Practical Guidelines
for Corporate Governance Systems
(CG Guidelines)

March 31, 2017
Ministry of Economy, Trade and Industry
Positioning of These Guidelines

These Guidelines are the guidelines on corporate governance practices formulated by the Ministry of Economy, Trade and Industry under the “Japan Revitalization Strategy 2016—Toward the Fourth Industrial Revolution.”

In the “Japan Revitalization Strategy 2016—Toward the Fourth Industrial Revolution,” one of specific new measures to be taken to promote “Proactive Management” is “enhancement of corporate value through the corporate governance reforms, in which it is added that the “Government will formulate guidelines and concrete case studies concerning the roles and method of administration of the board of directors, appointment and dismissal of a CEO and succession planning, introduction of incentive remuneration, and practical affairs of the nomination and remuneration committees (including those of an optional nature) by the end of this fiscal year.”

In response, based on the report titled “CGS Study Group Report—Guidebook for the Establishment and Operation of Effective Governance Systems” (released on March 10, 2017) compiled by the CGS (Corporate Governance System) Study Group (chair: Mr. Hideki Kanda, professor, Gakushuin University Law School), of which meetings had been held with the attendance of the observers from the Ministry of Justice and the Financial Services Agency since July 2017, the Ministry of Economy, Trade and Industry formulated the “Practical Guidelines for Corporate Governance Systems” (CGS Guidelines) which contained the matters considered beneficial for Japanese companies to discuss, from the standpoint of urging them to deepen their corporate governance efforts.

These Guidelines put together specific actions that are considered significant for companies to fortify their “earning power,” while complementing matters companies should consider in putting into practice the primary principles contributing to the realization of effective corporate governance specified by the Corporate Governance Code formulated in 2015 in view of keeping the coherency to the Corporate Governance Code. It is desired that companies should also take the items to be considered as suggested in the Guidelines into account when they independently discuss ideal approaches to their corporate governance systems suitable to themselves based on the provisions of the Guidelines and the various principles specified in the Corporate Governance Code.
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1. Introduction

1.1. Awareness of the Issues

For the past twenty years, Japanese companies as a whole has been suffering the downturn of the “earning power” in comparison with those of non-Japanese countries. It is pointed out that “corporate value” of Japanese companies represented by stock indices is consistently the “only loser” in relation to Western and emerging countries. One of the causes for lower “earning power” is that Japanese companies tend to keep on doing non-profitable business, compared with companies in Europe and the United States.

<Reference: Comparison of Rate on Sales (ROS) between Japan and the United States, and Long-term Trends in Stock Indices and Market Capitalization>

Japan-United States Comparison of Rate of Sales (ROS)

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<tr>
<th>Year</th>
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<th>United States</th>
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<tr>
<td>1995</td>
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</tr>
<tr>
<td>2015</td>
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Remarks:
- Stock price index values for 1990 and 2016 were at the end of December and March, respectively.
- Market capitalization amounts to the totals of market capitalization of listed companies in respective countries. For Japan, 2008 value was used instead of 2010 value. For India and China, 2003 value was used instead of 1990 value. For Indonesia, 1995 value was used instead of 1990 value.

Source: Bloomberg

<Reference: Distribution of Profitability by Business Segment>

Distribution of Profitability by Business Segment

Japanese companies
- Rate of sales of over 60% of Japanese Companies is below 5%.
- Up to 5%
- 5-10%
- 10% or more

U.S. companies
- Rate of sales of over 70% of U.S. Companies is below 5%.
- Up to 5%
- 5-10%
- 10% or more

European companies
- Percentage of business segments of which rate of sales by business segment is below 5% (including loss-making business segments)
- Up to 5%
- 5-10%
- 10% or more

Source: Prepared based on the materials for the lecture of Mr. Oba, Chairman of the Board of Tokio Marine Asset Management Co., Ltd. and the World Bank statistics.

Material submitted by Mr. Kobayashi, at the fourth meeting of the Council on Investments for the Future (held on January 27, 2017)
In the midst of global competition, the positions of Japanese economy and companies have been lowering. In terms of employment, it is pointed out that the number of employees in large companies has been substantially decreasing since 2000, and the number as a percentage of all employees has also largely fallen².

<Reference: Composition of Fortune Global 500 by Country>

Composition of Fortune Global 500 by Country

<table>
<thead>
<tr>
<th>Year</th>
<th>Others</th>
<th>China</th>
<th>UK, France, Germany</th>
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Source: Fortune

<Reference: Changes in the Number of Employees of Companies with 1 Billion Yen or More in Capital, and Percentage of All Employees>

Changes in the Number of Employees of Companies with 1 Billion Yen or More in Capital, and Percentage of All Employees

(Source: National Tax Agency, "Results of Statistical Survey of Actual Status for Salary in the Private Sector")

(Source: Extracted from the material submitted by Mr. Toyama at the fourth meeting of the Council on Investments for the Future (held on January 27, 2017))

² Materials submitted by Mr. Toyama at the fourth meeting of the Council on Investments for the Future (held on January 27, 2017).
The Corporate Governance Reform aims at constructing an economic system that will enable Japanese companies to get rid of such current situation of Japan where corporate value has continued to slow down over the past twenty years and realize a sustainable growth of companies and improvement of mid- and long-term corporate value³.

For companies to aim at securing a long-term sustainable growth, it is important to proceed with ESG (environment, society and governance)-based management. Of them, the key is the governance factor that involves fundamental decision of what each company aims at, including environment and society.

Moreover, many of the problems that a multitude of Japanese companies whose corporate value has continued to slow down must overcome to improve their mid- and long-term corporate value relate to corporate governance, and the substance of the problems varies from company to company, as described below.

(Examples of Problems)

- Appropriate reviews of business portfolio are insufficient, and useless resources have been allocated to non-core businesses and businesses that must be withdrawn.
- The axis of management judgment is unclear, and it requires too much time for decision-making process as a result of the emphasis on internal consensus.
- Sufficient time cannot be taken to discuss the future management strategies responding to changing circumstances, such as the Fourth Industrial Revolution.
- Because of the closed corporate structure for selection of managerial human resources, almost all of presidents/CEOs have no management experience at other companies, and cannot engage in multilateral discussions based on completely different sense of values and thoughts.
- How to connect the governance reform with improvement of corporate value is not fully understood, resulting in superficial “compliance” with the rules presented externally.
- Qualifications required from a president/CEO and other management members and fostering of successors are not clear.
- Apart from a president/CEO and other management members, there are some persons who have influential power over management, which interfere with resolute decision-making of a president/CEO and other management members.
- It is difficult to find outside director candidates with qualified qualification.

Merely taking formalistic actions reflecting the external voice calling for reinforcement of governance makes no sense, and it is important for companies to tackle improvement of governance from the standpoint of how they should resolve problems with corporate governance that is a key to improvement of corporate value. To this end, the diversity of autonomous efforts of companies should be respected, as those problems are so diversified.

³ Corporate value refers to the “attributes of companies contributing to shareholders’ interests, such as corporate properties, profitability, stability, efficiency and growth potential, and their degrees” (see page 2 of the “Guidelines Regarding Takeover Defense for the Purposes of Protection and Enhancement of Corporate Value and Shareholders’ Common Interests”) published by the Ministry of Economy, Trade and Industry and the Ministry of Justice on May 27, 2005), and is conceptually designed to presume “discounted present value of cash flow generated by a company” (see Note 2 on page 1 of the Report published by the Corporate Value Study Group on June 30, 2008, titled “Ideal Approaches to Anti-M&A Measures Based on Recent Changes in Various Environments”).
1.2. Concept of Discussion on the CGS Guidelines

- It is a president/CEO and other management members that will play pivotal roles in improving mid- and long-term corporate value. This is the same with all companies, regardless of their governance types (for example, a company is not run by its outside directors). For this reason, the question is what mechanism a company will build up, so that its president/CEO and other management members may play such roles.

- First, strategies that will become cores of management judgment will be necessary for a president/CEO and other management members to run the company with the aim of improving mid- and long-term corporate value. In drawing up those strategies, it is helpful for a board of directors to have a discussion to take in external viewpoints and knowledge.

- Second, it is essential for all companies to select an excellent president/CEO and other management members to grant appropriate incentives to them to urge them to take appropriate risks properly, thereby making up a mechanism to check their performance. And, it is a board of directors that is the core of this mechanism.

- From these standpoints, we decided to address how the management and monitoring functions of the board of directors should be fortified, how outside directors who should become one of the cores of the monitoring functions should be utilized, how management members should be nominated and compensated, and how the leadership of management members should be strengthened (ideal approaches to advisors (soudan-yaku) and consultants (komon)) in these Guidelines.

- These include the issues, such as the closed corporate mechanism of selection of managerial human resources and the conformist mentality-based compensation systems. These issues may be difficult to be changed by only one company because these issues are connected to the traditional management system of Japanese companies. In order to improve those issues, it is necessary for many companies to concurrently develop their efforts to utilize external officers, arrange for those who have management experiences to become outside directors of other companies, and review executive compensation systems.

1.3. Significance and Targets of the CGS Guidelines

- In 2015, the Corporate Governance Code was formulated, presenting the key principles that would contribute to the realization of effective corporate governance. These Guidelines provide complementary explanations about what companies should consider in putting those principles into practice by keeping the coherency to the Corporate Governance Code, and compile specific actions that can be considered significant to fortify their “earning power.”

- Although these Guidelines recommend the measures that request companies to consider taking, these Guidelines are not intended to request companies to take measures without exemption as what should be done to resolve corporate governance issues differs from company to company. How the corporate governance system should be built up and at what speed it should be reformed would be different, depending on the size and phase of development (i.e., start-up, growth or maturity period) of each company. It is desired for each company to take the items for consideration as proposed in these Guidelines into account when each company independently discusses ideal approaches to the corporate governance system that will suit each of them based on the substance of these Guidelines and various principles illustrated in the Corporate Governance Code.

- Basically, this Guidelines are instructive for listed company in many aspects, as these Guidelines are compiled based on the results of the questionnaires and hearings from the listed companies, and knowledge of the members of the Study Group who have management experiences at or served as outside directors of the listed companies. However, the situations
surrounding the listed companies would be different depending on the depth of and degree of interest in the corporate governance efforts. The substance of these Guidelines would also be instructive to non-listed large companies to raise their earning power.

- To give an example, many of companies that have just started working the corporate governance initiatives have no heap of internal discussion and worry about what they should actually do to achieve effective results, although they desire to seriously tackle the corporate governance. These Guidelines introduce the items for consideration and efforts that are considered instructive, reflecting the voices of advanced listed companies and investors. So, worrying companies should read these Guidelines and by reference to these Guidelines, deepen discussion about what the corporate governance best fit for each of them should be like.

- Next, considerable parts of the cluster of advanced companies that have ever positively tackled the corporate governance have already put into practice or are putting into practice of these Guidelines in advance. Such cluster of companies might feel as if the substance of these Guidelines is unsubstantial. If this is the case, such cluster of companies should refer to these Guidelines when they verify their own efforts, check the uniqueness of those efforts, or review any issues they have never tackled.

- Lastly, in the case of the cluster of companies that have ever had little interest in the corporate governance and the cluster of companies that cannot initiate the corporate governance reforms, management members of those companies should recognize once again the fact that many of Japanese companies have been unable to increase their corporate value over the past twenty years or more, which has led to a discussion that the corporate governance reforms are necessary to improve mid- and long-term corporate value after going through various discussions and trials and errors during that period of time. And then, management members of those companies should start up effective reforms by reference to the substance of these Guidelines and various principles illustrated in the Corporate Governance Code. Just mechanically adopting the recommendations of these Guidelines might result in higher costs. When companies start up their reforms, their boards of directors would deepen discussion about the items for consideration mentioned in these Guidelines and start up any items, even small-scaled, that they can tackle in sequence.

- As described above, issues with the utilization of outside officers and assumption of offices of outside directors at other companies sometimes cannot be resolved unless many companies address concurrently. It would be necessary for many companies, including those that have ever been less positive about tackling the corporate governance, to start considering those issues.

- As mentioned earlier, these Guidelines would be utilized differently depending on the circumstances under which companies are situated. We have no intention to press the substance of these Guidelines against companies, but are happy if these Guidelines are utilized to support the corporate governance reforms of companies.

- We also are happy if companies that are independently tackling go-ahead initiatives positively disseminate information on their own cases externally as a useful reference for other companies.

(Reference) Composition and Terminology of the CGS Guidelines

- It is difficult to substantiate the corporate governance reforms without understanding of a president/CEO. First of all, a president/CEO should understand the significance of tackling the corporate governance reforms and take a leadership role in tackling them.

- Strongly recognizing this point, we make recommendations about the corporate governance as a whole with a target on presidents/CEOs and other management members in the first half of these Guidelines (main text).
We also make numerous recommendations as more specific guidelines with a target on corporate executives and other managers in charge of corporate governance in the second half of these Guidelines (Appendices 1 through 3).

As corporate governance issues are largely rooted on the historical corporate cultures and climates, it will be sought to strive for change in awareness of directors and management members or their candidates, as well as certain individuals. To reform the awareness at all tiers, it is important to provide directors and other managements members with appropriate education and training programs on corporate governance under the leadership of a president/CEO and other corporate executives in charge of corporate governance. We are happy if these Guidelines will be used for such education and training.

The CGS Study Group Report based on which these Guidelines were formulated includes the results of the questionnaire survey for corporate governance targeting the companies listed on the First and Second Sections of the Tokyo Stock Market (as at the end of June 2016) conducted at the request of the Ministry of Economy, Trade and Industry (the “Company Questionnaire Survey”) for a referential material. Please refer to it as appropriate.

Unless the context otherwise requires, the terms as used in these Guidelines have the meanings set forth below:

- President/CEO refers to a person who serves as the top of corporate management. Just for information, CEO is an acronym of Chief Executive Officer.
- Outsiders refer to outside directors, outside auditors and outside experts.
- Insiders refer to internal directors, executives (shikkouyaku), executive officers (shikkou-yakuin), and other employees.
- Management members refer to the president/CEO, executive directors (gyoumu-shikkou-torishimariyaku), executives (shikkouyaku), executive officers (shikkou-yakuin) and other key employees.
- Individuals with management experience refer to incumbent management members and their retirees.
- Statutory nominating committee/compensation committee refers to the nominating committee/compensation committee at a Company with Nominating Committee, etc.
- Voluntary nominating committee/compensation committee refers to the nominating/compensation-related committee voluntarily set up at a Company with Company Auditor(s), company with Audit and Supervisory Committee or Company with Nominating Committee, etc. (howsoever called, and regardless of whether or not the committees are separated between nomination and compensation).
- Committees refer to both the statutory nominating committee/compensation committee and the voluntary nominating committee/compensation committee, except in cases where it is mentioned by restricting to statutory or voluntary (the same applies when it is described as the “nominating committee” or the “compensation committee”).

2. Ideal Approaches to the Board of Directors

2.1. Roles and Functions of the Board of Directors

- In fact, Japanese companies are in the phase of reviewing the roles and functions of their boards of directors once again, since the Corporate Governance Code came into force.

- To begin with, the functions of a board of directors are divided into: [1] the function of monitoring by evaluating business execution through nomination and determination of compensation of management members (among others, a president/CEO acting as a top of management) (monitoring function); and [2] the function of making concrete decisions on individual business execution (decision-making function). What is necessary in fulfilling the both of these functions is to decide basic management strategies and plans. Management strategies and plans will work as the criteria for monitoring evaluation of business execution, and as important guidelines for determining the rights and wrongs of individual business execution.

<Reference: Organization in the report of Corporate Governance System Study Group (published on July 24, 2015)>

“In addition to deciding basic management strategies and plans, a board of directors has the following two functions:

- Monitoring by evaluating business execution through nomination and determination of compensation (“monitoring function”); and
- Making of concrete decisions on business execution (decision-making function).

Thus, a board of directors will fulfill both of the monitoring function and the decision-making function.”

- However, the board of directors of Japanese companies would not have ever been able to fully discuss their management strategies. Moreover, more emphasis has been placed on the decision-making function, and the monitoring function has not been sufficiently exerted5.

<Reference: Results of the Company Questionnaire Survey>

For the areas in which the board of directors does not fully discuss, approximately 40% of respondent companies referred to the mid- and long-term management strategies, while approximately 47% of respondent companies referred to the succession planning and monitoring of the president/CEO (see Question 26 of the Company Questionnaire Survey).

- In order to ensure that a board of directors effectively functions, it is important for it to fulfill not only the decision-making function but also the monitoring function, as well as to decide basic management strategies and plans underlying them. For this reason, a company of which board of directors has not fully discussed matters relating to its basic management strategies and plans, and matters relating to the monitoring function would need to cope with a task of how its board of directors should develop discussions about those matters.

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5 This does not mean that the boards of directors of Japanese companies have never utterly functioned. At companies with company auditor(s) that make up a majority of Japanese companies, a board of directors is positioned by the Companies Act as an organ to make decisions on business execution, and it is required to expand the monitoring function of their boards of directors by making concrete decisions on business execution. Conventionally, companies with company auditor(s) have conservatively considered the scope of proposals that relate to decisions on business execution, and submitted many proposals to the meetings of the board of directors, and it would have been difficult to take sufficient time to discuss other management strategies and the monitoring function.
Possible measures to cope with such task would be to reconsider matters to be submitted to the meeting of a board of directors, to reduce less important business transactions that have been discussed at the meeting of a board of directors, and to develop discussions about management strategies and the monitoring function. According to the survey results of the Company Questionnaire Survey, many companies have already been considering reducing the matters to be submitted to the meeting of the board of directors by raising the criteria for submitting proposals or otherwise.

Reference: Survey Results of the Company Questionnaire Survey

For one year after the adoption of the Corporate Governance Code, approximately 39% of respondent companies have reviewed the scope of key business execution by the board of directors and the scope of powers to be delegated to the board of directors, and approximately 50% of respondent companies are considering reviewing them. Of the companies that have reviewed them or have discussed or intended to review them, approximately 59% have expanded the scope of delegation by raising the criteria for submitting proposals or reducing matters to be submitted to the meeting of the board of directors (see Question 27, 27-2 of the Company Questionnaire Survey).

When a company reconsidered the roles and functions of its board of directors (including reconsideration of matters to be submitted before the meeting of the board of directors) as part of the corporate governance reforms, the directivity will differ depending on its ideal approaches to management or the board of directors. Therefore, it is useful for a company to consider what company or what board of directors it will aim at.

Companies should consider the corporate governance by discussing what company or what board of directors it will aim at.

2.2. Organization of Ideal Approaches to the Corporate Management and the Board of Directors

The conditions in which companies are situated vary depending on their business areas, corporate size, number of years passed from the year of foundation, shareholder composition, and other factors, and therefore companies need to consider corporate governance suitable to each of them.

It is basically helpful to subjectively organize what company it will aim at and what board of directors it will aim at when it reconsidered the roles and functions of its board of directors.

These could be considered from the standpoint of (1) whether or not it wants to concentrate management powers on the president/CEO (horizontal axis), and (2) whether or not it wants to have its board of directors make individual decisions as much as practicable (vertical axis), as illustrated in Figure 1 below.

6 It may be possible to have time to discuss matters relating to management strategies and the monitoring function by increasing the frequency and time of holding board meetings, while maintaining matters previously submitted before the board meetings, but many companies would not find it a realistic choice.

7 Both the vertical and horizontal axes will not necessarily be linked to the organ design under the Companies Act. Even choice of any organ design would lead to any categorization depending on its substance. For example, if the board of directors of a Company with Nominating Committee, etc. makes decisions on individual business execution, it would be placed at any lower portion of Figure 1.

It is not the goal of discussion to make a simple comparison, such as which quadrant is better. In addition, the standpoints are not restricted to the two ones mentioned above. For example, the boards of directors may be categorized based on whether or not the ownership structure of shares is diversified (whether or not there are any controlling shareholders, such as the founding family) or whether or not it is a holding company, and, therefore, all cannot necessarily be categorized into these four quadrants. A focus is placed on suggesting that companies consider ideal approaches to its management and board of directors from several separate standpoints, rather than whether the above-mentioned categorization is correct.
With respect to how far the board of directors will handle decisions on individual business execution, in addition to decisions on basic management strategies and plans, it is helpful to consider it from the standpoint of what substantial reasons for the board of directors handling decisions on individual business execution are, and how effective it will be for the board of directors to handle decisions of individual business execution in order to make monitoring of management by the board of directors effective.

Addressing the roles and functions of a board of directors with Figure 1 below, for example, the speed of management judgment would generally tend to be prompter when the board of directors makes less decisions of individual business execution (upper half of the vertical axis) or when the management powers are concentrated on a president/CEO (right half of the horizontal axis)

In terms of the monitoring functions, it will become necessary to make efforts to strengthen equally in any quadrant (the directivities [2] and [5] expresses the strengthening of the monitoring functions). For this reason, each company need to aim at strengthening the monitoring functions that will suit its respective conditions, irrespective of whether it will make drastic reform that will result in a transition from any quadrant to another quadrant.

For details of the approaches regarding each of the directivities and efforts in each quadrant, see Appendix 1 “Points of View in Considering the Roles and Functions of Board of Directors.”

Figure 1 above shows what options are available from among, a variety of patterns in the ways to improve the effectiveness of corporate governance of companies, and helps each of companies to recognize where it is now, and from where to where it should go to reform itself. If companies consider them, it would contribute to improvement of the effectiveness of their boards of directors in the phase of evaluation of the effectiveness of their board of directors.

Hence it does not necessarily mean that any of the quadrants would be better in relation to the promptness in decision making because it is possible to secure the promptness in decision making through any administration means.
2.3. Points to Be Noted When Considering Transition to the Governance System with a Focus on the Monitoring Function

○ In order to have a board of directors effectively function, it is one of the options to adopt a governance framework under which the board of directors engages chiefly in management decision-making and performance evaluation and delegates the powers to decide individual business execution to management members. As a result, it is expected to enable prompter management decision-making.

○ In particular, for companies that are requested to maintain the governance framework with a focus on the monitoring function to respond to proposals made by overseas shareholders, customers, and other stakeholders because of their opportunities to procure funds, do business and acquire companies in overseas markets, it is an important task to shift into the governance framework with a focus on the monitoring function from the standpoint of obtaining understanding of those stakeholders, irrespective of howsoever their organs are designed.

○ In Europe and the United States, companies typically adopt the governance framework with a focus on the monitoring function, where independent outside directors account for a high proportion in relation to the board members as a whole and maintain the nominating and compensation committees.

○ If Japanese companies intend to use the governance system with a focus on the monitoring function (quadrant C in Figure 1 in section 2.2), it would be beneficial for them to pay attention to the following points, irrespective of howsoever their organs are designed:
  ➢ As the structure of the board of directors, independent outside officers would make up a considerable number of directors.
  ➢ They would reconsider items to be submitted before the board of directors from the standpoint of minimizing the powers of the board of directors to decide to conduct individual businesses (by delegating those powers to a president/CEO) as the roles and functions of the board of directors suitable for the above-mentioned structure, and have the board of directors specialize in the monitoring function to the extent permissible under the Companies Act.
  ➢ It may be a good idea to reconsider the frequency and time length of a board meeting while reducing the powers to decide individual business execution (e.g., to extend the hours of holding a single meeting, while reducing the frequency).
  ➢ Section or personnel that will centrally handle internal and external governance actions of a company would be designated.

○ The governance framework with a focus on the monitoring function is ultimately designed to enable dismissal of a president/CEO. But, such situation may occur to a very limited extent. Therefore, such governance framework can never be a hostile mechanism to management for many presidents/CEOs. It can become a mechanism to receive management support from shareholders and other stakeholders through outside directors and, as a result, would boost activities of president/CEO and other management members. Thus, it is not appropriate to take outside directors as enemies to management members, and it is important for management members, and outside directors and other outsiders to work together to contribute to improvement of mid- and long-term corporate value of a company by making the most of their respective characteristics.
2.4. Points of Issue Regarding the Administration of Board of Directors

2.4.1. Provision of Information to and Exchange of Opinions with Outside Directors (Utilization of Any Conference Body Other Than the Board of Directors)

- In order for a board of directors to make an effective discussion, it is necessary to provide directors with sufficient information and make preparations.
- With regard to internal directors, there is little problem with this because they are primarily familiar with internal affairs, business operations and participate in the operating or other committee meetings prior to attending the board meetings. Outside directors, however, primarily have no sufficient knowledge of the company and its business operations, and often do not attend the operating or other committee meetings. Any means to provide outside directors with sufficient information would become necessary so that outside directors can make an effective discussion at the board meetings.
- Examples of such means are to provide materials a few days prior to a board of meeting, and to provide explanations about proposals prior to a board meeting.
- In addition to the board of directors, some companies maintain a meeting differently called, such as the “council of directors” (torishimariyaka-hyougikai), where information is informally provided and opinions are exchanged, thereby securing improved communication between internal and outside directors (outside officers). Other companies set up a forum in which only outside officers gather up to secure communication between outside officers and help them make up their opinions. It is a problem if it is intended to emasculate a board of directors merely by moving matters to be deliberated at a board meeting to other meeting. If not so, it would be one of the options to utilize another meeting in preparation for effective discussion at a meeting of a board of directors.
- Though the above-mentioned means, it is useful to provide outside directors with sufficient information and make preparations. To this end, it is also necessary to pay attention so that advanced provision of information and exchange of opinions may not impose restrictions on deliberation at the actual meeting of a board of directors.
- In providing information to outside directors, it may be necessary to change the awareness of employees with respect to the timing of provision or content of information. If employees believe that they should keep certain information out of outside directors because they are the outsiders, or recognize that the board of directors should finally decide matters determined by the management conference, those employees may defer the timing of provision of information to outside directors or restrict the scope of information they provide. These acts interfere with sufficient deliberation at the meeting of the board of directors, and it is important to change the awareness of employees so that they can be fully aware that outside directors also have the duty of care as a prudent manager, and those employees should appropriately provide information to outside directors in a timely manner.

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9 Although it is useful to set up a meeting other than the board meeting, it would be important to transform a board of directors into a forum for free and open-minded discussion by providing the board of directors with risk information as much as possible.

10 Outside directors may present opinions or have discussion with internal personnel at the time of advanced provision of information and exchange of opinions. It is pointed out that if coordination of opinions has been finished prior to the meeting of board of directors through presentation of opinions and discussion in detail, actual meeting of board of directors would come to an end without special discussion or deliberation. For this reason, it would sometimes be necessary to refrain from making coordination of opinions too much in advance with respect to matters that directors should have substantial discussion at the formal place of a board of directors.
Case Examples of Specific Efforts

(Advanced provision of information and explanations about proposals)

- The company determines proposals three (3) weeks, sends notice of convocation seven (7) days, and distributes supporting materials three (3) business days, all prior to the meeting. The company provides an opportunity to provide explanations in advance about any transactions that it would need to provide prior explanations to outside officers.
- The company provides its outside directors with explanations prior to the board meeting. At that time, the company receives assignments from its outside directors and reflects replies to such assignments in the board meeting.
- The company provides materials by e-mail two (2) days prior to the board meeting. In principle, the company provides no explanations separately to its outside directors, except upon request of any of its outside directors.
- The company has its outside directors gather as a prior explanation meeting two (2) days prior to the board meeting, in which the officers in charge of the board of directors provide explanations about important proposals submitted before the board meeting.
- Upon request of the outside directors, the company sends all materials for deliberation including the previous ones, and a one-page summary of the proposals submitted before the board meeting, both two (2) days of the board meeting. The company has prepared the database and informs its outside directors whenever the company uploads the relevant materials to that database.
- The company requests the chairperson (outside director) to spare 1.5 hours or so prior to the board meeting, during which clerical staff provides explanations about businesses to be transacted at the meeting.
- The company supplies a single dedicated tablet device to each of its outside directors, and sends materials to such each tablet device in sequence whenever they are ready at least three (3) business days prior to the board meeting. Outside directors can see the materials previously distributed. The company gives a prior briefing to an outside director who requests it. Unlike hardcopies, the company can distribute materials in sequence whenever they are ready, providing us with more advantages in terms of security.

(Examples of companies setting up a meeting body other than a board of directors to provide information and exchange opinions)

- The company holds a non-regular meeting called the “Board Member Meeting”. Such meeting is a forum designed to share information and to make a candid discussion. Topics at that meeting are not necessarily submitted to the board of directors accordingly.
- The chairperson of the board, general manager of Management Planning Headquarters, and outside directors spend one hour or so prior to the meeting of the board of directors in exchanging their opinions.
- The outside director acting as the chairperson of the board of directors attends the management conference to make it helpful to transact businesses in an efficient and smooth manner at the board meeting, and shares necessary information obtained there with other outside directors at the board meeting and the meeting consisting solely of outside officers, thereby attempting to make information equally available.
2.4.2. Matters to be Resolved by/Reported to (or Deliberated at) the Board of Directors

- In determining whether or not to resolve any specific proposal at a meeting of a board of directors, many companies would prefer to take conservative action under the Companies Act and choose to have it resolved at the meeting as much as practicable.

- However, once outsiders take part in adoption of a resolution at the meeting of a board of directors, the board of directors would have no choice but to transform itself into a forum for substantial discussion and judgment even at a company that has ever taken the board of directors just as a forum to ratify a judgment of the operation committee or other meeting.

- If a proposal is submitted before the meeting of a board of directors for resolution, it may be necessary to provide information and explanations for outside directors to make decisions with responsibility and secure any chance to make flexible revisions based on opinions of outside directors. As a result, the time for the board meeting may be short or internal burdens may increase. Given these, if the board members include outside director(s), it is useful to reconsider whether or not it is an important affair to be submitted before the board meeting for resolution or whether it is just enough to report such an affair to the board of directors.

- In addition to classifying between those to be submitted before the board meeting for resolution or those to be reported to the board meeting, there may be affairs to be submitted to the board meeting for continuous deliberation. With respect to matters that the board cannot immediately reach conclusion at a single-time meeting, such as formulation of management strategies, it is useful for substantial discussion to try to submit them before the board meeting for deliberation without reaching conclusion.


- A company with board of company auditors would present factors to be considered in determining the scope of matters to be submitted before the board meeting and indicate that it can consider such scope restrictively in certain cases.

- Factors to be considered in determining the scope of matters to be submitted before the board meeting:
  - Nominating and compensation committees to be set up at the option of the company;
  - Election of outside director(s); and
  - Construction and administration of internal control systems.

<Reference: Case Examples of Specific Efforts>

- Phases of plans to implement business strategies have been discussed at the board meeting. Those plans have been submitted before the board meeting in early stage so that the board could discuss them three times or so. As a result, the substance and accuracies of discussion have been improved.

- Previously, mid-term plans were discussed at the board meeting once a year. However, such ad-hoc discussion is a waste of time, and the company now knowingly increases opportunities to discuss them in response to the requests for regular reporting and discussions.

- When the company reviewed its risk management system, the company reconsidered the matters to be submitted before the board meeting, and established the criteria for submission so that proposals on individual transactions could not be submitted. After the reconsideration, the board worked hard to discuss management strategies. For example, the company now
makes it a rule to have the board deliberate a 3-year plan three times or so, although it was previously determined at a single board meeting.

- The time required for a single meeting of the board of directors is two or three hours, about one hour of which is used for resolution of statutory and other typical matters, and the rest of which is used for discussion about M&A transactions that are largely significant in light of management plans and strategies, as well as for reporting. An individual transaction that will result in a change in asset allocation determined in the management plans would be submitted before the board meeting. Each business division has the power to decide individual business execution to realize prompt decision making. Reports are to be made chiefly on the matters that may affect the mid-term management plans, and quarterly/annual settlement of accounts, rather than the matters concerning detailed and individual business execution. As to management strategies, the company does not submit what has been prepared internally to the meeting of the board of directors. The board of directors discusses them from the stage of formulating them. The company places an emphasis on providing explanations to its outside directors, and tries to start explanations by going back to the origin of those strategies.

- The company picks up, and make a list of, key themes to be discussed at the board meeting at any point of time throughout the year in advance.

- Although the board of directors has the powers to decide significant business execution, involvements of the board of directors would differ depending largely on whether it relates to business or governance. Details of business-related matters, such as decision of management strategies or individual business execution should first be formulated by management members, and the board of directors will check whether those details are not distorted by internal logic or whether risks are appropriately analyzed (the board of directors is not expected to correct those details, and the power it has is close to a veto). On the other hand, the governance-related matters, such as the composition of the board of directors, nomination, and compensation will be substantially determined by the board of directors or any committee after deliberating them in detail.

2.4.3. Development of Organizations Handling the Corporate Governance

A company should consider developing a framework for taking internal and external corporate governance-related actions effectively.

- It is pointed out that at Japanese companies, there are so many organizations in charge of corporate governance, as a result of which internal decision-making process would require adjustments among several organizations, and it is difficult to access information from the outside, as such information is spread over those organizations.

- In Western countries, companies have their “company secretary” or any other position as a professional of governance communications with corporate governance work, administration of the board of directors and its committees, and advisory functions for outside and internal officers.

- Given that it is necessary for each company to formulate a comprehensive corporate governance strategy, each company should consider setting up a desk or personnel that will centrally supervise corporate governance actions, setting aside whether he/she is called “company secretary.” Such desk or personnel is expected to be responsible for will-based dialogue (engagement) with shareholders and other stakeholders, and to become an entity to provide information based on comprehensive strategies.

- It is useful for each company to consider ideal approaches to the section and personnel responsible for corporate governance, and reinforce frameworks that correspond to its
2.4.4. Evaluation of the Effectiveness of a Board of Directors

- While Japanese companies are required to evaluate the effectiveness of their boards of directors, quite a few companies may have been facing difficulties to work on this matter as they do not have much experience in coping with it.

- In order to evaluate the effectiveness of the board of directors, many companies collected questionnaires from their directors and auditors. In fact, not so many companies conducted interviews or group discussions of outside officers.

- How to evaluate the effectiveness of a board of directors should be considered by each company.
However, as a prerequisite of the evaluation, it would be necessary for each company, to have the board of directors discuss its management and ideal approaches to the board of directors, while accepting a third-party perspective whichever method it chooses.

In addition, it should be noted that in conducting evaluation, scoring or ranking does not necessarily have any meaning. Companies can choose to conduct a plan-do-check-act (PDCA) cycle-based evaluation: to consider whether there are any matters for which the board of directors should take corrective actions and what actions it should take, verify the effect(s) of those actions after taking them, and plan what further actions it should take.
3. Ideal Approaches to Utilization of Outside Directors

3.1. Problems to Be Tackled in Utilizing Outside Directors

- Some companies have successfully utilized outside directors whose actions and findings have been connected to concrete improvement of corporate behaviors. For example, there are the examples in which the company has reconsidered its business strategies based on the findings of its outside directors; the company has reconsidered the matters to be deliberated at the board meeting in response to the findings of its outside directors; the company has reviewed the conventional practices by utilizing the experience-advice of its outside director; and the outside director acting as the chair of the board meeting has properly controlled the proposals.

- On the other hand, there are the companies in which their outside directors have not played the roles expected from them, or which cannot find out any individuals qualified as outside directors. The reasons may be that outside directors are not fully aware of their own roles as such or that companies have not developed the environment in which outside directors could play their active roles.

- In Japanese companies where newly hired university graduates accumulate their occupational experiences and typically become directors through promotion from within the company in less fluid employment system, management would inevitably rely on internally accumulated experiences. However, such companies would find it not easy to win competitions with Japanese and overseas companies that are growing using external knowledge.

- In the future, it is necessary to change the management structure into the one in which it is easy to utilize knowledge and experiences of outside directors.

3.2. Toward Utilization of Outside Directors

| Companies should consider points they should organize to utilize their outside directors for each scene |

- There are some skeptical views on outside directors. For example, these include the views that outside directors who do not understand business cannot formulate any management strategy. It is impossible to delegate the power to appoint and dismiss a president/CEO to outside directors who have no information on inside individuals. Introduction of outside directors leads in no way to an improvement of operating performance.

- However, the role that should be expected from outside directors is not to cause them to run a company. As usual, it is inside management members led by a president/CEO that run the company.

- Outsiders would prove their merits especially based on their attributes as such when they get involved with any affairs that insiders find it difficult to properly judge and evaluate.

- Considering the division of such roles between insiders and outsiders, it is necessary to consider utilizing outside directors who are outsiders. If a company intends to maintain the governance framework with a focus on the monitoring function, that company would need to appoint outside directors so that they may make up a considerable part of the board members. Otherwise, if there are a considerable number of outside directors, there will be any scenes

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11 In Japan, the ratio of external invitees to newly appointed CEOs is lower in comparison with non-Japanese companies (approximately 3%), and the ratio of those who have the experience of working at other companies is also lower (approximately 24%) (Source: PWC’s strategy&, “2015 CEO Success study”).

12 From a long-term perspective, as the employee-level mobility of employment and efforts to invite external management members increase, external knowledge and experiences will be reflected in management. It, however, would take time to realize it. Utilization of outside directors would be an option that companies can take immediately.
where they may effectively function. Therefore, it is useful for any company to consider at what proportion it should utilize outside directors.

- It is useful for a company to consider how it will utilize outside directors in the following scenes: [1] the scene in which it considers whether or not outside directors are necessary, and desired image of outside directors; [2] the scene in which it looks for outside director candidates and asks them to assume the office as such; [3] the scene in which outside directors assume the office as such and play active roles within the company; and [4] the scene in which it evaluate performance of outside directors and considers appointing or dismissing them.

- If a company reaches a conclusion that it has been unable to utilize its outside directors, it would need to verify in which scene there have been the problems, and it is useful to consider the problems by scene.

- Specifically, a company should consider the problems by dividing into the following nine steps. For details, see Appendix 2: “Points of View in Utilizing Outside Directors.” Companies should take steps pursuant to Appendix 2.

<table>
<thead>
<tr>
<th>Step</th>
<th>Matters to be considered</th>
<th>Scenes</th>
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<tbody>
<tr>
<td>1</td>
<td>Consider ideal approaches to its board of directors.</td>
<td>Scene of considering whether outside directors are necessary, or the desired image of outside directors.</td>
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<tr>
<td>2</td>
<td>Clarify the roles and functions it expects from its outside directors.</td>
<td>Scene of looking for outside director candidates and asking them to assume the office as such.</td>
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<tr>
<td>3</td>
<td>Consider the qualifications and backgrounds that match the roles and functions.</td>
<td>Scene of having the outside director candidates assume the office as such and play active roles at the company.</td>
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<tr>
<td>4</td>
<td>Look for outside director candidates who have the required qualifications and backgrounds.</td>
<td>Scene of evaluating the performance of outside directors and considering reappointing or dismissing them.</td>
</tr>
<tr>
<td>5</td>
<td>Check the eligibilities of outside director candidates.</td>
<td>Scene of evaluating the performance of outside directors and considering reappointing or dismissing them.</td>
</tr>
<tr>
<td>6</td>
<td>Consider the terms of assumption of outside directors (such as remuneration).</td>
<td>Scene of evaluating the performance of outside directors and considering reappointing or dismissing them.</td>
</tr>
<tr>
<td>7</td>
<td>Provide support for effective activities of outside directors who have assumed the office as such.</td>
<td>Scene of having the outside director candidates assume the office as such and play active roles at the company.</td>
</tr>
<tr>
<td>8</td>
<td>Evaluate whether the outside directors have fulfilled the roles expected from them.</td>
<td>Scene of having the outside director candidates assume the office as such and play active roles at the company.</td>
</tr>
<tr>
<td>9</td>
<td>Consider reappointment/dismissal based on results of assessment.</td>
<td>Scene of having the outside director candidates assume the office as such and play active roles at the company.</td>
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- It is necessary for a company to consider what qualifications it requires from outside directors. As suggested in Step 3 of Appendix 2: “Points of View in Utilizing Outside Directors,” a company should consider appointing one of outside directors from among those with management experience.

3.3. Toward Expansion of Human Resources Market of Outside Directors

| Individuals with management experience should consider actively becoming outside directors of other companies, with the aim of expanding the human resources market for outside directors. |

- As it becomes necessary to expand the human resources market for outside directors, individuals with management experience who have engaged in management are strong outside director candidates who will formulate management strategies and evaluate management performance, and it is expected that the human resources market for outside directors will expand by such individuals actively becoming outside directors of other companies.

- In this respect, if each company encloses individuals with management experience as its chairman, advisor (komon) or consultant (soudan-yaku), there will be little hope that the human resources market for outside directors will expand. Each company is requested to take one or
two step in-depth actions for expansion of human resources market of outside directors, recognizing that knowledge brought about by outside directors and management experience of its own officers will expand and ultimately bring more benefit to it as the mobility of individuals with management experience progresses.

(Assumption of the office of an outside director by a person who has retired from management member)

- A person who has retired from management member should utilize the management knowledge he/she has developed through his/her long-term management experience by assuming the office of an outside director of another company, rather than staying at the company as an advisor (komon)/consultant (soudan-yaku). It is also useful from the standpoint of contribution to society.

(Assumption of the office of an outside director by an incumbent management member)

- Some of incumbent management members are the presidents/CEOs or other directors, while others are chairpersons who have retired from the office of the president/CEO. If a management member who may become a top of management experiences any different industry or culture as a director of any other company, he/she would have an advantage of using such experience for management of his/her own company in the future. A chairperson who has retired from the office of president/CEO may have more time compared with when he/she had been the president/CEO.

- From the standpoint of eliminating a shortage of human resources for outside directors and management members securing an opportunity to experience supervision of management of other company, incumbent management members may become outside directors of other companies to the extent that will pose no legal or practical problem after considering the conditions in which each of them is situated (such as positions, abilities, and available time).

- Assumption of the office of an outside director of other company by an incumbent management member would require understanding of shareholders and other stakeholders, as well as understanding of internal affairs within the company. Considering that the experience of a management member as an outside director of other company can be used for management of his/her company, shareholders and other stakeholders should not show an excessively negative reaction and take it as positive to the extent that it is not detrimental to management of the company.

Even if a company has any internal rules that restrict its management members from assuming the office of outside director at any other company, that company should consider administering those rules flexibly.

- Some companies have internal regulations that would restrict their management members from becoming an outside director of other company. While such restriction would be reasonable to a certain extent from the standpoint of securing their commitment to management, the experiences of supervising management of other company as an outside director and broadening his/her perspective may provide him/her with advantage in managing the home company.

- From this viewpoint, a company should consider flexibly operating its internal regulations by permitting its management members to assume the office of outside director of other company as much as practicable, unless it may have an adverse effect on its management\(^\text{13}\).

\(^{13}\) This assumes that if the internal regulations provide that a management member assuming the office of outside director of other company will be required to obtain the consent of the company, the company should flexibly give such consent. On the other hand, if the internal regulations totally prohibit a management member from becoming an outside director of other company (not requiring him/her to obtain the consent of the company), the company would
As mentioned above, if it becomes common for those with management experience to become outside directors of another company, it would naturally lead to a development of outside directors in quality and quantity.

Those who have the experience of acting as outside directors at several companies can develop their power of observing ideal approaches to corporate management comprehensively, and may assume the offices of outside directors at several companies within the scope of the concurrent services through which they can contribute to another companies taking their own positions into consideration.

consider making the terms of the regulations more flexible (e.g., he/she will be permitted to become an outside director with the consent of the company).
4. Ideal Approaches to Nomination and Compensation of Management members

4.1. Ideal Approaches to Nomination of Management Members

4.1.1. Nomination of Management Members and Corporate Governance

- While it is essential to select an outstanding president/CEO and other management members, check their performance and supervise a far-sighted succession planning with the goal of improving mid- and long-term corporate value, it is the board of directors that should take on such roles.

- In the current Japanese companies, however, many of the board members (i.e., directors and auditors) are insiders. In fact, the proportion of outsiders including outside directors is not so high in many companies. It is typically difficult to expect insiders to evaluate performance of a president/CEO or present opinions as to a successor determined by the current president/CEO. Moreover, insiders have a conflict of interest, as they are also successor candidates. For this reason, outsiders, among others, are requested to play a role of verifying evaluation of a president/CEO’s performance and succession planning from an objective perspective that is different of that of insiders. Thus, outsiders are expected to oversee the decision-making of the board of directors from an independent and objective perspective.

- This, however, does not mean that the right to take the lead to appoint and dismiss a president/CEO will be delegated totally to outsiders, and is an issue with the distribution of the roles between insiders and outsiders. In case of an emergency in which outsiders consider the current president/CEO as unqualified as a manager, there will arise a need for outsiders to take the lead. Otherwise, the current president/CEO should basically play the roles of appointing/dismissing a president/CEO and drawing up an original draft of succession planning at ordinary times just as in the past. What is different from the past practice is that it works to justify a final decision of the current president/CEO, as he/she is to be controlled in that it is impossible to ratify personnel affairs he/she cannot account for to others. Furthermore, it is expected that the fairness and objectivity of his/her decision will be increased through the process of explaining to outsiders what he/she has been thinking in his/her head.

- Some find it difficult for outside directors who do not know inside candidates to select a president/CEO or other management members. It is, however, not necessarily appropriate only for internal directors to make decisions, because internal directors sometimes hesitate to give comments to proposals of the president/CEO; may face a problem with a conflict of interest when any of them may become a candidate; or can only make decisions under the applicable internal standards. Companies would need to try to obtain understanding of outside directors based on the assumption that outside directors do not possess much information about internal candidates.

4.1.2. Ideal Approaches to Strategic Fostering of Managerial Human Resources

- To effectuate a succession planning, it is necessary to have a complete set of candidates who can become a president/CEO or other management members in the future. To this end, it is effective to foster multilayered levels of executives including executive officers who can become a president/CEO or head of each division of next generation, and division managers who can become a president/CEO or head of each division of future generation. In addition to internal and external individuals involved, the board of directors and nominating committee playing pivotal roles in selection of a successor will be sought to actively join the process of fostering those candidates.

- The methods of fostering candidates vary depending on the philosophy and circumstances of each company. However, the following common patterns can be observed in actual examples of Japanese and non-Japanese companies that are introducing leading-edge practices.
In order for a company to realize its own management strategies, it will need to identify key posts of a president/CEO or other management members to be fostered, and to clarify human resources images, and required abilities and other skills of those posts.

Then, a company will screen candidates by capturing and evaluating skills and abilities of internal human resources to make up a pool of candidates for a president/CEO or other management members. In screening them, its president/CEO or other management members must actively take part in the screening process to prevent enclosure of human resources by business divisions. If there are no qualified human resources within the company, it is necessary to examine ideal approaches to procurement of human resources, including external recruitment.

In addition, a company will provide each of the candidates it has screened with job assignments and training programs in line with the fostering strategies, and develop and support the fostering environment. In order to process appropriate job staffing in line with the fostering strategies, it is necessary to obtain understanding and help of various people concerned within the company. In order to realize personnel changes for tough assignment and effective fostering at each division, it is important that a president/CEO or other management members take the leadership roles and take time and effort to foster candidates. It is also necessary for the personnel affairs division and the business divisions to work together to provide support in fostering them.

Lastly, in order to produce results of fostering them, a company must evaluate its results of fostering candidates and reflect them in a next fostering plan, and reassess or review its fostering measures to verify whether or not it has worked to effectuate its management strategies. With the involvement of management-level individuals, it is required to make up a structure to systematically evaluate results of fostering candidates, judge how much the candidates could elevate their suitability as managers through the fostering program, and reflect them in the succeeding fostering programs.

For details, see “Guidelines for Strategic Human Resources Development of Future Top Management for Improvement of Corporate Value” (published by the Ministry of Economy, Trade and Industry on March 31, 2017)\(^\text{14}\).

4.1.3. Nomination of Management members and Directors (Itemized Discussion)

(Nomination of a President/CEO)

In considering screening its next president/CEO, a company should consider presenting several appropriate candidates, if any, from within the company.

- It is the insiders including the current president/CEO who have most information about candidates for a next president/CEO, as promotion from within the company is still prevailing. For this reason, it is naturally for the current president/CEO or other management members to prepare an original plan for selection of candidates.

- It is important for outside directors and other outsiders to check whether the procedure for selection of a next president/CEO has been properly taken, and whether sufficient examinations suitable for judgment that should decide the future of a company have been conducted. In the phase of reaching a conclusion of who will be selected as a top management, those outsiders will be expected to play a role of checking, from the eyes of outsiders, whether he/she is suitable to bear a heavy responsibility as a top management.

- It cannot be said that fair and transparent steps are taken only if the current president/CEO only offers a conclusion that he/she wants to appoint this person as a next president/CEO and asks outsiders to give approvals without providing additional information or explanation.

- If only a single candidate is offered, it is difficult to have a discussion because comparison is impossible. Furthermore, it is hard for outsiders to find out a candidate. Therefore, it may be helpful for management members to submit an original plan by naming several candidates to facilitate discussion by outsiders (on the other hand, it would be less helpful to struggle to offer a proposal by naming several candidates, although there is no suitable candidate).

- It is important to secure a “total number of hours” when the nominating committee (especially its members who are the outsiders) can communicate with candidates. Unless candidates are
monitored over a few years, there may be no option but to abruptly ratify an individual who has just been proposed. Some points out that many companies leave this unattended even now. In order to enable especially outsiders to substantially join the nomination process, it would be important to make efforts so that members of the nominating committee may have an opportunity and time to communicate with candidates during and beyond the committee meeting.

<Reference: Case Examples of Specific Efforts>
- The CEO offered the three candidates, and gave them a chance to attend the board meeting to present a briefing about the proposed transactions. The board members had many discussions by giving each of those three candidates scores of “〇”, “X” and “△” depending on the situations for comparative evaluation. Through these reasonable efforts, the board took one year to select the successor.
- The board meeting is held almost once a month, where candidates for president present briefings about the conditions of the business operations in charge. The advisory committee for nomination of president evaluate results of such briefings whenever the board meeting is held. This process continues for many years, based on which a next president is to be selected. An outside director acts as the chair of the advisory committee, and takes a considerable amount of time for this process. Although it is said to be difficult for outside directors to decide a next president, they can understand quite a lot of things, as they seriously observe the candidates over four or five years.

(Appointment of Directors)

In nominating directors, a company should consider the roles required from its board of directors and a composition (diversity) to realize it when it draws up a nomination policy.

- As the members of a board of directors, directors will formulate management and other strategies, supervise management, and join the decision-making process for business execution.
- Qualifications necessary to develop discussion at the meeting of a board of directors would differ depending on the roles required from a board of directors (i.e., a balance between the monitoring function and decision-making function). For this reason, companies should consider the roles required from the board of directors, as well as the qualifications and member composition necessary to realize them when they draw up a director nomination policy.

<Reference: Case Examples of Specific Efforts>
- Corporate practice of the company listing up the qualifications necessary for the board of directors to show the qualifications possessed by each director and identify which qualifications are lacking, prior to nominating new directors.
  (An example of the method of examining the qualifications required from directors and directors meeting those qualifications)
In drawing up a director nomination policy, a company may examine both the aspects relating to substantial details of the qualifications candidates should possess, and the aspects relating to procedural details to see through them.

In considering the composition of directors, it is especially important to recognize the perspective of diversity. A board of directors is required to monitor how the company promote “diversity management” utilizing diversified human resources to put its management strategies into practice. It is also necessary to secure the diversity of directors themselves from the standpoint of reflecting diverse values the company does not have in its management strategies.

(A through D: Internal directors; E through G: Outside directors)
<Reference: Diversity 2.0>

・“Diversity 2.0” is defined as “a company-wide and consistent management action which aims to continuously create added values, by maximally leveraging the diverse attributes and skills of each individual.” It is pointed out that in taking a company-wide and consistent action, a company will be required to achieve the systematic implementation illustrated below. Among others, it is important: [1] to integrate diversity into corporate strategies, and [2] to activate corporate governance to monitor strategies and efforts.

・For details, see “Diversity 2.0 Study Group Report—Toward Implementation of Diversity as a Competitive Strategy” and “Diversity 2.0 Action Guideline” (published on March 23, 2017)\(^\text{15}\).

・Seven Key Actions for “Diversity 2.0” Practice

4.2. Ideal Approaches to Executive Compensation

In designing its executive compensation system, a company should consider introducing performance-linked compensation and stock-based compensation.

- It is pointed out that Japanese companies still place a focus of its executive compensation system on fixed compensation, and the performance-linked compensation and stock-based compensation as a percentage of total compensation tends to be lower compared with Western companies\(^\text{16}\).

- Performance-linked compensation and stock-based compensation provides an incentive for improving mid- and long-term corporate value, as economic benefits management members can

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\(^\text{15}\) [Link](http://www.meti.go.jp/report/whitepaper/data/20170323001.html)

\(^\text{16}\) For comparison of president/CEO compensations between Japanese and Western companies, see explanatory materials presented by Willis Towers Watson at the sixth meeting of the CGS Study Group.
earn vary depending on fluctuation in performance or stock price\(^\text{17}\).

- In addition, stock-based compensation has the merit of contributing to the sharing of shareholder value with management members by holding the company stock.

- In considering introducing the performance-linked compensation or stock-based compensation plan, a company should take the following into consideration, depending on their respective situation:
  - Whether the plan conforms to the company’s management strategy and other basic policy;
  - Whether any financial or non-financial index has been chosen as appropriate goal;
  - Whether now is the right time to introduce the performance-linked compensation or stock-based compensation plan in light of its own situation\(^\text{18}\); and
  - Whether the percentage of total compensation is appropriate\(^\text{19}\).

- In considering the compensation policy (including whether a company should introduce a performance-linked compensation or stock-based compensation plan), a company needs to have its management strategy in effect. It is important to set up a Key Performance Indicator (KPI) to determine a company’s progress in achieving its management strategy and then consider designing the compensation systems to realize it. Considering a compensation policy without management strategy will not provide management members with an appropriate incentive.

<Reference: Corporate Governance Code>

[Principle 4-2 Roles and Responsibilities of the Board (2)]

“(…) the remuneration of management members should include incentives such that it reflects mid- to long term business results and potential risks, as well as promotes healthy entrepreneurship.”\(^\text{20}\)

\(^{17}\) The phases requiring business reconstruction may require a reform that will entail short- or mid-term worsening of earnings, in which case companies need to pay attention in designing the performance-linked compensation plan so that it may not provide the management with an incentive to avoid necessary reform.

\(^{18}\) For example, if a company strives to tackle various reforms for management reconstruction (e.g., business withdrawals, recognition of a special loss, and reduction in the workforce), its financial index values may temporarily worsen as a result of those reforms. Under such circumstances, introduction of (short-term) performance-linked compensation plan could cause hindrance to reforms. Thus, there may be the cases in which it is not appropriate to introduce a performance-linked compensation plan, and a company would need to consider it based on its own situation.

\(^{19}\) If the performance-linked compensation as a percentage of total compensation is raised, the amount of compensation the management will actually receive will decrease when they cannot achieve the target performance. In Japan where absolute amount of compensation tends to be not so high, introduction of a performance-linked compensation plan without reviewing the compensation levels would make the management worried about their life and, as a result, there is the possibility of the plan granting no appropriate incentive. It is necessary to consider introducing a performance-linked compensation plan as part of reviewing the compensation levels and ideal approaches to the compensation structure as a whole.
“In order for management remuneration to operate as a healthy incentive for sustainable growth, the proportion linked to mid- to long-term results and the balance of cash and stock should be set appropriately.”

<Reference: Organization in “Practices of Japanese Companies” as attached as Appendix 1 to the Corporate Governance System Study Group Report (published on July 24, 2015)>

What incentives are established will differ depending on the design of specific compensation plan. The following table shows the basic viewpoints of consideration, as well as the examples of merits and demerits.

<table>
<thead>
<tr>
<th>Points of view in examination</th>
<th>Merits (examples)</th>
<th>Demerits (examples)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Variable or not</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Variable</td>
<td>• Will function as an incentive to improve corporate value by taking risks appropriately.</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Linking index will basically be linked to a company’s goals or each director’s individual goals.</td>
<td></td>
</tr>
<tr>
<td>Fixed</td>
<td>• Will function as an incentive to conduct stable management by being able to expect stable income (living funds, etc.) which will not fluctuate depending on business performance or other factors.</td>
<td></td>
</tr>
<tr>
<td>Linking period</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Mid- and long-term</td>
<td>• Will function as an incentive to improve mid- and long-term corporate value.</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• Linking period will basically be linked to a company’s goals or each director’s individual goals.</td>
<td></td>
</tr>
<tr>
<td>Short-term</td>
<td>• Will more directly function as an incentive to day-to-day performance of duties.</td>
<td></td>
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<tr>
<td>Stock</td>
<td>• Will function as an incentive to increase stock price or dividend amount as a shareholder.</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• The function as an incentive will continue as long as equities are held after grant of compensation.</td>
<td></td>
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<tr>
<td>Items to be granted</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Share option (shinkabu-yoyaku-ken)</td>
<td>• Incentives to increase stock price will function.</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• The function as an incentive will continue as long as equities are held after grant of compensation.</td>
<td></td>
</tr>
<tr>
<td>Cash</td>
<td>• Highly liquid income can be expected.</td>
<td></td>
</tr>
<tr>
<td>Method of linking</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Only forward</td>
<td>• Will function as an incentive to increase corporate value.</td>
<td></td>
</tr>
<tr>
<td>Only downward</td>
<td>• Will function as incentives to prevent a reduction in corporate value.</td>
<td></td>
</tr>
<tr>
<td>Both forward/ downward</td>
<td>• Will function as an incentive to improve, and prevent a reduction of, corporate value.</td>
<td></td>
</tr>
<tr>
<td></td>
<td>• None</td>
<td></td>
</tr>
</tbody>
</table>

In order to urge shareholders and other stakeholders to understand compensation systems with the goal of improving mid- or long-term corporate value, a company should consider actively disseminating information about the status of introducing a performance-linked compensation and stock-based compensation plans, as well as the terms of those plans.

- As the performance-linked compensation and stock-based compensation plans of a company are designed under the corporate management strategy and other basic policy, its shareholders and other stakeholders are interested in the terms of those plans. For this reason, it is helpful for a company to actively disseminate information on the status of introduction of those compensation plans, as well as the terms of those plans.
- Especially in Japanese companies in which the percentage of such mid- or long-term incentive compensation is low, if they proactively provide persuasive explanations, they can expect to
receive understanding and evaluation of shareholders and other stakeholders, which would frequently support reviews of their compensation plans.

4.3. Utilization of the Nominating Committee and the Compensation Committees

A company should consider utilizing a statutory nominating committee (in case of a Company with Nominating Committee, etc.) or a voluntarily organized nominating committee (in case of a Company with Nominating Committee, etc., Company with Company Auditor(s) or company with Audit and Supervisory Committee) in order to appoint or dismiss a president/CEO and draws up a succession planning.20

○ In order to reinforce the independence, objectivity and accountability of a board of directors in connection with appointment or dismissal of a president/CEO and supervision of succession planning, several measures, including the following, can be taken.

(Measures to reinforce the independence, objectivity and accountability of a board of directors for nomination)

* A symbol of ○ attached to each item indicates the merits observed from the standpoint of improving the effectiveness of corporate governance (for example, the standpoint of ensuring the independence and objectivity), and a symbol of △ indicates the problems.

[1] Method of designating outside directors for a considerable number of the board members (for example, a majority) (to improve the independence of the board of directors itself)
○ A high level of independence of a board of directors is comprehensible from outside.
○ Consistent with an intention to have a board of directors specialize in monitoring.
△ A substantial degree of change to traditional Japanese companies.

[2] Method of setting up a statutory or voluntary committee consisting mainly of outsiders under a board of directors
○ Establishment of a mechanism will make the nomination/compensation decision-making process stable.
○ Consistent with ideal approaches to a board of directors even with a focus on decisions of individual business execution (a board of directors consisting mainly of insiders).
△ A threat of losing power depending on how the plan is designed or administered (especially in case of a voluntary committee).

[3] Method of expanding explanations to outside directors prior to deliberation at the board meeting and exchanging opinions individually without setting up a committee
○ It is possible to expand a similar level of the independence and objectivity as equivalent with setting up a voluntary committee, provided that sufficient explanations are provided and opinions are exchanged prior to the board meeting.
△ It may not be difficult to be evaluated despite a substantial level of explanations, as the situation is less understandable from outside.

20 In the case of the Company with Nominating Committee, etc., Company with Company Auditor(s) or company with audit or supervisory committee, a board of directors has the powers to appoint and dismiss a president/CEO (representative executive officer, and representative director) under the Companies Act. For this reason, a Company with Nominating Committee, etc. would have an option to voluntarily seek advice on appointment or dismissal of a president/CEO or succession planning from the statutory nominating committee, or would have an option to utilize any voluntary committee, for example, by setting up a separate voluntary committee consisting of all outside directors including those who are not members of the nominating committee, and seeking advice from that committee.
△ It may be less stable because there is no established mechanism.
△ Provided that there is only a very few outside directors, proposals submitted by management members may not be fully discussed, even if those proposals have any problem.
○ Of these methods, the method of appointing outside directors for a considerable number of the board members (e.g., a majority) may be adopted, as described in [1] above. However, many companies would feel it awkward because of a significant degree of change from a perspective of the composition of a board of directors now in Japan.
○ With respect to the method in [3], there is no problem if a substantial level of explanations are provided. However, the situation is less understandable from outside, or may be less stable. There is especially a problem if there are only a very few outside directors.
○ A company should consider utilizing a statutory or voluntary nominating committee as an effective means for any company to increase the effectiveness of corporate governance, irrespective of ideal approaches to a board of directors. A voluntary nominating committee would have a separate forum for mainly outsiders to engage in discussions from the standpoint of making independent and objective evaluation and ensuring transparency, and make a judgment on nomination and compensation as the board of directors after fully considering opinions of those outsiders.
  ➢ Even if a company decides to appoint outside directors for a considerable number (e.g., a majority) of the board members, it would be helpful to utilize the nominating committee from the viewpoint of increasing the proportion of outsiders than that at the board of directors or of making more in-depth and efficient discussions.
  ➢ In fact, discussions about nomination and compensation will be regularly repeated if a committee is set up at ordinary times. As a result, the committee is expected to be able to cope with any emergency case without hesitation. For this reason, it would be meaningful for a company in which there is no problem with appointment and dismissal of a president/CEO at this point of time to set up a committee at ordinary times in preparation for emergencies.
  ➢ For a president/CEO, if the fairness of his/her management is objectively evaluated by an independent committee, he/she will have the merits of reinforcing his/her authorities and connecting him/her to an environment where he/she can find it easy to make prompt and bold decisions. On the other hand, in case that a president/CEO goes out of control without justifiable cause, it is necessary to assign a role of putting a brake on it to that committee.
  ➢ As to the composition of a committee consisting mainly of outsiders, [1] outsiders would make up at least a majority of that committee; or [2] the numbers of insiders and outsiders are the same, but the chairperson is an outsider. For details, see “3. Composition of the Committees” of “Appendix 3: Points of View in Utilizing the Nominating Committee and Compensation Committees.”

<Reference: Corporate Governance Code>
[Supplementary Principle 4-1-[3]]
“Based on the company objectives (business principles, etc.) and specific business strategies, the board should engage in the appropriate oversight of succession planning for the CEO and other top executives.”

[Supplementary Principle 4-3-[1]]
“The board should ensure that the appointment and dismissal of the senior management are based on highly transparent and fair procedures and reflect the results of company performance.”
As it was pointed out by the investor that the nomination and compensation governance did not work when the company moved to the company with Audit and Supervisory Committee, the company decided to introduce the voluntary nominating committee and compensation committees at a time.

The president had the exclusive power to appoint a next president. However, the company thought that it had to externally clarify the reasons for appointment and set up the committee.

The founder proposed from the standpoint of succession planning and how the company should be after he/she left the company that the nominating committee and compensation committees be set up, and actually set up them.

In order to improve the effectiveness of appointing or dismissing a president/CEO, a company should consider utilizing a statutory compensation committee or a voluntarily established compensation committee in tandem with the nominating committee.

- In appointing or dismissing a president/CEO, there will be evaluation of such president/CEO. Evaluation is also necessary in the phase of fairly determining executive compensation, in addition to the phase of nomination, and those phases are common in many aspects. Evaluation of a president/CEO would typically be reflected in the compensation level for each fiscal period, not only in an extreme case of his/her dismissal. For this reason, it would be effective to set up a compensation committee, in addition to a nominating committee.

- The CEO gives a briefing about the annual action agenda at the meeting of the compensation committee consisting of CEO and external members, and conducts self-evaluation a year later. Then, the external members conduct assessment of his power of execution by scoring how much the CEO has carried out what he said a year ago.

- The use of the compensation committee in combination with a president’s evaluation works very well. For example, in the situation that the operating performance fell in one year. The company wants him to work a little harder, the company will rely on the compensation committee to assess that president in terms of compensation. If the company expresses its intention to the president by offering a flexible compensation, it will really mean so many different things. That is, it sometimes means that the company has presented a kind of preliminary judgment of potential dismissal in the future, or otherwise means that the company has expressed its intention to push a little more pressure on him.

A company should consider designing and administrating the nominating and compensation committees by reference to Appendix 3: “Points of View in Utilizing the Nominating Committee and Compensation Committees.”

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21 Conversely, only the compensation committee cannot completely evaluate a president/CEO. If the criteria for evaluation of compensation of a president/CEO include both quantitative criteria based on financial indices and qualitative criteria, qualitative evaluation can be reflected in the compensation. If, however, the criteria for evaluation only include quantitative evaluation, qualitative evaluation cannot be reflected in the compensation. In that case, the use of a nominating committee can be considered as a forum to give a feedback of qualitative evaluation (e.g., evaluation that he/she could have more actively dealt with corporate culture reforms, etc.) to the president/CEO.

22 If the nominating committee and the compensation committee are set up, whether to formally consolidate those committees into one or set up them separately would be determined after taking the burdens of their members into account.
While the nominating and compensation committees have the merit of being able to decide matters (other than those legally stipulated that should be determined by a statutory committee) in a highly flexible and free manner, they may have no power depending on how they are to be designed and administered.

In setting up a nominating or compensation committee (including a statutory committee), it is important to examine, for example, how the following matters should be designed and administered.

- Composition of the committees;
- Scope of advice targets;
- Details of matters to be advised;
- Relationship with the board of directors;
- Time schedule (frequency and time of holding a meeting); and
- Secretariat, and other relevant matters.

To help companies to examine the above-mentioned matters, the matters to be considered and examples to be referred to are presented in Appendix 3: “Points of View in Utilizing the Nominating Committee and Compensation Committee.” It is desired to examine what those committees suitable to each company should be by reference to Appendix 3.

If a company sets up a nominating or compensation committee (in particular, a voluntary committee), it should consider externally disseminating information on the structure and administration of that committee.

The nominating and compensation committees (in particular, voluntary committees) can be freely and flexibly designed and administered. For this reason, it is difficult to know the real conditions of those committees unless the company externally disseminates information. As a result, those committees might not be properly evaluated, although the company made many efforts to set up those committees.

Companies should externally disseminate information about the member compositions, matters deliberated, frequency of holding meetings, and other status of administration.

Although companies disclose the existence of those committees and the number of their members by attribute in their corporate governance report, companies should disseminate more information.
5. Ideal Approaches to the Leadership of Management Members

5.1. Ideal Approaches to Advisors (soudan-yaku) and Consultants (komon)

5.1.1. Issues with the Advisor/Consultant System

- There is a company that maintains a practice in which its retired president/CEO will continue to have a certain relationship with the company in the capacity of an advisor, consultant or other post.

- The roles of an advisor or consultant vary from company to company, and there is no intention to simply judge as good or bad to designate a retired president/CEO as an advisor or consultant. Considering that many activities in the business community are actually “without compensation,” if a retiring president/CEO engages in activities in the business community, plays a certain role to maintain the company’s relationship with its customers, or takes a certain time for handover to his successor as a person who knows historical business background, it would sometimes bring benefits to the company.

- Corporate value will be improved through contributions of various stakeholders including employees, customers, supplies and communities. If retired presidents/CEOs engage in social activities and public services in the capacity of advisors/consultants, it would be meaningful from the standpoint of corporate governance.

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24 For example, in case of a holding company, there may be similar problem when a president/CEO of one of its significant subsidiaries becomes an advisor or consultant of that subsidiary after his/her retirement. It is pointed out that it may be important to clarify the roles within the company and disseminate information as described in section 5.1.2 below.

25 Other than an “advisor” or “consultant”, there are various descriptions of titles. What is discussed here is that a retired president/CEO continues to maintain a certain relationship with the company, irrespective of howsoever he/she is called.

26 It is also pointed out that in order to maintain the relationship with customers, it would be more appreciated if seasonal greetings or ceremonial events are handled by an advisor or consultant who is the former president/CEO, rather than incumbent vice president or another officer.

27 For example, advisors/consultants can devote themselves to activities in the industry or other activities contributing to communities, as they retire from the incumbent management and have more time than ever before, which would make it possible for them to bring benefits to the company. Otherwise, if those advisors/consultants have their peculiar knowhow or personal connections, a company would sometimes adopt the advisor/consultant system to prevent them from spreading over to its competitors. Moreover, there is a case in which advisors/consultants provide a human resource pool of outside directors. In this regard, an advisors/consultant would choose to become an outside director of another company without continuing to be enrolled with the home company. However, a company that invites outside directors would sometimes have more advantages if its outside directors continue to be enrolled with their home company as advisors/consultants, maintain access to the industry information and utilize their knowledge when acting as its outside directors. Additionally, in Japan where the compensation levels of incumbent management are not higher than those of overseas companies, some view that in light of the independence of outside directors, they may keep more rigidly independent from the company in which they serve as outside directors if they receive pay or other remuneration from their home company. Comparing with the situation in which they have no other source of income and financial base (for this view, however, it is also pointed out that this problem should primarily be resolved by revising the compensation of incumbent management to appropriate levels to help them to build up a sufficient financial base prior to retirement, or that it is necessary to consider that if there are certain commercial relations between the company in which they are enrolled as advisors/consultants and the company in which they serve as independent directors, it might rather give rise to doubts on the independence).
Approximately 78% of respondent companies have the advisor/consultant system and practices, and approximately 62% of respondent companies have the current or former officers who actually serve as advisors/consultants (of which, approximately 58% of respondent companies have the current or former presidents/CEOs who actually serve as advisors/consultants (see Question 70 of the Company Questionnaire Survey).

With respect to the roles played by advisors/consultants, approximately 35% of respondent companies mentioned the activities in the business associations or communities, and other business-related activities; approximately 27% mentioned the activities to maintain and expand commercial relationships with customers; and approximately 20% mentioned the social activities, and other public activities including the council membership. On the other hand, approximately 36% of respondent companies mentioned the role of providing directions and guidance to the current management based on their management experiences (see Question 71 of the Company Questionnaire Survey).

On the other hand, it is pointed out that if the former president/CEO remains at a company as an advisor/consultant, the advisor/consultant who has no responsibility for company management may exercise unreasonable influential power over incumbent management members, and that there may arise a harmful effect that who is actually taking the management leadership cannot be understood. It is also pointed out that even if the advisor/consultant does not positively exercise unreasonable influential power, the current management may hesitate to make bold decisions, such as reconstruction of business portfolios, by thinking ahead the intention of the advisor/consultant who was previously the president/CEO.

In addition, because the roles and treatment of advisors/consultants vary from company to company and cannot be recognized from outside, there is no denying that they are in a way obscure. In fact, the actual conditions of advisors/consultants remain widely unidentified even internally, depending on companies.

From the viewpoint of promoting the corporate governance reforms throughout the country, it is desirable for a company to choose not to restrict its former president/CEO from serving as outside officer of another company, rather than keeping him/her for itself as advisor/consultant or any other post.

5.1.2. Clarification of Roles and Dissemination of Information within the Company

In considering whether to appoint its retired president/CEO as its advisor/consultant, a company should consider clarifying what roles it specifically expects him/her to play.

28 For example, when the former president/CEO who now serves as advisor/consultant is sought advice from the current management members who wanted to withdraw from the business the former president/CEO had previously started up or had been deeply involved with and increase investment in any other new business, the former president/CEO may have no option but to reconsider whether his/her judgment in the past was right, in which case it is difficult to make an objective judgment. In other words, it is pointed out that it is difficult to make a judgment independent from him/her in the past.

29 Even if the former president/CEO does not remain at the company as advisor/consultant, similar problem may occur, and cannot necessarily be resolved just by considering and reexamining the advisor/consultant system. If, however, the former president/CEO remains at the company as advisor/consultant, he/she would find it easier to access company information or keep communication with the current management. In that case, the abovementioned harmful effect would be more likely occur. It is also pointed out that the former president/CEO who did not choose to stay at the company as advisor/consultant would be free from the burden of keeping up with the company information, and be able to devote himself/herself to activities in different industry or company.
Then, a company should consider establishing treatment plans (such as compensation) commensurate with those roles.

In considering the above, a company should consider having outsiders join the process through the use of its statutory or voluntary nominating and compensation committees.

- If an advisor/consultant who has no responsibility to shareholders or other stakeholders exercises unreasonable influential power over appointment or dismissal of a president/CEO or the company management, it is questionable in that the current management should take appropriate leadership within the company, which must be improved. Such situation would pose a problem especially if the former president/CEO who was the top management remains at the company as advisor/consultant.

- Exercise of such unreasonable influential power is basically a problem to be corrected by a board of directors that properly functions. For example, it would be important to set up the nominating and compensation committees consisting mainly of outsiders to make the process for selection of a president/CEO and determination of his/her compensation transparent, and help outside directors and external members to recognize the roles they should play. This will lead to a function as a “shield” against the unreasonable influential power of the former president/CEO who serves as advisor/consultant.

- However, because there is no clear internal system for advisors/consultants, outside directors or even insiders, depending on companies, may not fully recognize their presence and roles, as well as their treatment plan.

<Reference: Survey Results of the Company Questionnaire Survey>
Approximately 10% of respondent companies replied that they do not identify the roles of advisors/consultants, and approximately 10% replied that they have no special role (see Question 71 of the Company Questionnaire Survey).

- In internally considering whether to appoint the retired president/CEO as advisor/consultant, it would be beneficial to clarify what roles the company expects him/her to play and examine whether or not his/her treatment plan is commensurate with such roles.

<Reference: Survey Results of the Company Questionnaire Survey>
Approximately 20% of respondent companies have ever reviewed or considered reviewing the adviser/consultant system (Question 75 of the Company Questionnaire Survey).

- It may ensure objectivity if a company has it discussed at a meeting of its board of directors. However, it may ensure more objectivity if a company chooses to have outsiders participate in discussion. As a result, a company may have outside directors or other outsiders participate in the process by seeking advice on its advisory/consultant system from its statutory or voluntary committee, which will have a discussion meeting at the time of appointment as advisor/consultant and the subsequent renewal of the term of office.

If a company retains its retired president/CEO as its advisor/consultant, it is meaningful to

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30 It is also pointed out that the issue with the exercise of unreasonable influential power by the former president/CEO against the current president/CEO is largely affected by the personnel connection (chain) that the current president/CEO was nominated by the former president/CEO. In order to resolve this issue, it would be one of effective reactions to reform the nomination process, for example, by having the nominating committee consisting chiefly of outsiders participate in the process, so that the current president/CEO may not select next president/CEO on his/her sole discretion.
voluntarily disseminate information on the number of the retired presidents/CEO who act as its advisors/consultants, and their roles and other treatment plans externally. The industrial circles are expected to make these efforts proactively.

- The roles of advisor/consultant differ from company to company, and it should not be determined one-sidedly that the retired president/CEO should be or should not be appointed as advisor/consultant. As described above, a company should internally establish appropriate roles and treatment plans and provide information externally after ensuring objectivity. By doing this, a company can obtain understanding of the fairness of its internal framework for corporate governance from investors and other outsiders.31

- It is also pointed out that in Japan where the level of compensation to presidents/CEOs is lower than that in overseas countries, receipt of compensation as advisor/consultant by a retired president/CEO has almost the same meaning as a deferred payment of the remuneration he/she should have primarily received when he/she had served as president/CEO.

At a company adopting a deferred payment system by setting the level of compensation to the current president/CEO based on the assumption that he/she will receive compensation as advisor/consultant later, it can be considered that it should make the executive compensation system more appropriate as a whole by increasing the level of compensation to incumbent management through introduction of incentive fees or otherwise, as well as by reconsidering the positioning of advisors/consultants and their compensation.

Retired presidents/CEOs who have chosen not to stay as advisors/consultants after examining the corporate systems on advisors and consultants will be expected to proactively become outside directors of other companies and utilize their management knowledge cultivated through their long-term management experiences, from the standpoint of ensuring contribution to society.32

5.2. Ideal Approaches to Chairman of the Board

A company should examine the powers and title of a chairman of the board (whether or not to grant the right of representation, etc.), considering whether it is right or wrong to concentrate the powers on a current president/CEO.

- In Japan, there are many companies with a “chairman of the board (torishimariyaku-kaichou).” However, the roles of a chairman of the board differ from company to company, as some companies use this title for a chairperson of a board of directors or others use it for a leading director (not a chairperson of a board of directors).

- Some companies would be suited to maintain a framework in which a chairman of the board and a president/CEO work together to conduct business as the top management from the standpoint of reinforcing the management leadership, while others would be suited for a chairman of the board to draw a line from conducting business from the standpoint of devoting himself/herself to monitoring the top management.

- By way of illustration, it is pointed out that at a company clearing dividing the execution

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31 In particular, it is considered helpful to give understanding and a feeling of security to foreign investors who have no similar practice.

32 There is no binary opposition between becoming an advisor/consultant and becoming an outside director of another company, and it would be possible to assume the office of outside director of another company while staying at the home company as advisor/consultant. Therefore, it is desired from the standpoint of ensuring contribution to society that a retired presidents/CEO who stays as advisor/consultant should proactively become outside director of another company.
function for which a president/CEO is totally responsible and the monitoring function for which a board of directors is responsible, a current president/CEO will find it difficult to conduct business when a former president becomes a chairman of the board with strong powers and title (for example, with the right of representation).

- If a chairman of the board devotes himself/herself to acting as a chairperson of the board of directors and evaluating the board of directors, his/her roles will be clearly divided from the roles of a current president/CEO, which would sometimes help a current president/CEO to make a prompt and resolute decision. For this reason, it would be helpful that what powers and title a chairman of the board should be given should be coordinated in view of the separation between monitoring and execution, as well as the concentration of the powers on a current president/CEO, depending on the situation of each company.

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33 A Company with Nominating Committee, etc. will examine whether a chairman of the board should concurrently serve as an executive officer and whether the right of representation should be given to him/her (i.e., whether he/she should serve as a representative executive officer), while a Company with Company Auditor(s) or company with Audit and Supervisory Committee will examine whether a chairman of the board should act as an executive director and whether the right of representation should be given to him/her (i.e., whether he/she should serve as a representative director).

34 It is also pointed out that when a trade association or government or other committee selects its representative or members from companies, certain authorities (right of representation) or title (e.g., a title of president or chairman, not a vice president) will be required, in which case companies have no option but to give any powers or titles other than those prevailing within the company.
6. Conclusion

- The survey results of the Company Questionnaire Survey (referential materials of the CGS Study Group Report) indicate that many companies took a year to respond to the Corporate Governance Code, and have now entered into the second year during which they should work out details to resolve various issues detected in the effectiveness evaluation after the first effectiveness evaluation by their boards of directors. It is the current big topic to enhance the corporate governance reforms from formality-based efforts to substance-based ones, and the above-mentioned survey results show that the movement of reform to substance-based efforts is steadily progressing.

- In order to construct an economic system that will enable Japan to move out the present situations in which corporate value has continued to slow down for more than twenty years in the past, and to achieve a sustainable growth and improve mid- and long-term corporate value, it is a key for companies to continue to step forward the corporate governance reforms. It is desired that each company should continue to construct and administer its optimal corporate governance system by reference to these Guidelines.
Appendix 1: Points of View in Considering the Roles and Functions of Board of Directors

1. Approaches to the Vertical Axis, Horizontal Axis and Dimensional Axis

1.1. Approaches to the Vertical Axis

- As the first viewpoint (i.e., vertical axis), the roles and functions of a board of directors is organized by categorizing them based on whether a board of directors makes many decisions on individual business execution (whether a focus is also placed on the decision-making function) or whether a board of directors makes only few decisions on individual business execution (whether a focus is placed on the monitoring function).
  - A board of directors plays the both decision-making function and monitoring function, provided that it decides basic management strategies and plans. What a board of directors should be would differ depending on how it attains balance between those two functions.
  - For example, if a board of directors makes decision on individual business execution, it places a focus on the decision-making function, in addition to the monitoring function. On the other hand, if a board of directors makes only few decisions on individual business execution and places a focus on the monitoring function, it will specialize in the monitoring function.
  - If either of the monitoring function and decision-making function is strengthened, the other may be weakened. However, the both functions are not totally contrary to each other and may be compatible. It does not mean that a board of directors that makes many decisions on individual business execution will not need to fulfill the monitoring function.

1.2. Approaches to the Horizontal Axis

- As the second viewpoint (i.e., horizontal axis), the roles and functions of a board of directors is organized by categorizing them based on whether the powers of a president/CEO to conduct business are decentralized or centralized.
  - The environment in which a president/CEO can exert a top-down style of management power in conducting business is defined as centralized. On the other hand, for example, the

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35 This does not mean whether the management competence of a president/CEO or other management members is high or low.
cases in which a president/CEO coordinates opinions of business division heads and other managers and management members run the company under mutual surveillance (they engage in a “mura-shakai” (closed society) or village community-style management) is defined as decentralized.

> There are certain cases in which the relationship with not only management but also employees should be considered. For example, if high competency of employees is a source of competitiveness and there are many excellent employees who can change jobs at any time, a president/CEO must pay attention to intentions of those employees. In such case, the powers of a president/CEO might be decentralized.

1.3. Approaches to the Dimensional Axis

- As the third viewpoint (i.e., dimensional axis), the roles and functions of a board of directors is organized by categorizing them based on whether or not the monitoring function of a board of directors is strong (i.e., effective). The vertical axis does not show the strength of the monitoring function (specializing is not strengthening), and it is necessary to strive to strengthen the monitoring function of a board of directors in any quadrant.

- As ideal approaches to strengthening the monitoring function would differ depending on each quadrant, it can be considered that efforts to strengthen the monitoring function in a way consistent with each quadrant will be chosen.
2. Directivity in Reviewing Management and Board of Directors

- Examining several directivities for reconsideration based on the organization in section 1 above, for example, the following directivities can be examined.

2.1. Directivity [1]

- Directivity [1] (From quadrant B to quadrant A; from quadrant D to quadrant C): A company intends to shift the roles and functions of a board of directors (i.e., a directivity to intend to have a board of directors specialize in monitoring).
  
  - A board of directors conventionally assumed the roles and functions to make decisions on individual business execution. However, a company intends to delegate the decision-making function to executive officers, and shift the roles and functions of a board of directors chiefly to the monitoring function.
  
  - For example, if a company moves from quadrant D to quadrant C, it can be considered that the company in which the powers are substantially concentrated on a president/CEO (for example, a top-down style management by a president/CEO) will create an environment in which it is easy for a president/CEO who is delegated the powers to make prompt business decisions without having to wait for the board meeting to be convened by reducing the number of individual agendas to be decided by a board of directors. On the other hand, there is a concern that mutual monitoring between executive officers cannot be expected in most cases. As a result, a company will expect its board of directors to play a role to monitor actions of a president/CEO who has strong powers and authorities so that he/she may not behave recklessly or engage in any corrupt practice, and will take actions to shift its board of directors to an organ with a focus on the monitoring function (it would be necessary to take actions to strengthen the monitoring function (directivity [5])).

2.2. Directivity [2]

- Directivity [2] (Actions within quadrant B and quadrant C): A company intends to strengthen the monitoring function within and outside of its board of directors, while placing an emphasis on the decision-making function of its board of directors.
  
  - This is the case with a company in which the roles and functions of its board of directors are intended to make decisions on individual business execution as in the past and are not intended to have its board of directors specialize in the monitoring function.
  
  - For example, in case of a company which stresses the independence of each business division and section and makes decisions by resolving conflicts of opinions expressed by each of them, there is no denying that maintaining the decision-making function of its board of directors with a focus on a consensus and internal harmony as in the past may be suitable to its own business characteristics and environment. In this situation, that company would not need to intend have its board of directors specialize in the monitoring function.
  
  - On the other hand, it is necessary to monitor the management members including a president/CEO, and a company will make internal possible efforts to strengthen the monitoring function of its board of directors (to ensure certain levels of fairness, objectivity and transparency in the decision-making process) and increase the monitoring function of any organs other than the board of directors (for example, monitoring by various committees of which majority is made up by outside directors), provided that its board of directors will make decisions on individual business execution.
2.3. Directivities [3] [4]

- Directivity [3] (from quadrant B to quadrant D): A company will strengthen the powers of its president/CEO (centralization of powers)
  
- Directivity [4] (from quadrant B to quadrant C): A company will shift the roles and functions of its board of directors in tandem with the directivity [3]

- For example, in case of a company that is located in quadrant B mentioned above, it is difficult to withdraw from the existing business, change its strategic policy or review its business portfolio in a timely and accurate manner, which may operate as one of impediments to improvement of its competitiveness.

- In order to address such issue, a company may make efforts with the intention of centralizing the powers to a president/CEO and expediting its decision-making process.

- Concurrently with centralizing the powers to a president/CEO, a company will need to strengthen monitoring of a president/CEO to keep balance and, especially as an ultimate means, prepare a mechanism that will enable the company to dismiss its president/CEO (e.g., establishment of a nominating committee consisting chiefly of outsiders, and formulation of the standards for dismissal)

- If the above-mentioned efforts are to be made with changes in the roles and functions of a board of directors (directivity [1]), it will be organized into directivity [4].

2.4. Ideal Approaches to Strengthening the Monitoring Function in Each Directivity

- Strengthening the monitoring function in directivity [1] (or directivity [5]) can typically be organized as described below.

- The roles a company expects its outside directors to play are to formulate management strategies of that company and what is more, to evaluate whether the management members run the company in line with those strategies.

- It is necessary to reconsider proposals submitted before the meeting of a board of directors from the standpoint of minimizing decisions on individual business execution at the meeting of the board of directors (i.e., to delegate substantial powers to a president/CEO)\(^{36}\).

- Although a board of directors may receive reports whenever decision is made on individual business execution, it may only choose to pick up especially important transactions it needs to evaluate due to time constraints, and ask the personnel in charge of those transactions to make reports.

- In order to enable a board of directors to objectively evaluate execution of business by insiders, the board of directors will basically consist mainly (e.g., a majority) of outsiders.

- As it may be inefficient to deliberate all matters at a meeting of a board of directors consisting mainly of outside directors, it can be considered to set up an expert committee, such as nominating or compensation committee for efficiency purposes. However, decisions made by such committee will not necessarily need to be binding upon the board of directors (because the board of directors consists mainly of outsiders).

- A company may choose not to hold a meeting of its board of directors each month, as it only makes minimal decisions on individual business execution. However, a company may hold a meeting of its board of directors each month as in the past to discuss, among others, management strategies that have not ever been fully deliberated.

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\(^{36}\) If a board of directors of a company continues to make many decisions, that company, even though it is the Company with Nominating Committee, etc., would not be considered to fall under Directivity [1] type.
It is desirable for any person other than executives to act as a chairperson of a board of directors from the standpoint of ensuring objective evaluation.

A company including its employees must be more aware that directors oversee management members.

In quadrant A (decentralization of powers to a CEO-type), outside directors will be required to evaluate the management members other than a president/CEO. On the other hand, in quadrant C (centralization of powers to a CEO-type), evaluation of the management members other than a president/CEO may primarily be left up to a president/CEO, as it is a factor for centralization that the president/CEO has the powers to decide personnel affairs.

Strengthening the monitoring function in directivity [2] can typically be organized as described below.

A company stresses that the roles it expects its outside directors to play are to formulate its management strategies and to give advice even in the decision-making process from an outsider’s perspective.

A company will need to reconsider matters to be submitted before a meeting of its board of directors so that the board may take more time to deliberate important matters, with the intention of delegating the powers to decide less important businesses to a president/CEO.

Decisions on individual business execution will ordinarily be made chiefly by executive directors who are familiar with internal operations. On the other hand, it is desired to select a specified number of outside directors to have them check, from the third-person point of view, whether decisions on individual business execution are made solely based on internal logic (the monitoring function will be further enhanced when more than one outside directors are appointed so that discussion can be made between or among outsiders).

At a meeting of a board of directors consisting mainly of internal executives, it is systematically difficult for the board of directors alone to conduct full monitoring and will be necessary to secure the monitoring function by any organs other than the board of directors. For this reason, nominating and compensation committees consisting chiefly of outsiders would be set up. Decisions made at the meetings of such nominating and compensation committees must be respected at the board of directors.

A meeting would have to be held at least once or so a month in order not to lose the promptness in decision making.

One of internal executive directors may act as a chairperson of a board of directors from the standpoint of taking the leadership of decision making. On the other hand, any person other than executives may act as such from the standpoint of enhancing the monitoring function by the board of directors even a little. In that case, a person who will act as a chairperson of the board of directors will need to understand the nature of business of the company to such a degree as he/she can decide whether or not to submit any matter before a meeting of the board of directors.

Centralization of the powers to a president/CEO in directivity [3] (or directivity [4]) can typically be organized as described below.

The scene in which a president/CEO cannot make resolute management decision just by thinking over internal business divisions and the retired president/CEO would be substantially affected by the internal ground based on which that president/CEO was appointed as such. For this reason, it is important to cut off a flow of selecting a president/CEO based on the internal logic or the intention of a retired president/CEO.

To this end, the nominating committee will be required to exert stronger roles. If a company moves from quadrant B to quadrant D, decisions on appointment of a
A company can consider utilizing a compensation committee to decide the compensation of a president/CEO, as it can be utilized as one of the means to present evaluation of a president/CEO.

Even if the powers are to be concentrated on a president/CEO, it is difficult for him/her to comprehensively lead all matters. In that case, it may be useful in centralizing the powers to a president/CEO by appointing a COO, CFO, CTO, and/or CIO who will supervise each field under the leadership and direction of a president/CEO. To this end, a president/CEO must hold the right to decide personnel affairs to practically place each of those chief officers under the leadership and direction of the president/CEO. In that sense, even if those chief officers are to be decided by the board of directors as selection of key employees, candidates for those chief officers should be proposed by the president/CEO (it would basically be sufficient for outside directors just to check whether there is no problem. Should it be considered that the selection of candidates or exercise of the right to decide personnel affairs by the president/CEO is unreasonable, outside directors should have a discussion with the president/CEO and, only if the situation is not corrected by such discussion, should finally resolve the situation by replacing the president/CEO).

In order to concentrate the powers on a president/CEO at ordinary times, outside directors will be required to internally and externally ratify the legitimacy of the execution of business by the president/CEO and evaluate him/her by reflecting it in his/her nomination and compensation, if they conclude that there is no problem from the standpoint of management judgment in developing an environment to assist the president/CEO in making resolute decisions on execution of business (to urge him/her take risks).

On the other hand, once a company concentrates the powers on its president/CEO, a certain level of tense relationship (balance) will become necessary to prevent the quality of the president/CEO from lowering. If any problem with the president/CEO is identified, a mechanism will be required in which an alarm will be given through evaluation of compensation to the president/CEO and, if it is found difficult to correct the situation, the president/CEO may ultimately be dismissed (e.g., establishment of a nominating committee consisting chiefly of outsiders, or formulation of dismissal criteria).

In addition, to concentrate the powers on a president/CEO, a company would need to reexamine its organization structure and change the actual situation by striving for a change in awareness throughout the company or a creation of new governance structure.
As a company with so many enterprises under its control, which is called a conglomerate, the president may not catch up all in part due to his/her career path, that is, he/she may most respect opinions of people who are actually doing business, and he/she cannot almost oppose to, or may have no tool to oppose to, what they have decided. Given such situation, we considered it necessary to introduce a tool to reinforce the powers of the president, and introduced a system called the strategic business evaluation system to evaluate business from a third-person viewpoint. We also changed the title of a head of the management to a CEO with the intention of concentrating the powers to a CEO.

We have set up the executive nomination advisory committee as one of the advisory committees of the board of directors, which has the role of drawing up a report on executive candidates. We secure the objectivity by designating an outside director as its chairperson. The board of directors will determine director candidates based on the opinions of that advisory committee, and those candidates will be elected as directors at the general meeting of shareholders.

The representative director/CEO has any and all authorities to decide execution of business and the right to give directions and orders to other executive officers, both under the supervision of the board of directors. The representative director/CEO instead has the accountability to the board of directors and other organs. It is a significant responsibility of the CEO to construct a relationship of trust by fulfilling his/her accountability. Outside officers will support the company in taking risks based on confidence and trust at ordinary times, while they will block any project or action of CEO in time of emergency. This is like a rope pulling contest between the CEO exerting a dynamic leadership and outside officers overseeing it, thereby creating a collaborative relationship with a feeling of tension between the CEO and outside officers.
Appendix 2: Points of View in Utilizing Outside Directors

- A company should mainly consider how it utilize outside directors in the following scenes: [1] the scene in which it considers whether or not outside directors are necessary, and desired image of outside directors; [2] the scene in which it looks for outside director candidates and asks them to assume the office as such; [3] the scene in which outside directors assume the office as such and play active roles within the company; and [4] the scene in which it evaluate performance of outside directors and considers appointing or dismissing them. It is useful to consider utilizing outside directors according to each of those scenes.

- If a company reaches a conclusion that it has been unable to utilize its outside directors, it would need to verify in which scene there have been the problems, and it is useful to consider the problems by scene.

- Specifically, a company should consider the problems by dividing into the following nine steps.

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<td>Consider ideal approaches to its board of directors.</td>
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<td>3</td>
<td>Consider the qualifications and backgrounds that match the roles and functions.</td>
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<td>4</td>
<td>Look for outside director candidates who have the required qualifications and backgrounds.</td>
<td>Scene of evaluating the performance of outside directors and considering reappointing or dismissing them.</td>
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<td>5</td>
<td>Check the eligibilities of outside director candidates.</td>
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<td>6</td>
<td>Consider the terms of assumption of outside directors (such as remuneration).</td>
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<td>Evaluate whether the outside directors have fulfilled the roles expected from them.</td>
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<td>Consider reappointment/dismissal based on results of assessment.</td>
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1. Step 1: Consider ideal approaches to its board of directors

A company should consider ideal approaches to its board of directors and the directivity it should head for before examining whether or not outside directors are required, and their roles and numbers.

- Ideal approaches to a board of directors vary depending on the situation of each company, and whether or not selection of outside directors is required, the roles and functions expected from them, and their number and proportion.
  - For example, if the powers of president/CEO are decentralized, outside directors will be expected to actively make proposals on any matters that are difficult to fulfill under the leadership of a president/CEO (e.g., withdrawal from certain business).
  - On the other hand, if the powers of president/CEO are centralized, outside directors will basically be expected to support resolute execution of business by a president/CEO and, if there is a problem with a president/CEO, to take actions including dismissal of such president/CEO.
If a board of directors has to make many decisions on individual business execution, outside directors will be expected to give advice on decisions on them. Although the number (proportion) of outside directors does not need to be large (high), what is important is the capabilities of individual outside directors.

On the other hand, if a board of directors makes a few decisions on individual business execution, it will tend to mainly monitor management and will not be so much expected to give advice on decisions on individual business execution. The larger (higher) the number (proportion) of outside directors is, their influence would become more coherent.

In any case, in Japanese companies in which many of management members have no experience of working outside, experiences of outside directors with external knowledge are effective for multifaceted discussion in making management judgment, and outside directors are expected to positively participate in both monitoring and advice.

2. Step 2: Clarify the roles and functions it expects from its outside directors

A company should consider internally clarifying the roles and functions it expects from outside directors or those it does not expect from them prior to appointing them.

2.1. Roles and Functions Expected from Outside Directors (General Discussion)

- If a company vaguely selects outside directors without clarifying the roles and functions it expects from its outside directors, it will be difficult to appropriately evaluate whether or not outside directors are helpful.
- So a company should consider internally clarifying the roles and functions it expects from outside directors or those it does not expects from outside directors prior to appointing them.
- Examples of the roles and functions expected from outside directors would include, for example:
  - Participation in formulation of management strategies and plans
  - Participation in the nomination/compensation decision-making process
  - Monitoring of a conflict of interest
  - Reflection of opinions of shareholders and other stakeholders
  - Participation in decision-making on execution of business
  - Acting as a contact office or desk for whistleblowers

- On the contrary, examples of the roles and functions not expected from outside directors would include, for example:
  - Detailed guidance of individual business execution
  - Preparation of an original plan for management strategy
  - Search and detection of a clue to unfair practice to be done in a level of corporate personnel in charge

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37 Some companies say that their outside directors attempted to give guidance on details of business execution, as a result of which the business execution went in the wrong direction, while other companies say that they have been embarrassed by the outside directors who had executed business (e.g., negotiations with customers that should normally have been conducted by personnel in charge). It should be aware, of course, that outside directors are not executives. If, however, a company appoints outside directors after clarifying the roles it expects from them, it would be helpful to avoid these kinds of problem.

38 The reason for including this description is that it is difficult for outside directors to actively search and detect any scandal involving any of management members (without any form of whistleblowing or other clue), because they generally do not know internal circumstances and actual business situations. This description is not intended to deny
Companies should make effective use of independent directors, taking into consideration the expectations listed below with respect to their roles and responsibilities:

(i) To provide advice on business policies and business improvement based on their knowledge and experience with the aim to promote sustainable corporate growth and increase corporate value over the mid- to long-term;

(ii) To monitor the management through important decision-making at the board including the appointment and dismissal of the senior management;

(iii) To monitor a conflict of interest between the company, and its management members or controlling shareholders, etc.; and

(iv) To appropriately represent the views of minority shareholders and other stakeholders in the boardroom from a standpoint independent of the management and controlling shareholders.”

To conduct appropriate evaluation of execution of business through nomination or compensation decisions, and monitoring by granting future-oriented incentives through evaluation or otherwise.

To monitor a conflict of interest.

To participate in decisions on execution of business by giving advice or exercising voting rights.

(Examples of acts outside directors are basically allowed to conduct)

- For example, the following acts will not ordinarily be done under any executive’s chain of command and, in principle, will not be considered “execution of business.”

1. To serve as a contact for whistleblowers that is independent from executives.

2. To engage in investigations as a member of internal investigation committee for any corporate scandal in order to conduct investigations independently from executives.

3. To give instructions and comments as to investigations to be conducted through the internal control system independently from executives.

4. The following conducts in a management buyout (MBO):
   - To examine opinions expressed by a board of directors of a target company (e.g., whether it should give approval; whether it gives a recommendation in favor of subscription; selection of advisors).
   - To gather information on the MOB and purchasers.
   - To have negotiations with purchasers.

5. To express opinions independently from executives on issue of shares through a third-party allotment, or material transactions with controlling shareholders, whenever it that outside directors should conduct hearings from those who are concerned within the company or take any other actions when they identify any clue to unfair practice or other problem. Outside directors who concurrently serve as members of the audit committee of a Company with Nominating Committee, etc. or serve as members of the Audit and Supervisory Committee of a company with Audit and Supervisory Committee engage in audit, and are sometimes expected to detect and unmask any unfair practice to an extent practically possible. However, the outside directors as described here should be discriminated from those directors who are members of the audit committee or the audit and supervisory committee.
is required by the listing regulations.

[6] To attend voluntarily set-up compliance committee, and provide officers and employees with lectures on their own experiences or otherwise participate in internal activities for improvement of compliance.

[7] To attend the management conference or any other meeting (other than the board meeting) to discuss management policy, and express their opinions.

[8] To use their personal network to find a counterparty of a merger and acquisition (M&A) or other commercial transaction and introduce such counterparty to a company.

[9] To have dialogues or meetings with shareholders and investors.

2.2. Roles and Functions Expected from Outside Directors (Detailed Discussion)

2.2.1. Participation in Formulation of Management Strategies and Plans

- To participate in formulation of management strategies and plans is one of the roles expected from outside directors, irrespective of what a board of directors should be.

- It is internal executives who are most familiar with management of a company, and it is the role of management members, not outside directors, to increase business performance of a company. Therefore, original drafts of management strategies and plans should naturally be prepared mainly by internal executives.

- The roles expected from outside directors are to encourage management members to fulfill their accountability for management strategies, for example, to raise questions, when outside directors have found something based on their knowledge:
  - Whether management members have not been caught by internal logic;
  - Whether the management strategies are designed to improve mid- and long-term corporate value;
  - Whether management members have not excessively avoided risks; and
  - Whether prospects of management members are adequate and based on reasonable grounds.

2.2.2. Participation in the Nomination/Compensation Decision-making Processes

- A focus of management monitoring by a board of directors is placed on to evaluate execution of business through nomination of management members (especially, a president/CEO) and determination of their compensation. There is a concern that management monitoring by management members is less objective. Such being the case, outside directors who are not executives are particularly expected to actively evaluate execution of business from an objective stance.

- More specifically, outside directors are expected to play the roles of requesting management members to provide explanations about their performance based on the management strategies and plans, as well as the roles of appropriately evaluating management members and reflecting such evaluation in their nomination and compensation from the standpoints described below:
  - Degree of, and factors for, achievement;
  - Whether there have been external factors not attributable to management members; and
  - Whether management members have made efforts to improve mid- and long-term corporate value.
Moreover, outside directors are expected to participate in the process to determine the nomination of and compensation to non-management directors. A president/CEO may take direct control of the powers to determine personnel affairs of management members; however, it is desirable that judgment of nomination and compensation of non-management directors such as outside directors will be made independently from a president/CEO. As a result, it will become necessary for outside directors to actively participate in that process.

2.2.3. Monitoring of a Conflict of Interest

In a scene in which there may arise a conflict of interest between the company on the one part and its management members and other controlling shareholders, etc. on the other part, it is not appropriate for any person who may have such interest to participate in that resolution. For this reason, outside directors are expected to actively participate in the monitoring by judging the reasonableness from an independent and objective stance.

Examples in which there may arise a conflict of interest between the company, and its management or other controlling shareholders, etc. would include:

- Determination of executive compensation;
- MBO (management buyout);
- Transactions with controlling shareholders, etc.
- Hostile acquisition (anti-M&A defense measures); and
- Response to a corporate scandal etc.

2.2.4. Reflection of Opinions of Shareholders and Other Stakeholders

Outside directors are expected to appropriately reflect opinions of stakeholders in the board of directors. As a result, it may be effective for outside directors to assume chief responsibility for dialogues with stakeholders.

Stakeholders include various entities and persons, and it is especially important for Japanese companies to pay full attention to shareholders. Japanese companies traditionally conduct management with an emphasis on its employees, customers, suppliers and others, and have not relatively paid full attention to their shareholders. In such situation, outside directors must be aware that they are expected to play the role of placing a focus on shareholders out of stakeholders and appropriately reflecting their opinions in the board of directors.

2.2.5. Participation in Decision on Individual Business Execution

As a company in which the board of directors frequently makes decision on individual business execution, a degree of outside directors participating in such decisions will go up. Participation in decisions on individual business execution by outside directors will make it possible for them to effectively monitor management.

On the other hand, too much participation may pose a problem of whether an outside director can fully monitor the matter he/she participated in the decision. Generally considering that outside directors primarily have less business knowledge and experience than insiders, expecting outside directors to deeply participate in decision on individual business execution would make it inefficient for them to make decisions.

For this reason, it is necessary to examine to what extent outside directors should participate in decision on individual business execution.

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39 When outside directors have identified a clue for wrongdoing or problem in any significant transaction, they would conduct hearings from those who are concerned within the company. They would also engage in investigations into the facts involving any corporate scandal detected within the company or provide guidance on efforts to prevent the recurrence.
decisions on individual business execution, in light of the balance with their monitoring function.

3. Step 3: Consider the qualifications and backgrounds that match the roles and functions

A company should consider the qualification and background it seeks from outside directors, and their balance, depending on the roles and functions of outside directors. A company should also consider appointing an individual with management experience as one of its outside directors.

- As described in section 2. above, outside directors are expected to play various roles and functions, and a company must examine qualifications and backgrounds of human resources who can fulfill such roles and functions.
- The independence is one of important qualifications and backgrounds; however, being independent is not enough and it is necessary to consider the diversity of other qualifications and backgrounds. A company must examine what qualifications and backgrounds required by outside directors to substantially fulfill their roles and functions are, in light of what its board of directors should be, as well as of the balances with the qualifications and backgrounds of its internal directors.
- In examining the above, it is important to have a point of view of ensuring diversity of directors. One of the roles expected from outside directors is the diversity to reflect diverse values a company does not have in the board of directors. A company should examine its management goals together with diversity, for example, by defining human resources required based on its management challenges.
- As a matter of fact, it may actually be difficult for a single outside director to fully perform all of the roles and functions expected from outside directors. Given this, it would be beneficial to ensure diversity among outside directors form the standpoint of having outside directors as a whole function through combined use of human resources with a variety of qualifications and backgrounds.
- As described above, the qualifications and backgrounds required from outside directors should be seriously examined by each company in the light of diversity. According to the expected roles and functions and the required qualifications and backgrounds, outside directors can be categorized largely into the following three types: [1] management experience-type; [2] expertise-type; and [3] attribute-focused type.
<table>
<thead>
<tr>
<th>Types</th>
<th>Characteristics</th>
<th>Examples</th>
</tr>
</thead>
<tbody>
<tr>
<td>Type A: Management experience-type</td>
<td>A type of individuals who are expected to present opinions from the viewpoint of experienced managers. Those individuals may or may not have an experience in the business sector of that company.</td>
<td>Current company managers, retirees, etc.</td>
</tr>
<tr>
<td>Type B: Expertise-type</td>
<td>A type of individuals who are expected to present opinions based on professional knowledge. Those individuals may have expertise in the business sector of that company or may have expertise in company management in general.</td>
<td>Lawyers, accountants, scholars, government officials, etc.</td>
</tr>
<tr>
<td>Type C: Attribute-focused type</td>
<td>A type of individuals who have a specific attribute on which a company places a focus for its management strategy purposes, and are expected to present opinions from that viewpoint. It is typical to examine the attribute cumulatively when examining a type of A or B above (this type of individuals fall under A or B in most cases).</td>
<td>Gender (female), nationality (foreigner), others (age, ethnicity, religion), etc.</td>
</tr>
</tbody>
</table>

- It is important for each company to fully consider what qualifications and backgrounds outside directors it needs to appoint should have, as well as the how the balance among types A, B and C should be in appointing outside directors.
- It would be considered important in effectively utilizing outside directors for a company to appoint an outside director of management experience-type as one of outside directors in light of the rules and functions expected from outside directors, although a voluntary examination by each company should be respected.
- Type A (management experience-type) and Type B (expertise-type) are the categories with a focus on experience (career) and knowledge (skill), while Type C (attribute-focused type) is the category with a focus on attribute, unlike Types A and B. Even in the case of Type C (attribute-focused type), it is not basically assumed to be appointed solely by placing a focus on any attribute. Individuals categorized into Type C will be appointed from among individuals with management experience (Type A) and expertise (Type B), especially with a focus on the attribute that she is a woman or he/she is a foreigner.
In many cases, we retain an outside director with management experience after the board of directors checks his/her background in various ways. When we “select” an outside director candidate who will become a member of the nominating committee, we must say that he/she has the ability to attract people. We can identify that he/she is a decent person, and identify that he/she possesses genuine “appetite for and concrete measures for improvement of corporate value.” When we “dismiss” an outside director, we must see through that his/her practice should ruin the company or his/her management ability is not enough to bring a sustainable growth, or that he/she should slow the internal process down.

What kind of individuals should be appropriate as outside directors? Our current outside directors consist extremely broadly of legal professional, actual manager of the pharmaceutical business, jurist, etc. Generally speaking, all of them have professional knowledge, experience and passion enough to understand and respond to changes in the market and technology as part of globalization processes. Although we used the words of monitoring and supervision of a CEO, we believe that the outside directors must always watch whether the CEO fulfills his accountability and, if not enough, must raise severe questions to him and request him to fulfill his accountability. Summing up, outside directors will be required to possess an insight and ability to judge correct information in anticipation of the future of the company.

When we choose candidates for outside officers, we consider their attributes, such as management experience, legal profession, science community member and female. Female officers give us advice from a broader point of view.

Naturally, outside directors are less familiar with internal affair than internal directors. It is important to steadily prepare a system to support outside directors by providing them with information they do not have in advance through a briefing or otherwise. It is not necessarily a qualification required from outside directors to be familiar with internal affairs.

4. Step 4: Look for outside director candidates who have the required qualifications and backgrounds

Once a company decides the qualifications and backgrounds it requires from its outside directors, the company will look for outside director candidates who possess them.

Although introduction by a president or another outside director is a choice, there is a concern that the scope of selection may be restricted or the selection may be affected by any personal connection. When a company searches for candidates out of those who serve as outside directors of other companies, there is a concern that the selection may be concentrated on the specific persons.

In order to broadly obtain information on outside director candidates, it would be a choice to utilize an executive search agency that engage in introduction of outside directors or other trade association. However, the business of introducing outside directors is not yet prevailing in Japan, and there is an issue against a backdrop of it that the quality and quantity of outside directors have not been sufficiently secured.

Given these, this is not an issue with a single company. The issue is that how Japan will construct and expand the human resources market for outside directors. In order to expand the human resources market for outside directors, it is desired that individuals with management experience to positively assume the office of an outside director of another company.

Now in Japan, it is also pointed that as executives join management when they get older, they will retire from management at higher age. If a company searches for outside director candidates with management experience, it should not eliminate any senior candidates because
of their age alone without exception, and it would be a choice to actively utilize outstanding individuals with management experience although they are older.

5. Step 5: Check the eligibilities of outside director candidates

- A company will elect an individual who is considered to be most suitable out of a list of outside director candidates. A company may find it difficult to interview or otherwise meet those candidates so openly to check their suitability, and may adopt any practical approach in light of this.

<Reference: Case Examples of Specific Efforts>

- When we selected outside directors, we asked several candidates to provide lectures within the company to help us identify their suitability. We did not inform them in advance that we might appoint them as outside directors after carefully examining the contents of their lectures.

- If any candidate has already served as an outside director of another company, evaluation by the directors who had served as the outside directors of that company may be utilized. A company may research such information using the executive search agencies, etc. as one of its practical approaches.

- In this regard, outside director candidates, although excellent and talented, should be aware that they may not ultimately assume the office as such, as they may not be elected depending on the circumstances of a company that has requested them to assume.

6. Step 6: Consider the terms of assumption of outside directors (such as remuneration)

In requesting any individual to assume the office of an outside director, a company should examine the terms for assumption of outside directors. In particular with respect to the compensation of outside directors, a company may consider granting to them incentive compensation, such as stock-based compensation of which number of grant will not change depending on business performance, in addition to fixed compensation.

- When a company requests any individuals to assume the office as an outside director, it must examine the terms for assumption of outside directors.

- In particular with respect to the compensation to outside directors, a company must examine the fee levels and structure from the standpoint of appropriately granting incentives to improve mid- and long-term corporate value to outside directors.

- There are many companies that only grant fixed compensation to outside directors. In Japan, however, it is pointed out that companies have never necessarily been highly aware of improving corporate value, and the probability of outside directors becoming negligent in monitoring because of incentive compensation is low. Therefore, it would be effective for a company to consider granting stock-based compensation and/or performance-linked compensation to outside directors with the aim of providing them with incentives.

  - Stock-based compensation may be effective for outside directors who should play the role of appropriately reflecting opinions of shareholders in the board of directors, with the intention of helping them to have a viewpoint of shareholders. In particular, stock-based compensation of a type without performance condition would be considered as an effective choice, as granting it will have little harmful influence unless the percentage of such grant is excessively higher in relation to cash compensation.

  - Performance-linked compensation will require a careful consideration, because it may not
be appropriate when outside directors independently monitor execution of business, provided that it is similarly linked with performance of management members. Performance-linked compensation, however, should not be deniable without exception, except in cases where there is no evil assumed. A company may be allowed to grant to outside directors a compensation that is more moderately linked with business performance than the compensation of management members.

- In addition, outside directors may spend a considerable amount of time and efforts to fulfill the roles and functions expected from them. Therefore, it is necessary to examine the level of compensation from the standpoint of whether it is consummate with such time and efforts.

- The degree of contribution of each outside director may differ depending on whether he/she concurrently serves as a member of the nominating or compensation committee. A company may otherwise choose to grant a compensation based on the efforts and time spent or the roles fulfilled by him/her by measuring how much he/she has contributed to the company.

Example: Fees to non-executive directors at BP (extracted from the 2016 Annual Report)

(Source: Extracted from the materials explained by Willis Towers Watson at the sixth meeting of the CGS Study Group)

- In addition, it is necessary to obtain understanding of shareholders and other stakeholders in reviewing the levels of compensation and composition of outside directors. As described in section 8. below, it would be important for a company to disseminate information on activities of outside directors to obtain understanding of shareholders and other stakeholders.

7. Step 7: Provide support for effective activities of outside directors who have assumed the office as such

A company should consider developing any environment, including construction of a support system, so that outside directors may play the roles expected from them.

- It would be considered to be difficult for outside directors to play the roles expected from them without a company’s support. Therefore, it would be effective to take the following measures:
  - To provide prior explanations to a board of directors;
  - To secure an access such as attendance in the management conference.
➢ To conduct office, plant and other inspection tours;
➢ To hold a non-board meeting to exchange opinions;
➢ To hold a meeting exclusively for independent outsiders;
➢ To elect a lead independent outside director; and
➢ To utilize voluntary committees (especially nominating and compensation committees).

<Reference: Case Examples of Specific Efforts>
(Prior explanations)→See pages 13 and 14 [of original Japanese text] of these Guidelines.

(Securing an access such as attendance in the management conference)
• We hold a meeting of the management conference once a week on the same day, and dispatch the minute of that meeting to outside directors together with the relevant monthly financial statements.
• Our outside directors including a chairperson attend a meeting of the management conference consisting mainly of internal officers to be held biweekly.
• Outside directors attend a meeting of the board of executive officers on their discretion. All of the outside directors do not attend it and they are free to attend it.

(Office, plant and other inspection tours)
• Outside directors will inspect major premises in Japan after their assumption.
• We provide inspection tours of our offices in Japan and the offices of our overseas local entities.
• A meeting of the board of directors have ever been held outside of Japan to provide the outside directors with an opportunity to inspect our overseas presence.

(Non-board meeting to exchange opinions)
• We hold a lunch meeting before the board meeting, although not each month. A lunch meeting may be held separately for outside directors and internal directors, or for the board members as a whole.
• We hold all-day off-site meeting outside of the company to exchange opinions on our mid-term management policy. At the offsite meeting, we showed our outside directors the draft mid-term management plan and collected their opinions.

(Election of a lead independent outside director)→See page 64 [of original Japanese text] of these Guidelines.

(Utilization of voluntary committees (especially nominating and compensation committees))
• A special subcommittee of the nominating committee is to be held on a non-regular basis to have a discussion about election of a president. Members consist exclusively of outside directors and outside auditors. The president will make a presentation, although he does not attend it as observer. After discussion at the special subcommittee, results will be communicated to the nominating committee for further discussion. The president is a member of the nominating committee, and will make reports on results of the discussion at the nominating committee at a meeting of the board of directors, which will adopt a resolution.
The examination committee to examine election of a chairman and president was set up as the committee equivalent to a nominating committee. It members previously consisted solely of outside directors, and now consist of outside directors and outside auditors (the chairperson of the board of directors acted as the chair of that committee) and the president attended it as observer. Subsequently, the committee handled the election of directors and executive officers, as those who would assist the president had to be examined. However, the committee now handles the election of directors, as outside directors told that they could undertake no responsibility for election of executives because sufficient information on all of executive officers were not made available.

A company should examine how much outside directors should grasp the status of discussion among executives at the management conference, based on what a board of directors should be, and what the company expects from outside directors.

- For example, in the case of a company of which board of directors makes many decisions on individual business execution, and in which the powers of a president/CEO are decentralized, it would be necessary for outside directors to grasp the status of discussion in considerably more detail.
- On the other hand, in the case of a company of which board of directors makes only a few decisions on individual business execution, and in which the powers of a president/CEO are centralized, it would be sufficient to grasp (or have the management members and departments in charge make reports on) the status of discussion from time to time only to the extent necessary for formulation of strategies, verify the progress of such strategies, and other management evaluation.

A company should consider setting up a forum in which only independent outsiders can exchange opinions, in addition to a meeting of the board of directors.

- By setting up a forum in which only independent outsiders can exchange opinions, in addition to a meeting of a board of directors, it would effective to make it easy to speak at a meeting of the board of directors by obtaining information held by, and sharing recognition with, other outsiders, and make it easy to communicate opinions of outsiders to a president/CEO.
- So a company should consider setting up a forum exclusively for independent outsiders to express opinions.
- At a meeting consisting solely of independent outsiders, discussions would be made about the following:
  - Points of improvements in administering the board of directors; and
  - Whether or not there are any evaluation of, or any matters to be found for, management members.

<Reference: Corporate Governance Code>  
[Supplementary Principles 4-8-1]

“In order to actively contribute to discussions at the board, independent directors should endeavor to exchange information and develop a shared awareness among them from an independent and objective standpoint. Regular meetings consisting solely of independent directors (executive sessions) would be one way of achieving this.”

<Reference: Case Examples of Specific Efforts>  
(Meeting consisting solely of independent outsiders)
The company has periodically held the meeting in which only independent outside directors (outside directors and outside auditors) participate (i.e., the meeting of outside officers) since FY2015. That meeting provides outside officers with a forum to exchange their opinions and is utilized as an opportunity for cooperation between outside officers, and full-time auditors and external accounting auditor.

- The nominating committee has a subcommittee like an executive committee, which consists solely of outside directors. Meeting schedule has been determined in advance throughout the year for its members who are so busy.
- Outside directors frequently have their meetings on their judgment.
- Only outside directors meet irregularly to have a dinner.

A company should consider electing a lead independent outside director so that outside directors may smoothly have dialogue with management members, or with shareholders and other stakeholders.40

- As the roles of outside directors in the corporate governance increase, it will become more necessary for outside directors to have dialogue with management members, and shareholders and other stakeholders. For this reason, it would be effective for a company to designate an outside director who will play the leading roles and functions as a core person of various dialogues, not just an coordinator, from among outside directors.
- If a chairperson of the board or a chair of each committee is an outside director, that person may play the similar function. Therefore, this is not intended to unconditionally mandate companies to designate a person whose title is “lead independent outside director.”

<Reference: Corporate Governance Code>
[Supplementary Principles 4-8-2]
“Independent directors should endeavor to establish a framework for communicating with the management and for cooperating with kansayaku or the kansayaku board by, for example, appointing the lead independent director from among themselves.”

<Reference: Case Examples of Specific Efforts>
- The person whose length of service is the longest serves as the lead outside directors. The lead outside director acts as a chair of the nominating committee and plays the roles like an opinion leader.

8. Step 8: Assess whether the outside directors have fulfilled the roles expected from them

Each company should consider evaluating whether its outside directors play the roles expected from them from the standpoint of improving the quality of outside directors.

- Outside directors are not always excellent and may not fulfill the roles expected from them. For this reason, a company should not give them special treatment and must properly evaluate them.
- The above-mentioned evaluation would include, for example:
  - Mutual evaluation of outside directors;
  - Evaluation in the course of assessing the effectiveness of a board of directors; and

40 From the term “lead,” you may have an impression that there may be a hierarchy among outside directors; however, there is no such implication in that term.
External dissemination of information to enable shareholders and other stakeholders to evaluate outside directors.

- When outside directors are initially appointed as such, they are not familiar with internal affairs and may not fully fulfill their roles. For this reason, a company will be required to evaluate them after taking the period of time elapsed after they are appointed and other factors into account.
- It is beneficial to have a point of view to evaluate whether the outside directors as a whole effectively function as a team, rather than to evaluate each of outside directors individually.

A company should consider developing external dissemination of information on activities of outside directors.

- It is pointed out that there is too little information that will enable shareholders and other stakeholders to understand activities (works) of outside directors within the company, although outside directors are expected to fulfill the roles of reflecting opinions of shareholders and other stakeholders in a board of directors.
- So it is important for a company to actively disseminate information on works of outside directors.
- For example, dissemination of the following information would be beneficial to shareholders:
  - Outline of activities of the committee in which outside directors have participated, if any;
  - Status of participation in the management conference and other meeting of executives;
  - Statements of outside directors that are especially helpful;
  - Status of communications among outside directors; and
  - Status of dialogues between outside directors, and management members and shareholders.

- Dissemination of information on works of outside directors would contribute to a fair evaluation of outside directors by shareholders and other stakeholders. For example, shareholders may find it difficult to give their consent to review of compensation of outside directors, when they have no idea of how they have worked. If shareholders receive information on works of outside directors and can fairly evaluate the significance and degree of contribution of outside directors based on such information, it would resultantly make it easy for a company to obtain consents of shareholders. In order to enable shareholders and other stakeholders to make a fair evaluation of outside directors, a company may set up an opportunity for outside directors to have a dialogue with shareholders and other stakeholders, in addition to dissemination of information.
- If information on outside directors is provided when other companies search for outside director candidates, it would be helpful for them to search for outside director candidates with the qualifications and backgrounds they are seeking by reference to such information, and identify whether those candidates are suitable to a company, and the company is expected to contribute to an expansion of the human recourses for outside directors through those efforts.
9. Step 9: Consider reappointment/dismissal based on results of assessment

A company should consider reappointing or dismissing outside directors based on evaluation of outside directors.

- Even if a company has duly considered Steps 1 through 7, outside directors may not have necessarily fulfilled the roles it had expected from them, because they were not eligible. There may be some companies that cannot take a step to appoint or increase the number of outside directors because they are concerned that they cannot easily dismiss an outside director once he/she was elected.

- Naturally, a company must consider choosing not to reappoint or dismiss any problematic outside director. Outside directors must have such a feeling of tension and make up their mind.

In judging reappointment of an outside director with prolonged length of service, a company should consider judging whether or not it is appropriate, after taking advantages and disadvantages of prolonged length of service into consideration.

- Prolonged length of service of outside directors will not pose a problem without exception. It is also pointed out that the degree of contribution to a company and influential power over management members will rather increase through the passage of a considerably prolonged length of service, and further that outside directors can play an effective role, thanks to the membership composition made up by those with longer length of services, as well as by those with shorter length of service. Therefore, it would be unnecessary to evenly impose a strict limit on reappointment (upper limit on the length of service).

- On the other hand, some question whether it is appropriate for an outside director to serve as such at the same company for too many years from the standpoint of independence, as it is one of important factors for outside directors to be independent from a company.

- Given the above, if, for example, a company sets a quantitative criterion for length of service (e.g., 10 years) without imposing a strict limit on reappointment, and continue to have any outside director serve as such beyond that duration, a company may judge whether or not reappointment is appropriate after the nominating committee, etc. fully deliberates the degree of contribution of that individual as the outside director and the necessity for continuing to have him/her serve as such, as well as possible evils, if any, resulting from longer length of service.

- In order to set up a mechanism in which outside directors will change on rotation at a certain interval as a safety valve to cope with any problem with the outside director once appointed, a company may consider stipulating a basic upper limit on reappointment in its internal regulations.

- As described in Step 8, a company must verify whether there is any vacancy in outside directors as a team and, if there is any vacancy, consider choosing to appoint a new outside director to fill such vacancy.

A company should consider utilizing the nominating committee consisting chiefly of outsiders, when it examines reappointment or dismissal of an outside director.

- Even if a company evaluates its outside directors, those outside directors will need to be independent from management members to effectively monitor execution of business by a president/CEO or other management members. For this reason, making a direct judgment on appointment or dismissal of an outside director only based on evaluation by management members would reduce the effectiveness of monitoring by outside directors, which is not desirable.
Therefore, for appointment or dismissal of an outside director, a company may consider utilizing the nominating committee consisting chiefly of outsiders to increase the effectiveness of governance.

As described in Step 8, it would be reasonable for a company to communicate to an problematic outside director what he/she should improve to play the roles expected him/her, rather than to make an early judgment on reappointment or dismissal based on evaluation at a point of time rather shortly after the assumption.

It is beneficial and should not be denied from a perspective of multifaceted evaluation to refer to evaluations by the internal management or the section that centrally take corporate governance-related actions in the discussion at the nominating committee.
Appendix 3: Points of View in Utilizing the Nominating Committee and Compensation Committee

1. Purpose of Setting up the Committees

- The purposes of setting up the nominating and compensation committees are largely divided into the following:
  - [1] To strengthen involvement by outsiders; and
  - [2] To narrow down the number of members for effective discussion (distribution of roles).

- When the proportion of outsiders of a company in a board of directors is not high (for example, when it does not reach a majority), the purpose in [1] above will more often become important.

- On the other hand, when the proportion of outsiders in a board of directors is high (for example, when it reaches a majority), it can often be evaluated that involvement of outsiders with a board of directors itself is strong, in which that company will not necessarily need to set up a committee for the purpose in [1] above. If the company sets up a committee, it would design a committee to attain the purpose in [1] above by increasing the proportion of outsiders than that in its board of directors, or would ensure collective discussion by narrowing down the number of members for the purpose in [2] above.

- It is desirable for each company to examine whether or not it should set up a committee and its concrete mechanism by keeping the above-mentioned two purposes in mind.

(How it relates to the organization design)

- The organization design of listed companies in Japan are divided into the following three types: A Company with Nominating Committee, etc., a company with Audit and Supervisory Committee, and a company with board of company auditors.

- Every Company with Nominating Committee, etc. has the following three committees in its board of directors: the nominating committee; compensation committee and audit committee, and the structure and authorities of those companies are stipulated by the Companies Act.

- On the other hand, a company with Audit and Supervisory Committee has its Audit and Supervisory Committee, but is not required by the Companies Act to set up a nominating or compensation committee. Separately from its board of directors, a Company with Company Auditor(s) has its board of company auditors, which prepares audit report or other documents, but is not required by the Companies Act to have nominating and compensation committees or meetings.

- Thus, whether or not a company should have a statutory nominating or compensation committees would be determined based on the organ design chosen by it. However, this proposal sometimes addresses this issue without distinguishing whether a committee is statutory or voluntary, as the statutory and voluntary committees have much in common.
In case of a company with Audit and Supervisory Committee, audit and supervisory members to be appointed by its Audit and Supervisory Committee have the right to state opinion on nomination and compensation of directors except the audit and supervisory members.

It is necessary to organize the relationship between such right to state opinion, and reports by a voluntary nomination and compensation committee and the powers of a board of directors to make decisions.

For example, if a company sets up its nominating and compensation committees, all of which members are the audit and supervisory members, how it relates to the right to state opinion can be easily organized. By contrast, there may be a drawback that the audit and supervisory members (in particular, outside directors) will have a large burden, as all of them need to devote themselves to all aspects of nomination, compensation, and audit matters.

On the other hand, if audit and supervisory members appointed by an Audit and Supervisory Committee participate in voluntary nominating and compensation committees on behalf of the Audit and Supervisory Committee, it is necessary to define how it should be evaluated that audit and supervisory members are affected by discussion at an organization other than the Audit and Supervisory Committee. There would be no practical problem, as the nominating and compensation committees typically draw up their original drafts after reflecting the opinions of the audit and supervisory members appointed by the Audit and Supervisory Committee.

It should be noted that if none of audit and supervisory members participate in the nominating and compensation committees, the audit and supervisory members appointed by the Audit and Supervisory Committee may express different opinions from those of the nominating and compensation committees.

If a company sets up the nominating and compensation committees, it should disseminate information on the purpose of setting up those committees, scope of the matters to seek advice, structure of members, and other relevant matters at an appropriate point of time, so that it can ensure transparency for investors and other stakeholders.

2. Advice Targets and Advised Matters

2.1. President/CEO

A company should consider including appointment or dismissal of a president/CEO and succession planning in the matters to seek advice from the nominating committee.

A company should consider including compensation of a president/CEO in the matters to seek advice from the compensation committee.

It holds true for all companies that the president/CEO and other management members play pivotal roles in improving corporate value (for example, outside directors do not run the company). It is essential for all companies to construct a mechanism to select excellent president/CEO and other management members, give them appropriate incentives, and check their performance.

A company may utilize a nominating committee in the phase of appointment or dismissal of a president/CEO.

A company may have a compensation committee monitor compensation of a president/CEO.
from the standpoint of giving appropriate incentives.

(How it relates to the nominating committee and the compensation committee)

- When it is evaluated that there are some problems with its president/CEO, a compensation committee may give a signal to ask him/her to make efforts to improve management through its evaluation before a nominating committee makes a strict choice of abruptly dismissing him/her (or not reappointing him/her). For this purpose, it is better to set up both, not only either, of the nominating committee and compensation committee at a time (either committee may play the both roles).

(How it relates to a Company with Nominating Committee, etc.)

- Even at a Company with Nominating Committee, etc., this may not have ever been dealt with by its nominating committee, as the nominating committee has no legal right to appoint a representative executive (i.e., a president/CEO).
- In fact, at a company in which the core role of its statutory nominating committee is to decide director candidates other than a president/CEO who is to be appointed as a matter of due course, it may take this opportunity to have its nominating committee discuss appointment or dismissal of its president/CEO or succession planning as well.

<Reference: How It Relates to the Companies Act>

At a Company with Company Auditor(s) and company with Audit and Supervisory Committee, a board of directors has the authority to appoint a representative director. By contrast, at a Company with Nominating Committee, etc., a board of directors has the authority to appoint a representative executive and a nominating committee has no such authority.

For this reason, a company will voluntarily seek advice from its nominating committee on appointment of a CEO (representative director or representative executive), irrespective of which organization design it chose under the Companies Act.

(Reference) Procedure for Selection of a CEO by Organ Design

<table>
<thead>
<tr>
<th></th>
<th>Company with company auditor(s)</th>
<th>Company with nominating committee, etc.</th>
<th>Company with audit and supervisory committee</th>
</tr>
</thead>
<tbody>
<tr>
<td>Selection of a CEO</td>
<td>To be determined by a board of directors (A company has the discretion to have a committee involved.)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Election of directors</td>
<td>To be resolved by the general meeting of shareholders</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Determination of candidates</td>
<td>To be determined by a board of directors (A company has the discretion to have a committee involved.)</td>
<td>To be determined by a nominating committee</td>
<td>To be determined by a board of directors (A company has the discretion to have a committee involved.)</td>
</tr>
</tbody>
</table>

(Source: Extracted from the materials submitted by Mr. Sakuma (member) at the third meeting of the CGS Study Meeting)

A company should consider establishing a policy on nomination of a president/CEO. A company should also consider having its nominating committee participate in formulation of a nomination policy based on which they should nominate individual candidates. The compensation committee should consider participating in formulation of a compensation policy based on which they should determine amounts of individual compensation of a president/CEO.

- As it is difficult to make a proposal on appointment of a president/CEO for discussion in the
absence of any policy, it is necessary to establish a nomination policy.

- A nominating committee would not only nominate individual president/CEO candidates and, as a prerequisite therefor, would participate in formulation of a policy on the qualifications a president/CEO should have.

- For appointment or dismissal of a president/CEO and succession planning, it is especially important to formulate “ideal image of a president/CEO.” It may be different depending on the companies so it is necessary for each company to define it on its initiative.

(Examples of qualifications and abilities required from a president/CEO)

- Strong stance and decisiveness to courageously address a difficult issue (not put off an issue)
- Ability to cope with change
- Integrity
- Courage: “Preparedness” for being a manager. Power to make endless efforts when facing personal risks, and to overcome criticism from interested parties and make courageous decisions, at any time with the goal of improving corporate value.
- Power of conception: Powers to identify changes in management environment and the ways company should go on, and design a company-wide strategy on a global level from a mid- and long-term perspective.
- Power to change: Power to change the organization to achieve its “ideal image” by encouraging the organization as a whole, with a viewpoint free from industrial and organizational common sense and conventional practices.

- In order to make a succession planning effective, it is necessary to upgrade a group of candidates who are qualified to become a president/CEO or other management members in the future. To this end, it is effective to foster a group of executive officers who may become a next president/CEO or head of each division and a beyond-next-generation group like head director who may become a president/CEO on multiple levels. A board of directors and nominating committee that will play pivotal roles in selecting a successor, in addition to internal and external parties involved, will be asked to participate in the process of fostering those candidates (see subsection 4.1.2 above). For more details, also see “Guidelines for Strategic Fostering Human Resource Development of Future Top Management toward Improvement of Corporate Value.” (published on March 31, 2017 by the Ministry of Economy, Trade and Industry)41.

- Similarly, a compensation committee will need to participate in formulation of a compensation policy.

A company should consider setting forth its standards for dismissal of a president/CEO (i.e., standards to start discussion about whether or not to dismiss him/her) even at ordinary times.

- It is difficult to make a proposal and discuss in what cases dismissal of a president/CEO should be discussed in the absence of any standards, when a company seeks advice on dismissal of a president/CEO, in addition to appointment of a president/CEO. If a company sets forth its standards for dismissal at ordinary times, it will make it easier for the Company to respond to an emergency.
- The standards for dismissal would not be utilized as the standards to dismiss president/CEO without exception when they infringe on those standards. Such standards would be utilized as

the standards to start discussion about issues, including whether or not a breach of the standards is attributable to a president/CEO and how it should be improved.42

- As a result, if the absence of the standards for dismissal is caused by the circumstance that is not attributable to a president/CEO, it will be expected that the such standards will support the president/CEO within the company and even in any external relations.
- It would be easier for outside directors to make a proposal on dismissal of a president/CEO. However, depending on the situation, internal directors should also make a proposal and have discussion, as they are the directors too.
- Even if the standards for dismissal are established, a situation in which dismissal is discussed would be an extreme case. The standards should not be easily invoked. It is rather important to give advice to and oversee a president/CEO through discussion at the board meeting or otherwise at ordinary times.

<Reference: Case Examples of Specific Efforts>

(Examples of the standards for dismissal formulated)
- The company has established the quantitative standards (for dismissal).
- The company has established the provision that the nominating committee will deliberate replacement of a president when the standards are met (e.g., continued reduction in profit).

(Measures for Usual Discussion)
- Company with Nominating Committee, etc.
  - The term of office of executives is established by law, primarily one year. Director candidates will be determined by the nominating committee of which majority is made up by outside directors.
- Company with Audit and Supervisory Committee
  - The voluntary advisory committee (nominating committee) of the board of directors will review whether or not to ratify reappointment once a year.
  - The Audit and Supervisory Committee is granted the right to express opinions on appointment and dismissal of directors including the president.
- Company with Company Auditor(s)
  - Evaluation of the president including evaluation of the company’s business performance is deliberated at the meeting of the nominating and compensation committees (voluntary), both of which majority is made up by outside directors.
  - The company has the nominating committee, which deliberates and give opinions on dismissal of a representative director or director/president.
  - The term of office of the president is one year, and the director reappointment and election examination committee examines reappointment of the president.
  - The president nomination advisory committee deliberates whether the president should continue to serve as such or should be retired for next year once a year. The current

42 As to the standards for dismissal, for example, there is a company which sets non-achievement of predetermined financial goals as the condition for dismissal. Even in that case, the non-achievement may have been affected by any business environment or other factors, and it would be not appropriate to directly conclude that the president/CEO is totally responsible. It is likely enough that a company will fairly evaluate contribution made by the president/CEO, aside from the predetermined goals, and conclude that it will not dismiss the president/CEO. Thus, once a company formulates its standards for dismissal, it would not be required to be a rigid system (it does not mean that a breach of the standards will lead to immediate dismissal).
43 Question 32 of the Company Question can be used as a reference
president will express his opinions on his continued service or retirement for next year and leave the meeting. The committee deliberates it without presence of the current president.

- The company has the president performance evaluation committee consisting of outside members, which deliberates execution of business by the president.
- We inform results of evaluation of business performances (company and individuals) made by the compensation committee to the nominating committee.
- The company has the voluntary personnel affairs and compensation committee, which has the obligation to deliberate and give opinions to the president on matters relating to executive candidates.

2.2. Outside Directors

A company should consider including appointment and dismissal of outside directors44 in the matters it seeks advice from the nominating committee, including not only formulation of a nomination policy but also appointment and dismissal of individual outside directors.

- Outside directors need to be independent from management members so that they can effectively monitor execution of business by a president/CEO or other management members.
- For this reason, making a direct decision on appointment or dismissal of an outside director exclusively based on evaluation by management members would impair the effectiveness of monitoring by outside directors, which is not desirable. In addition, a president/CEO does not need to grasp the right to decide appointment or dismissal of outside directors, as it is meaningful that outside directors are not under the direction of the president/CEO.
- For this reason, a company would seek advice on appointment and dismissal of outside directors from the nominating committee consisting chiefly of outsiders, with the aim of increasing the effectiveness of governance.

<Reference: How It Relates to the Companies Act>

At a Company with Company Auditor(s) or company with Audit and Supervisory Committee, a board of directors will determine details of proposals on appointment and dismissal of directors to be submitted before a general meeting of shareholders, and seeking advice from the nominating committee is voluntary.

On the other hand, at a Company with Nominating Committee, etc., the nominating committee will determine details of proposals on appointment and dismissal of directors to be submitted before a meeting of shareholders (seeking advice is not voluntary).

Thus, in examining what should be determined at the nomination (advisory) committee, it should be noted that the organizations that have the powers to determine details of proposals on appointment and dismissal of directors to be submitted before a general meeting of shareholders are different between the Company with Company Auditor(s) and company with Audit and Supervisory Committee, and the Company with Nominating Committee, etc.

A company should consider including formulation of a policy on fees of outside directors as well as nomination and determination of individual amounts in the matters it seeks advice from the compensation committee, from the standpoint of securing independence from management members.

44 At a company that elects internal non-executive directors separately from outside directors, the matters described in these Guidelines in relation to outside directors would often hold true for non-executive directors, provided that the company mainly expects those non-executive directors to fulfill the monitoring function.
As described above, outside directors may not effectively fulfill the monitoring function unless independence from management members is secured.

So it is beneficial for the purpose of increasing the effectiveness of governance to include fees of outside directors in the matters a company seeks advice from the compensation committee consisting chiefly of outsiders.

<Reference: Fees of Compensation Committee Members and Directors>

At a Company with Nominating Committee, etc., its compensation committee will determine the amount of fees of individual members and directors, as well as a policy for determining them.

2.3. Management Other Than a President/CEO

As to appointment and dismissal of management other than a president/CEO, the nominating committee, if it consists chiefly of outsiders, would not get positively involved with individual appointment and dismissal and solely participate in formulation of a nomination policy.

For to what extent the nominating committee gets involved with nomination of management members (including executive directors) other than a president/CEO, there would be several patterns, as shown below.

The problem with nomination is that if there are so many number of management, it is not easy for outsiders to identify all of such management candidates. In that case, a nominating committee may participate in formulation of a nomination policy and check whether there is any problem in the process of selection by a president/CEO, rather than engaging in selection of individual management member candidates.

In addition, the nominating committee may only positively participate in appointment and dismissal of individual candidates for any posts of management members who will play especially key roles (e.g., CFO).

[1] To engage in appointment and dismissal of individual management members other than a president/CEO (to positively check qualifications and abilities of individual candidates and judge who are eligible)

○ Highly transparent and objective in selection of candidates
△ If there are so many number of management members, it may be difficult for outsiders to make a judgment, because they have few concrete information on all of candidates for judgment.

[2] To request a president/CEO to provide explanations about the policy on selection of candidates and reasons for selection of each candidate (to give an approval to the original draft of a president/CEO unless such explanations are unreasonable)

○ The nominating committee can secure transparency and objectivity by having a president/CEO fulfill his/her accountability, while it still allows him/her to possess the right

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45 It is pointed out that if the compensation committee consists chiefly of outside directors, they may hesitate from discussing their compensation, because it relates to their own compensation. However, as there are no other persons who can appropriately judge them, there is no option but to have the compensation committee discuss them. The fairness of the levels and design of the fees determined as a result of discussion at the compensation committee would ultimately be judged depending on whether or not it is reasonably accountable to shareholders and other stakeholders.

46 In addition to these, it would be a choice to target presidents/CEO or other management members of significant subsidiaries.
to decide personnel affairs of other management members (i.e., the primary power to select other management member candidates).

[3] To do nothing (leave totally up to a president/CEO)
○ It may be effective to concentrate powers on a president/CEO.
△ It may allow a president/CEO to become self-justified.

* ○ and △ as added to each item indicate the merits and problems observed from the standpoint of improving the effectiveness of corporate governance (e.g., standpoint of securing independent and objectivity), respectively (hereinafter the same applies).

<Reference: Nominating Committee and Appointment and Dismissal of Executives at a Company with Nominating Committee, etc.>
At a Company with Nominating Committee, etc., its board of directors, not its nominating committee, has the powers to appoint and dismiss executives.

At a Company with Nominating Committee, etc., its nominating committee has the power to appoint and dismiss directors other than outside directors and non-executive directors (i.e., directors who concurrently serve as executives). As a matter of practice, the principal role of a nominating committee may be to ask a president/CEO to provide explanations about the policy on selection of candidates, and reasons for selection of each candidate (i.e., it will not necessarily engage in examination into individual appointment and dismissal).

A company should consider having its compensation committee participate in determination of amounts of fees of individual management members other than a president/CEO, although it consists chiefly of outsiders.

○ For to what extent the compensation committee gets involved with nomination of management members other than a president/CEO, there would be several patterns, as shown below.

○ In nominating candidates, it is often difficult to identify those candidates individually. By contract, individual amounts of fees will often be determined based on the compensation levels commensurate with positions, in which judgment based on individual information is less necessary than nomination.

○ For this reason, a compensation committee even consisting chiefly of outsiders would not only formulate a compensation policy but also participate in determination of individual amounts of fees to which such policy applies.

[1] To determine individual amounts of fees of the management members other than a president/CEO
○ Highly transparent and objective in determining fees
○ Quantitative evaluation is possible in more aspects under the compensation policy and standards, which will make it easy even for outsiders to make a judgment (in comparison with nomination).

[2] To request a president/CEO to provide explanations about the compensation policy or reasons for determination of individual amount of fees (to give an approval to the original proposal of a president/CEO unless such explanations are unreasonable)
○ The compensation committee can secure transparency and objectivity by having a president/CEO fulfill his/her accountability, while it still allows him/her to possess
the right to decide personnel affairs of other management members (i.e., the primary power to determine individual amounts of fees of other management members).

[3] To do nothing (leave totally up to a president/CEO)
   ○ It may be effective to concentrate powers on a president/CEO.
   △ It may allow a president/CEO to become self-justified.

<Reference: Compensation Committee and Compensation of Executives at a Company with Nominating Committee, etc.>
At a Company with Nominating Committee, etc., a compensation committee will determine individual amounts of compensation of executives, and establish a policy on such determination.

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<td>Executive directors</td>
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(Explanatory notes: ○: Participate in decision of details; △: Confirm the procedures; ×: Not participate)

○ It is important to keep diversity in mind in examining the structures of outside directors and management members. A board of directors will be required to monitor how the company is proceeding with “diversity management” to make the most of diversified human resources with the aim of implementing its management strategies. In addition, the company will be required to secure diversity of its board of directors from the standpoint of reflecting diversified sense of values it does not have in its management strategies. For more details, see “Diversity 2.0 Study Group Report—Toward Implementation of Diversity as a Competitive Strategy” and “Diversity 2.0 Action Guideline” (published on March 23, 2017)\(^ {47}\).

3. Composition of the Committee

3.1. Balance between Insiders and Outsiders

A company should consider making up a committee, [1] at which outsiders make up at least majority; or [2] at which the number of insiders and that of outsiders are equal, and an outsider will act as a chairperson.

○ For the options for the composition of a committee (ratios of insiders and outsiders), there would be several patterns, as shown below.

[1] Only outsiders
[2] Outsiders making up a majority of its members
   ➢ Consistent with the purpose of setting up a committee (i.e., to reinforce independence and

\(^ {47}\) [Link to the report](http://www.meti.go.jp/report/whitepaper/data/20170323001.html)
objectivity of a board of directors, as well as accountability), and easily accountable.

[3] 50:50 ratio of outsiders to insiders

- An environment in which it is easy for outsiders to express opinions can be developed.
- The committee would be designed not to be substantially inferior to a committee in which outsiders makes up a majority, for example, by designating an outsider as a chairperson.

[4] Insiders making up a majority

[5] Only insiders

- If a company cannot procure a sufficient number of outsiders, it may consider setting up a committee consisting chiefly of insiders, for example, by designating an outsider as a chairperson.
- However, once the number of potential outside candidates increases to a sufficient level, it would become necessary to reexamine the composition ratio in light of the purpose of setting up the committee.

○ In light of the purpose of setting up the committee, a company may choose [1] or [2] above. If a company chooses [3], it would be important to designate an outsider as a chairperson. Even if a company choose [3], it is essential to provide explanations about internal information at a committee. Therefore, it would be considered that insiders attend meetings of the committee to provide such explanations.

○ Whether the committee effectively works depends largely on whether or not outside members are working seriously. It is insufficient to formalistically appoint outsiders to work sufficiently. It is important for outsider members to recognize their own roles and make serious efforts.

○ A company may consider designating a chairperson who will play, for example, the following roles to administer the commission:
  - Role to transact the committee;
  - Role to explain advice of the committee to a board of directors;
  - Role to have discussion with the secretariat of the commission; and
  - Role to make a decision in case of equality of votes (depending on the composition of the committee).

○ If a company designates a chairperson, it will need to consider whether a chairperson should be an outsider or insider from the following standpoints:

  [1] To designate an outsider as a chairperson:
    ○ Consistent from the standpoint of reinforcing independence/objectivity and accountability
    ○ Designating an outsider as a chairperson in case of the numbers of outsiders and insiders being the same should be considered
    △ Difficult if there is no outsider who can undertake large burdens as a chairperson

  [2] To designate an insider as a chairperson:
    ○ Cooperation with internal parties and smooth management by a person who is familiar with internal affairs can be expected.
    △ If the committee consists chiefly of insiders and an insider acts as its chairperson, it may not be evaluated externally.
It is also pointed out that it is easier to derive active involvement from outsiders when an outsider is designated as a chairperson than when an insider is designated. On the other hand, at the time when the commission is initially set up, there may be no method of administration or method of international cooperation available. In this case, a company may choose to designate an insider as a chairperson and, when it becomes capable of administrating the committee relatively smoothly, consider whether or not it should designate an outsider as a chairperson.

3.2. Outsiders Who Will Become Members of the Committee

A company should consider appointing outside directors who will monitor management in light of the roles expected from outsiders as members. A company may consider utilizing an outside auditor to increase the ratio of outsiders.

When a company considers the composition of a committee, there would be several options, as shown below.

- First of all, outside directors will be designated as candidates for committee members in light of the roles expected from them.
- However, a company may utilize an outside auditor to increase the ratio of outsiders and make up for knowledge outside directors do not have.

[1] Outside directors

- (Independent) outside directors who can independently monitor management in light of the roles expected from the committee members would be most eligible.
- In the Corporate Governance Code, independent outside directors are expected to fulfill the roles and responsibilities of “monitoring of the management through important decision-making at the board including the appointment and dismissal of the senior management” (see Principle 4.7 ii).

[2] Outside auditors

- An outside auditor may be designated as a member or observer of a voluntary committee. This will be somewhat reasonable from the standpoint of increasing the ratio of outsiders, especially if there are no sufficient number of outside directors.

  △ If there are sufficient number of outside directors, it is necessary to define the reasons for venturing to designate an outside auditor, not outside director, as the committee member (e.g., the compensation committee wants legal and accounting expertise of an outside auditor).⁴⁸

[3] External experts (professionals)

- A company may designate an external expert as a member or observer, expecting him/her to play the role of leading an efficient discussion, if such position is established from the standpoint of efficiency.

  △ If the committee makes a decision by a majority vote, it is necessary to define the reason why any person who is not an officer of the company has the right to vote as the committee member, depending on its relationship with the board of directors.

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⁴⁸ It is pointed out that it is legally strange to designate an auditor as a committee member like an outside director, as an auditor is not an entity who is expected to play the role of monitoring (mainly evaluation of business performance of management members). On the other hand, there is an opinion that it may be appropriate for an outside auditor to become a committee member, because he/she sometimes has a lot of information regarding internal candidates based on his/her roles and authorities as an auditor.
3.3. Insiders Who Will Become Members of the Committee

If a president/CEO is included in the members of a committee that will give its advice on appointment and dismissal of a president/CEO and his/her compensation, a company should consider taking measures so that those members can discuss them, as necessary, without the presence of the president/CEO.

- Insiders who can be chosen as the committee members would include a president/CEO, executive director, non-executive director and internal auditor.

- It is the current president/CEO who is most responsible for selection of a next president/CEO, as well as for succession planning. On the other hand, the committee may not sufficiently deliberate evaluation (reappointment or dismissal, and compensation) of a president/CEO when the president/CEO is present at the meeting.

- So it would be helpful to take measures so that the committee may have discussion in the absence of a president/CEO.

[1] A company will not designate its current president/CEO as a member (i.e., merely designating him/her as an observer or calling up him/her as necessary).

[2] A company will designate its current president/CEO as a member but set up a separate meeting or have him/her to leave the meeting room when the committee engage in discussions on his/her evaluation.

<Reference: Case Examples of Specific Efforts>

- Neither chairman/director nor president/executive is a member of the compensation/nomination committee. Notwithstanding this, the inside director in charge of personnel affairs is the member of committees, and properly provides information on the compensation levels of other companies, and our business performance and personal achievements and results of each business head. Thus, the committee can be administered without problems.

- To evaluate performance of the CEO, the evaluation subcommittee consisting exclusively of outside directors and outside auditors has been set up as the common subcommittee of the nominating and compensation committees. That is not a place to decide something. That subcommittee will discuss whether there will be no problem with the CEO continuing to serve as such next year, including everything such as the qualitative and quantitative evaluations of the CEO’s performance throughout the year and the atmosphere of the company (whether there is a sign of the CEO becoming strange), and reports results of discussion to each of those committees.

- Members of the nominating committee consist exclusively outside directors and outside auditors, and the president joins the committee as an observer.

- The members of the committee are limited to outsiders, from the standpoint of who have the voting right. When the members need internal information, they will request such information to be submitted from inside and, if necessary, call for the president to speak at the committee meeting. Thus, there is no problem with us.
4. Relationship with the Board of Directors

The deciding entity is consistently a board of directors, even though the committee has made various deliberations and decisions. A company should consider having the committees make detailed reports on what it had deliberated to a board of directors so that the board of directors can make discussions and decisions based on the advice of the committee.

- Appointment and dismissal of a president/CEO, and succession planning are consistently the matters a company can only seek advice from the committee, irrespective of how the organizations have been designed. The committee consisting chiefly of outsiders will never make final decisions, as it is just sought advice.
- The deciding entity is consistently a board of directors, however, this does not mean that the board of directors do not have to discuss. The board of directors may make decisions that are different from advice given by the committee.
- On the other hand, if a board of directors has discussions and makes decisions based on the advice of the committee, it will conform to the purpose of setting up the committee.
- So, it is important for the committee to make detailed reports to the board of directors on the deliberations at the committee meeting, including the standards and process, so that the board of directors may have discussions and make decisions based on the advice of the committee.
- In addition, if the board of directors makes decisions different from the advice given by the committee, it would require any reasonable causes from the standpoint of respecting the advice of the committee. In response, a company may define such causes and, if necessary, externally disseminate them.

5. Matters to Be Handled by the Committees and Schedules

5.1. Matters and Schedule Regarding Nomination

The process of the succession planning of a president/CEO in the nominating committee can be considered, for example, as follows.\(^{(49)}\)

1. Process up to selection of next president/CEO candidates
   - [1] To formulate the management environment at the time of succession and “ideal image of a president/CEO” suitable to it;
   - [2] To evaluate those candidates from multifaceted sides and select candidates who satisfy the predesignated standards; and
   - [3] To identify issues for fostering selected candidates, and decide an ability development policy based on the identified issues prior to the assumption of a president/CEO as such

2. Process to foster candidates and nominate any of them as next president/CEO
   - [4] To formulate concrete fostering plans;
   - [5] To provide programs for fostering and developing his/her abilities and manage progress;
   - [6] To evaluate results of fostering and nominate a next president/CEO; and
   - [7] To support the next president/CEO after appointment.

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\(^{(49)}\) Organized based on the materials explained by Egon Zehnder at the sixth meeting of the CGS Study Group.
Points to strengthen the effectiveness of the nominating committee would include, for example, the following:

- To bring out the current president/CEO’s commitment: The nominating committee cannot exert its effective functions without the current president/CEO’s commitment (e.g., provision of information or presentation of opinions to the nominating committee, provision of support instructions to insiders, and attitude of respecting judgments of the nominating committee). It is the important duty of the members of the nominating committee to force the president/CEO to give commitment.

- To discuss “ideal image”: The nominating committee will fully discuss “ideal image” of a next president/CEO. It will clarify what “abilities, qualifications, experiences and sense of values” are required for a company to realize its sustainable growth and improve its mid- and long-term corporate value.

- To utilize “objective evaluation information”: In selecting candidates, the nominating committee will first upgrade “objective evaluation information” on “abilities, qualifications, experiences and sense of values” without sticking to a choice of Mr. A or Mr. B.

- To spend sufficient time: “Timeliness” means taking sufficient time, and it is necessary to monitor the processes of formulation of “ideal image,” and selection and fostering of candidates over a span of at least three years.

- To conduct a follow-up support after nomination: To conduct a follow-up support for adaptation to new post at an appropriate point of time.

It is necessary to set up a schedule for the nominating committee, taking the foregoing into consideration. Although the frequencies and times of meetings required to be held differ depending on whether or not it is in the phase of starting up formulation of a policy or whether or not it is time to appoint a new president/CEO, a considerable number of frequencies and times will be required for the meetings to engage in substantial discussions. In particular, the nominating committee would take a few years, not only a year to the next annual general meeting of shareholders, to examine successors of the president/CEO.
5.2. Matters and Schedules Regarding Compensation

- In determining the compensation, it is necessary to examine, for example, the following:

  (1) How the compensation policy and compensation programs are designed:
      - Organization of the circumstances surrounding the compensation of management members (information gathering)
      - Setting of goals to be derived from management strategies, etc.
      - Consideration of the reasonableness of incentives to achieve goals (examination of compensation mix)
      - Consideration of the appropriateness of compensation amount levels
      - Provision of explanations to obtain understanding of subjects
      - Consideration of external provision of information

  (2) How specific amounts of compensations have been determined under the compensation programs:
      - Evaluation of performance of subjects
      - Determination of compensation amounts based on performance evaluations (application)
In making judgments on how the executive compensation programs should be designed or administered, it is important to appropriately keep a balance between the standpoint of providing explanations to shareholders and the standpoint of granting incentives to management members.

Details of compensation programs will differ depending on strategies and other factors of each company. For this reason, it is necessary for a company to design a program that is consistent with its own management strategies, in addition to making comparisons with peer companies, which will take a certain amount of time to examine them.

Proper involvement with deliberations at and giving advice to the committee by outside directors will substantiate the reasonableness of management judgment about the compensation program, which will be of some help to external accountability of a company.

Therefore, it will become important to administer the compensation program by considering the comprehensiveness of matters to be deliberated, sufficiency of materials for judging (compensation-related information), and sufficiency of deliberation time (frequency of holding a meeting and number of hours spent for a meeting), from the standpoint of fully performing the accountability depending on the conditions of the programs of each company.

<Example of a schedule for the compensation committee of a company of which annual general meeting of shareholder is to be held in June>

(Source: Extracted from the materials explained by Willis Towers Watson at the sixth meeting of the CGS Study Group)

6. Secretariat of the Committees

In order for the nominating and compensation committees consisting chiefly of outsiders to effectively function, cooperation of insiders is essential. It is necessary for insiders to participate in and administer the committees, compile materials for discussions, prepare original drafts, provide information to the committees, and provide assistance on compilation of opinions, and it can be considered that a secretariat will be set up within each of the committees.

Which section will be in charge of those operations should be examined in conjunction with establishment of a section that will be responsible for centrally handling corporate governance actions.

- End -