japan, Inc.
	Yoshinori Nishimura	Audit & Supervisory Board Member, Shiseido Co., Ltd.
Daisuke Hamaguchi	Chief Investment Officer, Pension Fund Association	
Tomotaka Fujita	Professor of Graduate Schools for Law and Politics/Faculty of Law, The University of Tokyo	
Noriyuki Yanagawa	Professor of Graduate School of Economics, The University of Tokyo	
Observer	Saburo Sakamoto	Counsellor, Civil Affairs Bureau, Ministry of Justice
	Motoyuki Yufu	Director, Corporate Accounting and Disclosure Division, Financial Services Agency