Practical Guidelines
for Corporate Governance Systems
(CGs Guidelines)

Formulated: March 31, 2017
Revised: September 28, 2018
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.

March 31, 2017
Corporate System Division, Economic and Industrial Policy Bureau, Ministry of Economy, Trade and Industry
Regarding this Revision to the Guidelines

Five years have passed since the government policy to review corporate governance and to transform Japanese companies into internationally competitive forms was set out in the “Japan Revitalization Strategy 2013—JAPAN is BACK—.”

After the formulation of these Guidelines, the “Investments for the Future Strategy 2017—Reform for Achieving Society 5.0—” (cabinet decision dated June 9, 2017) added, “Within this fiscal year, the Government will analyze and publish the situations of companies’ utilization of nominating and compensation committees and of individuals with management experience as their outside directors, and the situations of their introduction of incentive compensation and disclosure of information in this regard, among other matters.”

Furthermore, the “New Economic Policy Package” (cabinet decision dated December 8, 2017) published at the end of the previous year has designated the three-year period up to the year 2020 as the concentrated investment period for productivity revolution, during which all possible measures are to be mobilized to raise the level of productivity of the entire Japanese economy with the aim of realizing “Society 5.0” and the corporate governance reforms are to be advanced to accomplish “productivity revolution by improving the profitability of companies and promoting investment.”

In response, the “Investments for the Future Strategy 2018—Change to Society 5.0 and Data-driven Society—” (cabinet decision dated June 15, 2018) states, “Amid companies reporting record-high earnings, the accomplishment of sustainable economic growth requires the utilization of such corporate earnings to advance aggressive investment for raising productivity, including investment in research and development and in human resources.” Furthermore, it adds, “The corporate governance reforms will be implemented with the aim of enabling companies to take autonomous actions for achieving sustainable growth and improving mid- and long-term corporate value through appropriate cooperation with various stakeholders including their shareholders, staff, customers, suppliers and local communities.”

Under these government-wide policies, the Ministry of Economy, Trade and Industry set out to conduct follow-up efforts concerning these Guidelines, and accordingly held a questionnaire survey of companies on corporate governance to grasp the situation of their actions in connection with the main recommendations set forth in these Guidelines. On the basis of the results of this survey, the second phase CGS Study Group (chair: Hideki Kanda, Professor of Gakushuin University Law School) evaluated the actual situation of the corporate governance reforms and examined issues in improving the effectiveness of corporate governance.

These processes show that companies’ actions to enhance their corporate governance have made firm progress as a whole. In particular, companies listed in the First Section of the Tokyo Stock Exchange, especially those constituting JPX-Nikkei Index 400, and companies with top market capitalization have made headway. On the other hand, as seen from the fact that the necessity of exertion of the monitoring function by outside directors in relation to the nomination and compensation of presidents/CEOs is not necessarily understood widely, the corporate governance reforms are, in reality, considered as in the process of deepening from “formality” to “substance” five years after the government policy to review corporate governance was laid out.

In addition, the Corporate Governance Code was revised in June 2018. The revised Corporate

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1 The “New Economic Policy Package” states, “the ‘productivity’ concerned herein means ‘labor productivity (real GDP per hour per head)’.”
Governance Code reinforces details on the utilization of voluntary nominating/compensation committees and on the principles of supervision of president/CEO succession planning, among other details. In turn, it is considered that the organization and indication of views and practices that companies can refer to when responding to such revisions are what is expected to be prepared.

On the basis of the above follow-up efforts concerning these Guidelines, the revision of the Corporate Governance Code, and other relevant activities, on May 18, 2018, the CGS Study Group prepared the “Issues for Future Consideration Toward Realization of Effective Corporate Governance,” which is an interim report on the directivities of future actions, including a review of these Guidelines, pertaining to matters regarded as important in deepening the corporate governance reforms.

The recent revision concerned is a revision of these Guidelines on the basis of the recommendations raised in the interim report, and pertaining to the matters, the consideration of which is regarded as beneficial in realizing effective corporate governance.

In order to deepen the corporate governance reforms from “formality” to “substance,” we will also make further efforts to improve the environment as required, including improvements from institutional aspects, on the basis of the objectives of the “New Economic Policy Package” and the “Investments for the Future Strategy 2018—Change to Society 5.0 and Data-driven Society—.” Furthermore, we expect the top management of each company to exercise their leadership over the development and operation of an effective corporate governance system suitable for their company.

September 28, 2018
Corporate System Division, Economic and Industrial Policy Bureau,
Ministry of Economy, Trade and Industry
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1. Introduction

1.1. Awareness of the Issues

For the past twenty years, Japanese companies as a whole have been suffering a downturn of the “earning power” in comparison with those of non-Japanese countries. It is pointed out that the “corporate value” of Japanese companies represented by stock indices is consistently the “only loser” in comparison with 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\(^2\).

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

![Graph showing Japan-United States Comparison of Rate of Sales (ROS)](image)

Source: Bloomberg

<table>
<thead>
<tr>
<th>Year</th>
<th>Japan</th>
<th>United States</th>
</tr>
</thead>
<tbody>
<tr>
<td>1995</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2005</td>
<td></td>
<td></td>
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<tr>
<td>2010</td>
<td></td>
<td></td>
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<tr>
<td>2015</td>
<td></td>
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</tr>
</tbody>
</table>

Remark: Return on equity (ROE) can be broken into:

\[
\text{ROE} = \text{Rate of sales (ROS)} \times \text{Total assets turnover} \times \text{Financial leverage.}
\]

<Reference: Distribution of Profitability by Business Segment>

![Graph showing Distribution of Profitability by Business Segment](image)

Source: Processed the materials prepared by Deloitte Tohmatsu Consulting based on Bloomberg database. Companies which are ranked among top 50% in terms of degree of diversification by country (Herfindahl-Hirschman Index) and 20% or more in terms of overseas sales ratio out of the world’s top 500 companies (consolidated sales) from which both sales and operating profit data can be collected for 8 consecutive years between FY2006 and FY2013.

![Graph showing Long-term Trends in Stock Price Index and Market Capitalization](image)

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.

<table>
<thead>
<tr>
<th></th>
<th></th>
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</thead>
<tbody>
<tr>
<td>Japan</td>
<td>0.7</td>
<td>1.7</td>
</tr>
<tr>
<td>United States</td>
<td>7</td>
<td>8.1</td>
</tr>
<tr>
<td>United Kingdom</td>
<td>3</td>
<td>2.2</td>
</tr>
<tr>
<td>Germany</td>
<td>4.8</td>
<td></td>
</tr>
<tr>
<td>Hong Kong</td>
<td>7</td>
<td>38.2</td>
</tr>
<tr>
<td>India</td>
<td>24</td>
<td>5.4</td>
</tr>
<tr>
<td>China</td>
<td>24</td>
<td>1.60</td>
</tr>
<tr>
<td>Indonesia</td>
<td>12</td>
<td>5.3</td>
</tr>
<tr>
<td>Thailand</td>
<td>2</td>
<td>17.1</td>
</tr>
</tbody>
</table>

Remarks:
- Stock price index values for 1990 and 2016 were as at the end of December and March, respectively
- Market capitalization amounts to the totals of market capitalization of listed companies in respective locations. For United Kingdom, 2008 value was used instead of 2015 value. For India and China, 2003 values were used instead of 1990 value. For Indonesia, 1996 value was used instead of 1990 value.

\(^2\) 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 the Japanese economy and Japanese companies have been lowering. In terms of employment, it is pointed out that the number of employees at large companies has been substantially decreasing since 2000, and the percentage of all employees has also largely fallen\(^3\).

\(^{3}\) Materials submitted by Mr. Toyama at the fourth meeting of the Council on Investments for the Future (held on January 27, 2017).
Corporate governance reforms aim at constructing an economic system that will enable Japanese companies to get out of the current situation of Japan where corporate value has continued to slow down over the past twenty years and will realize a virtuous cycle in which sustainable growth of companies and improvements in mid- and long-term corporate value\(^4\) can be facilitated through creation of added value and productivity enhancement\(^5\) led by innovations based on effective utilization of human resources, and in which the fruits of these are widely shared with their own staff, consumers and others, thereby leading to economic growth based on investment and expanded consumption.

Furthermore, the elements of ESG (Environment, Society and Governance) are important for investors and shareholders in their evaluation of the sustainable growth of companies and improvements in the mid- and long-term corporate values of companies. For corporate management, each company is required to consider and indicate its own sense of value, business model, risks, strategy and other relevant matters on the basis of such elements and in a comprehensive manner, and the way governance is put into practice as the key imposing discipline on them is called into question\(^6\).

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

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\(^4\) 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”). Furthermore, the Final Report of the “Competitiveness and Incentives for Sustainable Growth: Building Favorable Relationships between Companies and Investors” Project (Ito Review) published by the Ministry of Economy, Trade and Industry in August 2014 introduces a number of different concepts of corporate value and, while focusing on the corporate value brought to shareholders (value for shareholders) among the different concepts of corporate value, makes a recommendation that value for shareholders should not be regarded as independent from the other types, and that companies should be aware that the creation of added value for stakeholders other than shareholders, such as value for customers, value for staff, and value for suppliers, eventually leads to the creation of value for shareholders.

\(^5\) “Productivity enhancement” here means the enhancement of labor productivity (real GDP per hour per head) based on not only efficiency and labor saving but also the creation of new added value, in the light of the “New Economic Policy Package” (cabinet decision dated December 8, 2017) stating, “The recent emergence of new innovations including the IoT, big data, robots and artificial intelligence makes it possible to resolve various social issues such as energy-environment constraints, and has continuously created unconventional and groundbreaking businesses and services. Such innovations are not limited to their usage merely for efficiency or labor-saving but have a huge potential to boost up productivity quite ‘revolutionarily’ through creation of entirely new added value suited for the ‘Society 5.0’ era’.”

\(^6\) With this awareness in mind, the “Guidance for Collaborative Value Creation” (published by the Ministry of Economy, Trade and Industry on May 29, 2017) was formulated and published as a framework (common language) for company-investor dialogues (for details, refer to Reference 2). This guidance plays a role as guidelines according to which companies (business owners/managers) are able to systematically and comprehensively organize their own management philosophies, business models, strategies, governance and other relevant matters, thereby aiming to promote their information disclosure and enhance the quality of company-investor dialogues. The guidance also plays a role as guidelines for investors to assess companies from mid- to long-term perspectives. For investors, it is an essential condition that companies have their own governance systems which can enforce discipline that directs them to firmly execute strategies to realize their business models and to enhance their corporate values in a sustainable manner, and an essential condition that their governance systems are properly functioning.
(Examples of Problems)

- Appropriate reviews of the business portfolio are insufficient, and useless resources have been allocated to non-core businesses and businesses from which the company must withdraw.
- The axis of management judgment is unclear, and the decision-making process takes too much time as a result of the company’s emphasis on internal consensus.
- Sufficient time has not been taken to discuss 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 presidents/CEOs have no management experience at other companies, and cannot engage in multilateral discussions based on completely different senses of value and thoughts.
- How to connect governance reforms with improvements in 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 the fostering of successors are not clear.
- Apart from the president/CEO and management members, there are some other persons who have influence over management, which interferes with the resolute decision-making of the president/CEO and management members.
- It is difficult to find outside director candidates with required qualifications.

○ Merely taking formal actions reflecting the external voice calling for reinforcement of governance makes no sense, and it is important for companies to tackle the 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.

1.2. Concept of Discussion on the CGS Guidelines

○ It is the president/CEO and other management members that will play pivotal roles in improving the mid- and long-term corporate value of their company. This is the same for 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 can play such roles.

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

○ Secondly, it is essential for each company to select an excellent president/CEO and other management members and grant appropriate incentives to them to urge them to take appropriate risks, thereby making up a mechanism to check their performance. And, it is the 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 function 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 such issues as a closed corporate mechanism of selection of managerial human
recourses and a conformist mentality-based compensation system. It may be difficult for a company to change these issues on its own 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

○ The Corporate Governance Code was formulated in 2015 and revised in 2018, presenting the key principles that are to contribute to the realization of effective corporate governance. These Guidelines provide complementary explanations about what companies should consider in putting those principles into practice while keeping the coherency to the Corporate Governance Code, and compile specific actions that can be considered significant in fortifying their “earning power.”

○ Although these Guidelines recommend the measures that companies are requested to consider taking, these Guidelines are not intended to request companies to take measures without any exception as what should be done to resolve corporate governance issues differs from company to company. How a corporate governance system should be built up and at what speed it should be reformed would be different, depending on the size, extent of globalization, shareholder composition, breadth of the business areas, and phase of development (i.e., start-up, growth or maturity period) of each company, among other matters.

○ For instance, large-scale/diversified companies that have well advanced their global expansion face complex management issues amid dynamic changes in their management environments. Accordingly, it is considered highly necessary for such companies to promote swift and resolute decision-making, including appropriate review of their business portfolios. In addition, in many cases, it is considered that such companies tend to have large ratios of foreign investors’ shareholding and consequently they are urged to set easily-comprehensible governance systems from the viewpoint of global standards. These companies are expected to consider actively implementing the approaches recommended in these Guidelines.

○ In contrast, for example, in the case of an owner-managed firm at which ownership and management are not separated, the incentive structure for management members such as the owner-president can be partially different from such structure at an ordinary company. In consideration of the interests of minority shareholders, and from the standpoint of putting a brake on the owner-president and/or management members in the event of their reckless action or corruption, it is considered highly necessary for such owner-managed firm to establish a corporate governance mechanism with outside directors playing a central role.

○ In addition, for start-up/medium-sized companies whose resources are limited, it is also important to consider corporate governance mechanisms and the order of priority of relevant actions from the perspective of deployable management resources and other relevant matters.

○ It is desired for each company to take the items for consideration as proposed in these Guidelines into account when the company independently discusses ideal approaches to the corporate governance system that will suit it on the basis of the substance of these Guidelines and various principles illustrated in the Corporate Governance Code.

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7 On the other hand, with regard to relatively small-scale companies that have yet to diversify and have low ratios of foreign investors’ shareholding, it is pointed out that problems with them lie in the fact that even where such companies may potentially have excessive cash and deposits, discipline imposed by institutional investors is difficult to work on them, and they have rather little interest in corporate governance. Also, it is pointed out that it is particularly necessary, through the reinforcement of corporate governance, to encourage companies that have failed to achieve business results proportionate to their capital costs to put into practice swift and resolute decision-making, for example, in relation to review of management strategies and conversion of business models.
Basically, these Guidelines are instructive for listed company in many aspects, as these Guidelines are compiled based on the results of questionnaire surveys of and hearings from listed companies, and the knowledge of the members of the CGS Study Group (first phase and second phase) who have management experiences at or have served as outside directors of listed companies. However, the situations surrounding listed companies would be different depending on the depth of, and degree of interest in, corporate governance efforts. The substance of these Guidelines would also be instructive for non-listed large companies in raising their earning power.

To give an example, many of companies that have just started working on corporate governance initiatives have not been through a heap of internal discussions and worry about what they should actually do to achieve effective results, although they desire to seriously tackle corporate governance. These Guidelines introduce items for consideration and efforts that are considered instructive, reflecting the voices of advanced listed companies and investors. Accordingly, worrying companies should read these Guidelines and, by reference to these Guidelines, deepen discussion about what corporate governance that is best fit for each of them should be like.

Next, considerable parts of the cluster of advanced companies that have ever positively tackled corporate governance have already put into practice or are putting into practice 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 corporate governance and the cluster of companies that cannot initiate corporate governance reforms, the management members of those companies should recognize once again the fact that many of Japanese companies have been unable to increase their corporate values over the past twenty years or more, which has led to a discussion that corporate governance reforms are necessary to improve their mid- and long-term corporate values after going through various discussions and trials and errors during that period of time. And then, the 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, start from any items, even small items, that they can tackle, and step up their engagement gradually.

As described above, issues with the utilization of outside officers and the assumption of offices of outside directors at other companies sometimes cannot be resolved unless many companies address such issues concurrently. It would be necessary for many companies, including those that have been less positive about tackling 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 grateful if companies that are independently taking leading-edge initiatives positively disseminate information on their own cases externally as a useful reference for other companies.

(Reference 1) Composition and Terminology of the CGS Guidelines

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

○ Strongly recognizing this point, we make recommendations about corporate governance as a whole, with the main targets being 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 the main targets being corporate executives and other managers in charge of corporate governance, in the second half of these Guidelines (Appendices 1 through 4).

○ As corporate governance issues are largely rooted in historical corporate cultures and climates, it will be necessary to concurrently strive for changes in the awareness of not only certain individuals but also directors and management members as well as the candidate tier situated below them, when advancing corporate governance reforms. To reform the awareness at all tiers, it is important to provide directors and other management members with appropriate education and training programs on corporate governance under the leadership of the 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 Exchange (as at the end of June 2016) conducted at the request of the Ministry of Economy, Trade and Industry (the “Company Questionnaire Survey 2016”) for a reference 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), a Company with Audit and Supervisory Committee, or a Company with Nominating Committee, etc. (howsoever called, and regardless of whether or not 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 a

committee is limited to the statutory or voluntary one when mentioned (the same applies when it is described as the “nominating committee” or the “compensation committee”).

(Reference 2) Positioning of the CGS Guidelines in the “Guidance for Collaborative Value Creation”

○ In the “Guidance for Collaborative Value Creation,” which are guidelines for integrated disclosure of information including information on governance, for investors’ assessment in response to such disclosure, and for company-investor dialogues, corporate governance and the CGS Guidelines are positioned as follows.


2. Ideal Approaches to the Board of Directors

2.1. Roles and Functions of the Board of Directors

○ In fact, Japanese companies have been 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 of, and determination of the compensation of, management members (among others, presidents/CEOs who are at the top of management) (monitoring function), and [2] the function of making specific decisions on individual business execution (decision-making function). What is necessary in fulfilling either of these functions is to decide basic management strategies and plans. Management strategies and plans will work as the criteria for the evaluation of business execution in the course of monitoring, and as important guidelines for determining the rights and wrongs of individual business execution.


“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 boards of directors of Japanese companies have not been fully able to discuss their management strategies. Moreover, more emphasis has been placed on the decision-making function, and the monitoring function has not been sufficiently exerted11.

<Reference: Results of the Company Questionnaire Survey>

For the areas in which the board of directors had not fully discussed, approximately 42% of the respondent companies referred to mid- and long-term management strategies, while approximately 51% of the respondent companies referred to succession planning for presidents/CEOs and the supervision of such planning (see Question 17 of the Company Questionnaire Survey 2017).

○ 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 the functions. For this reason, a company whose 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.

○ Possible measures to cope with such task would be to reconsider matters to be submitted to

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11 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 meetings of the board of directors, and it would have been difficult for their boards of directors to take sufficient time to discuss other management strategies and the monitoring function.
meetings of the board of directors, to reduce less important business transactions that have been discussed at meetings of the board of directors, and to develop discussions about management strategies and the monitoring function. According to the results of the Company Questionnaire Survey, many companies have already been considering reducing the matters to be submitted to meetings of their boards of directors by raising the criteria for submitting proposals or otherwise.

<Reference: Results of the Company Questionnaire Survey>

After the adoption of the Corporate Governance Code, approximately 70% of the respondent companies have reviewed the criteria for submitting proposals to their boards of directors, and approximately 25% of the respondent companies are planning to review or considering reviewing them. Of the companies that have reviewed them, are planning to review them, or are considering reviewing them, approximately 67% have raised the criteria for submitting proposals or reduced matters to be submitted to meetings of their boards of directors (see Question 20 of the Company Questionnaire Survey 2017).

○ When a company reconsiders the roles and functions of its board of directors (including reconsideration of matters to be submitted before meetings of the board of directors) as part of 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.

Each company should consider 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 each company is situated vary depending on its business areas, corporate size, extent of globalization, number of years passed from the year of foundation, shareholder composition, and other factors, and therefore each company needs to consider what corporate governance is suitable for it.

○ It is basically helpful to subjectively organize what company it will aim at and what board of directors it will aim to have when it reconsiders 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.

○ 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

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12 It may be possible to have some 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 board meetings, but many companies would not find it a realistic choice.

13 Both the vertical and horizontal axes will not necessarily be linked to the organ design under the Companies Act. Any organ design may lead to either of the categories, 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 part 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 mentioned above. For example, the board 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, not all cases can necessarily be categorized into these four quadrants. A focus is placed on suggesting that companies should consider ideal approaches to their management and boards of directors from several separate standpoints, rather than whether the above-mentioned categorization is correct.
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 (the upper half of the vertical axis) or when management powers are concentrated on the president/CEO (the right half of the horizontal axis)\(^\text{14}\).

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

With respect to the roles and functions of a board of directors, a company should consider making not only a drastic reform of its organizational design but also efforts to strengthen the monitoring function, including more progressive efforts.

\(^\text{14}\) Hence it does not necessarily mean that any of the quadrants would be better in relation to promptness in decision making because it is possible to secure promptness in decision making through any administration means.
2.3. Points to Be Noted When Considering Transition to a Governance System Focusing 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 strategy decision-making and performance evaluation and delegates the power 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 a 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 a governance framework with a focus on the monitoring function from the standpoint of ensuring the understanding of those stakeholders, irrespective of howsoever their organs are designed.

○ In Europe and the United States, companies typically adopt a governance framework with a focus on the monitoring function, where independent outside directors account for a high proportion of the board members and nominating and compensation committees have been established.

○ If Japanese companies intend to shift into a governance system with a focus on the monitoring function (quadrant C in Figure 1 of section 2.2), it would be beneficial for them to consider such actions as the following, 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 their boards of directors from the standpoint of minimizing the power of the boards of directors to decide to conduct individual businesses (by delegating such power to their presidents/CEOs) as the roles and functions of the boards of directors suitable for the above-mentioned structure, and have the boards of directors specialize in the monitoring function to the extent permitted under the Companies Act.
  ➢ It may be a good idea to reconsider the frequency and time length of a board meeting while reducing the power to decide individual business execution (e.g., to extend the hours of a single meeting, while reducing the frequency).
  ➢ A non-executive director such as an outside director would act as chairperson of the board of directors.
  ➢ A section or personnel to centrally handle internal and external governance actions of the company would be designated.

○ A governance framework with a focus on the monitoring function is ultimately designed to enable dismissal of a president/CEO. However, such situation may occur to a very limited extent. Therefore, such governance framework can never be a hostile mechanism to management for many management members such as presidents/CEOs. It can become a mechanism to gain the backing of shareholders and other stakeholders through outside directors in relation to management and, as a result, would boost activities of the president/CEO and other management members. Thus, it is not appropriate to take outside directors as enemies to management members. It is important to secure outside directors with the required qualifications and establish a trust relationship between management members and outside directors, and important for management members and outside directors to work together to contribute to improving the mid- and long-term corporate value of the company by making the most of their respective characteristics.
2.4. Nomination of Directors

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

- As the members of the 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 discussions at meetings of the board of directors may differ depending on the roles required from the board of directors (i.e., the balance between the monitoring function and the decision-making function). For this reason, it is beneficial for companies to consider the roles required from the board of directors, as well as the qualifications and member composition necessary to realize the fulfillment of such roles when they draw up a director nomination policy.

<Reference: Case Examples of Specific Efforts>

- A company’s practice of listing the qualifications required from the board of directors and listing which director possesses which qualifications in order to identify which qualifications are lacking, prior to nominating new directors
  (An example method of examining the qualifications required from directors and directors meeting those qualifications)

<table>
<thead>
<tr>
<th>Qualification Director</th>
<th>General management</th>
<th>Industry knowledge</th>
<th>International background</th>
<th>Marketing/ sales</th>
<th>Technology/ R&amp;D</th>
<th>ICT</th>
<th>Government service experience</th>
<th>Legal</th>
<th>Finance/ accounting</th>
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(A through D: Internal directors; E through G: Outside directors)

- In drawing up a director nomination policy, a company may examine both the aspect of substantial details concerning the qualifications candidates should possess, and the aspect of procedural details to see whether such candidates have the qualifications.
- From the standpoint of ensuring sound exercise of functions by the board of directors and reflecting diverse values which the company does not have in management strategies, it is particularly important, in examining the composition of directors, to ensure diversity in the composition in terms of such aspects as gender and internationality, while securing the quality of directors as a premise. Especially, a company without any female director should actively consider appointing female directors while securing the quality of directors as a premise.
- A board of directors is required to monitor how its company promotes “diversity management” under which diverse human resources are utilized to put its management strategies into practice.
The board should be well balanced in knowledge, experience and skills in order to fulfill its roles and responsibilities, and it should be constituted in a manner to achieve both diversity, including gender and international experience, and appropriate size. [Principle 4-11 Preconditions for Board and Kansayaku Board Effectiveness]

In order to generate sustainable growth and increase corporate value over the mid- to long-term, is the board of directors constituted in a manner such that it is equipped with appropriate knowledge, experience, and skills as a whole and ensures diversity, including gender and international experience? Are there women appointed as directors? [3-6] [Reference: Guidelines for Investor and Company Engagement]

Approximately 33% of the respondent companies have at least one female director, and approximately 8% of the respondent companies have at least one director who is not Japanese (see Question 11 of the Company Questionnaire Survey 2017). [Reference: Results of the Company Questionnaire Survey]

“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 its systematic implementation illustrated below. Among others, it is important [1] to integrate diversity into corporate strategies, and [2] to reform corporate governance so as to be able to monitor strategies and efforts.

For details, see “Diversity 2.0 Study Group Report—Toward Implementation of Diversity as a Competitive Strategy” (published on March 23, 2017)\(^\text{15}\), “Toward Further Enrichment of Diversity 2.0 <Recommendations Compiled by “Study Group for Ideal Approaches to Diversity Management as a Competitive Strategy”>” (published on June 8, 2018), and “Diversity 2.0 Action Guideline” (published on March 23, 2017; revised on June 8, 2018)\(^\text{16}\).

\(^\text{15}\) http://www.meti.go.jp/report/whitepaper/data/20170323001.html
2.5. Points of Issue Regarding the Administration of the Board of Directors

2.5.1. Chairperson of the Board of Directors

A company should consider who should act as chairperson of its board of directors in terms of appropriateness by taking account of the roles, functions and other factors of the board of directors. In so doing, such company should also consider whether to have a non-executive director such as an outside director act as chairperson of the board of directors, if it places a significance on the monitoring function of the board.

○ Currently, at a majority of companies in Japan, the president/CEO or the company chairman with the right of representation acts as chairperson of the board of directors. The number of companies at each of which a non-executive director such as an outside director acts as chairperson of its board of directors is small.

○ A meeting of a board of directors is a forum to consider and design strategies which serve as the center of management judgment, and also the core of a mechanism for selecting excellent presidents/CEOs and other management members, granting them appropriate incentives to urge them to take appropriate risks, and checking their performance. For that reason, the chairperson of a board of directors, who selects proposals for deliberation by the board of directors and presides over board proceedings, plays extremely important roles in the realization of effective corporate governance.

(General roles of the chairperson of the board of directors)

- Selection of proposals to be submitted to the board of directors
- Convocation of a meeting of the board of directors

17 In addition to transactions that should be referred to the board of directors in accordance with the predetermined criteria for submission, the chairperson of the board of directors is expected to refer other transactions to the board at his/her own discretion.
➢ Presiding over the proceedings of meetings of the board of directors (leading board proceedings)
➢ Preparation of meeting minutes of the board of directors

Since each company is required to enhance the monitoring function of its board of directors, it is easier to ensure the effectiveness of the function if a non-executive director such as an outside director, who is in the position to conduct monitoring, acts as chairperson of the board of directors while executives concentrate on their role of providing explanations concerning business execution, in comparison with the case where a management member such as the president/CEO, who is subject to being monitored, concurrently acts as chairperson of the board of directors and takes initiatives in selecting proposals and expediting board proceedings.

For instance, in the selection of proposals for deliberation by the board of directors, when a director on the monitoring side acts as chairperson of the board of directors, such chairperson is regarded as able to facilitate substantial discussions by enriching not only transactions to be referred to the board of directors in accordance with the criteria for submitting proposals thereto but also discussions concerning management strategies, by submitting to the board of directors those transactions whose submission is regarded as important in terms of monitoring but has not been recognized as necessary by executives, and by referring important transactions to the board of directors at an appropriate time.

Furthermore, the chairperson of a board of directors, who is responsible for expediting the proceedings of board meetings, is required to treat each board meeting as a forum for discussions and exchange of opinions in an open-hearted and constructive manner and to make efforts to vitalize deliberation. On this basis, when a director on the monitoring side acts as chairperson, the deliberation of the board of directors is centered on the monitoring side, and in this manner it is considered easier to substantialize the provision of sufficient explanations and information to the monitoring side, the securing of sufficient time for deliberation, and the creation of an atmosphere in which the monitoring side feels less difficult to participate in discussions and raise issues.

Outside directors are not necessarily thoroughly familiar with internal information. However, at least, at a company whose board of directors makes less decisions on individual business execution since an emphasis is placed on the monitoring function of the board of directors (the upper half of the vertical axis in Figure 1 illustrated in 2.2 above), an outside director is regarded as sufficiently able to select proposals and lead board proceedings properly as chairperson of the board of directors if sufficient information is provided by the company’s executives.

Meanwhile, in the case where an outside director acts as chairperson of the board of directors at a company that places an emphasis also on the decision-making function of the board (the lower half of the vertical axis in Figure 1 illustrated in 2.2 above), it is considered necessary, as the development of an environment for the outside director who is not necessarily well-familiar with internal information to appropriately select proposals and lead board proceedings, to secure sufficient time for the outside director to act as chairperson, in addition to the reorganization of matters subject to the resolution of, or subject to being reported to, the board of directors, among other matters. Moreover, it is considered necessary also on the part of an outside director acting as chairperson of the board of directors to make special commitments, such as making efforts to obtain information, for example, by personally attending management conferences or other similar meetings.

18 In the current situation where a president/CEO acts as chairperson of the board of directors in many cases, the fact that a person other than a president/CEO acts as chairperson itself can liberalize the situation in which it is difficult to have substantial discussions since only one person concurrently engages in making proposals, leading board proceedings and providing explanations, and can vitalize deliberation by the board of directors. Accordingly, it is pointed out that there is significance in taking the practical approach in which a company should start its actions by doing the same as above first, then gradually develop the environment described herein, and deepen the involvement
In the case where there is an internal non-executive director who is well familiar with internal information and assumes a role of monitoring executives at a company that places an emphasis also on the decision-making function of its board of directors as above\(^\text{19}\), such non-executive director may, by acting as chairperson of the board of director, be able to manage both the securing of the effectiveness of the monitoring function of the board and the appropriate selection of proposals and implementation of board proceedings.

**<Reference: Results of the Company Questionnaire Survey>**

At approximately 71% of the respondent companies, the attribute of the chairpersons of their respective boards of directors is president/CEO; at approximately 20% of the respondent companies, the attribute is company chairman with the right of representation; at approximately 6% of the respondent companies, the attribute is company chairman without the right of representation; and at approximately 2% of the respondent companies, the attribute is outside director (see Question 13 of the Company Questionnaire Survey 2017).

**<Reference: Case Examples of Specific Efforts>**

(Vitalization of the deliberation of the board of directors)

- An outside director acting as chairperson of the board of directors engages in managing board proceedings with a strong attention to filling a gap between the internal officers and the outside officers in terms of the quality and quantity of information. Since the internal and outside officers started mixing with each other with certain tension maintained in the relationship between them, we realize that discussions at meetings of the board of directors have been increasingly vitalized.

- Since an outside director started acting as chairperson of the board of directors, discussions at meetings of the board of directors have been vitalized; for instance, the outside directors feel easier to speak out at meetings, and moreover, even the internal directors started expressing opinions on, and asking questions concerning, transactions outside the scope of their duties.

- I (outside director) declared that I would continue to ask questions even after becoming the chairperson of the board of directors so as not to be preoccupied with the role of moderator and fail to fulfill my role as an outside director.

- The chairman of the company acts as chairperson of the board of directors. Although the chairperson of the board of directors (company chairman) is an executive director, he does not attend management conferences or other similar meetings, and thus is not bound by discussions held in such conferences or meetings. Meanwhile, he is familiar with internal affairs, unlike outside directors. Since the chairperson (company chairman) actively asks questions at meetings of the board, high-level questions and answers are exchanged, and meetings of the board of directors are very energized.

(Selection of proposals)

- Where an outside director becomes the chairperson of the board of directors, it becomes easy to submit not only transactions that are referred to the board according to the criteria for submitting proposals but also matters such as company-wide basic policies and mid- and long-term plans to the board as proposals at the discretion of the outside director.

\(^{19}\) A possible example case is where a retired president has become the chairman of the company without the right of representation, and concentrates on monitoring as a non-executive director. However, for this case to guarantee the effectiveness of the monitoring function of the board of directors, it is considered that there should be a premise that the non-executive director acting as chairperson remains substantively separate from business execution and dedicates himself/herself to monitoring. It would be necessary to exercise caution to ensure that the situation where the chairman who was a retired president currently acts as chairperson of the board of directors does not allow any unjustifiable interference with the business execution of the incumbent president/CEO.
Previously, important transactions such as M&A transactions were referred to the board of directors at times at which it was practically impossible to reject such transactions (e.g., immediately prior to signing). After an outside director became the chairperson of the board of directors, the timing of discussion by the board of directors is in the process of being changed to an earlier timing.

Where a director on the monitoring side acts as chairperson of the board of directors, the directors tend to have such a mindset as saying, “I want this transaction to be reported at this time,” in the selection of proposals.

(As an outside director) What I am careful of while acting in the capacity of the chairperson of the board of directors is the selection of proposals. When proposals made by the secretariat do not contain transactions that should be deliberated by or reported to the board of directors, I make sure that such transactions are included in proposals.

(Leading board proceedings)

Previously, in passing a resolution, the chairperson asked the directors, “Does anyone have an objection?” Only when a director had an objection, he/she expressed his/her opinion. Since I thought this method might discourage directors from offering their opinions even if they had objections or were willing to set certain conditions concerning proposals, the method of determination was changed to voting by show of hands on the basis of a suggestion made by the chairperson (outside director).

Where an outside director becomes the chairperson of the board of directors, this can, at his/her own discretion, facilitate the choices of deferring decisions on proposals and continuing the deliberation of proposals without voting (without going as far as voting down proposals).

Where a director on the monitoring side acts as chairperson of the board of directors, the provision of additional information can be easily facilitated when information is insufficient.

The advantage of having an internal non-executive director (former president) act as chairperson of the board of directors is that the chairperson may ask executives hard questions and can, conversely, provide help to them when outside directors ask them rather irrelevant questions. On the other hand, it is necessary to thoroughly ensure that insiders do not hesitate in dealing with the decisions made during the period in which the chairperson was acting as president.

(Advance preparation, etc.)

When an outside director is to act as chairperson of the board of directors, it is important to ensure that [1] this person has served as an outside director for at least two years and is reasonably familiar with the businesses of the company and its executives; [2] this person is able to allocate a certain amount of time for the company; and [3] a system to support the chairperson of the board of directors has been organized (for instance, an internal director acts as deputy chairperson).

I have heard that the outside director acting as chairperson of the board of directors has allocated a considerable amount of time for the company, although not as much as half of the chairperson’s own time. The chairperson personally attends management conferences, conducts office inspection tours, shares important points at issue with the other outside directors at board meetings, and provides supplementary explanations about difficult details.

Proposals to be referred to the board of directors are decided at meetings between the secretariat and me as the chairperson of the board of directors (outside director). The selection of proposals can be a difficult task if the chairperson of the board of directors is not specifically familiar with details concerning the business execution of the company to some extent. Since I started acting as chairperson, the number of meetings with the secretariat has significantly increased.
I (chairperson of the board of directors [outside director]) also act as a member of the audit committee. There is another full-time outside director among the members of the audit committee. Since this full-time outside director sits in management conferences and reports the main details discussed at such conferences to the audit committee, I can find out about most of the internal situation by attending meetings of the audit committee.

(Other)

An internal non-executive director who was the former president acts as chairperson of the board of directors. In addition to the role of chairperson, this person plays the role of overseeing enhancement of the effectiveness of corporate governance, for example, by leading the evaluation of the effectiveness of the board of directors.

2.5.2. 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 and business operations and participate in management conferences or other meetings prior to attending board meetings. Outside directors, however, primarily have no sufficient knowledge of the company and its business operations and often do not attend such conferences or meetings. Any means to provide outside directors with sufficient information would become necessary so that outside directors can make an effective discussion at board meetings.
- Examples of such means are to provide materials a few days prior to a board meeting, and to provide explanations about proposals prior to a board meeting.
- In addition to the board of directors, some companies maintain a meeting body differently called, such as a “council of directors” (torishimariyaku-hyougikai), where information is provided and opinions are exchanged informally, thereby securing improved communication between internal and outside directors (outside officers). Other companies set up a forum in which only outside officers gather to secure communication among them and which helps them form opinions concerning management members. It is a problem if the emasculation of the board of directors is intended by moving matters to be deliberated at a board meeting to other meeting bodies. If not so, the utilization of another meeting body in preparation for effective discussion at a meeting of the board of directors would be an option.\(^20\)
- Though such measures as those mentioned above, it is useful to provide outside directors with sufficient information and make preparations. To this end, it is also necessary to pay attention to ensure that advanced provision of information and exchange of opinions may not impose restrictions on deliberation at an actual meeting of the board of directors\(^21\).
- 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 outsiders, or

\(^{20}\) Although it is useful to set up a meeting body other than the board of directors, it would be important to transform the board of directors itself into a forum for free and open-minded discussion by providing the board with risk information as early as possible.

\(^{21}\) Outside directors may present opinions or have discussion with insiders 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 a board meeting through advanced presentation of opinions and discussion in detail, the actual board meeting may rather end without specific discussion or deliberation by the board. For this reason, it would sometimes be necessary to refrain from coordinating opinions too much in advance with respect to matters concerning which directors should have substantial discussion at the formal place of the board of directors.
recognize that the board of directors should finally decide matters determined at management conferences, 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 meetings of the board of directors, and it is important to change the awareness of employees so that they can be fully aware that board meetings are the forum for substantial discussion and judgment, that outside directors also assume the duty of care as a prudent manager, and that those employees should appropriately provide information to outside directors in a timely manner.

<Reference: Case Examples of Specific Efforts>

(Advanced provision of information and explanations about proposals)

- The company determines proposals three (3) weeks, sends a notice of convocation seven (7) days, and distributes supporting materials three (3) business days, all prior to each meeting. The company can choose to provide explanations in advance about any transactions about which prior explanations to outside officers are regarded as necessary.

- The company provides its outside directors with explanations prior to a board meeting. At the same time, the company receives assignments from its outside directors and reflects its replies to such assignments in the board meeting.

- The company provides materials by e-mail two (2) days prior to a board meeting. In principle, the company provides no individual explanation to its outside directors, except upon request of any of them.

- The company has its outside directors gather for a prior explanation meeting two (2) days prior to a 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 outside directors, the company sends all materials for deliberation including past materials, and a one-page summary of the proposals to be submitted before the board meeting, both two (2) days prior to the board meeting. The company has also prepared a database and informs its outside directors whenever the company uploads relevant materials to that database.

- The company requests the chairperson (outside director) to spare 1.5 hours or so prior to a board meeting, during which clerical staff provide 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 each tablet device as such materials are prepared, at least three (3) business days prior to a board meeting. Outside directors can also see the materials previously distributed. Furthermore, the company gives a prior briefing to an outside director upon his/her request. Unlike hardcopies, the company can distribute each material as it is prepared, which provides us with more advantages in terms of security.

(Examples of companies setting up meeting bodies other than their boards of directors to provide information and exchange opinions)

- The company holds a non-regular meeting called “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.

- The chairperson of the board, the general manager of Management Planning Headquarters, and outside directors spend one hour or so prior to a meeting of the board of directors in exchanging their opinions.

- The outside director acting as chairperson of the board of directors attends management conferences so as to contribute to efficient and smooth transaction of businesses at board meetings, and shares necessary information obtained there with other outside directors at board
meetings and meetings consisting solely of outside officers, thereby attempting to make information equally available.

2.5.3. Matters to be Resolved by/Reported to (or Deliberated by) the Board of Directors

○ In determining whether or not to resolve any specific proposal at a meeting of the board of directors, many companies would prefer to take conservative approaches in connection with the Companies Act and choose to have it resolved at meetings as much as practicable.

○ However, once outsiders take part in adoption of resolutions at meetings of the 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 taken the board of directors as just a forum to ratify judgments made at management conferences or other meetings.

○ If a proposal is submitted before a meeting of the board of directors for resolution, it may be necessary to provide sufficient information and explanations for outside directors to make a responsible decision and secure any chance to make flexible revisions based on opinions of outside directors. As a result, the time for a board meeting may become insufficient or internal burden may increase. Given these, if board members include any outside director, it is useful to reconsider whether or not it is an important matter to be submitted before a board meeting for resolution or whether reporting such matter to the board in lieu of seeking a resolution is sufficient.

○ In addition to classifying matters into those to be submitted before board meetings for resolution or those to be reported to board meetings, there may be affairs to be submitted to board meetings for continuous deliberation. With respect to matters that the board cannot immediately reach conclusions at a single-time meeting, such as the formulation of management strategies, the submission of such matters before board meetings for deliberation without contemplating any conclusions can still be useful in facilitating substantial discussion.

<Reference: Organization in the Corporate Governance System Study Group Report
(published on July 24, 2015)>  
- A Company with Board of Company Auditors would present factors to be considered in determining the scope of matters to be submitted before board meetings 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 board meetings:
  - Nominating committee and compensation committee to be set up at the option of the company;
  - Appointment of outside directors; and
  - Construction and administration of internal control systems.

<Reference: Case Examples of Specific Efforts>
- Implementation planning phases for business strategies are discussed at board meetings. Those phases are submitted before board meetings in an early stage so that the board can discuss them three times or so. As a result, the substance and precision of discussion have been improved.
- Previously, mid-term plans were discussed at a board meeting once a year. However, such ad-hoc discussion is a waste of time, and the company now consciously increases opportunities to discuss them in response to requests for regular reporting and discussions.
- When the company reviewed its risk management system, it reconsidered which matters to be submitted before board meetings, and established criteria for submission so that most proposals on individual transactions would not be submitted. After the reconsideration, the board has
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, whereas 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 resolving 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 the asset allocation determined in a management plan would be submitted before a 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 matters that may affect mid-term management plans and the quarterly/annual settlement of accounts, rather than matters concerning detailed and individual business execution cases. As to management strategies, the company does not submit what has been prepared internally to a 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 makes a list of, key themes to be discussed at board meetings throughout the year in advance.

- Although the board of directors has the power to decide significant business execution, the involvement of the board of directors differs depending largely on whether the subject matter relates to business or governance. Details of business-related matters, such as decisions on 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, 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 other voluntary committee after deliberating them in detail.

### 2.5.4. Development of Organizations Handling 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 organs in charge of corporate governance, as a result of which internal decision-making process would require adjustments among several organs, and it is difficult to access information from the outside, as such information is spread over those organs. |
| ○ In Western countries, companies have their “company secretaries” or other similar positions as a professional of governance communication serving for corporate governance work, the 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 assigning personnel, that will centrally supervise corporate governance actions, irrespective of whether such desk/personnel are called “company secretary.” In terms of external relations, such desk or personnel are expected to be responsible for will-based dialogues (engagement) with shareholders and other stakeholders, and to become the main body to provide information based on comprehensive strategies, in addition to its/their significance as the central contact point. |
| ○ It is useful for each company to consider ideal approaches to the section and personnel |

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responsible for corporate governance, and reinforce frameworks that correspond to its conditions.

2.5.5. Evaluation of the Effectiveness of the Board of Directors

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

<Reference: Results of the Company Questionnaire Survey>
Approximately 15% of the respondent companies answered that they had not evaluated the effectiveness of their boards of directors (see Question 59 of the Company Questionnaire Survey 2017).

As a method of evaluation of the effectiveness of the board of directors, many companies collected completed questionnaires from their directors and auditors. In fact, not so many companies conducted interviews with or group discussions among outside officers.

<Reference: Results of the Company Questionnaire Survey>
A comparatively popular method for analysis and evaluation of the effectiveness of the board of directors is the use of questionnaires targeting directors or auditors (approximately 74% and 49%, respectively). Only a small number of companies conducted interviews with their directors and auditors or group discussions among outside officers (both around 10%) (see Question 59 of the Company Questionnaire Survey 2017).
How to evaluate the effectiveness of the 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 taking account of third-party perspectives, whichever method it chooses.

Furthermore, since the nominating committee, the compensation committee and other relevant committees are in charge of the substantive monitoring function with regard to the nomination, compensation and other matters of presidents/CEOs and other management members, it is considered useful to evaluate, as part of evaluation of the effectiveness of the board of directors, whether the board of directors and the committees function effectively in an integrated manner.

<Reference: Results of the Company Questionnaire Survey>
Approximately 80% of the respondent companies answered that they had not evaluated the effectiveness of their nominating committees and compensation committees (see Question 61 of the Company Questionnaire Survey 2017).

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 to improve such matters, verify the effect(s) of those actions after implementing 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 specific improvements in corporate behavior. For example, there are 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 board meetings in response to the findings of its outside directors; the company has reviewed its conventional practices by utilizing the experience-based advice of its outside director; an outside director acting as chairperson of board meetings properly controls proposals; and an outside director is proactively involved in the formulation and administration of succession plans through the nominating committee or other bodies.

○ On the other hand, there are companies in which their outside directors have not played the roles expected from them, or which cannot find 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 an environment in which outside directors could play their active roles.

○ In Japanese companies within which newly hired university graduates accumulate their occupational experiences and become directors typically through internal promotion on the basis of less fluid employment systems, management would inevitably rely on internally accumulated experiences. However, amid rapid changes of the times, 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 one in which it is easy to secure outside directors with the required qualifications and utilize their knowledge and experiences.

3.2. Toward Utilization of Outside Directors

A company should consider what points it should organize to utilize its outside directors for each scene.

○ There are some skeptical views on outside directors. For example, these include views that outside directors who do not understand relevant businesses cannot formulate any management strategy; that it is impossible to delegate the power to appoint and dismiss presidents/CEOs to outside directors who have no information on individuals in the company; and that the introduction of outside directors has in no way led to an improvement of operating performance.

○ However, the role that should be expected from outside directors is not to run a company in the first place. As ever, it is internal management members led by the president/CEO that run the company.

○ Outsiders may prove their merits especially based on their attributes as such when they get

22 In Japan, the ratio of external invitees to newly appointed CEOs is lower in comparison with non-Japanese companies (approximately 3% in Japan, approximately 13% in the United States and Canada, and the world average of approximately 18%), and the ratio of those who have experience of working at other companies is also lower (approximately 33% in Japan, approximately 82% in the United States and Canada, and the world average of approximately 74%) (Source: “2016 CEO Success study” by Strategy&).

23 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, will take time to realize this. Utilization of outside directors would be an option that companies can take immediately.
involved in any affairs that insiders find it difficult to properly judge and evaluate.

○ It is necessary to take account of such division of roles between insiders and outsiders in considering how to utilize outside directors who are outsiders. If a company intends to maintain a governance framework with a focus on the monitoring function, that company would need to appoint outside directors to the extent that they make up a considerable part of the board members. Even in other cases, there will be scenes where outside directors may effectively function, provided that there are a considerable number of outside directors. Therefore, it is useful for any company to consider the proportion of outside directors it utilizes.

○ A company should mainly 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 the image of desired outside directors; [2] the scene in which it looks for outside director candidates and asks them to assume office as such; [3] the scene in which outside directors assume office as such and play active roles within the company; and [4] the scene in which the company evaluates the performance of outside directors and considers reappointing 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 to a satisfactory extent, it would need to verify in which scene there have been problems. In so doing, it is useful to consider problems according to the scenes.

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

<table>
<thead>
<tr>
<th>Step</th>
<th>Matter to be considered</th>
<th>Scene</th>
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</thead>
<tbody>
<tr>
<td>1</td>
<td>Consider ideal approaches to its board of directors.</td>
<td>Scene of considering whether outside directors are necessary, and the image of desired 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></td>
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<tr>
<td>3</td>
<td>Consider qualifications and backgrounds that match the roles and functions.</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 looking for outside director candidates and asking them to assume office as such.</td>
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<tr>
<td>5</td>
<td>Check the eligibility of outside director candidates.</td>
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<tr>
<td>6</td>
<td>Consider the terms of assumption of outside directors (such as remuneration).</td>
<td></td>
</tr>
<tr>
<td>7</td>
<td>Provide support for effective activities of outside directors who have assumed office as such.</td>
<td>Scene of having outside director candidates assume office as such and play active roles at the company.</td>
</tr>
<tr>
<td>8</td>
<td>Evaluate whether outside directors have fulfilled the roles expected from them.</td>
<td>Scene of evaluating the performance of outside directors and considering reappointing or dismissing them.</td>
</tr>
<tr>
<td>9</td>
<td>Consider reappointment/dismissal based on results of evaluation.</td>
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</table>

○ 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 Utilization of Outside Directors,” a company should consider appointing one of its outside directors from among those with management experience.

3.3. Toward Expansion of Human Resources Market of Outside Directors

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

○ As it becomes necessary to expand the human resources market of outside directors, individuals
with management experience who actually engaged in management as presidents/CEOs or directors or in other similar positions, and incumbent management members are strong outside director candidates to formulate management strategies and evaluate management performance, and it is expected that the human resources market of outside directors will be expanded by such individuals actively becoming outside directors of other companies. Individuals with management experience are expected to be a role model for outside directors by assuming important roles as outside directors at other companies and thereby accumulating example cases of their contribution to enhancement of other companies’ corporate values.

In this respect, if each company insists on holding onto individuals with management experience as its chairman, advisors (komon) or consultants (soudan-yaku) as before, there will be little hope that the human resources market of outside directors will expand. Each company is requested to go one step or even two steps further in their actions for expansion of the human resources market of outside directors, recognizing that the knowledge brought about by outside directors and the management experience of its own officers will expand and ultimately bring more benefits to it as the mobility of individuals with management experience progresses.

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

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

In particular, retired presidents, CEOs, CFOs and other similar positions have broad and advanced knowledge of management acquired through their experience of working as top management, and are accordingly regarded as leading candidates for outside directors to supervise overall management. Therefore, they should actively consider assuming the office of outside director at other companies.

Furthermore, even in the case where a person becomes a non-executive chairman after retiring from being a management member and therefore stays at the same company in a position to supervise its management, the concurrent assumption of the office of outside director at another company is regarded as meaningful even in terms of performing duties as a supervisor at the chairman’s home company, for example, because such assumption enables a comparison of actions taken by the chairman’s home company with those by another company.

As described above, a model in which a retired management member actively assumes the office of outside director at another company and utilizes his/her management experience and knowledge at such company is expected to be established.

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

Incumbent management members include presidents/CEOs and other directors as well as company chairs who have retired from the office of president/CEO.

Even for these incumbent management members’ future management of their own companies, it is beneficial that such management members experience working on the monitoring side as outside directors at other companies and broaden their views by coming in touch with different industries and cultures from those of their own companies. In particular, company chairs who have retired from the office of president/CEO have rich management experience and may have more time compared with when they were presidents/CEOs. For that reason, they can be regarded as strong candidates.

From the standpoints of eliminating a shortage of human resources for outside directors and of securing opportunities for management members to experience supervision of the management
of other companies, 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 under which each of them is situated (such as positions, abilities, and available time).

- Assumption of the office of outside director of another company by an incumbent management member requires the understanding of shareholders and other stakeholders as well as the understanding of personnel within the company. Considering that the experience of a management member as an outside director of another company can be used for management of his/her home company, shareholders and other stakeholders should not show an excessively negative reaction and should take it as a positive choice to the extent that it is not detrimental to the management of his/her home 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, such company should consider administering those rules flexibly.

- Some companies have internal regulations that would restrict their management members from becoming outside directors of other companies. While such restriction would be reasonable to a certain extent from the standpoint of securing their commitment to management, the experience of supervising the management of other companies as outside directors and the broadening of their perspectives may provide them with some advantage in managing their home companies.

- From this viewpoint, a company should consider flexibly operating its internal regulations by permitting its management members to assume the office of outside director at other companies as much as practicable to the extent that it will not cause an adverse effect on its management.

- As mentioned above, if it becomes common for those with management experience to become outside directors of other companies, 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, taking their own positions into consideration, concurrently assume the offices of outside director at several companies within the permitted number of concurrent services for contributing to other companies.

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24 This assumes that if internal regulations provide that a management member assuming the office of outside director at another company will be required to obtain the consent of the company, the company should flexibly give such consent. On the other hand, if internal regulations totally prohibit a management member from becoming an outside director of another company (rather than requiring him/her to obtain the consent of the company), the company would consider making the provisions 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 and Succession Planning of a President/CEO

The replacement of top management and the nomination of successors involve significant decisions that have a huge impact on corporate value. On this basis, companies should consider engaging in succession planning with sufficient time and resources allocated for such planning, in order to ensure that the nomination of excellent successors takes place at optimal times.

In order to pass the management of a company onto an outstanding successor, its president/CEO is expected to personally exercise leadership in the implementation of succession planning as an important part of his/her own responsibilities. Each president/CEO should consider embarking on succession planning right from the time of assumption of the office of president/CEO, in anticipation of his/her own replacement.

○ A president/CEO is at the helm of corporate management, playing a central role in achieving sustainable growth and improving the mid- and long-term corporate value of his/her company. As there is a saying, “A company cannot grow higher than the caliber of its president,” a company’s corporate value varies depending on who leads its management as the top. Accordingly, the replacement of top management and the nomination of their successors are among the most important decisions in corporate management.

○ It is desired that top management should be replaced with the most outstanding successors, meaning the persons with the qualifications to maximize the corporate value of the company, at the best times. Only after ensuring that the administration of a company is to be transferred from its top management to their successors in such manner, it is possible to secure its sustainable growth and improve its mid- and long-term corporate value.

○ In comparison with the past in which the Japanese economy as a whole could expect a constant growth, the present age has seen the advancement of dynamic and aggressive—also often considered as “revolutionary”—changes in the management environment due to globalization and digitalization among others. Against this backdrop, issues concerning management have become complex, for which the mere continuance of existing policies or an extension of existing measures are not sufficient, and the implementation of fearless management reforms that defy inertial force is required. For such management reforms, top-down execution is inevitable. Consequently the “management ability of top management” is the key in determining the success or failure of the reforms.

○ This trend is particularly noticeable among companies that have been globally expanding their businesses. The roles that their top management play are becoming even more essential, and at the same time the importance of securing excellent successors who can assume such roles is growing as well.

○ Therefore, it is important to engage in mid- and long-term efforts for nomination of appropriate successors, which thus mean “succession planning,” by systematically and strategically developing successor candidates and equipping them with necessary qualifications with sufficient time and resources allocated for these purposes in anticipation of future replacement, and then by ascertaining and selecting the most suitable persons as successors.

○ The president/CEO of each company is required to recognize that it is an important duty imposed on him/her as the top management position to raise excellent human resources for successors and select a successor, and, with this in mind from the time of assumption of the office of president/CEO, required to engage in succession planning with sufficient time and resources...
allocated for such planning, in order to achieve sustainable growth of the company and improve its mid- and long-term corporate value.

Furthermore, the replacement of top management and the nomination of successors have a significant impact on corporate value, indicating an important situation where the real value of corporate governance is tested. The board of directors (in particular, outside directors independent from executives) is required to fully recognize the importance of such succession planning and effectively supervise the formulation and administration of succession plans to ensure the appropriateness of these processes.

<Reference: Corporate Governance Code>
[Supplementary Principle 4-1-[3]]
“Based on the company objectives (business principles, etc.) and specific business strategies, the board should proactively engage in the establishment and implementation of a succession plan for the CEO and other top executives and appropriately oversee the systematic development of succession candidates, deploying sufficient time and resources.”

[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 via an appropriate evaluation of the company’s business results.”

[Supplementary Principle 4-3-[2]]
“Because the appointment/dismissal of the CEO is the most important strategic decision for a company, the board should appoint a qualified CEO through objective, timely, and transparent procedures, deploying sufficient time and resources.”

<Reference: Results of the Company Questionnaire Survey>
As an area which the board of directors had not fully discussed, approximately 51% of the respondent companies referred to the succession planning for presidents/CEOs and the supervision of such planning (see Question 17 of the Company Questionnaire Survey 2017).

4.1.2. Significance of Securing Objectivity and Transparency of Succession Planning

A board of directors should appropriately supervise succession planning and consider implementing the replacement of a president/CEO and the nomination of a successor through highly objective and transparent procedures.

Up until now, it is considered that, at many Japanese companies, the replacement of top management and the nomination of successors are actually determined solely and substantively by the incumbent president/CEO as within the scope his/her exclusive authority and what the board of directors actually does is only to confirm relevant decisions made by the president/CEO. In this situation, the selection of successors relies on an individual element of the president/CEO in office, which is his/her ability to judge personal characteristics, and objective standards and information for evaluation are not used in many cases. In addition, a successor fostering plan is considered to exist only in the head of the incumbent present/CEO (if any plan actually exists), and many companies are considered not to have any clear fostering policy or process.

In a stable and static management environment, as in the past, the aforementioned approach to successor nomination can be regard as reasonable to a certain extent with such employment practices as across-the-board recruiting of new graduates, lifelong employment and promotion by seniority. However, in today’s drastically-changing management environment, there is considered to be an increasing risk that an appropriate successor nomination will not be
conducted.

Also, such conventional method of successor nomination as described above is not necessarily and sufficiently objective or transparent. Consequently, such suspicions as the following may potentially be raised: in nominating a successor, a suitable person is not selected from a wide range of candidates because any aspect other than corporate value, such as the internal logic of the company \(^{25}\) or a subjective judgment or personal circumstances of the incumbent president/CEO\(^{26}\), is prioritized; or the replacement of top management is not conducted at an appropriate timing. In addition, the accountability to the stakeholders of the company such as its shareholders, investors and staff for the nomination of an appropriate successor may not be fully fulfilled, resulting in a failure to obtain sufficient trust or consent in relation to the nomination. Moreover, there can also be concerns that the newly appointed president/CEO may be apprehensive about the intention of the previous president/CEO since the latter selected the former, and may consequently hesitate to embark on management reforms that go counter to the course of business set by the previous president/CEO.

Appropriate supervision of succession planning by the board of directors (in particular, outside directors independent from executives) and the consequent enhancement of the objectivity and transparency of processes toward successor nomination can lead to a procedural guarantee that successor nomination does not rely on internal logic or a subjective or arbitrary judgment of the incumbent president/CEO, but is carried out to accomplish the purposes of achieving sustainable growth of the company and improving its mid- and long-term corporate value. On top of that, it is likely that stakeholders such as shareholders, investors and staff trust and consent to the appropriateness of successors nominated through such processes, and accordingly the new top management are expected to feel more comfortable with exercising their leadership.

These efforts are not necessarily in conflict with the conventional approach of successor nomination. Many presidents/CEOs are considered to have been devoting themselves to the fostering and selection of successors in order to hand over the management of their companies to outstanding successors. In that case, on the assumption that the incumbent president/CEO still plays a leading role in succession planning as before, it is possible to understand that the significance of supervising succession planning lies in the fact that such supervision can enhance objectivity and transparency and thereby guarantee the appropriateness of judgments of the president/CEO by, while respecting his/her opinion, verbalizing and documenting the thought and judgment processes and grounds for thoughts and judgments in his/her head\(^{27}\) and by adding a process of providing explanations that outside directors and others can easily comprehend and obtaining their understanding, and in the fact that such supervision can enhance the trust and consent of stakeholders in relation to successor nomination and thereby support the new leadership after the nominated person has assumed the office concerned.

However, it is considered that the premise on which the supervision of succession planning can fulfill its originally expected functions is that outside directors and other members who carry out the supervision should be competent for the supervision with sufficient knowledge about management.

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\(^{25}\) For example, this includes promotion by seniority, the year of joining the company, age, the balance between two internal factions or business units, the department of origin, academic backgrounds, and customary personnel practices in the past.

\(^{26}\) For example, this includes the fact that it is easy for the incumbent president/CEO to exert his/her influence even after his/her retirement.

\(^{27}\) With regard to the verbalization and documentation of succession planning, refer to “5. Verbalization and Documentation of Succession Planning” of Appendix 4 “Points of View in Formulation and Administration of a Succession Plan for a President/CEO.”
as the president/CEO is respected in relation to successors.” This suggests that, for Japanese companies, the nomination of successors is still persistently regarded as a matter to be determined exclusively by the incumbent president/CEO or other management members (see Question 35 of the Company Questionnaire Survey 2017).

4.1.3. Formulation and Administration of a Succession Plan

○ Ideal and specific approaches to the formulation and administration of succession plans may differ according to the situation of each company, its corporate culture and the situation surrounding candidate persons, among other matters. What matters is that each company actually discusses what efforts are necessary for itself, goes through trials and errors and takes various measures in order to accomplish the original purpose of replacement of top management with appropriate successors at optimal times.

○ For each company to embark on the formulation and administration of succession plans, it is useful to consider its actions according to the following seven steps as a basic framework. For details, companies should refer to Appendix 4 “Points of View in Formulation and Administration of a Succession Plan for a President/CEO” when taking actual steps.

○ For a company to newly embark on succession planning, it may be difficult to construct a full-featured mechanism from the beginning. On this basis, it is quite likely that such company focuses on what it can do in the beginning and takes one step at a time, on the basis of the objective of ensuring the objectivity and transparency of succession planning processes.

<table>
<thead>
<tr>
<th>Step</th>
<th>Main Details</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Drawing up a roadmap for succession planning</td>
</tr>
<tr>
<td>2</td>
<td>Formulating an “ideal image of a president/CEO” and evaluation standards</td>
</tr>
<tr>
<td>3</td>
<td>Selecting successor candidates</td>
</tr>
<tr>
<td>4</td>
<td>Formulating and implementing a fostering plan</td>
</tr>
<tr>
<td>5</td>
<td>Evaluating, narrowing down and, if applicable, replacing successor candidates</td>
</tr>
<tr>
<td>6</td>
<td>Evaluating the final candidates and nominating the successful successor</td>
</tr>
<tr>
<td>7</td>
<td>Supporting the successor after nomination</td>
</tr>
</tbody>
</table>

4.1.4. Division of Roles between Insiders and Outsiders

○ For a company, succession planning is important efforts for nominating the best suited successors in terms of achieving sustainable growth of the company and improving its mid- and long-term corporate value. Basically, insiders such as the incumbent president/CEO and outsiders such as outsider directors belonging to the nominating committee are to work on succession planning in cooperation with each other from their respective positions and toward the common goal of improving the effectiveness of succession planning.

○ This means that the supervision of succession planning is not to totally delegate the right to take the lead in appointing and dismissing a president/CEO and in nominating a successor to outsiders; it is an issue with the distribution of roles between insiders and outsiders. In an exceptional case where trust or confidence in insiders such as the incumbent president/CEO has been lost, outsiders may potentially be required to lead succession processes more proactively. Otherwise, in an ordinary situation where trust or confidence in insiders such as the incumbent president/CEO remains intact, outsiders are basically expected to make efforts to appropriately supervise the company’s succession planning from an independent standpoint while respecting the opinions of insiders including the president/CEO, and the fact that the incumbent president/CEO takes charge of leading the preparation of draft plans in relation to the formulation
of succession plans and the nomination of successors remains unchanged.

(Roles expected from the incumbent president/CEO)

○ The president/CEO of a company is the chief executive for achieving sustainable growth of the company and improving its mid- and long-term corporate value, thus expected to play a central role as the representative of insiders in the nomination of successors, which involves important management decisions in connection with the above achievement and improvement, and in succession planning that assists such nomination.

○ In particular, the fostering and strategic rotation of successor candidates require the understanding of the company’s business units since these processes may have an impact on the units’ daily businesses, and the understanding of the human resources department in order to assign such candidates in accordance with the fostering strategy. Efforts for succession planning involve issues that may affect multiple sections of the company. For that reason, it is difficult to secure the understanding and cooperation of personnel in the company without the incumbent president/CEO making commitments, resulting in lack of effectiveness.

○ Therefore, it is necessary for the incumbent president/CEO to allocate sufficient time, personally and seriously commit himself/herself to the formulation and administration of succession plans, and develop the required environment.

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 centrally base their executive compensation systems on fixed compensation, and the use of performance-linked compensation and stock-based compensation tends to account for lower percentages compared with those percentages of Western companies.

○ Performance-linked compensation and stock-based compensation provide an incentive for improving mid- and long-term corporate value, as economic benefits management members can earn vary depending on fluctuations in performance or the stock price.

○ 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 a performance-linked compensation plan or a stock-based compensation plan, a company should take the following elements into consideration, depending on its situation:

  ➢ Whether the plan conforms to the company’s management strategy and other basic policies;
  ➢ Whether any financial or non-financial index has been chosen as an appropriate goal;
  ➢ Whether it is the right time to introduce the performance-linked compensation plan or stock-

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28 Especially, when starting making efforts for succession planning, it is crucial that the top management takes the initiative in such efforts, for example, by assigning a full-time officer in charge and organizing a necessary personnel structure.

29 For a comparison of president/CEO compensations between Japanese and Western companies, see the explanatory materials presented by Willis Towers Watson at the sixth meeting of the CGS Study Group.

30 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 to their designing of performance-linked compensation plans so that the adoption of performance-linked compensation will not provide the management with an incentive to avoid necessary reforms.
based compensation plan in light of its own situation; and
- Whether the percentage in the total compensation is appropriate.

In considering a compensation policy (including whether a company should introduce a performance-linked compensation plan or a stock-based compensation plan), a company needs to have its management strategy in effect. On that basis, it is important to set up Key Performance Indicators (KPIs) as specific goals in the light of management strategies and then consider designing compensation systems to realize them. Considering a compensation policy without any management strategy will not provide management members with an appropriate incentive.

(Conceptual Diagram)

<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.”

[Supplementary Principle 4-2-[1]]
“The board should design management remuneration systems such that they operate as a healthy incentive to generate sustainable growth, and determine actual remuneration amounts appropriately through objective and transparent procedures. For that reason, the proportion of management remuneration linked to mid- to long-term results and the balance of cash and stock should be set appropriately.”

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31 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, the introduction of a (short-term) performance-linked compensation plan could cause a hindrance to reforms. Thus, there may be cases in which it is not appropriate to introduce a performance-linked compensation plan, and a company would need to consider it on the basis of its own situation.

32 If the percentage of performance-linked compensation in the total compensation is raised, the amount of compensation the management are actually to receive will decrease when they cannot achieve the target performance. In Japan where an absolute amount of compensation tends not to be so high, the introduction of a performance-linked compensation plan without reviewing the compensation levels would make the management worried about their lives 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.
What incentives are established will differ depending on the design of a specific compensation plan. The following table shows the basic viewpoints of consideration as well as some 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>○ If the percentage of variable compensation is too high, it may impede stable management.</td>
<td></td>
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<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></td>
<td>○ If the percentage of fixed compensation is too high, directors may run the company without appropriately taking necessary risk.</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>○ Difficult to function as an incentive to day-to-day performance of duties.</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>
</tr>
<tr>
<td></td>
<td>○ May be an incentive to aim at improvement of short-term corporate value only.</td>
<td></td>
</tr>
<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>
</tr>
<tr>
<td></td>
<td>○ May not function as incentives, because stock price may be affected by external factors, such as economic trends.</td>
<td></td>
</tr>
<tr>
<td>Items to be granted</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Share option</td>
<td>○ Incentives to increase stock price will function.</td>
<td></td>
</tr>
<tr>
<td></td>
<td>○ Same as the demerit of “stock.”</td>
<td></td>
</tr>
<tr>
<td></td>
<td>○ It may be more difficult for holders to feel incentives than when directly holding stock, because holders are not shareholders.</td>
<td></td>
</tr>
<tr>
<td>Cash</td>
<td>○ Highly liquid income can be expected.</td>
<td></td>
</tr>
<tr>
<td></td>
<td>○ The function as an incentive will cease to exist after grant of compensation.</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></td>
<td>○ If there is too large a gap between the target linking index and the present value, compensation may not function as an incentive or may function as an incentive to take excessive risks.</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></td>
<td>○ An incentive to improve corporate value beyond a certain target value will not function.</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 the mid- or long-term corporate value, a company should actively consider disseminating information about the status of introducing performance-linked compensation plans and/or 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 its corporate management strategy and other basic policies, 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 the understanding and appreciation of shareholders and other stakeholders, which would support reviews of their compensation plans in many cases.
4.3. Utilization of the Nominating Committee and the Compensation Committee

A company should consider utilizing a statutory nominating committee (in the case of a Company with Nominating Committee, etc.) or a voluntarily organized nominating committee (in the case of a Company with Nominating Committee, etc., a Company with Company Auditor(s) or a Company with Audit and Supervisory Committee) in relation to the appointment or dismissal of presidents/CEOs and the supervision of succession planning\(^3\).\(^3\)

○ In connection with the appointment or dismissal of presidents/CEOs and the supervision of succession planning, several measures, including the following, can be taken.

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

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

[1] Method of designating outside directors to make up 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 the board of directors is noticeable from the outside.
  ○ Consistent with an intention to have the 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 the board of directors
  ○ Establishment of a mechanism will make the nomination/compensation decision-making process stable.
  ○ Consistent with ideal approaches to the board of directors even with a focus on its decision-making in relation to individual business execution (the board of directors consisting mainly of insiders).
  △ A threat of losing power depending on how the plan is designed or administered (especially in the case of a voluntary committee).

[3] Methods of expanding explanations to outside directors prior to deliberation at board meetings and exchanging opinions individually, without setting up a committee
  ○ It is possible to materialize such expansion in substance to a certain degree, provided that sufficient explanations are provided and opinions are exchanged.
  △ It may be difficult for this to be evaluated despite a substantial level of explanations provided, since the situation is less understandable from the outside.
  △ It may be less stable because there is no established mechanism.
  △ If there are only a very few outside directors, proposals submitted by management members may not be fully discussed even where those proposals have any problems.

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\(^3\) In the case of a Company with Nominating Committee, etc., a Company with Company Auditor(s) or a Company with Audit and Supervisory Committee, the board of directors has the power to appoint and dismiss a president/CEO (representative executive officer or representative director) under the Companies Act. For that reason, a Company with Nominating Committee, etc. would have an option to voluntarily seek advice on the appointment or dismissal of a president/CEO or the supervision of 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.
Of these methods, the method of appointing outside directors to make up a considerable number of the board members (e.g., a majority) may be adopted, as described in [1] above. However, many companies would feel awkward because this involves a significant degree of change in light of the composition of a typical board of directors today in Japan.

With respect to the method in [3], there is no problem if explanations of a substantial level are provided. However, the situation is less understandable from the outside, or may be less stable. Especially, it is a problem if there are only a very few outside directors.

Accordingly, as a measure that is regarded as effective for any company irrespective of the approaches of its board of directors, and that is to enhance the independence, objectivity and accountability of the board of directors in relation to the appointment or dismissal of presidents/CEOs and the supervision of succession planning, companies should consider utilizing a statutory or voluntary nominating committee. In the case of a voluntary nominating committee, this committee may be established as a separate forum from the board of directors for mainly outsiders to engage in discussions from the standpoints of making independent and objective evaluations and ensuring transparency, and may make judgments as the board of directors for matters concerning nomination and compensation after fully considering opinions of those outsiders.

- Even if a company decides to appoint outside directors to make up a considerable number (e.g., a majority) of the board members, it would be helpful to utilize the nominating committee from the viewpoint of having a larger proportion of outsiders than the proportion in the board of directors or of making more in-depth and efficient discussions with increased confidentiality achieved by limiting internal members.

- In fact, discussions about nomination and compensation will be regularly repeated if a committee is set up during 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 even to a company in which there is no problem with the appointment and dismissal of presidents/CEOs for the time being to set up a committee during 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 authority and leading himself/herself to an environment where he/she can find it easy to make prompt and bold decisions. On the other hand, in case a president/CEO goes out of control without a justifiable cause, it is necessary to assign a role of putting a brake on him/her to the relevant committee.

- As to the composition of a committee consisting mainly of outsiders, a potential option to consider is that [1] outside officers make up at least a majority of that committee; or [2] the number of outside officers and that of other officers are the same, but the chairperson is an outside officer. For details, refer to “3. Composition of the Committee” in Appendix 3 “Points of View in Utilization of the Nominating Committee and the Compensation Committee.”

<Reference: Case Examples of Specific Efforts>

- As it was pointed out by investors that the nomination and compensation governance was not working when the company was changed into a Company with Audit and Supervisory Committee, the company decided to introduce a voluntary nominating committee and a voluntary compensation committees at the same time.

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

- The founder proposed, from the standpoint of what to do in relation to his/her successor and
In order to improve the effectiveness of appointing or dismissing presidents/CEOs, a company should consider utilizing a statutory compensation committee or a voluntarily established compensation committee in tandem with a nominating committee.

○ In appointing or dismissing a president/CEO, there is to be an evaluation of such president/CEO as a premise for the appointment or dismissal. Evaluation is also necessary in the phase of fairly determining executive compensation, in addition to the phase of nomination, and these phases have many aspects in common. 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 dismissal34.

○ For this reason, the establishment of a compensation committee in addition to a nominating committee would be effective35.

○ Evaluation of a president/CEO conducted to determine his/her compensation for each fiscal period also becomes the basis of judging his/her reappointment. Thus, if a nominating committee and a compensation committee are set up separately, efforts to enhance the cooperation between the two committees are regarded as effective from the standpoints of improving the effectiveness of appointing or dismissing presidents/CEOs and efficient administration of the committees.

<Reference: Corporate Governance Code>
[Supplementary Principle 4-10-[1]]
“If the organizational structure of a company is either Company with Kansayaku Board or Company with Supervisory Committee and independent outside directors do not compose a majority of the board, in order to strengthen the independence, objectivity and accountability of board functions on the matters of nomination and remuneration of the senior management and directors, the company should seek appropriate involvement and advice from independent outside directors in the examination of such important matters as nominations and remuneration by establishing independent advisory committees under the board, such as an optional nomination committee and an optional remuneration committee, to which independent outside directors make significant contributions.”

<Reference: Results of the Company Questionnaire Survey>
Companies with committees established tend to be making progress with the formulation of succession plans and with the introduction of incentive compensation plans. This means that approximately 22% of companies with their nominating committees established have some sort of documented succession plans, whereas only approximately 4% of companies without such committees have such documented plans. In addition, approximately 72% of companies with their compensation committees established have introduced mid- or long-term incentive compensation plans, whereas only approximately 42% of companies without such committees have introduced such compensation plans (see Question 30, Question 36 and Question 50 of the Company Questionnaire Survey 2017).

34 Conversely, a compensation committee alone cannot fully evaluate a president/CEO. If the criteria for evaluation of the 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 cover 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 feedback of qualitative evaluation (e.g., evaluation of whether he/she could have more actively dealt with corporate culture reforms, etc.) to the president/CEO.

35 If a nominating committee and a compensation committee are set up, whether to formally consolidate these committees into one committee or set up them separately may be considered with the burdens of their members taken into account.
Furthermore, companies with their committees established tend to have considerably high appreciation when it comes to whether or not their outside directors fulfill the monitoring function concerning the nomination and compensation of presidents/CEOs. Accordingly, the percentages of companies with both nominating and compensation committees that answered that outside directors fulfilled their roles in relation to the monitoring of appointment and dismissal of presidents/CEOs or the monitoring of compensation decisions were approximately 76% and 89%, respectively, whereas the percentages of companies without either of the two committees in the same regards were only approximately 48% and 44%, respectively (see Question 28 and Question 36 of the Company Questionnaire Survey 2017).

<Reference: Case Examples of Specific Efforts>

- The CEO gives a briefing about the annual action agenda at a meeting of the compensation committee consisting of the CEO and external members, and conducts self-evaluation a year later. Then, the external members conduct assessment of his power of execution by grading how much the CEO has carried out what he said a year ago.
- The parallel use of the compensation committee for evaluation of a president works very well. For example, in the situation where the operating performance fell during one year, and the company is not sure about his dismissal and wants him to work a little harder, the company can rely on its compensation committee to assess that president in terms of compensation. If the board of director expresses its intention to offer a flexible compensation plan to the president, 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 apply a little more pressure on him.

A company should consider the designing and administration of its nominating and compensation committees by reference to Appendix 3 “Points of View in Utilization of the Nominating Committee and the Compensation Committee.”

- While a committee concerning nomination or compensation has the merit of being able to decide matters (other than statutory matters to be determined by a statutory committee) in a highly flexible and free manner, it may not have any power depending on how it is designed and administered.
- In setting up a committee concerning nomination or compensation (including a statutory committee), it is important to examine, for example, how the following matters should be designed and administered.
  - Composition of the Committee
  - Scope of advice targets;
  - Details of matters to be advised;
  - Relationship with the board of directors;
  - Time schedule (frequency and duration of a meeting); and
  - Structure of its secretariat, etc.

- To help companies 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 Utilization of the Nominating Committee and the Compensation Committee.” It is desirable that each company should examine the way those committees should be for the company 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.

- Nominating and compensation committees (in particular, voluntary committees) can be freely and flexibly designed and administered. For that reason, it is difficult for the outside to know the real conditions of those committees unless the company externally disseminates information. As a result, those committees might not be properly valued, despite many efforts made by the company to set up those committees.
- Therefore, companies should externally disseminate information about the compositions of the committees, the names of committee members, matters deliberated, the frequency of meetings, and other statuses of their administration.\(^\text{36}\)

\(^{36}\) Although companies disclose the existence of those committees and the number of their members by attribute in their “Corporate Governance Reports,” 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 are companies that maintain the practice that their retired presidents/CEOs continue to have certain relationships with the companies in the capacity of an advisor, a consultant or other posts.

○ The roles of an advisor or consultant vary from company to company, and there is no intention to simply judge whether it is 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 retired president/CEO engages in activities in the business community as an advisor or consultant, 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 backgrounds, it would sometimes bring benefits to the company.

○ Corporate value will be improved through contributions of various stakeholders including employees, customers, suppliers 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.

<Reference: Results of the Company Questionnaire Survey>

Approximately 78% of the respondent companies have the advisor/consultant system and practices, and approximately 62% of the respondent companies have current or former officers who actually serve as advisors/consultants (of which, approximately 58% of the respondent companies have former presidents/CEOs who actually serve as advisors/consultants).

37 For example, in the case of a holding company, there may be a similar problem when the 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 of such positions within the company and disseminate information as described in section 5.1.2 below.

38 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.

39 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 a former president/CEO, rather than an incumbent vice president or another officer currently in office.

40 For example, advisors/consultants can devote themselves to activities in the industry or other activities contributing to communities, as they have more time than ever before after retirement from management, 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 an 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 advisor/consultant would choose to become an outside director of another company without continuing to belong to the home company. However, a company that invites outside directors would sometimes have more advantages if its outside directors continue to belong to their home company as advisors/consultants, maintain access to industry information and utilize their knowledge when acting as its outside directors. Additionally, in Japan where the compensation levels of incumbent management are not high compared with those of overseas companies, some view that in light of the independence of outside directors, they may be able to keep more rigid independence 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 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 to which they belong as advisors/consultants and the company in which they serve as outside directors, it might rather give rise to doubts about their independence).
With respect to the roles played by advisors/consultants, approximately 35% of the respondent companies mentioned activities related to business associations or communities, and other business-related activities; approximately 27% mentioned activities to maintain and expand commercial relationships with customers; and approximately 20% mentioned social activities and other public activities including council membership. On the other hand, approximately 36% of the respondent companies mentioned the role of providing directions and guidance to the current management on the basis of their experience of serving as officers (see Question 71 of the Company Questionnaire Survey 2016).

On the other hand, it is pointed out that if a former president/CEO remains at his/her company as an advisor/consultant, the advisor/consultant who has no responsibility for company management may exercise unreasonable influence over incumbent management members, and that there may arise a harmful effect that who is actually taking the management leadership is not clear. It is also pointed out that even if an advisor/consultant does not actively exercise unreasonable influence, the advisor/consultant may still be a factor causing the current management to hesitate to make bold decisions, such as the reconstruction of business portfolios, when the current management are apprehensive about the intention of the advisor/consultant who was a previous president/CEO.

In addition, because the roles and treatment of advisors/consultants vary from company to company and cannot be recognized from the outside, there is no denying that they are in a way obscure. In fact, the actual conditions of advisors/consultants are not widely known 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 presidents/CEOs from serving as outside officers of other companies, rather than keeping them in the company as advisors/consultants or in 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, firstly and internally, consider clarifying what roles it specifically expects him/her to play.

Then, such 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, for example, through the use of its statutory or voluntary nominating and compensation committees.

41 For example, when a former president/CEO who now serves as an advisor/consultant is asked to give advice by the current management members who want to withdraw from the business the former president/CEO previously started up or was deeply involved in 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 himself/herself in the past.

42 Even if a former president/CEO does not remain at the company as an advisor/consultant, a similar problem may occur and cannot necessarily be resolved just by considering and reexamining the advisor/consultant system. If, however, a former president/CEO remains at the company as an advisor/consultant, he/she would find it easier to access company information or keep communication with the current management. In that case, the aforementioned harmful effect would be more likely to occur. It is also pointed out that a former president/CEO who did not choose to stay at the company as an 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 a different industry or company.
○ If an advisor/consultant who has no responsibility to shareholders or other stakeholders exercises unreasonable influence over the appointment or dismissal of a president/CEO or company management, it is a question concerning whether the current management is able to take appropriate leadership within the company, and some improvements are required. Such situation would pose a problem especially if a former president/CEO who was in the top management position remains at the company as an advisor/consultant.

○ Exercise of such unreasonable influence is basically a problem that should be corrected by the properly functioning board of directors. For example, it would be important to set up a nominating committee and a compensation committee, both of which consist mainly of outsiders, to make the processes of selecting presidents/CEOs and determining their compensation transparent, and help outside directors and outsiders, who are members of the committees, recognize the roles they should play. This will consequently function as a “shield” against the unreasonable influence of any former president/CEO who serves as an advisor/consultant.43

○ 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: Results of the Company Questionnaire Survey>
Approximately 10% of the respondent companies replied that they did not fully recognize the roles of advisors/consultants, and approximately 10% replied that advisors/consultants had no particular role (see Question 71 of the Company Questionnaire Survey 2016).

○ In internally considering whether to appoint a retired president/CEO as an 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: Results of the Company Questionnaire Survey>
Approximately 30% of the respondent companies have reviewed or considered reviewing their adviser/consultant systems (Question 64 of the Company Questionnaire Survey 2017).

○ For the above matters to be considered, a company may have such matters discussed at a meeting of its board of directors. However, it may be able to ensure more objectivity if a company chooses to have outsiders participate in discussions. Accordingly, a company may have outside directors or other outsiders participate in the process by treating its advisory/consultant system as a matter to be referred to its statutory or voluntary nominating/compensation committee for advice and having it discussed at a committee meeting at the time of appointment of an advisor/consultant and subsequent renewal of the term of office of such advisor/consultant.

If a company retains its retired president/CEO as its advisor/consultant, it is meaningful to voluntarily disseminate information on the number of its retired presidents/CEOs serving as its advisors/consultants, their roles and treatment plans, and other relevant details to the outside. Industrial circles are expected to make these efforts proactively.

○ The roles of advisors/consultants differ from company to company, and whether the appointment

43 It is also pointed out that the issue with the exercise of unreasonable influence by the immediately preceding president/CEO against the current president/CEO is largely affected by the personnel connection (chain) between them based on the fact that the current president/CEO was nominated by the preceding president/CEO. In order to resolve this issue, one of effective countermeasures is to reform the process of nomination of top management, for example, by having the nominating committee consisting chiefly of outsiders proactively participate in the formulation and administration of succession plans, so that the current president/CEO cannot select the next president/CEO at his/her sole discretion.
of a retired president/CEO as an advisor/consultant is right or wrong should not be determined in a single uniform way. As described above, a company should internally establish appropriate roles and treatment plans and provide information to the outside after ensuring objectivity. By doing this, a company can obtain the understanding of investors and other outsiders in relation to the fairness of its internal framework for corporate governance.

○ On January 1, 2018, the Tokyo Stock Exchange partially revised the form of “Corporate Governance Report” and the guidelines for preparing Corporate Governance Reports, newly setting a column to state the appointment of any retired president & representative director, etc. as an advisor/consultant or to a similar advisory position. In the case where any retired president & representative directors, etc. have been appointed as advisors/consultants or to other similar advisory positions continuously after retirement, it is expected that their names, titles, positions, duties and other relevant details are stated. Furthermore, companies are expected to use this column to actively disseminate information.

○ It is also pointed out that in Japan where the level of compensation to presidents/CEOs is lower than those in overseas countries, the receipt of compensation as an 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 was serving as president/CEO.

At a company adopting a deferred payment system by setting a relatively low level of compensation to the incumbent president/CEO on the assumption that he/she will receive compensation as an advisor/consultant later, such company may make its executive compensation system more appropriate as a whole by combining such measures as increasing the level of compensation to incumbent management through introduction of incentive compensation or otherwise, and reviewing the positioning of advisors/consultants and their compensation.

Retired presidents/CEOs who have chosen not to stay at their companies as advisors/consultants after examining the respective corporate systems for advisors and consultants are expected to proactively become outside directors of other companies and utilize their management knowledge cultivated through their long-term management experience, from the standpoint of contribution to society.

5.2. Ideal Approaches to the Chairman of the Board

A company should examine the powers and title of a chairman of the board (e.g., whether or not to grant the right of representation), considering whether it is right or wrong to concentrate powers on the incumbent 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

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44 In particular, it is considered helpful in ensuring the understanding of foreign investors who do not have similar practices and in offering them a feeling of security.

45 As of July 13, 2018, 35.2% of the companies that have updated their “Corporate Governance Reports” by using the revised form and the revised guidelines for preparing Corporate Governance Reports have disclosed information concerning their advisors/consultants, etc. (“Appointment of Independent Directors, Establishment of Nomination and Remuneration Committees, and Disclosure of Sodan-yaku, Komon etc. by TSE-Listed Companies” (published by the Tokyo Stock Exchange on July 31, 2018))

46 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 an advisor/consultant. Therefore, it is desired from the standpoint of ensuring contribution to society that a retired president/CEO who stays as an advisor/consultant should proactively become an outside director of another company. In such case, for example, by stating that effect in the company’s “Corporate Governance Report” as “Business Details,” the company should consider actively disseminating the information that its advisors/consultants play significant roles in society.
companies use this title for the chairperson of a board of directors, and others use it for a leading director (not the chairperson of a board of directors).

- Some companies would be suited to maintaining a framework in which the chairman of the board and the 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 framework in which the chairman of the board is away from conducting business from the standpoint of devoting himself/herself to monitoring the top management, meaning there is a line drawn between business execution and monitoring.

- By way of illustration, it is pointed out that at a company clearly dividing the execution function for which the president/CEO is totally responsible and the monitoring function for which the board of directors is responsible, the current president/CEO will find it difficult to conduct business when a former president becomes the chairman of the board with strong powers and a strong title (for example, with the right of representation).

- If the chairman of the board concentrates on supervision as the chairperson of the board of directors and focuses on board evaluation, the chairman’s roles will be clearly separated from the roles of the current president/CEO, which would sometimes help the current president/CEO make prompt and resolute decisions. For this reason, it would be helpful that what powers and title a chairman of the board should be given should be coordinated in views of the separation between monitoring and execution as well as the concentration of powers on the current president/CEO, depending on the situation of each company.

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

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

○ The results of the Company Questionnaire Survey (reference 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 found in their first effectiveness evaluations conducted by their boards of directors. The deepening of the corporate governance reforms from formality-based efforts to substance-based ones is a current big topic, and the above-mentioned survey results show that the movement of the reforms to substance-based efforts is steadily progressing.

○ The continued advancement of the corporate governance reforms by companies is the key to construct an economic system that will enable Japan to move out of the present situation in which corporate value has continued to slow down over the past twenty years, and to achieve sustainable growth and improve mid- and long-term corporate value through enhancement of productivity, and that will eventually lead to economic growth through investment and boosted consumption. 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 Consideration of 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 are organized by categorizing them on the basis of whether the board of directors makes many decisions on individual business execution (whether a focus is also placed on the decision-making function) or whether the 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 both the decision-making function and the 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 a balance between those two functions.
  
  - For example, if a board of directors makes decisions 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 specializes in the monitoring function.
  
  - If either of the monitoring function or the decision-making function is strengthened, the other may be weakened. However, both the functions are not totally in conflict with 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 are organized by categorizing them on the basis of whether the powers of the president/CEO in relation to business execution are decentralized or centralized⁴⁹.

  - The environment in which the president/CEO can exert a top-down style of management power in conducting business is defined as centralized. On the other hand, for example,

⁴⁹ This does not mean whether the management competence of the president/CEO or other management members is high or low.
cases in which the president/CEO coordinates opinions of business division heads and other managers, and management members run the company under mutual surveillance (they engage in “mura-shakai” (closed society) or village community-style management) are 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 are organized by categorizing them on the basis of whether or not the monitoring function of the 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 is considered that efforts to strengthen the monitoring function in a way consistent with each quadrant will be chosen.

2. Directivity in Reviewing Management and the Board of Directors

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

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 the board of directors (i.e., the directivity of intention to have the board of directors specialize in monitoring).

  - A board of directors conventionally assumed the roles and functions to make decisions on individual business execution. However, this directivity concerns the case where a company intends to delegate the decision-making function to executive officers, and shifts the roles and functions of its 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 powers are substantially concentrated on the president/CEO (for example, a top-down style management by the president/CEO) will create an environment in which it is easy for the president/CEO to whom powers are delegated to make prompt business decisions without having to wait for a board meeting to be convened by reducing the number of individual agenda items to be decided by the 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 the president/CEO who has strong powers and authority so that he/she may not behave recklessly or engage in any corrupt practice, and will take actions to convert its board of directors into 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 D): A company intends to strengthen the monitoring function within and outside its board of directors, while placing an emphasis on the
decision-making function of its board of directors.

- This is the case where the roles and functions of the board of directors of a company are intended to make decisions on individual business execution as in the past, and the company does not intend to have its board of directors specialize in the monitoring function.
- For example, in the case of a company which stresses the independence of each business division and section and makes decisions by resolving the conflict 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, such company would not need to intend to have its board of directors specialize in the monitoring function.
- On the other hand, it is necessary to monitor management members including the president/CEO, and the company will make possible internal 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 expand the monitoring function of any organs other than the board of directors (for example, monitoring by various committees of which outside directors make up a majority), provided that the 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 the case of a company that is located in quadrant B mentioned above, it is difficult for the company to withdraw from the existing business, change its strategic policy or review its business portfolio in a timely and accurate manner, which can be one of impediments to improvement in the company’s competitiveness.
  - In order to address such issue, the company may make efforts with an intention to centralize powers in the president/CEO and expedite its decision-making process.
  - Concurrently with the centralization of powers in the president/CEO, the company will need to strengthen monitoring of the president/CEO to keep balance and, especially as an ultimate means, prepare a mechanism that enables the company to dismiss its president/CEO (e.g., the establishment of a nominating committee consisting chiefly of outsiders, and the formulation of standards for dismissal).
  - If the above-mentioned efforts are to be made with changes in the roles and functions of the 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 particularly expects its outside directors to play are to formulate management strategies of that company and also to evaluate whether its management members run the company in line with those strategies.
It is necessary to reconsider proposals submitted before meetings of the board of directors from the standpoint of minimizing decisions on individual business execution at board meetings (i.e., to delegate substantial powers to the president/CEO).\(^{50}\)

Although the board of directors may receive reports whenever a 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 the board of directors to objectively evaluate business execution by insiders, the board of directors basically consists mainly (e.g., a majority) of outsiders.

As it may be inefficient to deliberate all matters at a meeting of the board of directors consisting mainly of outside directors, a company may consider setting up an expert committee such as a nominating or compensation committee for efficiency purposes. However, decisions made by such committee will not necessarily need to bind 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 minimum decisions on individual business execution. However, a company may hold a meeting of its board of directors each month as in the past to intensively discuss, among others, management strategies that have not ever been fully deliberated.

It is desirable for any person other than executives to act as the chairperson of the board of directors from the standpoint of ensuring objective evaluation.

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

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

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

The roles a company particularly expects its outside directors to play are to formulate its management strategies and to give advice even in the decision-making process concerning individual business execution from an outsider’s perspective.

A company is required to reconsider matters to be submitted before a meeting of its board of directors so that the board can take more time to deliberate important matters, with an intention to delegate the power to decide less important businesses to the president/CEO.

Decisions on individual business execution are ordinarily made chiefly by executive directors who are familiar with internal operations. On the other hand, a specified number of outside directors should be selected to have them check, from a third-person point of view, that decisions on individual business execution are not made solely based on internal logic (the monitoring function will be further enhanced when more than one outside director is appointed so that discussions can be made between or among outsiders).

At a meeting of the board of directors consisting mainly of internal executives, it is systematically difficult for the board of directors alone to conduct full monitoring, and it will be necessary to secure the monitoring function by using any organ other than the board of directors. For this reason, nominating and compensation committees consisting chiefly of outsiders may be set up. Decisions made at meetings of such nominating and compensation committees can typically be organized as described below.

\(^{50}\) If the board of directors of a company continues to make many decisions, that company, even if it is classified as a Company with Nominating Committee, etc., would not be considered to fall under Directivity [1] type.
committees must be respected by the board of directors.

- It is expected that a meeting should be held at least once a month or so in order not to lose promptness in decision making concerning business execution.

- One of internal executive directors may act as the chairperson of the board of directors from the standpoint of taking the leadership in decision making concerning business execution. 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 to act as the chairperson of the board of directors is required to understand the nature of business of the company to such a degree as to be able to decide whether specific matters should be submitted before meetings of the board of directors.

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

- It is considered that the internal foundation based on which the president/CEO was appointed as such substantially affects the situation in which the same president/CEO cannot make resolute management decisions due to being apprehensive about internal business divisions and a retired president/CEO. For that reason, it is important, in centralizing powers in the president/CEO, to cut off the flow of selecting presidents/CEOs based on certain internal logic or the intention of any retired president/CEO.

- To this end, the nominating committee is required to exert stronger roles. If a company moves from quadrant B to quadrant D, decisions on the appointment of a president/CEO by the nominating committee must be respected by the board of directors.

- A company can consider utilizing a compensation committee to decide the compensation of the president/CEO, as it can be utilized as one of the means to present evaluation results of the president/CEO.

- Even if powers are to be concentrated on the president/CEO, it is difficult for him/her to comprehensively lead all matters. In that case, it may be useful, in centralizing powers in the president/CEO, to appoint a COO, CFO, CTO and/or CIO, who will supervise his/her own field under the leadership and direction of the president/CEO. To this end, the president/CEO must hold the right to decide personnel affairs to practically place each of such 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 the selection of key employees, candidates for those chief officers should be proposed by the president/CEO (it is basically sufficient for outside directors just to check that there is no problem. Should it be considered that the selection of candidates or the 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 powers on the president/CEO during ordinary times, and in developing an environment to assist the president/CEO in making resolute decisions on execution of business (to urge him/her take risks), outside directors are required to internally and externally ratify the legitimacy of the business execution by the president/CEO and evaluate him/her by reflecting it in his/her nomination and compensation if they conclude that the business execution by the president/CEO poses no problem from the standpoint of management judgment.

- On the other hand, once a company concentrates 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, through which an alarm will be given through evaluation of the compensation of the president/CEO and, if it is still found difficult to correct the situation, the president/CEO may ultimately be dismissed (e.g., the establishment of a nominating
committee consisting chiefly of outsiders, or the formulation of dismissal criteria).

- In addition, in order to concentrate powers on the president/CEO, a company would need to reexamine its organization structure since it is difficult to change the actual situation without a change in awareness throughout the company or the creation of a new governance structure.

<Reference: Case Examples of Specific Efforts>

- At a company with so many enterprises under its control, which is called a conglomerate, the president may not be able to have a grip on everything due to his/her career path, which results in the situation where he/she may most respect opinions of people who are actually engaging in business operations, and he/she cannot oppose to, or has no tool to oppose to, what they have decided in most cases. 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 view point. We also changed the title of the head of management to CEO with the intention of concentrating powers to the CEO.

- We have set up an executive nomination advisory committee as one of the advisory committees of the board of directors, which has the role of drawing up reports on executive candidates. We secure its objectivity by designating an outside director as chairperson. The board of directors will determine director candidates on the basis of opinions of that advisory committee, and those candidates will be appointed as directors at general meetings of shareholders. The representative director/CEO has any and all authority 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 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 are to support the company in taking risks on the basis of confidence and trust during ordinary times, while they block any project or action of the 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 Utilization of Outside Directors

A company should mainly 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 the image of desired outside directors; [2] the scene in which it looks for outside director candidates and asks them to assume office as such; [3] the scene in which outside directors assume office as such and play active roles within the company; and [4] the scene in which the company evaluates the performance of outside directors and considers reappointing 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 to a satisfactory extent, it would need to verify in which scene there have been problems. In so doing, it is useful to consider problems according to the scenes.

Specifically, a company can consider problems by dividing the process of consideration into the following nine steps.

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1. Step 1: Consider ideal approaches to the 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, or their roles or number.

Ideal approaches to a board of directors vary depending on the situation of each company, and whether or not the selection of outside directors is required, the roles and functions expected from them, and their number and proportion may differ accordingly.

- For example, if the powers of the 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 the president/CEO (e.g., withdrawal from certain business).
- On the other hand, if the powers of the president/CEO are centralized, outside directors will basically be expected to support the resolute execution of business by the president/CEO and, if there is a problem with the president/CEO, to take actions including dismissal of such president/CEO.
If the board of directors has to make many decisions on individual business execution, outside directors will be expected to give advice on such decisions. 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 the 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, the more coherent their influence would become.

In any case, at Japanese companies in which many of management members have had no experience of working outside their companies, the experience of outside directors with external knowledge is effective for multifaceted discussions in making management judgment, and outside directors are expected to positively participate in both supervision and advising.

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 them, it will be difficult to appropriately evaluate whether or not they are helpful.
- Therefore, a company should consider internally clarifying the roles and functions it expects from outside directors or those it does not expect from outside directors prior to appointing them.

Examples of the roles and functions expected from outside directors may include, for example, the following:

- Participation in the formulation of management strategies or plans
- Participation in nomination/compensation decision-making processes
- Monitoring of conflicts 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, the following:

- Provision of detailed guidance on individual business execution
- Preparation of the original plans of management strategies
- Search and detection of a clue to unfair practice conducted at the level of corporate personnel

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51 Roles and functions specific to audit and supervisory members at Companies with Audit and Supervisory Committee, and audit committee members at Companies with Nominating Committee, etc. are not described.
52 Some companies say that their outside directors attempted to give guidance on details of business execution, as a result of which actual business execution went in the wrong direction, while other companies say that they have been embarrassed by their outside directors who excessively interfere with business execution (e.g., negotiations with customers, which should normally be conducted by personnel in charge). It is clear that outside directors are not, of course, executives. It is considered that such problems can be avoided by appointing outside directors after clarifying the roles each company expects from them.
Companies should make effective use of independent directors, taking into consideration the expectations listed below with respect to their roles and responsibilities:

(i) Provision of 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) Monitoring of the management through important decision-making at the board including the appointment and dismissal of the senior management;
(iii) Monitoring of conflicts of interest between the company and the management or controlling shareholders; and
(iv) Appropriately representing the views of minority shareholders and other stakeholders in the boardroom from a standpoint independent of the management and controlling shareholders.”


(Roles and functions of outside directors)

[1] To conduct appropriate evaluation of execution of business through nomination or compensation decisions, and monitoring by granting future-oriented incentives through evaluation or otherwise.
[2] To monitor a conflict of interest.
[3] 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).

The reason for including this description is that it is difficult for outside directors to actively search and detect any scandal involving management members (without any form of whistleblowing or other clues), because they do not generally know internal circumstances and actual business situations. This description is not intended to deny that outside directors should conduct hearings from persons concerned within the company or take any other actions when they identify any clue to unfair practice or other problems in relation to important transactions. 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 the extent practically possible. However, the outside directors described here are distinguished from those directors who are members of audit committees or audit and supervisory committees.
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<td>5</td>
<td>To express opinions independently from executives on issue of shares through a third-party allotment, or material transactions with controlling shareholders, whenever it is required by the listing regulations.</td>
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<tr>
<td>6</td>
<td>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.</td>
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<td>7</td>
<td>To attend the management conference or any other meeting (other than the board meeting) to discuss management policy, and express their opinions.</td>
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<tr>
<td>8</td>
<td>To use their personal network to find a counterparty of a merger and acquisition (M&amp;A) or other commercial transaction and introduce such counterparty to a company.</td>
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<tr>
<td>9</td>
<td>To have dialogues or meetings with shareholders and investors.</td>
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2.2. Roles and Functions Expected from Outside Directors (Detailed Discussion)

2.2.1. Participation in the Formulation of Management Strategies and Plans

- To participate in the formulation of management strategies and plans is one of the roles expected from outside directors, irrespective of how the board of directors is administered.

- It is internal executives who are most familiar with management of their company, and it is the role of management members, not outside directors, to increase business performance of the 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, by raising questions when outside directors find any concerns based on their knowledge from such standpoints as the following:
  - Whether management members have not been caught by internal logic;
  - Whether 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 Nomination/Compensation Decision-making Processes

- A focus of management monitoring by the board of directors is placed on evaluation of business execution through nomination of management members (especially the 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 business execution from an objective stance.

- More specifically, outside directors are expected to play the role of requesting management members to provide explanations about their performance based on the management strategies and plans, as well as the role of appropriately evaluating management members on the basis of explanations provided by them and reflecting evaluation results 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.

In addition, outside directors are expected, as their role, to supervise not only the nomination of the incumbent president/CEO (reappointment, dismissal, etc.) but also the replacement of future presidents/CEOs and succession planning toward successor nomination.

Outside directors are also expected to participate in the process to determine the nomination of and compensation to non-management directors. The president/CEO may take direct control of the power to determine personnel affairs of management members; however, it is desirable that judgments on the nomination and compensation of non-management directors such as outside directors, who assume the role of monitoring management members, should be made independently from the president/CEO. As a result, it is particularly necessary for outside directors to actively participate in that process.

2.2.3. Monitoring of Conflicts of Interest

In a situation 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 the resolution of the conflict. For this reason, outside directors are expected to actively participate in the monitoring of any conflict of interest by judging its reasonableness from an independent and objective stance.

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

- Determination of executive compensation;
- Response to MBO (management buyout) transactions and acquisition by controlling shareholders, etc.;
- Transactions with controlling shareholders, etc.;
- Response to hostile acquisitions (anti-M&A defense measures); and
- Response to corporate scandals, 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. Accordingly, 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.

54 For details, refer to Appendix 4 “Points of View in Formulation and Administration of a Succession Plan for a President/CEO.”

55 When outside directors identify a clue to a wrongdoing or problem in any significant transaction, they may conduct hearings from those regarded as relevant within the company, among other actions. They would also engage in investigations into facts involving any corporate scandal detected within the company or provide guidance on efforts to prevent the recurrence of such scandal.
2.2.5. Participation in Decision on Individual Business Execution

- At a company in which the board of directors frequently makes decisions on individual business execution, the degree of outside directors’ participation in such decisions increases. Participation in decision-making on individual business execution by outside directors makes 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 for which he/she participated in decision-making. Generally considering that outside directors primarily have less business knowledge and experience than insiders, expecting outside directors to deeply participate in decision-making on individual business execution may make decision-making rather inefficient.

- For that reason, it is necessary to examine to what extent outside directors should participate in decision-making on individual business execution, in light of the balance with their monitoring function.

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

A company should consider what qualifications and backgrounds it seeks from outside directors, and their balance, according to the roles and functions of outside directors. Furthermore, the appointment of at least one individual with management experience as one of its outside directors should be considered.

- As described in section 2. above, since outside directors are expected to play various roles and functions, a company must examine the qualifications and backgrounds of human resources to identify those who can fulfill such roles and functions.

- 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 are necessary for outside directors to substantially fulfill their roles and functions, in light of what its board of directors should be as well as the balance of the qualifications and backgrounds of its internal directors.

- In examining the above, it is also important to consider ensuring the diversity of directors from such aspects as gender and internationality, in order for the board of directors to fulfill functions in a sound manner. Especially, a company without any female director should actively consider appointing female outside directors while securing the quality of directors as a premise.

- In the first place, one of the roles expected from outside directors is to embody diversity by reflecting diverse values that the company does not have in its 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.

- Furthermore, it may actually be difficult for a single outside director to fully perform all of the roles and functions expected from outside directors. For this reason, in examining what qualifications and backgrounds are required from outside directors, it is also useful to secure the diversity of outside directors from the standpoint of regarding the board of directors and outside directors as a whole (collective body) and equipping these two with the qualifications and backgrounds they require as a whole by combining human resources with various qualifications and backgrounds, as well as from the standpoint of ensuring that such whole should be composed of individuals with multiple and diverse perspectives for corporate management.

- 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 expected roles and
functions and 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.

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<tr>
<th>Types</th>
<th>Characteristics</th>
<th>Examples</th>
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<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 the company.</td>
<td>Current company managers, retirees, etc.</td>
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<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 the company or may have expertise in company management in general.</td>
<td>Lawyers, accountants, scholars, government officials, etc.</td>
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<tr>
<td>Type C: Attribute-focused type</td>
<td>A type of individuals who have a specific attribute on which the 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 Type A or B above (individuals under this type also fall under Type A or B in most cases).</td>
<td>Gender (female), nationality (foreigner), others (age, ethnicity, religion), etc.</td>
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</table>

○ It is important for each company to fully consider what qualifications and backgrounds the company requires outside directors to have in appointing outside directors, as well as how the balance among Types A, B and C should be in appointing outside directors.

○ It would be considered important for a company, in effectively utilizing outside directors, to appoint at least one outside director under the management experience-type as one of its outside directors in light of the roles and functions expected from outside directors, although voluntary consideration 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 attributes, unlike Types A and B. Even in the case of Type C (attribute-focused type), it is not basically assumed that an outside director is to be appointed solely for the reason of any attribute; the premise is to ensure the quality of directors. Individuals categorized into Type C will be appointed from among individuals with management experience (Type A) or expertise (Type B) when the focus is especially on the attribute of being, for example, female or
from other countries.

<Reference: Case Examples of Specific Efforts>

・We have our board of directors check the backgrounds of outside director candidates in various ways before appointing, and in many cases we choose to appoint those with management experience. When we “appoint” an outside director as a member of the nominating committee, he/she must be able to talk about what constitutes an attractive personality and human skills. We expect our outside directors to be able to distinguish decent persons from others. Especially, we require outside directors to find out whether or not a candidate’s “motivation and specific measures to improve the company’s corporate value” are genuine, in the light of outside directors’ own management practice. In relation to “dismissal,” outside directors should be able to see through whether a candidate’s practice will ruin the company, whether he/she lacks a management ability to bring sustainable growth, or whether he/she will slow down internal processes.

・What kind of individuals should be appropriate as outside directors? Our current outside directors consist extremely broadly of a legal professional, an actual manager of the pharmaceutical business, a jurist, etc. Generally speaking, all of them have sufficient professional knowledge, experience and passion to understand and respond to changes in the market and technology incidental to globalization processes. When we mention the monitoring and supervision of a CEO, we mean that outside directors must always watch out for whether the CEO fulfills his accountability and, if not sufficient, must be rigorous enough to raise 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 membership and female gender. Female officers give us advice from a broader point of view.

○ With regard to the qualifications of outside directors, aside from the qualifications and backgrounds required according to each company’s circumstances and the roles and functions expected from its own outside directors, it is considered that outside directors should possess, as the basis of the aforementioned qualifications and backgrounds, basic knowledge and experience related to corporate management, including those associated with finance, accounting or legal affairs. This means that outside directors are required to possess a minimum level of management literacy as a minimum standard common to all listed companies and all outside directors.

○ Naturally, outside directors are less familiar with internal affairs than internal directors. It is important to steadily prepare a system to support outside directors by providing them with information they need in advance through briefings or otherwise. Thorough knowledge of the company’s businesses or the situation of the industry to which the company belongs is not necessarily a qualification required from outside directors.

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 an introduction from 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 specific types of person.
In order to broadly obtain information on outside director candidates, it would be a choice to utilize an executive search agency that engages in introduction of outside directors or other trade associations. However, the business of introducing outside directors is not yet prevailing in Japan against the backdrop of the issue that the quality and quantity of outside director candidates 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 a human resources market for outside directors. In order to expand this market, it is desired that individuals with management experience to positively assume office as outside directors of other companies.

With the above-mentioned limitations on the supply of human resources for outside directors in the current situation, companies are required to come up with various ideas for finding ideal qualified persons. For instance, an effective approach would be to make preparations to smoothly find a candidate when the appointment of an outside director is required by treating meetings of economic associations as opportunities on a regular basis, keeping consciously sensitive to individuals who can potentially be outside director candidates, such as other companies’ management members, and collecting information to evaluate the eligibility of potential candidates by inviting them to internal training sessions, lectures, etc. Furthermore, it is also important for each company to systematically engage in finding successors of outside directors, considering their term of office at the company.

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

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

A company will appoint an individual who is considered to be the most suitable in a list of outside director candidates. A company may find it difficult to interview or otherwise meet candidates openly to check their eligibility. Some companies have adopted practical approaches in light of this situation.

<Reference: Case Examples of Specific Efforts>

- When we were to select outside directors, we asked several candidates to provide lectures at the company to help us identify their suitability. We decided not to inform them in advance that we might appoint them as outside directors and carefully examined the contents of their lectures.

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

For outside directors to substantively fulfill their roles and functions, it is important to ensure that, in addition to having the required qualifications and backgrounds, they are available (they can spend time as required and their labor for another company as its outside directors) and have a sense of responsibility and preparedness (they are willing and motivated to improve the corporate value of another company). To this end, for example, it is worth considering checking the situations of outside director candidates’ main businesses and concurrent positions as part of confirmation of their eligibility, and setting an upper limit on the number of outside directors’ concurrent positions in advance.

56 In the United States, it is pointed out that an experimental study has found that the concurrent assumption of the
On the part of outside director candidates, they should be aware that no matter how excellent and talented they are, they may not ultimately assume office as such, as they may not be appointed depending on the circumstances of the company that has requested them to assume.

<Reference: Corporate Governance Code>
[Supplementary Principle 4-11-[2]]
“Outside directors, outside kansayaku, and other directors and kansayaku should devote sufficient time and effort required to appropriately fulfill their respective roles and responsibilities. Therefore, where directors and kansayaku also serve as directors, kansayaku or the management at other companies, such positions should be limited to a reasonable number and disclosed each year.”

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

In requesting any individual to assume the office of outside director, a company should examine the terms of 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, with which the number of shares to be granted will not change depending on business performance, in addition to fixed compensation.

- When a company requests any individual to assume office as an outside director, it must examine the terms of assumption of the outside director.
- 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 them incentives to improve mid- and long-term corporate value.
- 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 their corporate values, 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, as a choice among others, 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 in relation to outside directors who are responsible for playing 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 any 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 high in relation to cash compensation.
  - Performance-linked compensation requires careful consideration because it may not be appropriate when outside directors independently monitor execution of business, if it is linked with performance in a similar manner to such compensation of management members. It does not mean performance-linked compensation should be totally ruled out, in cases where no adverse effect is expected. Companies may consider allowing for, and granting outside directors, a type of compensation that is more moderately linked with business performance than the compensation of management members.
- In addition, outside directors may be required to spend a considerable amount of time and efforts offices of director of a certain number of companies may result in a decline in the performance of advising and monitoring.
to fulfill the roles and functions expected from them. Therefore, it is necessary to examine whether the level of their compensation is commensurate with such time and efforts.

○ In particular, in the case where, for example, an outside director concurrently serves as a member or chairperson of the nominating committee, compensation committee, audit committee, audit and supervisory committee, etc., serves as chairperson of the board of directors, or serves as a lead independent outside director, the time and efforts he/she has to spend as an outside director and the roles and responsibilities he/she has to fulfill are considered to increase significantly. It can be considered important to grant such outside director an appropriate level of compensation in the light of such burden and responsibilities.

○ Furthermore, as other terms and conditions for assumption of office, companies should consider the appropriate utilization of company indemnification and directors and officers liability insurance (D&O insurance).


Example: Fees to non-executive directors at BP (extracted from the 2015 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 the understanding of shareholders and other stakeholders in reviewing the compensation levels 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 in order to secure the consent of shareholders and other stakeholders.

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

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

○ It would be difficult for outside directors to play the roles expected from them without their companies’ support. Therefore, it would be effective to take the following measures:
  ➢ To provide prior explanations to the board of directors;
  ➢ To secure access such as attendance at management conferences;
  ➢ To conduct office, plant and other inspection tours;
➢ To hold non-board meetings to exchange opinions;
➢ To hold meetings exclusively for independent outsiders;
➢ To select 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 22 and 23 [of the original Japanese text] of these Guidelines.

(Securing access such as attendance at management conferences)
・ We hold a management conference once a week on the designated day, and send the minutes of that conference to outside directors together with the relevant monthly financial statements.
・ Our outside directors including the chairperson attend a management conference organized mainly by internal officers and held biweekly.
・ Outside directors attend a meeting of the board of executive officers at their discretion. Not all of our outside directors attend it and attendance is voluntary.

(Office, plant and other inspection tours)
・ Outside directors inspect major premises in Japan after their assumption of office.
・ We conduct inspection tours of our offices in Japan, overseas subsidiaries, etc.
・ A meeting of the board of directors was held outside Japan to provide outside directors with an opportunity to inspect our overseas business sites.

(Non-board meetings to exchange opinions)
・ We hold a lunch meeting before a board meeting, although it is not every month. A lunch meeting may be held for outside directors and internal directors separately, or for the board members as a whole.
・ We hold an all-day off-site meeting at a venue outside the company to exchange opinions on our mid-term management policy. At the off-site meeting, we showed our outside directors a draft mid-term management plan and received their opinions.

(Selection of a lead independent outside director) → See page 77 [of original Japanese text] of these Guidelines.

(Utilization of voluntary committees (especially nominating and compensation committees)
・ A meeting of a special subcommittee under the nominating committee is held on a non-regular basis to have a discussion about the appointment of a president. Its 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 a meeting of the special subcommittee, results are communicated to the nominating committee for further discussion. The president is a member of the nominating committee, and reports the results of discussion of the nominating committee to the board of directors, which will adopt a resolution.
・ An examination committee to examine the appointment of a chairman and a president was set up as a committee equivalent to a nominating committee. Its members previously consisted solely of outside directors, but now outside directors and outside auditors (the chairperson of the board of directors acts as chair of that committee). The president attends it as an observer. Once the committee handled the appointment of directors and executive officers, on the basis of the idea that those who would assist the president had to be examined. However, the committee now deals with the appointment of directors after outside directors asserted that they could undertake no responsibility for the appointment of executives because of their lack...
A company should examine how much outside directors should grasp the status of discussion among executives, for example, at management conferences, on the basis of how the board of directors should be administered, and what the company expects from outside directors.

- For example, in the case of a company whose board of directors makes many decisions on individual business execution, and in which the powers of the president/CEO are decentralized, it would be necessary for outside directors to grasp the status of discussion considerably in depth.

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

- Moreover, it is considered necessary at least for an outside director who acts as chairperson of the board of directors to grasp the status of discussion by executives, for example, by attending management conferences or other similar meetings, in order for such outside director to appropriately select proposals and lead board proceedings as the board chairperson.

A company should consider setting up a forum in which independent outsiders can exchange opinions only among themselves, aside from meetings of the board of directors.

- The establishment of a forum in which independent outsiders can exchange opinions only among themselves, in addition to board meetings, would enable them to obtain information held by, and share the same awareness with, other outsiders, thereby feel easy to speak at board meetings, and smoothly communicate their opinions to the president/CEO.

- Therefore, companies should consider setting up a forum exclusively for independent outsiders to exchange opinions.

- At a meeting consisting solely of independent outsiders, discussions would be made about the following:
  - Points of improvement in the administration of the board of directors; and
  - Evaluation of management members, whether or not there are any matters to be pointed out, etc.

<Reference: Corporate Governance Code>
[Supplementary Principle 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>
(Meetings consisting solely of independent outsiders)
- The company has periodically held meetings in which only independent outside directors (outside directors and outside auditors) participate (i.e., meetings of outside officers) since FY2015. These meetings provide outside officers with a forum to exchange their opinions and are utilized as an opportunity to cooperate among outside officers, full-time auditors and
external accounting auditors.

- The nominating committee has a subcommittee like an executive committee, which consists solely of outside officers. The meeting schedule is determined annually in advance since its members are busy.
- Outside directors recently have their meetings at their discretion.
- Outside directors meet irregularly to dine together without any other party.

A company should consider selecting a lead independent outside director so that outside directors can have a smooth dialogue with management members or with shareholders and other stakeholders.

- As the roles of outside directors in corporate governance increase, it becomes more necessary for outside directors to have a dialogue with management members, 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 a coordinator, from among outside directors.
- If the chairperson of the board of directors or the chair of each committee is an outside director, that person may fulfill a substantively 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 Principle 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 director. The lead outside director acts as chair of the nominating committee and plays opinion-leader-like roles.

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

A company should consider evaluating whether its outside directors have played the roles expected from them from the standpoint of improving the quality of outside directors.

- Outside directors may not necessarily be 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, the following:
  - Mutual evaluation among outside directors;
  - Evaluation in the course of assessing the effectiveness of the board of directors; and
  - Dissemination of information to the outside to enable shareholders and other stakeholders to evaluate outside directors.
- When outside directors are appointed as such, they are not familiar with internal affairs at first

The term “lead” may imply that there is a hierarchy among outside directors; however, there is no such intention in the use of that term.
and may not be able to fully fulfill their roles. For this reason, their evaluation is required to take
the period of time elapsed after their appointment and other factors into account.

○ Furthermore, it is beneficial to consider evaluating whether outside directors as a whole function
effectively from the standpoint of their functionality as a team, in addition to evaluation of 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 not much available information that enables shareholders and other
stakeholders to find out about the activities (work) of outside directors within the company,
although outside directors are expected to fulfill the role of reflecting opinions of shareholders
and other stakeholders in the board of directors.

○ Therefore, it is important for a company to actively disseminate information on the work of
outside directors.

○ For example, the dissemination of the following information would be beneficial to shareholders
and other stakeholders:
  ➢ Outline of activities of the committees in which outside directors have participated, if any;
  ➢ Status of participation in management conferences and other meetings of executives;
  ➢ Statements of outside directors that are especially helpful;
  ➢ Status of communication among outside directors; and
  ➢ Status of dialogue between outside directors and management members/shareholders.

Dissemination of information on the work 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 a review of the compensation of outside directors,
when they have no idea of how they have worked. If shareholders receive information on the
work of outside directors and can fairly evaluate the significance and degree of contribution of
outside directors on the basis of such information, it would consequently make it easy for the
company to obtain the consent of shareholders. In order to enable shareholders and other
stakeholders to make a fair evaluation of outside directors, a company may arrange an opportunity
for outside directors to have a dialogue with them, in addition to dissemination of information.

○ If information on outside directors is provided when other companies search for outside director
candidates, it would help them search for candidates with the qualifications and backgrounds they
are after by reference to the provided information, and identify whether candidates are suitable
to such companies. Companies are expected to contribute to the expansion of the human recourses
market of outside directors through these efforts.

9. Step 9: Consider reappointment/dismissal based on results of evaluation

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

○ Even if a company has duly put Steps 1 through 7 in practice, outside directors may not have
necessarily fulfilled the roles the company had expected from them, because they might not have
been sufficiently competent. There may be some companies that hesitate to take a step to appoint
or increase the number of outside directors because of their concern that they cannot easily
discriminate an outside director once he/she has been appointed.
Naturally, a company must consider choosing not to reappoint or dismiss any problematic outside director. Outside directors must also have such a feeling of tension and be prepared for such eventuality.

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

A prolonged length of service of an outside director will not pose a problem by itself. It is also pointed out that the degree of his/her contribution to the company and his/her influence over its management members will rather increase through the passage of a certain length of service, as the outside director’s knowledge and experience relating to the company has been developed and an adequate trust relationship between the outside director and its management members has been formed over time. Furthermore, it is pointed out that outside directors can play an effective role owing to the member composition made up of those with long lengths of service as well as those with short lengths of service. Therefore, it would be unnecessary to uniformly 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 considerably many years from the standpoint of independence, as the independence of outside directors from companies is one of important factors.

Furthermore, the establishment of an upper limit on reappointment is regarded as meaningful since the establishment of such limit and a mechanism based thereon to shift the timing of each replacement to realize a certain cycle of replacement of outside directors can address the issue of vested interests in the post of outside director arising due to the fact that outside directors chiefly deal with the appointment, reappointment and dismissal of outside directors, and can facilitate the independence of outside directors. In addition, such limit is considered meaningful from the standpoint of achieving the regeneration of the board of directors.

Given the above, if, for example, a company sets a quantitative criterion for a length of service without imposing a strict limit on reappointment, and continues to have any outside director serve as such beyond that duration, such company may judge whether or not the reappointment is appropriate after its nominating committee, etc. has fully deliberated the degree of contribution of that individual as an outside director, the necessity for continuing to have him/her serve as such, and possible adverse effects, if any, resulting from a longer length of service, among other factors.

In order to set up a mechanism in which outside directors change on a rotational basis at certain intervals as a safety valve to cope with a problem with any appointed outside director, 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 deficiency in the performance of its outside directors as a team and, if there is any deficiency, consider choosing to appoint a new outside director to fill up such deficiency.

58 The revised version of the Corporate Governance Code of the United Kingdom published in July 2018 specifies that the assumption of office as an non-executive director for nine years or more is a factor that potentially damages the independence of non-executive directors. In the United States, while companies that have set their upper limits on the length of service of outside directors only account for 5.4% of the S&P 500 companies, there are many companies that have set their mandatory retirement ages for directors (73% of the S&P 500 companies) (“Board Refreshment Trends at S&P 1500 Firms” by IRRC Institute & ISS).

59 However, it is also pointed out that if an upper limit on reappointment is set, it may function effectively to ensure outside directors can be reappointed up until they reach the year limit, thereby potentially causing problems in the replacement of outside directors before reaching the limit. Accordingly, if a basic upper limit is to be set, it is necessary to be cautious when, for example, providing explanations to outside directors.
A company should consider utilizing its nominating committee consisting chiefly of outsiders, when it examines the reappointment or dismissal of an outside director.

Even if a company evaluates its outside directors, those outside directors need to keep their independence from its management members to effectively monitor the execution of business by the president/CEO or other management members. For this reason, making a direct judgment on the 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 a problematic outside director what he/she should improve to play the roles expected from him/her, rather than to make an early judgment on reappointment or dismissal based on evaluation conducted shortly after his/her assumption of office.

In the discussion of the nominating committee, reference to evaluations conducted by the internal management or the section that centrally takes corporate governance-related actions is beneficial and should not be denied from the perspective of multifaceted evaluation.

A company should consider establishing standards for reappointment of outside directors

There is a concern that when the nominating committee considers, for example, the reappointment or dismissal of an outside director, it is regarded as difficult for its members to decide not to reappoint him/her even if the outside director has turned out to be not qualified for the position and has failed to play the roles expected from him/her, if there is no common standard on which the committee members can base their judgment.

In addition, although the independence of outside directors from management members is required to be secured so as to enable them to effectively monitor the execution of business by the president/CEO or other management members, outside directors may not be able to sufficiently engage in monitoring without standards for reappointment and dismissal of outside directors, for fear that their reappointment or dismissal totally depends on the intention of executives without such standards, and that those outside directors with a high degree of contribution from an objective perspective may be denied reappointment at the direction of executives if such executives are unwilling to reappoint them.

Therefore, from the standpoint of both guaranteeing the quality of outside directors and securing their independence and the effectiveness of their monitoring, it is desirable that a nominating committee consisting chiefly of outsiders should, in advance, set out certain standards for reappointment of outside directors (such standards may not necessarily be limited to quantitative standards but are also expected to be qualitative standards that take into consideration factors important in considering the appropriateness of reappointment and points of evaluation), in order to ensure that the deliberation of the nominating committee in relation to the reappointment and dismissal of outside directors and other relevant matters is substantive and objective.

For details, refer to “2.2 Outside Directors” of “2. Advice Targets and Advised Matters” in Appendix 3 “Points of View in Utilization of the Nominating Committee and the Compensation Committee.”
<Reference: Results of the Company Questionnaire Survey>

Only approximately 24% of the respondent companies have established standards for reappointment of outside directors (see Question 56 of the Company Questionnaire Survey 2017).
Appendix 3: Points of View in Utilization of the Nominating Committee and the 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 in the board of directors at a company is not high (for example, when it does not reach a majority), the purpose in [1] above will become important in many cases.

○ On the other hand, when the proportion of outsiders in the board of directors is high (for example, when it reaches a majority), it can often be considered that the involvement of outsiders in the board of directors is strong, in which case the 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 higher than that in the board of directors, or would ensure intensive 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 a specific mechanism of the committee by keeping the above-mentioned two purposes in mind.

(How it relates to the organization design)

○ The organization designs 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 under its board of directors: a nominating committee, a compensation committee and an audit committee. The structure and authority of such committees 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. Other than its board of directors, a Company with Board of Company Auditors has its board of company auditors, which prepares audit reports and other documents, but is not required by the Companies Act to have nominating or compensation committees or meeting bodies.

○ Thus, whether or not a company should have a statutory nominating or compensation committee would be determined on the basis of the organization design chosen by it. However, this recommendation partially addresses this issue without distinguishing whether a committee is statutory or voluntary, as statutory and voluntary committees have much in common.

<Reference: How It Relates to the Companies Act—A Company with Audit and Supervisory Committee and Voluntary Nominating and Compensation Committees—>

In the case of a Company with Audit and Supervisory Committee, audit and supervisory members selected by its audit and supervisory committee have the right to state opinions on the nomination and compensation of directors other than audit and supervisory members at general meetings of shareholders.

It is necessary to organize the relationship between such right to state opinions, and reports by voluntary nomination and compensation committees and the power of the board of directors to make decisions.
For example, if a company sets up its nominating and compensation committees, all of whose members are audit and supervisory members, their relationship with the right to state opinions can be easily organized. By contrast, there may be a drawback that 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 selected by the 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 the fact that audit and supervisory members are affected by discussions held by bodies other than the audit and supervisory committee should be evaluated. In this regard, there would be no practical problem, as the nominating and compensation committees typically draw up their original proposals with opinions of the audit and supervisory members selected by the audit and supervisory committee reflected therein.

It should be noted that if none of audit and supervisory members participates in the nominating and compensation committees, audit and supervisory members selected by the audit and supervisory committee may express different opinions from those of the nominating and compensation committees.

If a company sets up nominating and compensation committees, it would be beneficial for the company to disseminate information on the purpose of setting up those committees, the scope of matters on which their advice is to be sought, the compositions of their members, and other relevant matters at an appropriate timing, so that it can ensure appropriate administration and judgments of the committees and transparency for investors and other stakeholders.

2. Advice Targets and Advised Matters

2.1. President/CEO

A company should consider including the appointment or dismissal of a president/CEO in the matters on which advice is to be sought from the nominating committee.

A company should consider including the compensation of a president/CEO in the matters on which advice is to be sought from the compensation committee.

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

To this end, a company may utilize a nominating committee in the phase of appointment or dismissal of a president/CEO.

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

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

When an evaluation of the president/CEO finds that there are some problems with him/her, a compensation committee may give a signal to urge 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). From this perspective, it is better to set up both a nominating committee and a compensation committee, rather than one of them, at
the same time (or one of these committees may play both of the roles).

○ Both a judgment on the appropriateness of appointment, reappointment or dismissal of a president/CEO and the determination of the compensation of a president/CEO require an evaluation of such president/CEO as a premise, involving many common aspects. Therefore, if a nominating committee and a compensation committee are set up separately, it is important to ensure close cooperation between the two committees, for example, by assigning the same outside directors to both committees.

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

○ Even at a Company with Nominating Committee, etc., this point may not have ever been dealt with by its nominating committee, as a nominating committee has no legal right to appoint a representative executive (i.e., a president/CEO).

○ In fact, for a company at 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 the appointment or dismissal of a president/CEO.

<Reference: How It Relates to the Companies Act>

At a Company with Company Auditor(s) or a Company with Audit and Supervisory Committee, the board of directors has the authority to appoint a representative director. By contrast, at a Company with Nominating Committee, etc., the board of directors has the authority to appoint a representative executive, not its nominating committee.

For that reason, a company will voluntarily seek advice from its nominating committee on the appointment of a CEO (representative director or representative executive), irrespective of which organization design it has chosen 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>
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</tr>
<tr>
<td>Election of directors</td>
<td>To be resolved by the general meeting of shareholders</td>
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<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)

In addition to the nomination of a successor of a president/CEO, the nominating committee should consider proactively participating in the formulation and administration of a succession plan on which such nomination is based, and making efforts to appropriately supervise the plan. The compensation committee should consider participating in the formulation of a compensation policy based on which it should determine individual amounts of the compensation of a president/CEO.

○ The replacement of top management and the nomination of their successors are among the most important decisions in corporate management, having a tremendous impact on the company’s corporate value. It is important to secure the objectivity and transparency of the process of
nomination of successors to top management in order to guarantee the appropriateness of the process. The fact that the nominating committee confirms the final candidate for the succeeding president/CEO selected by executives in the final phase is not really sufficient to conclude that the committee has sufficiently fulfilled its roles; it is required to proactively participate in and appropriately supervise the overall processes of succession planning.

○ From this perspective, it is desired that each company should consider its ideal and suitable approaches to the formulation and administration of succession plans by reference to Appendix 4 “Points of View in Formulation and Administration of a Succession Plan for a President/CEO” that shows matters that should be considered and leading-edge approaches to be referred to as examples in relation to the formulation and administration of succession plans.

○ Similarly, the compensation committee is required to be involved from the stage of formulation of a compensation policy.

○ When the compensation committee is involved in the formulation of a compensation policy for the president/CEO, it is desirable that the committee should hold discussions from the perspectives of whether the details of the policy can function as a mechanism to grant appropriate incentives to the president/CEO and encourage him/her to take appropriate risks, and of whether the policy reaches a sufficient level to secure excellent human resources as presidents/CEOs; such discussions should also include, for example, the following points.

(Examples of matters that are potentially discussed by the compensation committee)

- Roles and authority of the president/CEO of the company;
- Level of compensation61;
- Composition ratio of fixed compensation, performance-linked compensation and stock-based compensation;
- Design and mechanism of performance-linked compensation (for example, management indices to link with, the relationship with the target management indices set forth in the relevant management plan, the degree of linking, performance goals, etc.);
- Design and mechanism of stock-based compensation (for example, the timing of granting shares, the period of transfer restriction, any performance condition set, incentive function, etc.); and
- Risk management mechanism (for example, a mechanism to discourage excessive risk taking, such as claw-back provisions).

○ Some of companies that acquire companies overseas with the aim of expanding their businesses globally may be in a reversal situation in which the management members of their overseas subsidiaries receive higher amounts of compensation than those of the presidents/CEOs at the head offices in Japan due to differences between Japan and other countries in terms of the level of compensation. When the compensation committee of a company discovers such a reversal situation after grasping not only the level of compensation of its management members but also the levels of compensation at its group companies including overseas subsidiaries, the committee is required to consider, for example by benchmarking itself against overseas competing companies, whether to maintain the double-standard for Japan and other countries for the sake of securing outstanding human resources abroad as management members or to strive to organize a

61 It is pointed out that when the compensation committee deliberates the level of compensation at its company, the committee rather adheres too rigidly to a comparison with other companies in some cases. While a comparison of the level of compensation with other companies is regarded as helpful in validating the level of compensation at the company concerned for the sake of securing outstanding human resources, it is important to bear in mind that an optimal compensation system should be strategically created by reflecting each company’s specific circumstances including its management strategies in such system, and that such system cannot be derived solely from a comparison with other companies.
single compensation system by moving the level of compensation in Japan toward the global level of compensation.

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

- When a company includes the dismissal of a president/CEO in the matters on which it seeks advice from other bodies in addition to the appointment of a president/CEO, it is difficult to make a proposal on and discuss such dismissal in the absence of any standards concerning in what cases the dismissal of a president/CEO should be discussed. The establishment of standards for dismissal during ordinary times will create an environment in which the company can respond to an emergency smoothly.

- The establishment of standards for dismissal does not mean that a president/CEO is dismissed without any exception when he/she is found in breach of those standards. Such standards would be utilized as the standards for starting discussion about issues, including whether or not a breach of the standards is attributable to the president/CEO and how the situation should be improved\(^\text{62}\).

- As a result, if a breach of standards for dismissal is due to circumstances not attributable to a president/CEO, it is expected that the existence of such standards will support the president/CEO within the company and even in terms of his/her external relations.

- Dismissal of a president/CEO is the most important phase in which governance functions are exerted. Since it is normally necessary to consider dismissal together with the nomination of a successor, outside directors who are members of the nominating committee (especially the chairperson of the committee) are expected to play a leading role including convocation of meetings of the committee and presentation of proposals to the board of directors. However, depending on the situation, it is also necessary for internal directors to be prepared to make a proposal and have a discussion, as they are directors, too.

- Even if 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 the president/CEO through discussion at board meetings or otherwise during ordinary times, and to have the nominating committee hold substantive discussions\(^\text{63}\) on the basis of the performance evaluation for each fiscal period and other relevant factors when the appropriateness of reappointment is to be judged.

<Reference: Corporate Governance Code>

[Principle 4-3 Roles and Responsibilities of the Board (3)]

“The board should view the effective oversight of the management and directors from an independent and objective standpoint as a major aspect of its roles and responsibilities. It should appropriately evaluate company performance and reflect the evaluation in its assessment of the senior management...”

[Supplementary Principle 4-3-[3]]

“The board should establish objective, timely, and transparent procedures such that a CEO is

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\(^{62}\) As to standards for dismissal, as an example, there is a company which sets financial goals and also the non-achievement of such predetermined financial goals as the condition for invocation of its standards for dismissal. Even in that case, the non-achievement may have been affected by the business environment or other factors, and it would not be appropriate to immediately conclude that the president/CEO is totally responsible. It is likely enough that the company would fairly evaluate contributions made by the president/CEO, aside from the predetermined goals, and conclude that it would not dismiss the president/CEO. Thus, even where a company formulates its standards for dismissal, such standards would not mean to be a rigid system (a breach of the standards would not necessarily lead to an immediate dismissal).

\(^{63}\) It is also possible that the committee directly gives feedback to the president/CEO as required.
dismissed when it is determined, via an appropriate evaluation of the company’s business results, that the CEO is not adequately fulfilling the CEO’s responsibilities.”

<Reference: Case Examples of Specific Efforts64>

(Examples of the standards for dismissal formulated)
- The company has established quantitative standards (for dismissal).
- The company has established the provision that the nominating committee will deliberate the 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 primarily established by law as one year. Director candidates are determined by the nominating committee of which outside directors make up a majority.
○ Company with Audit and Supervisory Committee
- The voluntary advisory committee (nominating committee) of the board of directors conducts a review to reach a decision of confidence or no-confidence once a year.
- Under the Companies Act, the audit and supervisory committee is granted the right to state opinions on the appointment and dismissal of directors including the president at general meetings of shareholders.
○ Company with Company Auditor(s)
- Evaluation of the president including evaluation of the company’s business performance is deliberated at meetings of the nominating and compensation committees (voluntary), both of which outside directors make up a majority of.
- The company has established a nominating committee which deliberates and gives opinions on the dismissal of representative directors and directors/presidents.
- The term of office of the president is one year, and the director reappointment and appointment examination committee examines the reappointment of the president each year.
- The president nomination advisory committee deliberates once a year whether the president should continue to serve as such or should be retired. The current president expresses his opinions on his continued service or retirement concerning the following term and then leaves the meeting. The committee deliberates it without the presence of the current president.
- The company has a president performance evaluation committee consisting of outside members, which deliberates execution of business by the president.
- We report results of evaluation of business performance (company and individuals) prepared by the compensation committee to the nominating committee.
- The company has a voluntary personnel affairs and compensation committee, which has the obligation to deliberate and give opinions to the president on matters relating to executive candidates.

64 Question 32 of the Company Questionnaire Survey 2016 can be used as a reference.
2.2. Outside Directors

A company should consider including the appointment and dismissal of outside directors in the matters it seeks advice on from the nominating committee, including not only the formulation of a nomination policy but also the 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 the president/CEO or other management members.

- For that reason, decision-making on the appointment or dismissal of an outside director on the basis of evaluation by management members would potentially impair the effectiveness of monitoring by outside directors. Thus, it is desirable that the involvement of management members who are subject to being monitored should be kept to the minimum. In addition, it is not necessary for the president/CEO to hold the right to decide personnel affairs and thereby control the appointment or dismissal of outside directors, since the significance of outside directors is that they are not under the direction of the president/CEO.

- Accordingly, even a Company with Company Auditor(s) or a Company with Audit and Supervisory Committee would seek advice on the appointment and dismissal of outside directors from its nominating committee consisting chiefly of outsiders, with the aim of increasing the effectiveness of governance.

<Reference: How It Relates to the Companies Act>

For a Company with Company Auditor(s) or a Company with Audit and Supervisory Committee, the board of directors determines, under the Companies Act, the details of proposals on the appointment and dismissal of directors to be submitted before general meetings of shareholders, and thus seeking advice on this matter from its nominating committee is voluntary.

On the other hand, for a Company with Nominating Committee, etc., the Companies Act provides that it is the nominating committee that determines the details of proposals on the appointment and dismissal of directors to be submitted before general meetings of shareholders (seeking advice is not voluntary).

Thus, in examining what should be determined by the nomination (advisory) committee, it should be noted that the organ that has the power to determine the details of proposals on the appointment and dismissal of directors to be submitted before general meetings of shareholders differs among Companies with Company Auditor(s), Companies with Audit and Supervisory Committee, and Companies with Nominating Committee, etc.

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

- As described above, outside directors may not be able to effectively fulfill their monitoring function unless their independence from management members is secured.

- Therefore, it is beneficial, for the purpose of increasing the effectiveness of governance, to

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65 At a company that appoints internal non-executive directors separately from outside directors, many of 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.

66 Since there is a particularly strong demand that the involvement of insiders in the appointment and dismissal of outside directors should be kept to the minimum from the standpoint of securing the effectiveness of the monitoring function, it is pointed out that special care is required in relation to the manner of operation of nominating committee meetings when such appointment or dismissal is discussed by the nominating committee.
include the fees of outside directors in the matters on which a company seeks advice from the compensation committee consisting chiefly of outsiders.

<Reference: Fees of Compensation Committee Members and Directors>
The Companies Act provides that at a Company with Nominating Committee, etc., it is its compensation committee that determines the individual amounts of compensation of directors as well as a policy for determining such amounts.

2.3. Management Other Than a President/CEO

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

- For to what extent the nominating committee gets involved in the nomination of management members (including executive directors) other than presidents/CEOs, there would be several patterns, as shown below.

- The problem with nomination is that if the number of management members is large, it is not easy for outsiders to grasp all management candidates individually. In that case, the nominating committee may only participate in the formulation of a nomination policy and check whether there is any problem in the process of selection by the president/CEO, rather than engaging the selection of individual management candidates. However, even in such case, as part of succession planning for a president/CEO, it may be necessary for the nominating committee to grasp the situation of individual candidates for nomination, from the standpoint of fostering successor candidates.

- In addition, the nominating committee may choose to actively participate only in the appointment and dismissal of individual candidates for management members who will play key roles (e.g., the CFO).

[1] Engage in the appointment and dismissal of individual management members other than the president/CEO (actively check the qualifications and abilities of individual candidates and judge who are eligible)

- Highly transparent and objective selection of candidates

△ If the number of management members is large, it may be difficult for outsiders to make judgments because of a lack of much specific information on all the candidates for judgment.

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67 It is pointed out that if the compensation committee consists chiefly of outside directors, they may possibly hesitate to discuss the compensation of outside directors, because it relates to their own compensation. However, as there are no other persons regarded as able to appropriately judge this matter, there is no option but to have the compensation committee discuss it. The fairness of the levels and designs of fees determined as a result of discussion by the compensation committee would ultimately be judged on whether or not it is reasonably possible to convince shareholders and other stakeholders.

68 In addition to these, it would be a choice to target the presidents/CEOs or other management members of significant subsidiaries.

69 With regard to the roles of a nominating committee, its substantive involvement in the appointment and dismissal of presidents/CEOs and its appropriate supervision of such appointment and dismissal are of essence. On this basis, it is pointed out that the level of necessity for direct involvement of a nominating committee in the appointment and dismissal of other management members is low since this process should basically be left to the president/CEO, who is the chief of business execution, and the committee, only where necessary, holds the president/CEO responsible if the result of such appointment or dismissal is not satisfactory.
[2] Request the president/CEO to provide explanations about the policy on the selection of candidates and the reasons for selection of each candidate (give approval to the original plan of the president/CEO unless such explanations are unreasonable)

- The nominating committee can secure transparency and objectivity by having the president/CEO fulfill his/her accountability, while it still allows him/her to hold the right to decide the personnel affairs of other management members (i.e., the power to primarily select other management member candidates).

[3] Do nothing (leave it totally up to the president/CEO)

- This may be effective in concentrating powers on the president/CEO.
- This may allow the president/CEO to become self-justifying.

* ○ and △ 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 independence 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 determine the details of proposals on the appointment and dismissal of directors other than outside directors and non-executive directors (i.e., directors who concurrently serve as executives) to be submitted before general meetings of shareholders. As a matter of practice, the principal role of the nominating committee may be to ask the president/CEO to provide explanations about the policy on the selection of candidates and the reasons for selection of each candidate (i.e., it does not necessarily engage in examination into individual appointments and dismissals).

A company should consider having its compensation committee participate in processes in connection with the fees of management members other than the president/CEO, including and up to the determination of the individual amounts of such fees, even if it consists chiefly of outsiders.

- For to what extent the compensation committee gets involved in the determination of the compensation of management members other than the president/CEO, there would be several patterns, as shown below.

- In relation to compensation, the compensation committee consisting chiefly of outsiders would participate in not only the formulation of a compensation policy but also the determination of individual amounts of compensation to which such policy applies, from the standpoint of granting appropriate incentives to management members.

[1] Determine the individual amounts of fees of management members other than the president/CEO

- Highly transparent and objective determination of compensation
- Quantitative evaluation is possible in many aspects if a compensation policy and compensation standards are available, which make it easy even for outsiders to make judgments (in comparison with nomination).
[2] Request the president/CEO to provide explanations about the compensation policy and the reasons for the determined individual amounts of fees (give approval to the original proposal of the president/CEO unless such explanations are unreasonable)

- The compensation committee can secure transparency and objectivity by having the president/CEO fulfill his/her accountability, while it still allows him/her to hold the right to decide the personnel affairs of other management members (i.e., the power to primarily determine the individual amounts of fees of other management members).

[3] Do nothing (leave it totally up to the president/CEO)

- This may be effective in concentrating powers on the president/CEO.
- △ This may allow the president/CEO to become self-justifying.

<Reference: Compensation Committee and Compensation of Executives at a Company with Nominating Committee, etc.>

The Companies Act provides that at a Company with Nominating Committee, etc., it is its compensation committee that determines the individual amounts of compensation of executives as well as a policy for determining such amounts.

<Reference: Examples of combinations of advice targets and advised matters>

<table>
<thead>
<tr>
<th>Advised matters</th>
<th>Nomination</th>
<th>Compensation</th>
</tr>
</thead>
<tbody>
<tr>
<td>advice targets</td>
<td>Formulation of a nomination policy</td>
<td>Nomination of individual candidates</td>
</tr>
<tr>
<td>President/CEO</td>
<td>○</td>
<td>○</td>
</tr>
<tr>
<td>Outside directors</td>
<td>○</td>
<td>○</td>
</tr>
<tr>
<td>Executive directors</td>
<td>○</td>
<td>△</td>
</tr>
<tr>
<td>Executive officers</td>
<td>○</td>
<td>△</td>
</tr>
<tr>
<td>Other key employees</td>
<td>△</td>
<td>×</td>
</tr>
</tbody>
</table>

(Explanatory notes: ○: Participate in decision of details; △: Confirm the procedures; ×: Not participate)

○ From the standpoint of ensuring sound exercise of functions by the board of directors and reflecting diverse values which the company does not have in its management strategies, it is particularly important, in examining the composition of outside directors and management members (executive directors), to ensure diversity in the composition in terms of such aspects as gender and internationality, while also securing the quality of directors and management members as a premise. Especially, a company without any female director should actively consider appointing female directors while securing the quality of directors as a premise.

○ Furthermore, a board of directors is required to monitor how its company promotes “diversity management” under which diverse human resources are utilized to put its management strategies into practice. For details, see “Diversity 2.0 Study Group Report—Toward Implementation of Diversity as a Competitive Strategy” (published on March 23, 2017)70, “Toward Further Enrichment of Diversity 2.0 <Recommendations Compiled by “Study Group for Ideal Approaches to Diversity Management as a Competitive Strategy”>” (published on June 8, 2018), and “Diversity 2.0 Action Guideline” (published on March 23, 2017; revised on June 8, 2018)71.

3. Composition of the Committee

3.1. Outsiders Who Will Become Members of the Committee

In light of the roles that outsiders are expected to play when they become committee members, a company should consider appointing outside directors monitoring management as committee members. Furthermore, a company may consider utilizing outside auditors on a supplemental basis to increase the ratio of outsiders.

○ When a company selects outsiders as committee members, there would be several options, as shown below.

○ First of all, outside directors are designated as candidates for committee members in light of the roles expected from them.

○ However, a company may consider utilizing outside auditors on a supplemental basis to increase the ratio of outsiders and make up for knowledge outside directors do not have.

[1] Outside directors

○ (Independent) outside directors who independently monitor management would be the most eligible in light of the roles expected from committee members.

○ In the Corporate Governance Code, independent outside directors are expected to fulfill the role and responsibility 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

○ On the basis that, in general, outside auditors have rich knowledge and information concerning companies, and that today there are still many companies which have only a few outside directors working for them, outside auditors may be designated as committee members or observers in the case of a voluntary committee. The designation of outside auditors as committee members on a supplemental basis is reasonable to a certain extent from the standpoints of increasing the ratio of outsiders, especially if the number of outside directors is insufficient, and of making up for knowledge if the knowledge of outside directors is not sufficient.

△ Outside auditors are essentially not in the position to supervise the nomination or compensation of management members. Accordingly, if there are a sufficient number of outside directors, it is necessary to define reasons for venturing to designate an outside auditor, not an outside director, as a committee member (e.g., the compensation committee expects expertise such as legal or accounting expertise from an outside auditor)72.

[3] External experts (professionals)

○ A company may designate an external expert as a committee member or observer, expecting him/her to play the role of contributing to efficient discussion, if such

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72 An auditor is not an entity expected to play the role of monitoring (mainly evaluation of the business performance of management members). In the light of the legal position of auditors, it is pointed out that it is strange that an auditor is designated as a committee member as in the same position as an outside director. On the other hand, there is an opinion that there are cases where an outside auditor may be more suited to become a committee member compared with an outside director, because sometimes an outside auditor has a lot of information regarding internal candidates on the basis of his/her roles and authority as an auditor.
position is established from the standpoint of efficiency.

△ With regard to external experts (professionals), it is pointed out that [1] they do not have a legally-based position unlike outside directors or outside auditors since they are not appointed at general meetings of shareholders in comparison with directors, [2] it is sometimes difficult to ensure independence from executives depending on their contractual statuses, and [3] the utilization of their expertise is possible even when they participate as observers. Therefore, if a committee makes a decision by majority vote, it is necessary to define reasons why any person who is not an officer of the company has the right to vote as a committee member, depending on the roles of the committee in connection with the board of directors.

3.2. Balance Between Outside Officers and Other Committee Members

A company should consider setting up a committee [1] of which outside officers make up at least a majority of the members; or [2] in which the number of outside officers and that of other members are equal and an outside officer acts as chairperson.

○ For options of the composition of a committee (ratio of outside officers (outside directors and outside auditors) to other committee members), there would be several patterns, as shown below.

[1] Only outside officers
[2] Outside officers making up a majority of the committee members
  ➢ Consistent with the purpose of setting up a committee (i.e., to reinforce the independence and objectivity of the board of directors as well as its accountability), and easily accountable.

[3] Outside officers make up half of the committee, and other members make up the other half
  ➢ An environment in which it is easy for outside officers to express opinions can be developed.
  ➢ The committee would be designed not to be substantially inferior to a committee of which outside officers make up a majority, for example, by designating an outside officer as chairperson.

[4] Members other than outside officers make up a majority of the committee
[5] Only members other than outside officers
  ➢ If a company cannot secure a sufficient number of outside officers, it may consider setting up a committee consisting chiefly of members other than outside officers to begin with, provided that some measures, such as designating an outside officer as chairperson, are taken.
  ➢ However, once the number of potential outside officer 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, it is desirable that its composition should consist mainly of outside officers. On this basis, a company may choose [1] or [2] above. If a company chooses [3], it would be important to designate an outside officer as chairperson.

○ With regard to external experts (professionals) who are not officers, the issue described in section 3.1 [3] is applicable. For that reason, in examining the composition of a committee for nomination or compensation, it is desirable, as stated above, that the ratio of outside officers to other committee members including external experts (professionals) should be taken into consideration.

○ Whether the committee can effectively work depends largely on whether or not outside officers who are its members are working seriously. Appointing outside officers as committee members as a matter of form is insufficient; it is important for outside officers to recognize their own roles

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and make serious efforts as committee members.

3.3. Committee Chairperson

○ A company may consider designating a chairperson to play, for example, the following roles to administer a committee:
  ➢ Role to lead the committee’s proceedings;
  ➢ Role to explain the advice of the committee to the board of directors;
  ➢ Role to have discussions with the secretariat of the committee;
  ➢ Role to make a decision in the case of a tie vote (depending on the composition of the committee); and
  ➢ Role to convocate a committee meeting where necessary, for example in the case of an emergency.

○ Furthermore, when a company designates a chairperson, it is necessary to consider whether such chairperson should be an outside officer or any other committee member by reference to section “2.5.1. Chairperson of the Board of Directors” in the main text of these Guidelines and from the following standpoints:

  [1] Designate an outside officer as chairperson:
    ○ Easy to facilitate effective operation of the committee from the standpoint of reinforcing its independence, objectivity and accountability
    ○ An outside officer may be designated as chairperson in the case where the number of outside officers and that of other committee members are the same
    △ Difficult if there is no outside officer who can undertake a huge burden of acting as chairperson

  [2] Designate a committee member other than outside officers as chairperson:
    ○ Cooperation with internal parties and smooth management by a person who is familiar with internal affairs can be expected if an insider acts as chairperson
    △ If the committee consists chiefly of members other than outside officers and a member other than outside officers acts as chairperson, the committee may not be evaluated externally

○ Rather than designating a committee member other than outside officers as chairperson of a committee, the designation of an outside officer as chairperson is expected to bring out active involvement by outside officers and facilitate effective committee administration of the committee from the standpoint of reinforcing its independence, objectivity and accountability. On the other hand, at the time when a committee is initially set up, there may be no method of administration or internal cooperation established. In this case, a company may choose to designate an insider as chairperson of the committee and, when the company becomes capable of administrating the committee relatively smoothly, consider whether or not it should designate an outside officer as chairperson.

3.4. Points to Be Noted When Insiders Participate in Discussions of the Committee

If the president/CEO is included as a member of a committee that gives advice on the appointment and dismissal of presidents/CEOs or their compensation, the company should consider taking measures so that the committee members can discuss such matters without the presence of the president/CEO, where necessary.
In relation to the nomination of management members and their compensation, important elements to be considered include the management strategies, management plans, business performance, financial conditions, and estimated future performance of the company, as well as information concerning internal human resources to whom such nomination and compensation are relevant. Therefore, it is essential for the company’s nominating committee and compensation committee to receive sufficient information on the aforementioned matters. On this basis, depending on the number of outside directors and their lengths of service among other relevant matters, it can be regarded as reasonable, to a certain extent, for insiders who are familiar with such internal affairs to join the committees as their members.

Even if a company chooses to set up a committee only with outsiders, the provision of explanations about internal information is still essential. Therefore, it is considered that insiders may still attend meetings of the committee to provide such explanations.

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

It is an important responsibility of the incumbent president/CEO to ensure appropriate implementation of succession planning and the appointment of a succeeding president/CEO. On the other hand, a committee may not be able to sufficiently deliberate matters associated with evaluation of the incumbent president/CEO (reappointment or dismissal, and compensation), when the president/CEO is present at its meeting.

Accordingly, it would be helpful to take measures in relation to such matters to enable the committee to have discussions in the absence of the president/CEO.

[1] The company is not to designate its incumbent president/CEO as a committee member (i.e., merely designating him/her as an observer to provide explanations or calling him/her to a committee meeting as necessary).

[2] The company designates its incumbent president/CEO as a committee member but also sets up a separate meeting or have him/her leave the meeting room when the committee deliberates matters relating to his/her evaluation.

<Reference: Case Examples of Specific Efforts>

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

- To evaluate the performance of the CEO, an evaluation subcommittee consisting exclusively of outside directors and outside auditors has been set up as a common subcommittee of the nominating and compensation committees. That is not a place of decision-making. That subcommittee discusses whether there will be no problem with the CEO continuing to serve as such next year, covering all aspects of the CEO such as the qualitative and quantitative evaluations of the CEO’s performance throughout the year and the atmosphere of the company (whether there is any sign that the CEO has acted irrationally), and reports the results of its discussions to each of the committees.

- The members of the nominating committee consist exclusively of 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 should have a voting right. When the members need internal information, they request insiders to provide it to them and, if necessary, call the president to a committee meeting for explanations. This works for us without problems.
3.5. Ideal Approaches to the Composition and Administration of the Committee According to Advice Targets and Advised Matters and the Circumstances of the Company

○ The advice targets of each committee (e.g., the president/CEO, other management members, and outside directors), and matters on which its advice is sought (nomination (new appointment, reappointment and dismissal) or compensation) can potentially be diverse, and accordingly a desirable committee composition and the desirable manner of committee administration are not regarded as uniform, either.

○ For example, in relation to the nomination of presidents/CEOs or other management members and the determination of their compensation, it can be regarded as reasonable, to a certain extent, for insiders who are familiar with internal affairs to become committee members.

○ In contrast, for the nomination of outside directors to act as supervisors and the determination of their compensation, it is particularly desirable that outside directors should play a leading role in order to ensure their independence from management members. From this perspective, it is considered that outside directors should form a majority of the members of the committee that deliberates the above matters, and an outside director should act as chairperson of such committee. In this regard, it is pointed out that the nomination process of outside directors and the determination process of their compensation should ideally be separated from those processes of presidents/CEOs and other management members, and that relevant committees should be composed only of outside directors.

○ In addition, in normal succession planning processes among matters concerning the nomination of presidents/CEOs, it is regarded as reasonable for the incumbent president/CEO, who are well familiar with internal affairs and circumstances, to actively participate in discussions held by the nominating committee73. On the other hand, when the nominating committee is to judge whether or not it is appropriate to reappoint or dismiss the president/CEO, the involvement of the president/CEO concerned in relevant discussions is not basically desirable since his/her own direct interests are involved. If he/she is a member of the nominating committee, it is considered necessary to take measures to ensure that the committee members can hold discussions without the presence of the president/CEO, where necessary.

○ In the meantime, it is considered unnecessary to set up separate committees for different targets to receive advice and different matters on which advice is given from the standpoint of efficient administration of committees, since much of the information required by different committees is the same in many cases. However, if a committee deals with a number of matters with different characteristics, it is still desirable that the manner of operation of such committee should be individually thought out as required.

○ Furthermore, the manner of committee operation may also differ depending on the situation the company is in, even if the advice targets and matters on which advice is sought are the same.

○ For instance, in an ordinary situation where trust and confidence in the incumbent president/CEO and other management members continue, the nominating committee is basically expected to strive to appropriately monitor their nomination and compensation from an independent standpoint while also respecting their opinions. However, in an exceptional case where trust or confidence in the incumbent president/CEO and other management members is lost, for example, due to the occurrence of a large-scale scandal or considerable deterioration in earnings, the nominating committee chiefly consisting of outsiders is required to voluntarily play a leading role in relevant processes.

73 However, the president/CEO is not necessarily required to participate in discussions as a committee member; it is considered that his/her participation merely as an observer to provide explanations, where necessary, should be sufficient.
4. Relationship with the Board of Directors

In relation to matters on which advice is sought from committees, the ultimate deciding entity is consistently the board of directors, even where such committees have made various deliberations and decisions. A company should consider having its committees make detailed reports on what they have deliberated to the board of directors so that the board of directors can make discussions and decisions based on findings of the committees.

○ Appointment and dismissal of a president/CEO, and succession planning remain as matters on which committees can only give advice, irrespective of how the corporate organization has been designed. A committee consisting chiefly of outsiders does not make final decisions, as only advice is sought from it.

○ The deciding entity is consistently the board of directors. However, this does not mean that the board of directors does not have to discuss. The board of directors may make decisions that are not consistent with advice given by a committee.

○ On the other hand, the fact that the board of directors has discussions and makes decisions based on the advice of a committee conforms to the purpose of setting up the committee.

○ Therefore, it is important for a committee to make detailed reports to the board of directors on deliberations at committee meetings, including its standards and processes, so that the board of directors can have discussions and make decisions based on the advice of the committee.

○ In addition, if the board of directors makes decisions different from advice given by a committee, the board would require reasonable grounds for such decisions from the standpoint of respecting the advice of the committee. Such company may define such grounds and, if necessary, externally disseminate information on such grounds.

5. Evaluation of the Effectiveness of the Committee

As part of evaluation of the effectiveness of its board of directors, a company should consider evaluating whether its board of directors and its committees function effectively in an integrated manner, which should also cover the compositions of its committees, their advice targets, matters on which the committees offer their advice, and the manner of their deliberation and operation.

○ While nominating and compensation committees can be effective as measures to reinforce the independence, objectivity and accountability of the board of directors in their supervision of the nomination and compensation of directors and management members, it is possible that these committees become powerless depending on the designs or operation of their systems.

○ Accordingly, as part of evaluation of the effectiveness of its board of directors, a company should evaluate whether its board of directors and its committees function effectively in an integrated manner, which also covers the compositions of its committees, their advice targets, matters on which the committees offer their advice, and the manner of their deliberation and operation, and make necessary improvements on the basis of evaluation results.
6. Matters to Be Handled by the Committee and Schedules

6.1. Matters and Schedule Regarding Nomination

With regard to the processes of the nominating committee’s supervision of succession planning for a president/CEO, refer to Appendix 4 “Points of View in Formulation and Administration of a Succession Plan for a President/CEO.”

6.2. Matters and Schedules Regarding Compensation

In determining 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 the understanding of subjects
   - Consideration of external provision of information

(2) How specific amounts of compensation are determined under compensation programs:
   - Evaluation of the performance of subjects
   - Determination of compensation amounts based on performance evaluation (application)

In making judgments on how executive compensation programs should be designed or administered, it is important to keep an appropriate balance between the standpoint of providing explanations to shareholders and the standpoint of granting incentives to management members.

Details of compensation programs differ depending on the strategies and other factors of each company. For that 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 require a certain amount of time to conduct necessary examinations.

Outside directors’ proper involvement with deliberations of the committee and their appropriate advice to the committee substantiate the reasonableness of management judgments about compensation programs, which will be of some help to the company in terms of its external accountability.

Therefore, it is important to administer compensation programs by considering the comprehensiveness of matters to be deliberated, the sufficiency of materials for judging (compensation-related information), and the sufficiency of deliberation time (the frequency of meetings and the duration of each meeting), from the standpoint of fully fulfilling accountability depending on the conditions of the programs of each company.
7. Secretariat of the Committee

- 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 as a basis for discussions, prepare original drafts, provide information to the committees, and provide assistance in the compilation of opinions, and it is considered that a secretariat may be set up under each of the committees to take charge of the aforementioned operations.

- Which section is to be in charge of those operations should be examined in conjunction with the establishment of a section that will be responsible for centrally handling corporate governance actions.
Appendix 4: Points of View in Formulation and Administration of a Succession Plan for a President/CEO

1. Efforts Constituting Succession Planning

- Succession planning of a president/CEO can be regarded as efforts to ensure that the replacement of a president/CEO, who plays a central role in his/her company, with an outstanding successor at an appropriate timing, with the aim of achieving sustainable growth of the company and improvements in its mid- and long-term corporate value.

- The center of such efforts is mid- and long-term efforts to screen and foster successor candidates with the “expected timing of replacement of the incumbent president/CEO” in mind, equip them with the required qualifications, and identify the most suitable person for the top management position.

- However, it is possible that the originally expected timing of replacement may require reviewing depending on the achievement status of the performance goals in the management plan or other relevant factors. Furthermore, there may be cases in which an urgent replacement of the president/CEO is required due to unforeseen circumstances. It is the responsibility of listed companies to appropriately handle such changes in their situations, and make preparations during ordinary times to avoid any blank period in terms of management and to secure the stability and sustainability of management even in a state of emergency. Efforts for fulfilling such responsibility are also important elements of succession planning.

- In particular, in an emergency, the time line and processes of succession planning and the roles required from the successor may greatly vary from those during ordinary times; for instance, it is not possible to take sufficient time to fully foster or identify successor candidates. For that reason, it is necessary to separately consider a plan other than a succession plan for ordinary times (i.e., an emergency plan or a crisis response plan).

- As described above, it is desirable that companies should assume various different scenarios and engage in succession planning on multiple time lines so as to be able to appropriately handle future changes in their situations or unforeseen circumstances.

- Furthermore, although, in the current situation of Japan, a person for the top management position is frequently chosen from within the company, there may be cases in which it is appropriate to consider appointing successors from the outside depending on the circumstances of each company, from the perspective of selecting the most prominent successors. Such case is considered to go through a different time line and different processes from those in the case of an internally selected person for the top management position, and this should be regarded as one of

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74 Although these Guidelines outline the concept of succession planning mainly for a president/CEO who is at the top of management, succession planning may cover other positions, taking account of the circumstances of each company, such as the degree of importance of such positions in relation to its corporate value, and the roles of its president/CEO at the company. There are considered to be various different ways to view succession planning among companies; for example, the succession planning of some companies may cover only their presidents/CEOs who are at the top of their respective management, and their right to decide personnel affairs is respected in relation to other positions that assist the presidents/CEOs, while other companies include vice-presidents, COOs and the top management of their core subsidiaries in their succession planning, and have their boards of directors or nominating committees monitor the planning.

75 This means the expected timing around which the replacement of the incumbent president/CEO is relatively likely to take place in the light of various circumstances including the period covered by the mid-term management plan, the period required for execution of management strategies and a rough timing of the basic upper limit on reappointment, and it does not indicate an absolute timing at which the replacement has to actually take place irrespective of the situation the company concerned is in or its business performance at that time. In order to systematically foster and nominate a successor, it is considered necessary to assume a likely timing of replacement as a goal, as described above, and count time backward from the assumed timing to examine what efforts must be made by each time point.
ideal approaches to succession planning for appropriate successor nomination.**

At the end, the final candidate selected through such efforts as those mentioned above for succession planning is nominated as the succeeding president/CEO. Therefore, it is necessary to regard succession planning and successor nomination as a single concept.

2. Time Lines of Succession Planning

Succession planning (in particular, mid- and long-term succession planning during ordinary times carried out toward the expected timing of replacement, the basic policy of which is to appoint an individual within the same company to the top position of its management) consists of a basic cycle starting from the assumption of the office of president/CEO to replacement thereof, and it can be divided broadly into the two elements of selection (and identification for selection) and fostering.

Firstly, in the replacement of the person at the top of management, it is considered necessary in any case to go through the processes of identification and selection of the most suitable person from candidates.

Moreover, in order to select the most suitable person, it is important to foster candidates and equip them with the qualifications required for the top management position, and this fostering should take place in parallel with the process of identification of the final candidate. This is the second element of succession planning.

Especially in the aspect of the second element, fostering, companies may have their own ideas of how much effect they expect from such fostering and what efforts should be made for how long. These can be broadly divided into the following two stages.

- Firstly, it is considered that fostering in succession planning targets, for example, a few of or several dozen candidates at the officer level, and mainly focuses on efforts implemented in parallel with the identification of the most suitable successor, with the aim of achieving the “ideal image of a president/CEO” (Figure B below).

- Furthermore, to effectuate succession planning more substantially, it is important to have a complete set of candidates who can qualify as a president/CEO or other management members in the future. In particular, companies that have plentiful human resources and basically choose to select their top management from within themselves are expected to screen promising personnel early while these personnel are at the early stage of their career (in their 30s to 40s) as a group of candidates for next-generation senior management, and take sufficient time to foster them while replacing them with others as needed. These approaches should be implemented as basic efforts to raise the level of successor candidates.

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76 In the case of inviting external human resources, refer to “6. Invitation of External Human Resources.”
ensure diversity and improve the effectiveness of succession planning (Figure C below)\(^\text{77}\).

○ It is considered that many listed companies, with their human resources departments playing a main role, have put in practice such efforts as those in the latter stage of fostering above as human resource development measures for personnel at the manager level or lower. From the standpoint of whether such existing efforts are consistent in supporting the effectiveness of succession plans of presidents/CEOs, it is desirable that the nominating committee should appropriately supervise such efforts, for example, by receiving reports as required.

○ However, irrespective of the degree of emphasis placed on the effect of fostering under succession plans, it is considered desirable that each company should basically embark on succession planning for the succeeding president/CEO right from the time when the incumbent president/CEO assumes office as such (Figure B below).

3. Seven Basic Steps for Engaging in Formulation and Administration of a Succession Plan

○ On the basis of the aforementioned standpoints, it should be beneficial for each company to consider its engagement in the formulation and administration of succession plans by dividing it into the following seven steps.

○ However, ideal and specific approaches to the formulation and administration of succession plans may differ among companies according to the situation, corporate culture and candidate personnel of each company, among other details. What matters is that, on the basis of the following basic framework, each company should actually discuss what efforts are necessary for itself, go through trials and errors and take various measures in order to accomplish the original purpose of replacement of the top management position with an appropriate successor at an optimal timing.

<table>
<thead>
<tr>
<th>Step</th>
<th>Main Details</th>
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<tbody>
<tr>
<td>1</td>
<td>Drawing up a roadmap for succession planning</td>
</tr>
<tr>
<td>2</td>
<td>Formulating an “ideal image of a president/CEO” and evaluation standards</td>
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<td>3</td>
<td>Selecting successor candidates</td>
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<td>4</td>
<td>Formulating and implementing a fostering plan</td>
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<td>5</td>
<td>Evaluating, narrowing down and, if applicable, replacing successor candidates</td>
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<td>6</td>
<td>Evaluating the final candidates and nominating the successful successor</td>
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<td>7</td>
<td>Supporting the successor after nomination</td>
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</table>

- Although succession planning are mid- and long-term efforts, the details and depth of such efforts, and the manner in which an emphasis is placed on such efforts may differ according to time; for example, at the time the incumbent president/CEO assumes office as such, mainly basic matters are organized and reconfirmed by drawing up a roadmap for succession planning (Step 1) and discussing an “ideal image of a president/CEO” (Step 2); and as the time for replacement of the top management position comes closer, the selection, fostering, evaluation, replacement and narrowing-down of successor candidates are carried out in full scale, and the successful successor is finally nominated immediately before the replacement concerned.

- Also, since the situation of a company may change even while it is engaging in succession planning, and the plan should be properly reviewed at an appropriate time, where necessary.

- A company which is to start embarking on succession planning may, even if it is difficult for such company to implement all the steps on a full scale from the beginning, start first by having its nominating committee mainly discuss core efforts directly linked with successor nomination, and then expand its efforts into fostering in a stepwise manner; for example, the nominating committee starts from discussing the “ideal image of a president/CEO” (Step 2), and then takes a certain period of time to evaluate successor candidates and identify their suitability (Step 5), or select successor candidates (step 3) and evaluate each of such candidates (Step 6).

- Corporate organs to engage in efforts in each step may vary depending on the circumstances of each company. On the basis of the revised Corporate Governance Code, the description below assumes, as a standard structure, a structure under which insiders, with the president/CEO playing a central role, prepare and propose a draft plan and provide explanations, and the nominating committee, which chiefly consists of outside directors and is a voluntary advisory body established under the board of directors, confirms the reasonableness and appropriateness of the plan through discussion with insiders and from an independent standpoint, and reports its findings to the board of directors.

- In addition, the following seven steps organize one standard type of ideal approaches on the basis of a company with a rich pool of internal human resources and a basic policy of appointing an individual within the company to the top position of its management. Although companies may, depending on the situations they are in, consider inviting external human resources in appropriate cases, their time lines and processes may differ from those in the following steps in such cases, which may include, for example, omitting Step 4 or 5 in part.

78 With regard to the roles of each organ, refer to “4. Roles of Each Corporate Organ.”
3.1. Step 1: Drawing up a roadmap for succession planning

○ Toward the expected timing of replacement of the president/CEO from the time of his/her assumption of the office of president/CEO, the company is to consider an outline of processes and a schedule (e.g., “who does what and when”) and draw up a succession plan roadmap.

○ In so doing, the company should also consider how the incumbent president/CEO, other insiders, the board of directors, the nominating committee and others are to be involved in each process.

○ Basically, a roadmap should be drawn up on the basis of a mid- and long-term time line that takes account of the expected timing of replacement of the incumbent president/CEO. However, it is desirable that various different scenarios should be assumed and multiple time lines considered so as to be able to handle future changes in the situation or unforeseen circumstances.

○ Such roadmap serves as a basis for appropriate implementation of processes under the relevant succession plan, and it is considered that insiders, chiefly the president/CEO, prepare a draft roadmap, and that the nominating committee discusses it and makes a decision in this regard (reports to the board of directors, if required).

3.2. Step 2: Formulating an “ideal image of a president/CEO” and evaluation standards

The nominating committee should deliberate on and clarify an “ideal image of a president/CEO,” taking account of the management environment surrounding the company, and its own management principles, mid- and long-term management strategies, management issues and other factors and, upon such deliberation and clarification, consider formulating objective evaluation standards.

○ The ensuring of objectivity in the subsequent efforts (Steps 3 to 6), which are the selection, fostering and evaluation of successor candidates and the ultimate nomination of a successor, and of effective supervision by the board of directors and the nominating committee presupposes that the “ideal image of a president/CEO,” which is the basis of decision on which outside directors and others should rely, and objective evaluation standards (i.e., a requirement definition) are shared.

○ Thus, the nominating committee should discuss the “ideal image of a president/CEO” (the qualifications, abilities, experiences, achievements, expertise, skills, personality and other factors required from the succeeding president/CEO), clarify these details as much as possible, establish relevant objective evaluation standards, and consider recording these details in writing.

○ Since the most suitable successor is an individual with the qualifications to lead the officers and staff of the company and maximize its corporate value while promoting appropriate cooperation

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79 As a premise for this, it is assumed that a rough indication of the expected timing of replacement of the incumbent president/CEO is shared with the nominating committee and other organs.

80 Required experiences may include, for example, experience of engaging in business operations abroad to develop international perspectives, and experience of assuming company-wide management responsibility as the top position at a subsidiary, which includes dealing with not only the earnings and expenses (P/L) of specific businesses but also financial strategies (B/S).
with various stakeholders, it is essential, in discussing the “ideal image of a president/CEO” and formulating evaluation standards, to take into consideration the management environment surrounding the company, its corporate culture, management philosophy, growth phase, mid- and long-term management strategies and management issues, and the roles, authority of the president/CEO at the company, among other details.

○ As described, the “ideal image of a president/CEO” and evaluation standards should be examined according to the management environment each company is in, and there are not universal ones; even for the same company, these may change depending on its situation\(^{81}\). Succession planning is mid- and long-term efforts, and the circumstances of the company may alter while it is carrying out such efforts. Accordingly, it is desirable that the “ideal image of a president/CEO” and evaluation standards should be regularly checked and reviewed as required even after their formulation.

○ With regard to the “ideal image of a president/CEO” and evaluation standards, it is beneficial to guarantee objectivity by having the nominating committee chiefly led by outside directors sufficiently discuss these so as to ensure that successor nomination will not be based on the internal logic of the company or subjective/arbitrary judgments, and also beneficial to consider the image and standards in a multilateral manner from an independent standpoint and broad perspectives, and to add the viewpoints of management such as outside directors with management experience.

○ Furthermore, the “ideal image of a president/CEO” should be reported to the board of directors to obtain its consent, in the light of the importance of the image.

<Reference: Examples of qualifications and abilities required from a president/CEO>

- Strong stance and decisiveness to courageously address a difficult issue (not postpone 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 to conceptualize: Powers to identify required changes in the management environment and the direction the company should head in, and design company-wide growth strategies on a global level from a mid- and long-term perspective.
- Ability to execute: Ability to execute designed growth strategies
- 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.

\(^{81}\) Qualification items such as decisiveness, the ability to execute, the power to change, the power to conceptualize, integrity and courage may share some common or universal characteristics. However, at more specific levels, such as on which elements an emphasis is placed and on which field an emphasis is placed in terms of experience and knowledge, whether the characteristics of such items are common or universal may vary according to the management environment each company is in. For instance, in a stable management environment, adjustment-focused top management are more suitable, whereas reform-oriented top management with strong leadership are more suitable for a situation where the management environment drastically changes and a transformation of the company’s business model is urged. In a management environment that requires reform-oriented top management, for example, any company should not select an “passable” individual who cannot implement a reform for the top position, in an attempt to fulfill its accountability as a matter of form; companies should fulfill their accountability in a substantial manner that helps them achieve sustainable growth.
3.3. Step 3: Selecting successor candidates

○ In this step, the company is to select successor candidates according to the “ideal image of a president/CEO” and evaluation standards.

○ There are various different ideas concerning from which level successor candidates should be selected and the number of successor candidates to be selected, depending on the scale of the company and the period during which it engages in its succession plan. Normally, the number of successor candidates that the nominating committee is able to identify by name, grasp and evaluate individually should be a few to a few tens at most.

(Where there is expected to be plenty of time until the replacement of the president/CEO)

○ For instance, in the case where a succession plan was started at the time when the president/CEO assumed office as such, and consequently there is expected to be plenty of time until the expected timing of replacement, it is considered that a few or a few tens of candidates are selected from personnel at the officer level as the subjects of the succession plan, and are to be fostered in the “finishing process” to lead them to reach as close to the “ideal image of a president/CEO” as possible.

○ In such case, in the light of the “ideal image of a president/CEO” and evaluation standards, insiders led by the president/CEO are required to specifically explain to the nominating committee through what selection processes they have gone through to identify the candidates on the basis of what evaluation information.

○ However, even in this case, it is desirable to list not only successor candidates for nomination in a mid- and long-term period but also those for nomination in a short-term period, in preparation for any case requiring an urgent replacement of the president/CEO due to unforeseeable circumstances.

○ In addition, since the “ideal image of a president/CEO” may change depending on such factors as a future management environment or future management strategies, it is beneficial to assume various different scenarios and select diverse human resources from a wide-range population as successor candidates in advance, in order to be able to handle any change in the future situation of the company.

(Where the replacement of the president/CEO is expected to take place in the near future)

○ For instance, in the case where a succession plan was started during the length of service of the incumbent president/CEO, and consequently the replacement of the president/CEO is expected to take place in the near future, it is considered that a certain number of successor candidates should be selected from senior officers such as vice presidents and the COO, and that the right candidate is to be identified among them by determining who is able to assume the office of president/CEO immediately.

○ However, even in this case, it is desirable that a certain number of successor candidates should be listed if the situation permits, since notifying the nominating committee of only one candidate makes it difficult for the committee to hold substantive discussions without any other candidate for comparison.

○ When a certain number of candidates are notified to the committee, this inevitably compels the incumbent president/CEO to explain his/her view on the priority order of such candidates, in which case the reasons for setting such priority order should be explained.

3.4. Step 4: Formulating and implementing a fostering plan

○ For each of the candidates selected in Step 3, the company is to clarify his/her issues in reaching
the target level in the light of the “ideal image of a president/CEO” and evaluation standards, and formulate and implement a fostering plan.

(Examples of fostering methods employed by companies)

- Successor candidates are strategically rotated beyond their business units in order to equip them with management abilities based on company-wide-/group-wide-optimized perspectives.\(^{82}\)
- Successor candidates are given tough assignments to gain experience of overcoming dreadful scenes, in order to mature them.\(^{83}\)
- In order to boost the qualifications and abilities (potential) of successor candidates, they receive, for example, one-to-one interviews with outside directors and coaching from external experts, with the aim of allowing them to come to new realizations.

- In the case where the company engages in succession planning on a long-term time line beyond the basic cycle from the president’s/CEO’s assumption of the office of president/CEO to his/her replacement, it is possible for the company to screen promising personnel early while they are in the early stage of their career, take time to foster them, for example, by enabling them to gain experience of assuming highly responsible positions early and intensively providing them with off-the-job training such as group training and management seminars in the light of the possibility that such personnel may take charge of management in the future, and thereby increase the effectiveness of fostering. In Japan, there are not many cases in which presidents/CEOs are appointed from outside companies. Under this situation, in comparison with other countries, it is considered important to find outstanding insiders, or recruit outsiders as mid-career personnel and uprear them. Therefore, for Japanese companies, the merit of fostering individuals who will potentially be candidates under a succession plan based on a long-term time line can be regarded as significant.\(^{84}\)

3.5 Step 5: Evaluating, narrowing down and, if applicable, replacing successor candidates

- In this step, the company is to regularly monitor the situation of successor candidates, evaluate them according to the “ideal image of a president/CEO” and evaluation standards, and narrow them down or replace them with others where necessary. Furthermore, it is considered possible to enhance the effectiveness of fostering by concurrently monitoring the implementation status of the fostering plan (Step 4) and moving on to review the plan if required.

(Examples of evaluation methods employed by companies)

- Interviews with candidates
- 360-degree evaluation (checking by referring to the superior, colleagues, subordinates and others)
- Awareness surveys targeting employees (finding out about management issues by

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\(^{82}\) For example, experience of managing group companies, experience of working at the head office, experience of working overseas, experience of working in different industries, etc.

\(^{83}\) For example, experience of engaging in poorly performing businesses, experience of being involved in emerging markets, etc.

\(^{84}\) In many companies, succession planning for a president/CEO and other various screening and fostering measures implemented by their human resources departments for executive candidates and managers (e.g., next-generation leader development programs) are separately designed and operated from each other. It is pointed out that the supply line of human resources to potentially be candidates under a president/CEO succession plan has not been systematically constructed at such companies. There are case examples in which leading companies have systematically constructed such supply lines of candidates and coordinated measures for the selection and fostering of successor candidates for the position of president/CEO with various measures for screening and personnel development implemented by their human resource departments in order to enhance the effectiveness of succession planning for presidents and CEOs.
aggregating survey results by department)

- Aptitude test employing psychological techniques
- Some companies utilize external experts for the purpose of assisting evaluations and guaranteeing objectivity.

○ In guaranteeing the objectivity of the evaluation, narrowing-down and replacement of successor candidates, it is beneficial to periodically report the monitoring status to the nomination committee and have the outside members of the nomination committee, such as outside directors, participate in the processes concerned.

○ In so doing, it is also beneficial to increase opportunities for outside directors belonging to the nominating committee and other members thereof to directly come into contact with successor candidates in order to have them evaluate not only the past business achievements of such candidates but also the potential of such candidates for the top management position. The arrangement of opportunities for outsiders to monitor the situation of successor candidates on a routine basis as shown is expected to enable outsiders’ supervision to smoothly and appropriately function even in the process of the final stage involving the nomination of the succeeding president/CEO.

(Examples of measures to increase opportunities for outsiders and successor candidates to come into contact with each other)

- Arranging opportunities to have one-to-one interviews with candidates and to exchange opinions in a group
- Having successor candidates provide explanations and answer questions at meetings of the board of directors
- Asking outside directors to work as lecturers in training courses held for successor candidates
- Arranging opportunities of casual interpersonal exchange such as dining

<Reference: Case Examples of Specific Efforts>

・The CEO offered the three candidates, and gave them a chance to attend board meetings to present a briefing about the proposed transactions. The board members had many discussions by giving each of the three candidates the scores of “〇”, “△” and “□” depending on their situations in this comparative evaluation. Through these reasonable efforts, the board took one year to select the successor.

・A board meeting is held almost once a month, where candidates for presidency present briefings about the conditions of the business operations in their charge. The advisory committee for president nomination evaluates the results of such briefings whenever a board meeting is held. This process continues for many years, based on which the next president is to be selected. An outside director is the chair of this advisory committee, and takes a considerable amount of time for this process. Although it is said to be difficult for outside directors to decide the next president, they can understand quite a lot of things after having seriously observed the candidates over four or five years.

○ In the case where the company engages in succession planning on a mid- and long-term time line, it is considered that the company repeats the cycle of Steps 4 and 5 where necessary and, in this process, gradually narrows down successor candidates.

85 In addition, the securing of opportunities for such contact during ordinary times is expected to have the merit of enabling prompt responses when an urgent replacement of the president/CEO is required due to unforeseeable circumstances even if no emergency plan has been prepared.
3.6. Step 6: Evaluating the final candidates and nominating the successful successor

○ After the candidate group has been narrowed down to a few final candidates through the aforementioned efforts, in this step, the nominating committee is to conduct the final evaluation of the remaining candidates in the light of the “ideal image of a president/CEO” and evaluation standards, and nominate the most suitable candidate for the top management position of the company among them as the successor.

○ From the standpoint of guaranteeing objectivity, it is desirable, in evaluating the final candidates, that the final evaluation should not blindly rely on individualistic views (e.g., merely indicating Mr. A or Mr. B) but should instead be carried out for each candidate with sufficient objective evaluation information provided for judging whether the candidate is suitable for the top management position of the company in the light of the “ideal image of a president/CEO” and evaluation standards.

○ If there is not sufficient time to narrow down or replace candidates as the timing of replacement is approaching, possibly Steps 4 and 5 can be skipped to move straight onto Step 6. Particularly in such case, insiders led by the president/CEO should strive to provide the nominating committee with a wide range of information for the final evaluation and thereby enable it to hold substantive discussions.

3.7. Step 7: Supporting the successor after nomination

○ It is desirable that the newly appointed president/CEO should be able to fully perform his/her duties immediately after his/her assumption of office. To this end, for instance, it is considered beneficial to set a certain transition period between the nomination of a successor and actual replacement, and make necessary preparations during the said period, which include the handover of work between the incumbent president/CEO and the successor, the familiarization of inside and outside interested parties with the successor, and networking. As described, it is regarded as the important responsibility of the incumbent president/CEO to develop an environment that enables the successor to be fully prepared for embarking on management.

○ Furthermore, if necessary, outside directors belonging to the nominating committee are also expected to explain to stakeholders such as shareholders that the successor nomination was appropriately conducted.

4. Roles of Each Corporate Organ

4.1. Division of Roles between Insiders and Outsiders

The nominating committee of a company should consider making efforts to appropriately supervise the company’s succession planning from an independent standpoint while respecting opinions of insiders including the president/CEO.

However, in an exceptional case where it is difficult to expect insiders such as the incumbent president/CEO to properly formulate and administer a succession plan, the nominating committee should, as its important responsibility, consider voluntarily playing a leading role in judging the need for and timing of replacement of the incumbent president/CEO and developing succession planning processes for the nomination of a successor.

86 There are cases in which it is beneficial to have the former president/CEO support the newly appointed president/CEO for a certain period of time after replacement. Accordingly, the fact that the former president/CEO stays at the company should not be rigidly denied without any exception. However, in order for the newly appointed president/CEO to fully exert his/her capabilities, any situation where the former president/CEO continues to have an influence over the new president/CEO beyond the realm of the aforementioned support is not desirable. In such case, the company should clarify the authority, roles and responsibilities of the former president/CEO (also, refer to “5. Ideal Approaches to the Leadership of Management Members” in the main text of these Guidelines).
For a company, succession planning is important efforts for nominating the best suited successors in terms of achieving sustainable growth of the company and improving its mid- and long-term corporate value. Basically, insiders such as the incumbent president/CEO and outsiders such as outsider directors belonging to the nominating committee are to work on succession planning in cooperation with each other from their respective positions and toward the common goal of improving the effectiveness of succession planning.

The specific manner of involvement of insiders and outsiders and the division of roles between them should not be considered as uniform or fixed. On the basis of the situation the company is in, it is regarded as necessary for each of insiders and outsiders to consider how they should participate in each process from the standpoint of accomplishing the original purpose of replacing the top management position with a suitable successor at an optimal timing. Basic approaches to the division of roles can be broadly categorized into the following two situations.

In practice, these two situations are regarded as consecutive, and there can be another situation placed in the middle of the two situations concerned. With this basic form in mind, each of insiders and outsiders are expected to consider ideal approaches from the perspective of accomplishing the original purpose of succession planning, in accordance with the situations they are in.

4.1.1. Normal Situation

The incumbent president/CEO of a company, as the actual top of its management, is supposed to be well familiar with internal information and affairs including the management environment surrounding the company and information on successor candidates, and thus the degree of importance of his/her opinions is regarded as great. By contrast, it is normally considered difficult for outsiders, who are not necessarily familiar with internal information, to lead the preparation and administration of a draft succession plan in many cases.

For that reason, in an ordinary situation where trust or confidence in the incumbent president/CEO remains intact, he/she is expected to proactively prepare draft plans for the designing of succession planning, the selection of successor candidates, the formulation and implementation of fostering plans, and the determination of final candidates and successors.

In contrast, outsiders such as outside directors assume, through their involvement as members of the nominating committee, the roles of ensuring that insiders including the incumbent president/CEO sufficiently fulfill their accountability for draft plans; checking that the internal logic of the company is not prioritized and draft plans do not fall into subjective/arbitrary judgments from an independent stance; appropriately supervising succession plans, for example, by requiring the provision of further information or encouraging them to reconsider draft plans where necessary; and thereby securing the objectivity and transparency of successor nomination processes.

Outsiders who mainly assume these roles, such as outside directors belonging to the nominating committee, are required to make considerable commitments (in terms of time, labor and

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87 It is unlikely that outsiders are denied playing active and leading roles, depending on the circumstances of each company.

88 The basic division of roles above only pertains to the succession planning of a president/CEO. It is necessary to bear in mind that the desirable manner of involvement of executives including the president/CEO may differ according to advice targets and advised matters. For instance, in relation to the appointment or dismissal of outside directors, it is desirable that the involvement of management members who are subject to being monitored should be limited to the minimum necessary. For details, refer to “2.2 Outside Directors” of “2. Advice Targets and Advised Matters,” and “3.4 Ideal Approaches to the Composition and Administration of the Committee According to Advice Targets and Advised Matters and the Circumstances of the Company” of “3. Composition of the Committee,” in Appendix 3 “Points of View in Utilization of the Nominating Committee and the Compensation Committee.”
preparedness) since they are expected to play the role of appropriately supervising succession plans, and also required to be qualified to appropriately monitor such advanced management judgments as the selection, fostering, evaluation and suitability identification of successor candidates.

○ With regard to the timing of replacement of the incumbent president/CEO, he/she is not denied personally making a proposal to the nominating committee or other relevant bodies, on the basis of the company’s or his/her situation or the fostering situation of successor candidates, among other matters.

○ However, the incumbent president/CEO has a direct interest in the timing of his/her replacement in terms of the fact that he/she is not to be reappointed. For that reason, it is desirable that the board of directors and the nominating and compensation committees should clarify, between them and the incumbent president/CEO, basic management strategies and plans of the company and the missions of the incumbent president/CEO for accomplishing such strategies and plans, regularly evaluate his/her performance, and make preparations so as to enable outsiders such as outside directors to play a leading role in proposing the replacement of the incumbent president/CEO if it is necessary to do so on the basis of evaluation results89.

○ Since the replacement of the incumbent president/CEO and the nomination of the succeeding president/CEO are inextricably linked together, it is not possible to propose the replacement of the incumbent president/CEO unless an appropriate candidate for the succeeding president/CEO has already been identified. In order to enable an outsider to take the initiative in proposing the replacement of the incumbent president/CEO, where necessary, outsiders are required to strive to appropriately supervise succession plans, grasp the situation of successor candidates, and supervise efforts made for fostering such candidates on a routine basis.

○ As described above, where there is created an environment in which the achievements of the incumbent president/CEO and other management members are constantly checked by outsiders, there can be appropriate discipline compelling management members to improve the corporate value of their company on a daily basis, which can also serve as a ground for shareholders’ and other relevant parties’ confidence in the incumbent management members.

<Reference: Results of the Company Questionnaire Survey>
Approximately 39% of the respondent companies, which accounted for the largest proportion of the respondent companies, answered that the decisive factor for determining whether to reappoint a president/CEO at the expiration of his/her term of office was the president/CEO himself/herself. Approximately 17% of the respondent companies answered that such factor was their company chairmen or vice chairmen. In contrast, only approximately 4% of the respondent companies answered that such factor was their outside directors (see Question 14 of the Company Questionnaire Survey 2017).

4.1.2. Situation Where Outsiders Are Required to Play Active Roles

○ In comparison with the aforementioned situation, there may be exceptional cases in which, for example, trust or confidence in the incumbent president/CEO is lost due to the occurrence of a large-scale systematic scandal, considerable deterioration in earnings, or other circumstances under which the president/CEO is found to be incompetent, and consequently it may not be possible to expect the incumbent president/CEO to formulate and administer an appropriate succession plan or make a proposal concerning the nomination of a successor.

89 Refer to “4.1.2 Situation Where Outsiders Are Required to Play Active Roles.” In addition, refer also to “2.1 President/CEO” of “2. Advice Targets and Advised Matters” in Appendix 3 “Points of View in Utilization of the Nominating Committee and the Compensation Committee.”
In such case, it is necessary for outsiders such as outside directors to proactively play a leading role in deciding whether the replacement of the incumbent president/CEO is required and its timing, and develop succession planning processes toward the replacement of the president/CEO and the nomination of a successor, which include convoking a meeting of the nominating committee and making a proposal to the board of directors.

From the standpoint of enhancing the stability of processes, it is also regarded as beneficial to specify, in the rules of the nominating committee or other relevant rules, that outsiders hold relevant authority and responsibilities. However, even if there are not such express provisions, the chairperson of the nominating committee, its outside members such as outside directors, and other outside directors are required to be aware that they personally assume relevant roles and responsibilities, and take the initiative in implementing appropriate actions in such cases as that described above.

In this regard, outsiders who take the initiative in succession planning and successor nomination should recognize that they are not necessarily familiar with internal information, and thus collect sufficient information, for example, by requesting necessary information from executives, follow necessary processes and undertake careful consideration over and over with a humble attitude.

<Reference: Corporate Governance Code>

[Principle 4-3 Roles and Responsibilities of the Board (3)]
“The board should view the effective oversight of the management and directors from an independent and objective standpoint as a major aspect of its roles and responsibilities. It should appropriately evaluate company performance and reflect the evaluation in its personnel assessment of the senior management...”

[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 via an appropriate evaluation of the company’s business results.”

[Supplementary Principle 4-3-[3]]
“The board should establish objective, timely, and transparent procedures such that a CEO is dismissed when it is determined, via an appropriate evaluation of the company’s business results, that the CEO is not adequately fulfilling the CEO’s responsibilities.”

4.2. Nominating Committee

4.2.1. Necessity for Supervision by the Nominating Committee

As a measure to ensure the objectivity and transparency of successor nomination processes, it should be considered that the nominating committee should proactively participate in the formulation and administration of succession plans and properly supervise such plans.

The selection of outstanding presidents/CEOs for the sake of improving mid- and long-term corporate value is an important role of the board of directors, and the primary responsibility for supervising succession planning lies with the board of directors90.

90 According to the revised Corporate Governance Code, the establishment of a “voluntary nominating committee chiefly consisting of independent outside directors” is a general rule in “cases where a listed company is a Company with Board of Company Auditors or a Company with Audit and Supervisory Committee, and its independent outside directors do not account for a majority of the members of the board of directors.” However, even in other cases, the establishment of a nominating committee as an advisory body of the board of directors to supplement its monitoring function, and the assignment of a substantive monitoring function targeting succession planning to this committee (or
On the other hand, there exist some issues; for instance, since internal directors (executives) are subject to the right to decide personnel affairs held by the incumbent president/CEO, they cannot be expected to effectively monitor proposals made by the president/CEO. Also, it is a structural problem that many internal directors are actually potential successors and thus hold an interest in successor nomination. Moreover, due to the fact that a high level of confidentiality attaches to succession plans, it is not realistic to have substantive discussions concerning such plans especially at meetings of the board of directors largely consisting of internal directors.

As shown above, in cases where it is difficult for the board of directors at a company to effectively monitor succession planning or successor nomination, such company should consider establishing a nominating committee chiefly consisting of outside directors as an advisory body of the board of directors, having it proactively participate in the formulation and administration of succession plans and carry a function to substantively supervise such plans, and creating a system to have the committee provide the board of directors with its reports and opinions on successor nomination.

In this case, the board of directors is to entrust the nominating committee with supervision of the formulation of administration of succession plans, and grasp the supervision status of the committee by receiving reports on important matters associated with the supervision from the committee as required. Also, it is desirable that the appointment of presidents/CEOs should sufficiently respect opinions of the nominating committee.

4.2.2. Roles of the Nominating Committee

It should be considered that the objectivity and transparency of successor nomination processes should be ensured by having the nominating committee participate in such processes in all aspects and check that the internal logic of the company is not prioritized and such processes do not fall into subjective/arbitrary judgments.

The nominating committee is required to participate in succession planning from the first stage of its processes, ensure that insiders including the incumbent president/CEO sufficiently fulfill their accountability, check that the internal logic of the company is not prioritized and such processes do not fall into subjective/arbitrary judgments, and thereby secure the objectivity and transparency of succession planning and successor nomination. The fact that the nominating committee merely deliberates and confirms the final candidate selected by insiders such as the president/CEO in the final stage is not really sufficient to conclude that the committee has sufficiently fulfilled its roles; it is required to proactively participate in and appropriately supervise the overall processes of succession planning.

(Examples of matters deliberated and confirmed by the nominating committee)

- Reasonableness of the overall succession planning processes (roadmap)
- Reasonableness of the “ideal image of a president/CEO” and evaluation standards
- Reasonableness of the successor candidate selection policy

making succession planning a voluntary matter to be submitted to the statutory nominating committee for advice) should be regarded as reasonable since, for example, the appointment of a representative executive is not a statutory matter for resolution by the nominating committee even at a Company with Nominating Committee, etc., and the degree of confidentiality of successor nomination and succession planning is extremely high due to their nature.

This Appendix 4 uses the term “nominating committee” not for the sake of its name but focusing on its substantive function as an advisory body in charge of supervising succession plans for presidents/CEOs. Since judgments on the continuous service or replacement of the incumbent president/CEO and discussions on the nomination of successors are closely associated with the performance evaluation of management members, a company may consider having its compensation committee that is well familiar with such evaluation take part in such judgments and discussions and utilize the experience and knowledge of the committee. Furthermore, the establishment of a separate committee specializing in succession planning for presidents/CEOs and successor nomination may be effective.
- Reasonableness of the fostering policy and plan for successor candidates
- Fostering status and evaluation of important successor candidates
- Reasons for selecting the final candidate and reasonableness of such selection

There can be various different approaches to how specifically the nominating committee discusses individual successor candidates, depending on the number and scope of candidates in the candidate group and the period of time until the expected timing of replacement of the president/CEO, among other details.

- For example, pertaining to successor candidates for the president/CEO whose replacement is scheduled to take place in the near future, on the basis of the importance of succession, it is desirable that the nominating committee should individually understand each of such candidates and discuss the fostering status and evaluation results of the candidates in detail.
- In contrast, the candidate group for next-generation senior management is regarded as a pool from which successor candidates for a succession plan are selected, and thus the fostering of candidates in the group is effective when it is coordinated with succession plans. However, it may not be necessarily realistic to expect outside directors to be able to individually grasp in detail and evaluate all of such candidates in some cases. Thus, a company may choose to limit the coverage of outside directors’ supervision to a certain level by having them mainly confirm such processes as those associated with the candidate selection policy and fostering policy, and may leave the actual operation of succession plans to insiders such as the incumbent president/CEO.

Furthermore, it is beneficial to actively utilize the knowledge of outside directors and others in the nominating committee, for example the ability of individuals with management experience to judge managers, not only in guaranteeing objectivity by checking for any points of improvement in draft plans prepared by insiders, but also in reflecting diverse values and multi-layered thoughts in discussions on the “ideal image of a president/CEO” and the formulation of evaluation standards and in evaluating successor candidates and identifying their suitability.

4.2.3. Composition of the Nominating Committee

- On the basis that it is a role of the nominating committee to appropriately supervise succession planning for presidents/CEOs, each company should consider arranging the composition of the committee as chiefly made up of outsiders such as outside directors.
- On the other hand, in supervising succession planning, it is essential to take account of internal information and affairs, such as the management environment surrounding the company and information on successor candidates. Accordingly, the inclusion of the incumbent president/CEO and other management members, who are well familiar with such information and affairs, in the nominating committee as its members may contribute to substantializing discussions held by the committee. In particular, as the incumbent president/CEO assumes a leading role in implementing the formulation and administration of a succession plan, the involvement of a person in such position in discussions as a member of the nominating committee may make the committee’s involvement in and supervision of the formulation and administration of a succession plan more substantial in some cases.

- However, in examining whether to include the incumbent president/CEO and other management members as members of the nominating committee, it is also necessary to take into consideration the facts that the incumbent president/CEO holds a direct interest in whether his/her replacement takes place and its timing, and that many of other management members may potentially be successor candidates and thus have an interest in successor nomination. In cases where the

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92 With regard to the composition of the nominating committee, refer to “3. Composition of the Committee” in Appendix 3 “Points of View in Utilization of the Nominating Committee and the Compensation Committee.”
incumbent president/CEO and/or other management members are included as members of the nominating committee, special attention is required to relevant problems, particularly in relation to the operation of the committee; for instance, they need to leave meetings depending on subject matters of discussion, which are to be discussed only among outsiders in the absence of the incumbent president/CEO and management members.

4.2.4. Support for the Nominating Committee

○ For outside members of the nominating committee to effectively supervise succession plans, the provision of sufficient information to them for making judgments is essential.

○ Furthermore, the existence of a secretariat that supports the nominating committee as at its beck and call is crucially important in securing the effectiveness of the committee’s supervision, since such secretariat may take charge of the collection, organization and provision of information necessary for the administration of the committee and for evaluation of successor candidates, the arrangement of opportunities for outside committee members to have contact with successor candidates, and the organization and summarization of discussions held by the committee.

○ From this viewpoint, relevant parties are expected to make active efforts in this regard; for instance, the president/CEO should strive to develop a sufficient support structure for the nominating committee, and outside members of the nominating committee should expressly request executives to provide information as required.

5. Verbalization and Documentation of Succession Planning

A company should consider verbalizing and documenting important matters pertaining to succession planning so as to be able to share such matters with the nominating committee responsible for supervision.

○ Because succession planning requires appropriate supervision by the board of directors and the nominating committee and requires them to secure its objectivity and transparency, it is considered necessary at a minimum that important matters pertaining to the formulation and administration of succession plans are verbalized and the details of such matters are presented to and shared with the nominating committee responsible for supervision and other relevant organs. In addition, the verbalization of schedules, evaluation standards and other relevant details may be regarded as necessary from the standpoint of allowing multiple members of the nominating committee to have reasonable discussions on the same ground at committee meetings.

○ Moreover, from the standpoints of ensuring the effectiveness of supervision by the nominating committee and the stability and continuity of processes over a mid- and long-term period, and of enabling the accumulation, looking-back, review, etc. of discussions, it is considered beneficial to document the roles and authority of the nominating committee and an overview of discussions held at its meetings in such forms as rules, materials or meeting minutes of the nominating committee or other forms, and to store such documents in an integrated fashion.\(^{93}\)

○ Furthermore, for the nominating committee, which is an advisory body, to fulfill its accountability to the board of directors, it is important to put the details of its deliberation and grounds for its judgments into writing.

\(^{93}\) “Documentation” referred to in this section does not necessarily mean the preparation of a systematic document named “succession plan,” but supposes the preparation of relevant documents for succession planning in such forms as materials or meeting minutes of the nominating committee or other bodies, and the storing of such documents for their respective required periods. Such documents normally contain highly confidential information, such as information on candidates, and require particularly strict information management. Basically, the disclosure of such documents themselves is not expected (also, refer to “8. Information Provision”).
(Examples of matters that may potentially be verbalized)

- Roadmap for a succession plan
- Roles and authority of the nominating committee in relation to succession planning and successor nomination
- “Ideal image of a president/CEO” and evaluation standards
- Important successor candidates and their fostering policy
- Reasons for selecting the final candidate

6. Invitation of External Human Resources

○ In Japan, there are not many cases in which presidents/CEOs are appointed from the outside of their companies. However, in some cases, the successor pool is limited if only internal human resources are available. From the perspective of selecting the most prominent successors, it is beneficial to consider including external human resources as potential candidates and screening successors in a wider-ranging candidate pool.

○ Especially, for example, in cases where, at a company that has well expanded its business globally, any experience or qualification that insiders do not possess is required from its next president/CEO due to a drastic change in the management environment surrounding the company, where a company has a serious management issue and has no choice but to carry out a radical reform, or where a urgent replacement of the president/CEO is required due to unforeseen circumstances and there is no time to foster internal personnel, the relevant company should actively consider inviting external human resources.

○ Furthermore, in a case where all successor candidates are internal human resources, it is inevitable that the nomination of a successor is examined solely by comparing internal human resources. Comparison between internal human resources and external human resources and benchmarking the former against the latter can help understand the relative situations of successor candidates, and contribute to confirmation of the eligibility of candidates within the company.

○ In the meantime, although top management are required to have deep understanding of businesses, the problem that Japan faces is its lack of a market for external managers with such understanding. Additionally, it is also pointed out that when the invitation of external human resources is considered, it is necessary to pay special attention to the motivation and morale of internal human resources. There are considered to be cases where it may take a reasonable period of time for external human resources to be able to embody the company’s management philosophy and sense of value.

○ Thus, since appointment from among internal human resources and the invitation of external human resources have both merits and demerits, each company is to consider whether or not to invite external human resources on the basis of its own situation.

7. Ideal Approaches to Succession Planning for Companies Falling Under Special Cases

○ The above outlined viewpoints on engagement in the formulation and administration of succession plans and successor nomination do not necessarily apply to all listed companies.

○ For instance, some listed subsidiaries are found to be in the situation where a president/CEO is

94 There are considered to be cases where a company considers appointing an outside individual as president/CEO, it may be beneficial to temporarily receive him/her as the manager of a business unit or a top management member at a key subsidiary in lieu of immediately appointing him/her directly as president/CEO, provide him/her with opportunities to acquire the company’s management philosophy and sense of value and to understand its businesses, and identify whether he/she is suitable with his/her achievements at the business unit or subsidiary also taken into consideration.
determined according to the intention of the parent company or dispatched by the parent company according to customary practice. Thus, it is not realistic for such listed subsidiaries to formulate succession plans and foster and nominate successors on their own. However, it is desirable, in a normal situation, even for such listed subsidiaries to work together with their parent companies and engage in the formulation and administration of succession plans toward the nomination of the most suitable successors to their top management positions.

○ Moreover, in the case of a company whose management depends on the abilities and skills of a charismatic manager and which has no plan for replacement of its top management position for the time being, it may not be realistic to formulate and administer a succession plan by specifically assuming a timing of replacement of its top management position. However, for a company of this type, management risks potentially arising from an urgent replacement of its charismatic manager due to unforeseen circumstances are extremely high, and consequently the necessity of formulating an emergency plan and making preparations for such circumstances is higher than other companies. In addition, in preparation for a future replacement of the charismatic manager, the necessity of embarking on the fostering of successor candidates over a long time span is also higher than other companies95.

○ In relation to an owner-managed firm whose management members are selected from parties associated with its founder’s family according to its customary practice, general succession planning may not necessarily be applicable, either. With regard to such firm, its peculiarity lies in the fact that its successor candidates are virtually limited to those related to its founder’s family. If it is not realistic for it to select a successor with qualifications commensurate with its top management position from a wide-ranging human resource pool, its necessity of engaging in the fostering of successor candidates associated with the founder’s family to equip them with qualifications commensurate with the top management position is especially high.

○ At such companies under special circumstances, the creation of a form of succession planning similar to those of other companies is unlikely to work in practice; it is rather important for those companies to recognize their special circumstances and discuss what actions they can actually take in order to accomplish the purpose of replacing their top management positions with the best suited successors at optimal timings.

8. Information Provision

| A company should consider providing information on succession planning processes and successor nomination processes, on the composition, roles and involvement of the nominating committee, and other relevant matters to stakeholders such as shareholders, since succession planning for its presidents/CEOs and the nomination of successors are significant matters of concern for them. |

○ Whether or not a company has a system to replace its top management position with the best suited successor at an optimal timing is a serious matter of concern for stakeholders such as its shareholders, investors and staff, because this has an impact on its corporate value.

○ On this basis, from the standpoints of enhancing the transparency of succession planning and successor nomination and winning the trust and conviction of stakeholders, it is beneficial to disseminate information on succession planning processes and successor nomination processes, on the composition, roles and specific involvement of the nominating committee responsible for supervising such processes, and other relevant matters, to an extent that the disclosure of such

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95 For companies falling under this type, it should be beneficial to start by, as the first step, considering the way the company should be after its charismatic manager has stepped down.
information to the outside will not cause any problem.\textsuperscript{96,97}

9. Case Examples of Specific Efforts

○ The description below introduces, as examples, the specific efforts of leading companies that have actively engaged in the formulation and administration of succession plans for presidents/CEOs and appropriate supervision thereof.

○ Ideal approaches to the formulation and administration of succession plans may differ according to the situation of each company. For that reason, the details described below introduce companies’ specific efforts as they are, including those details that are not necessarily according to the basic framework organized above. Additionally, many of the companies mentioned below are still going through trials and errors and taking various measures with an awareness of their respective issues, in order to reinforce the effectiveness of their succession planning. Therefore, the efforts below should not be necessarily treated as perfect forms or the general-purpose best practice, but are supposed to be referred to as a diverse range of examples when each company discusses what efforts are necessary for nomination of a suitable individual for its top management position.

9.1. Company A

\textit{<Reference: Case Examples of Specific Efforts [1]>}

- Organization design: Company with Nominating Committee, etc.
- Respondent: Chairperson of the board of directors (former president)

(Processes, etc.)

- Under the framework of our company, throughout the entire succession planning processes, the incumbent president proposes a draft plan first, and the members of the nominating committee brush up the details of such plan by asking questions, providing advice, offering opinions and making requests.
- Specifically, the incumbent president was first asked to make a proposal on what processes we were to go through in the time ahead to proceed with the company’s succession planning, and the nominating committee deliberated the proposal. In so doing, in particular, what roles the committee was to fulfill in the relevant processes were confirmed.
- Subsequently, the incumbent president was asked to make a proposal in relation to his view on the requirements and qualifications required from a successor of the president. In response, the members of the nominating committee expressed their opinions reflecting their respective backgrounds, and had a heated discussion. In this discussion, the committee covered not only the requirements and qualifications generally required from top management but also what unique requirements and qualifications our company was seeking on the basis of the current situation of our company and our businesses and characteristics. Through this discussion, we brushed up the requirements and qualifications required from a successor of the president.
- Next, on the basis of the above requirements and qualifications, the incumbent president selected a group of candidates (a few, at first). In response, the members of the nominating committee requested some explanations about the appropriateness of the number and scale of

\textsuperscript{96} For instance, the specific details of the “ideal image of a president/CEO” may contain details closely associated with corporate management strategies, and therefore inevitably there is considered to be a limit on information provision.

\textsuperscript{97} Also, while the announcement or publication of the details of a succession plan to successor candidates and personnel within the company may contribute to the growth of successor candidates through facilitation of sound competition among such candidates, it is necessary to exercise special care for officers and employees who are not selected as successor candidates, for any effect on the motivation or morale of the candidates who are not ultimately appointed as the successor, and for the mood inside the company.
candidates in the group and whether or not it was necessary to consider inviting personnel outside, and held a discussion on these matters. In this discussion, the members reached a common recognition concerning the invitation of external personnel; it was desirable for an outsider to be involved in the company for at least five years, assume various roles and develop his/her understanding of the company before assuming office as president.

- Furthermore, the nominating committee discussed points of concern in implementing an assessment. Normally, we use external professionals for the implementation of an assessment. In addition to the items of assessment such professionals usually use, we request them to add other assessment items unique to our company in relation to the assessment viewpoints that our company regards as particularly important.

- After the implementation of the assessment, the incumbent president was asked to provide explanations on the assessment results of each candidate and to propose a future fostering plan based on such results, and the members of the nominating committee expressed their opinions in these regards.

- The fostering plan for each candidate has been carried out chiefly by the incumbent president, and the fostering situation is reported to the nominating committee every six months. In parallel with this, the members of the nominating committee also watch for the successor candidates on a daily basis. Also, the training of the successor candidates and the identification of their suitability have been carried out; for instance, at meetings of the board of directors, its members deliberately asked the successor candidates hard questions to observe their responses; and the members of the nominating committee hold discussions among themselves.

- Currently, we are narrowing down the successor candidates one by one while continuously engaging in the above processes.

- When ultimately narrowing down the successor candidates to the last one, our processes are that the president proposes and explains a draft plan, the nominating committee discusses it, and then the board of directors deliberates it and makes a decision.

- We have engaged in succession planning on the basis of the following two scenarios: [1] the case where the president is to be replaced upon the expiration of the term of office prescribed in internal rules; and [2] the case where the term of office is to be extended. Some of the successor candidates are listed as such under both the scenarios, while the others are listed as such under only one of the scenarios.

- Although succession planning is not prescribed in the company’s internal rules or other similar rules, discussions held at meetings of the nominating committee have been recorded as meeting minutes and materials. Furthermore, the requirements and qualifications required from successors have also been recorded as materials of the committee.

(Fostering)

- The fostering methods differ between the successor candidates in Scenario [1] and those in Scenario [2]. There is only one or two career positions that the company expects the successor candidates in Scenario [1] to experience before becoming the president, and they are currently in such positions. On the other hand, the successor candidates in Scenario [2] are required to be the leaders of small-scale business projects first and, when successful in achieving good results, then to take charge of larger-scale business projects.

(Committee)

- Since what kind of person is to be in the top management position of the company is important, we consider it necessary to include individuals who are well familiar with internal affairs in discussions in order to hold substantive discussions concerning succession planning. At our company, however, there are internal non-executive directors, and thus executives are not members of the nominating committee.
The nominating committee learns new viewpoints by hearing opinions of individuals with management experience. Although there are cases in which it is difficult for the president to make judgments, insiders still hesitate to express dissenting opinions to the president. Against this backdrop, it is extremely important that outside directors and other similar positions express their opinions at meetings of the board of directors and the nominating committee, even if the conclusions of discussions remain the same.

(Emergency plan and crisis response plan)

- A person to act on behalf of the president in the case where the president is unable to act as such due to unforeseen circumstances has been designated. The role of this person is to act as pinch hitter and determine the next president within a short period of time while keeping the company from collapsing.
- In the case of considerable deterioration in earnings or other similar events, the nominating committee will take the initiative in replacing the president.

9.2. Company B

<Reference: Case Examples of Specific Efforts [2]>

- Organization design: Company with Nominating Committee, etc.
- Respondents: Person in charge in the human resources department, and person in charge in the legal department

(Subject)

- The system of our company enables the nominating committee to add positions other than the president position as the subjects of its succession planning, if the committee considers it should do so. However, what the board of directors and the committee should consider most is the next president, and basically there is no problem as long as these bodies properly hold discussions concerning the next president. We think it is not realistic for outside directors to discuss the succession planning of many positions.

(Processes, etc.)

- Who is to be the next president involves high-level and complex decision-making, which, we believe, should not be regarded so much in a uniform or fixed manner. Accordingly, we do not have established elaborated systematic processes.
- With changes in the businesses of the company group, the top management are required to comprehend diverse matters. Consequently, it has become even more challenging to identify individuals who can observe the entire group. In this situation, the current system has been developed from the standpoint of increasing the probability that appropriate leaders are selected.
- Under the system, the incumbent president prepares a draft succession plan, and outside directors review it at a meeting of the nominating committee. Since the incumbent president is well aware of the internal affairs of the company, it is not realistic to proceed with succession processes without hearing his opinions. Still, there is a process of confirming that a draft plan prepared by the incumbent president is truly appropriate. For instance, the officer in charge of personnel affairs, who takes charge of the secretariat of the nominating committee, screens successor candidates in consultation with the incumbent president, and prepares a draft plan. Subsequently, if outside directors raise any points about the draft plan from different standpoints, the incumbent president and the officer in charge of personnel affairs reconsider it on the basis of the points raised.
- The image of the workings of the system is that the chairperson of the nominating committee,
the incumbent president, and the officer in charge of personnel affairs, who supports the
president, work together as a core and proceed with the processes to determine the next
president.

- There were approximately ten candidates at the beginning, who were then narrowed down to
  a few on the basis of an evaluation conducted by the incumbent president and through
discussions held by the nominating committee. Through this process, a few short-term
successor candidates and a few mid- and long-term successor candidates have been selected.
Compared with the short-term successor candidates, relatively younger individuals were also
considered for mid- and long-term successor candidates.

(Qualifications required from a president)

- Management abilities, leadership, the understanding of global-scale business, the flexibility to
  respond to drastic changes in the management environment without being shackled by
conventional practice, diversity, mental toughness have been designated as the qualifications
required from a president.
- Although such qualifications are not formally formulated in the form of a “requirement sheet,”
  the nominating committee discusses such qualifications, and these qualifications are updated
  where necessary.
- Although it is difficult for the candidates to have all the above qualifications, we occasionally
  ask the nominating committee to return to the qualifications and to consider in such manner
  as, “How qualified is this candidate?”
- The above qualifications are not shared with employees.

(Fostering)

- Discussions held by the nominating committee mainly focus on the aspect of identifying,
  “Whether or not this candidate is suitable for the next president.” Fostering is not, for example,
a matter for resolution by, or to be reported to, the committee. Despite that, when the succession
plan of the president is discussed, naturally we make mention, “To foster the next resident, it
is necessary to have the candidates experience this.”

(Evaluation)

- The nominating committee checks the backgrounds, experience (non-experience) and
  achievements of the successor candidates, and their evaluations carried out by outsiders.
- We check the strengths and weaknesses of the successor candidates by conducting awareness
  surveys targeting all employees and using other means.
- The candidates have been compared with and benchmarked against global external resources.
- 360-degree evaluation has also been conducted for strong successor candidates.
- Measures have been taken for outside directors to get to know the successor candidates, which
  include having the candidates provide explanations at meetings of the board of directors and
  providing them with one-to-one interviews with outside directors and coaching.

(Committee)

- Many parties including the secretariat take part in meetings of the board of directors, which
  renders it difficult to have discussions concerning the succession plan of the president. In
addition, when a discussion is held at a meeting of the board of directors, at which a large
number of individuals attend, there is a risk that the details of such discussion may spread. For
that reason, our system requires the nominating committee to have discussions and carry out
evaluations first.
- The nominating committee discusses the succession plan of the president twice a year.
However, since the succession plan of the president is treated as a mission of the committee, the committee members are sharply conscious of who is suitable to be the next president, and have conversations about the plan on a routine basis, for example, “Concerning that person, this is his/her positive quality as a president (candidate), whereas that is his/her negative quality.” The two meetings annually held by the nominating committee can be described as a forum to hold discussions by consolidating such discussions as mentioned above in a fixed-point-observation-like manner.

- The incumbent president is a member of the nominating committee. Insiders may be asked to leave the room to allow outside directors to have a discussion only among themselves in some cases.

- An overview of discussion held by the nominating committee is reported to the board of directors. Although it is an overview, it sufficiently indicates what the nominating committee discussed. In the phase of ultimately selecting the president’s successor, the board of directors is to have a serious discussion again, taking opinions of the committee into consideration.

(Invitation of external human resources)

- At the current moment, personnel who have a good understanding of the businesses of the company are considered suitable for the position of president, and thus we do not factor external human resources into the current succession plan. However, in the phase of actual succession, we believe that whether or not it is necessary to consider receiving external human resources is one of the points to be confirmed by the board of directors and the nominating committee.

(Emergency plan and crisis response plan)

- It is considered that the short-term successor candidates have also been selected for an emergency plan. Naturally, the company has to take into account any eventuality.

9.3. Company C

<Reference: Case Examples of Specific Efforts [3]>

- Organization design: Company with Nominating Committee, etc.

- Respondents: Person with experience of serving as head of the office for the board of directors, person in charge of corporate governance, and person in charge of personnel affairs

(Purpose of efforts, etc.)

- A company cannot grow higher than the caliber of its president. We consider that top management assume such serious roles. The era during which continuing to do the same things as yesterday could lead to growth has ended. We believe that our company cannot survive, unless a person who can create a new business in the drastically-changing management environment assumes the office of president.

(Processes, etc.)

- Approximately ten candidates selected by executives receive individual interviews with outside directors, individual coaching, group interviews and other opportunities, through which the potential of each candidate is evaluated. In addition, the candidates are evaluated through third-party evaluation by external experts and on the basis of the situation of their growth through coaching.

- Upon the request of members of the nominating committee for “In order to prevent any unconscious bias in the selection of candidates, re-implement the selection of candidates with
that perspective in mind,” the selection of additional candidates was carried out.

- Our company has not specifically determined what to do by when. Although we think we should make our candidates ready in a few years (three to five years), this timing may be moved forward or backward as there can be some change in the management environment.
- The annual schedule of the nominating committee is documented to be shared among its members. The details of this schedule are reported to the board of directors by the chairperson of the nominating committee.

(Fostering)
- Next-generation management leader candidates receive tough assignments.
- Several dozen important positions that may have an impact on the business performance of the company have been identified, hundreds of personnel who may be able to become candidates for those positions have been selected, and a fostering program has been implemented for such personnel. The top management of the company are deeply involved in this fostering program.
- Among the personnel under the fostering program, particularly outstanding personnel have been selected as next-generation management leader candidates. Thus, the fostering program organically functions as a mechanism to support the background of our succession plan.

(Committee)
- The nominating committee consists of three outside directors and one internal director. As this committee deliberates the appointment and dismissal of presidents, the president who is an interested party is not its member.
- Eight meetings of the nominating committee were held during fiscal 2017, at which the succession plan was frequently discussed.
- We believe that only managers can raise managers. Accordingly, in order to establish direct contact between outside directors including individuals with management experience and the candidates, one-to-one individual interviews are held once in a few months.
- It may be difficult for parties other than executives to come up with an idea of who is the best individual for the company’s businesses. We rather ask outside directors to observe the candidates from substantive viewpoints such as the following: whether the candidate is the right person for the top of the group, whether the candidate is mentally prepared as a manager, how the candidate would lead officers and employees, what sense of risk the candidate has, and how the candidate would interact with outsiders.
- Outside directors and executives have common objectives and are in a relationship of considering “what type of captain would be ideal for the ship called company in order to reach its destination with its compass” together. As long as this good trust relationship continues, our system will not become a mere facade.

(Sharing within the company)
- The candidates have been notified that they are next-generation management leader candidates.

(Emergency plan and crisis response plan)
- Since required responses may differ depending on circumstances, we have not created a list indicating “the next president is this person.” We suppose that in times of emergency, an extraordinary meeting of the nominating committee will be held to have a discussion. Despite that, if the nominating committee and executives maintain good communication with each other on a routine basis, we consider that they can smoothly deal with such emergency with speed.
(Invitation of external human resources)
- We believe that a person who can manage the company with an understanding of its culture among other factors is desirable. On the basis of this perspective, the appointment of an outsider straight to the office of president requires careful consideration.

(Succession plans of listed subsidiaries)
- We consider that it is necessary also for our listed subsidiaries to engage in succession planning. Although listed subsidiaries maintain their independence as listed companies, the fostering program of the parent company (our company) also covers the personnel of listed subsidiaries.

9.4. Company D

<Reference: Case Examples of Specific Efforts [4]>
- Organization design: Company with Nominating Committee, etc.
- Respondents: Office of the board of directors, and section in charge of the human resources department

(Subject)
- In addition to our company’s own top management, company heads, the top management of core subsidiaries and other relevant positions are covered by our succession plan.

(Processes, etc.)
- For candidates for the president’s successor, 360-degree evaluation, third-party evaluation by external experts, question-and-answer sessions, and other relevant evaluations are conducted.
- The basic principles and other relevant details of our succession plan are documented and published.

(Fostering)
- Candidates for the president’s successor have assumed posts in which they can polish their qualifications as managers.

(Committee)
- Taking account of opinions of the president, the nominating committee deliberates the timing of replacement of the president, personnel requirements applicable to the president’s successor, the setting of a candidate pool, the fostering and evaluation of candidates, the grasping of the characters of candidates, the determination of the president’s successor and other relevant matters. Whether or not the replacement of the president is necessary is considered annually.
- Although the president is not a member of the nominating committee, the committee may request the president’s attendance and hear his opinions. Since outside directors do not possess sufficient information, it is considered necessary for them to hear opinions of executives.
- Each committee member comprehends the qualifications, abilities and “personality” of each candidate, for example, by attending meetings of various meeting bodies, participating in off-site meetings, and interviewing the candidate. For instance, off-site meetings are arranged separately from board meetings as a forum for outside directors to receive explanations about matters that they need to know to deliberate management policies and other similar matters, and to hold free discussions. As a secondary effect, these meetings serve as opportunities for outside directors to get to know the characters of the company’s management members. Since outside directors spend considerable time and energy striving to understand the characters of candidates as described above, they can understand the “personalities” of candidates despite
being outsiders.

(Emergency plan and crisis response plan)

・ A person to temporarily exercise the powers and authority of the president on behalf thereof in the event where the president is unable to act as such due to unforeseen circumstances has been designated.
・ In other emergency situations, this point is also taken note of in updating the candidate pool annually.

(Fostering of next-generation personnel)

・ We have been implementing a program whose basic concept is to discover a wide range of next-generation management leaders at an early stage and to foster them strategically and systematically over a time span of approximately ten years. This program targets personnel lower than executive officers.
・ The purpose of the program is to raise the level of the pool of human resources for senior management candidates, rather than fostering a single outstanding manager.
・ Hundreds of diverse personnel are selected on a group-wide and global scale as candidates. Candidates are not limited to comprehensively excellent personnel, but an emphasis is also placed on the human resource portfolio by field. The fostering of personnel in a field with a small number of candidates is particularly intensively implemented. The pool of human resources is reviewed on a periodic basis, including the replacement of personnel in it and additional selection of human resources.
・ For candidates classified into three classes, a cycle consisting of the following processes is repeated in the following order: assessment/feedback - leadership training - coaching - strategic assignment - evaluation - re-selection/replacement. Through an assessment, each candidate receives a program corresponding to his/her issues, and coaching conducted by external experts encourages candidates to undergo behavioral changes. In the stage of strategic assignment, candidates gain experience of working in important positions or positions that involve a high level of burden.
・ The president is also deeply involved in leadership training. Furthermore, outside directors are involved in such program.
・ Although this program is managed separately from our succession plan, we hope that the program will produce a new-generation president and other top management.

9.5. Company E

<Reference: Case Examples of Specific Efforts [5]>

・ Organization design: Company with Nominating Committee, etc.
・ Respondents: Manager of and person in charge in the section responsible for the operation of the board of directors and committees

(Subject)

・ In addition to our company’s own top management, other officers and executive candidates (the highest class for employees) are covered by our succession plan. Furthermore, our succession plan has been determined on a group-wide basis, which includes officers of core subsidiaries.

(Qualifications required from a president)

・ As an evaluation and fostering indicator for candidates, officers’ competency has been set. The
more a person embodies this competency, the more suitable to be a top management member that person is regarded as. Although appointment criteria for directors have been established, we do not have separately established appointment criteria peculiar to the position of president.

- The essence of the competency is also incorporated into evaluation of management members and employees.

(Processes, etc.)

- The president finds out about the situation of each group company by hearing from its top, compiles a group-wide succession plan on the basis of the situations of group companies, and seeks advice from the nominating committee.

- Personnel under the succession plan are categorized according to classes, and screening and fostering programs are implemented. Personnel subject to the screening process and those subject to the fostering process are not necessarily the same.

- In the screening process, interviews with outside directors and assessments by external consultants are carried out.

- In the fostering process, training courses are mainly held. In addition, each year, management seminars are held for approximately twenty employees in the department manager class and the store manager class with the company’s top management taking part in them, in which such employees receive lectures delivered by well-known business persons, opportunities to acquire knowledge necessary for business management, interactive talks given by representatives, etc., and leadership training and workshops given by external lecturers (simulation training for managers, such as mock board meetings with the incumbent management members), among other events.

(Successor recommendation system)

- Each officer excluding outside officers is required to specify the following three types of human resources: [1] a candidate for his/her successor; [2] a type of person suitable for his/her position from a mid- and long-term perspective; and [3] personnel expected to be officers in the future.

(Committee)

- The nominating committee consists of outside directors only.

- The nominating committee discusses an overview of the succession plan and an overview of assessment implementation.

- We ask outside directors to take sufficient time to observe the characteristics of candidates, for example, by having candidates provide explanations at board meetings, arranging interviews, having outside directors participate in internal events, and planning social gatherings.

(Invitation of external human resources)

- We may potentially invite external human resources at the officer level. However, in the current situation, we do not think we will appoint individuals from the outside or abroad as our top management.

(Emergency plan and crisis response plan)

- As an emergency plan, we have appointed a few representatives other than the president. However, we have not decided that the top management position will definitely be selected from among them in the case where the president is unable to act as such due of unforeseen circumstances.
The details of proposals for appointment of directors at listed subsidiaries are also deliberated by the nominating committee of the parent company (our company) from the standpoint of group business administration.

However, with regard to the personnel affairs of the management members of each listed subsidiary, we consider it necessary for its own nominating committee to independently and firmly discuss such affairs.

9.6. Company F

<Reference: Case Examples of Specific Efforts [6]>

- Organization design: Company with Company Auditor(s)
- Respondent: Outside director (chairperson of the nominating committee)

(Processes, etc.)

- We believe that it is too early to start considering the next successor immediately after the replacement of a president. Rather, the business performance of the new president should mainly be evaluated when it is immediately after the replacement of a president. We think we should start paying attention to the next successor about two to three years after replacement.
- It is not necessary to consider the term of office of a president rigidly. As long as the nominating committee functions as a mechanism to rigorously evaluate a president, we consider that there is no need to have a specific term of office. We are continuing to make necessary preparations including human resource development for the roughly expected timing of replacement, which would take place probably in six to eight years from now. It is necessary to prepare a pool of human resources for successor candidates a few years prior to the expected timing of replacement. Despite that, an earlier replacement than the expected timing is possible depending on evaluation results of the performance of the incumbent president.
- In addition to internal evaluation, candidates for the president’s successor receive evaluation and interviews conducted by the nominating committee, third-party evaluation by external experts, and coaching.
- With regard to evaluation of managerial human resources, since examination by comparing among internal human resources has limitations, managerial human resources are compared with external human resources in the market.
- Managerial human resources are divided into such layers as the executive candidate class and the department manager candidate class, and a candidate list is created for each layer and is reviewed each year. The higher a layer is, the more detailed our check is: for example, whether there are “immediate” candidates, and whether there are candidates to be ready within two to three years.

(Committee)

- The nominating committee consists of the company chairman, the president and outside directors. Outside directors account for a majority of the committee members, and the committee chairperson is also an outside director.
- Since the atmosphere of the nominating committee allows committee members to discuss harsh performance evaluation results without hesitation even in front of the president, the attendance of the president when evaluating the performance of the president poses no problem. However, when the committee is to discuss whether the president is to continue serving as such or to be replaced, such discussion should be held in the absence of the president.
- Up to which layer the nominating committee’s involvement in personnel affairs should go
remains debatable. We consider that the committee is not required to know individual candidates up to the executive officer class, although it should still supervise the mechanism to pick up candidates.

(Invitation of external human resources)
* It is not necessary to limit successors to internal human resources. If there is no suitable person in the company, or if the company administration is not doing well, we should consider utilizing external human resources.

9.7. Company G

<Reference: Case Examples of Specific Efforts [7]>
* Organization design: Company with Company Auditor(s)
* Respondents: Head of the office for the board of directors, and person in charge of corporate governance

(Background of efforts, etc.)
* We consider that the ultimate corporate governance responsibility that a company has to fulfill is to appoint or dismiss presidents/CEOs.
* With advancing globalization and diversification of business areas and employees in the 2000s, we considered it necessary to visualize our president/CEO nomination processes and thereby ensure fair and open selection in order to obtain the understanding of stakeholders such as employees. On this basis, we established an advisory organ specializing in the appointment of presidents/CEOs, and started relevant efforts.

(Premise)
* On the basis of our corporate principles, we formulated “long-term visions” for the purpose of improving our corporate value in a sustainable manner, and possess a management structure to formulate and put in practice a mid-term management plan and a short-term management plan on the basis of the long-term visions. The president/CEO is responsible for implementing all of these.

(Organization design)
* Since the nomination of presidents/CEOs is positioned differently from the nomination of other directors and senior management, a committee specializing in the former was established. More transparency and fairness are required from this committee. For that reason, with regard to the composition of this committee, an independent outside director acts as chairperson, independent outside directors make up a majority of the committee members, and all the committee members are non-executive directors.

(Roles of the committee)
* The committee deliberates the following three points annually, and reports its findings to the board of directors:
  1) The president/CEO during the next fiscal year (in the case of reappointment, evaluates and deliberates on the basis of his/her actual performance);
  2) The president’s/CEO’s successor during the next fiscal year in the event of emergency; and
  3) The succession plan of the president/CEO.
The committee annually appoints a president/CEO for the next fiscal year. When making a proposal for reappointment, the committee evaluates the president/CEO on the basis of his/her performance results and other relevant factors, and deliberate his/her reappointment by reference to evaluation results. When making a proposal for new appointment, the committee engages in deliberation through the succession process for presidents/CEOs below.

A successor during the next fiscal year in the event where the president/CEO encounters an emergency has been decided separately from the succession plan of the president/CEO below. This is a preparation for the risk that the president/CEO becomes unable to fulfill his/her duties due to unforeseeable circumstances, and is deliberated by the committee as one of the matters important for corporate governance.

We have taken up a challenge to maintain a process to screen and foster competent personnel and to select candidates for the position of president/CEO on the basis of the results of such screening and fostering. We utilize human resource strategies for the screening and fostering of human resources for senior management, and the committee supervises these processes. The committee works toward the realization of nomination of the selected president/CEO candidate as the next president/CEO.

In nominating the next president/CEO, the members of the committee evaluate each candidate through board meetings and other face-to-face occasions.

An important factor concerning the monitoring function that outside directors are asked to fulfill is the nomination of presidents/CEOs. Accordingly, individuals with management experience and individuals equivalent thereto are appointed as outside directors.

A few years prior to replacement, a list of successor candidates was shown to the committee. Some contact was arranged between the committee and successor candidates, which included the arrangement of opportunities for successor candidates to make reports at board meetings and the arrangement of meetings. Thus, the nomination process was implemented with opportunities to come into direct contact with successor candidates arranged.

The circumstances surrounding this nomination were disclosed in the annual report for the year after the nomination of a new president/CEO (then).

9.8. Company H

<Reference: Case Examples of Specific Efforts [8]>

Organization design: Company with Company Auditor(s)

Respondent: Person in charge of corporate governance

We treat the process of listing president successor candidates and narrowing down this list as succession planning. On this basis, the determination of personnel to be entered in the list of
president successor candidates and the fostering of listed personnel are regarded as the roles and missions of the president.

- Objectives concerning succession planning are included in the president’s own strategic objectives annually formulated by the president.
- Today, not all parts of succession planning have been specified in writing. For instance, in the future, it is necessary to consider such matters as the following: in an emergency situation requiring the replacement of top management, who is to propose such replacement through what procedure, who is responsible for supporting, and whether or not it is appropriate for employees belonging to the executive side of the company hierarchy to provide support.

(Fostering)

- As a fostering program for the group of candidates for next-generation senior management, training courses and other learning opportunities are provided to young personnel to acquire MBA-related skills and management knowledge.
- In contrast, it is considered important for management members to gain actual experience of engaging in business operations and duties.

(Committee)

- As a common deliberative organ for the nominating committee and the compensation committee, we have established a subcommittee specializing in evaluation of the president.
- The subcommittee evaluates the performance of the president, and deliberates the adequacy of the level of compensation and the appropriateness of reappointment or replacement, among other details.
- The subcommittee consists of all outside directors and all outside auditors. Since it is considered necessary to take into consideration opinions of outside auditors who possess more information on the company compared with outside directors and to evaluate the president and successors in a multilateral and comprehensive manner, outside auditors are selected as members of the subcommittee.
- In order to avoid any problem in examining the adequacy of a draft plan for a president successor, the incumbent president is not a member of the subcommittee although he attends its meetings to provide explanations where necessary.
- The subcommittee conducts an interview with the president three times a year. The first interview is to set objectives, the second interview is a semiannual review, and the third interview is to evaluate the annual period concerned. The president receives comments and feedback from the subcommittee.
- In reporting the progress of the president’s own strategic objectives and his achievements, the president reports to the subcommittee on the details of programs and assignments implemented to foster successor candidates.
- In an exceptional case, for example where the president is unable to act as such, the committee may possibly play a leading role.
- Many aspects concerning the authority and responsibilities of the committee and concerning the manner of its involvement in succession planning are still under consideration.

(Emergency plan and crisis response plan)

- A person to act on behalf of the president in the event where the president is unable to act as such due to unforeseen circumstances has been designated, since a representative other than the president has been selected.
<table>
<thead>
<tr>
<th>Past president nomination</th>
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<tr>
<td>· Each candidate, for example, exchanged opinions and had informal talks with a certain number of outside directors.</td>
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<tr>
<td>· Assessments conducted by external experts were also used as reference materials.</td>
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</tbody>
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9.9. Company I

<Reference: Case Examples of Specific Efforts [9]>

- Organization design: Company with Nominating Committee, etc.
- Respondents: Head of the office of the board of directors, and manager of the human resources department

(Background of efforts, etc.)
- Triggered by the formulation of the Corporate Governance Code in 2015, we started discussing our succession plan at meetings of the nominating committee (then, a voluntary advisory committee).

(Qualifications required from a president)
- The incumbent president prepared a draft proposal on the basis of advice from external experts, and the nominating committee discussed the proposal.
- Successor candidates are numerically evaluated from the aspect of such qualifications.

(Fostering)
- Management seminars are held for each of the group of candidates for next-generation senior management and the group of manager candidates.
- On the basis of a list of human resources submitted by each group company, the human resources department of the head office creates a candidate pool and selects personnel to receive management seminars from the pool. Personnel in the candidate pool may be transferred by the head office exercising its right to decide personnel affairs.
- It is considered that the greatest mission of group-wide personnel affairs is to continue producing future managerial human resources all the time.

(Committee)
- The nominating committee consists of two internal directors and three outside directors. The committee chairperson is an outside director.
- The nominating committee discusses the succession plan of the president at least once a year. Compared with the time when the president decided personnel affairs alone, discussions held by the nominating committee have led to the better consent of employees within the company to their personnel affairs.
- The nominating committee comprehensively evaluates successor candidates on the basis of third-party evaluation by external experts, and the daily business execution and annual performance evaluation results of each candidate. Third-party evaluation by external experts is regarded as highly objective and reliable.
- After the above process, the nominating committee discusses what careers successor candidates should pursue in years to come.
- The chairperson of the nominating committee reports an overview of its discussions to the board of directors. Since a succession plan contains extremely sensitive information such as the names of successor candidates and the timing of replacement of the incumbent president, it is regarded as difficult for the board of directors to directly supervise the succession plan of the president.
- An outline of the progress of proceedings at meetings of the nominating committee, including succession planning, and the results of such proceedings are stored by the legal department as meeting minutes.
9.10. Company J

<Reference: Case Examples of Specific Efforts [10]>

- Organization design: Company with Company Auditor(s)
- Respondents: Manager of the human resources department, and person in charge of corporate governance

(Succession plan of the president/CEO)
- The handbook for all employees specifies that top management are required to always consider the fostering of successors as one of necessary preparations.
- The personnel advisory committee composed of the company chairman, the president and outside directors discusses candidates for the president’s successor. Although the personnel advisory committee does not micromanage the selection of individuals as successor candidates, it discusses and defines the company’s “ideal image of a president.”

(Succession plans of personnel other than the president)
- Personnel in the officer class, the general manager class or the department manager class are required to constantly consider the fostering of successors to their own posts and, as an assignment during the summer vacation each year, to list not only their successors but also their successors’ successors. Consequently, they have made a habit of being aware of their own successors on a daily basis, which encourages them to assign difficult jobs to candidates for the purpose of improving these candidates.
- In order to allow outstanding personnel to gain and accumulate diverse experience, the head office may play a leading role in transferring them, irrespective of the intention of their immediate superiors.

- End -