Provisional translation

Practical Guidelines for Corporate Governance Systems (CGS Guidelines)

Executive Summary

Toward Realization of

Effective Corporate Governance

経済産業省

Regarding This Executive Summary

This Executive Summary is an overview of the main recommendations set out in the “Practical Guidelines for Corporate Governance Systems (CGS Guidelines)” (formulated on March 31, 2017, and revised on September 28, 2018 by the Ministry of Economy, Trade and Industry).

Pertaining to the recent revision to the CGS Guidelines, this Executive Summary is prepared for management such as presidents and CEOs as well as personnel engaging in realization of effective corporate governance to readily grasp the essence of the CGS Guidelines.

As guidelines covering practical approaches for corporate governance formulated by the Ministry of Economy, Trade and Industry (METI), and maintaining coherency with and working as a supplementary document to the “Corporate Governance Code” (put into force since June 1, 2015, and revised on June 1, 2018 by the Tokyo Stock Exchange), the CGS Guidelines detail the significant points that companies should consider in implementing major principles that contribute to the realization of effective corporate governance stipulated in the Corporate Governance Code, and also compile specific, productive actions that companies should take to fortify their earning power.

Furthermore, in addition to the recommendations specified in this Executive Summary, the CGS Guidelines feature numerous pieces of information that companies can refer to in considering corporate governance systems suitable for them, which include the basic concept behind the recommendations, practical matters to be considered, various possible measures that companies can take, and initiatives taken by some advanced companies as examples.

In this Executive Summary, the right side of each page contains the corresponding section number(s) of the CGS Guidelines. It is thus our hope that you will use this Executive Summary as a starting point and refer to the CGS Guidelines as well.

Practical Guidelines for Corporate Governance Systems (CGS Guidelines)

URL：https://www.meti.go.jp/english/press/2018/0928_005.html

[Composition of the CGS Guidelines]

	Main Details	Main Target Readers
Main Text	• Ideal Approaches to the Board of Directors • Ideal Approaches to Utilization of Outside Directors • Ideal Approaches to Nomination and Compensation of Management Members • Ideal Approaches to the Leadership of Management Members	Management members such as the president/CEO
Appendix 1	Points of View in Consideration of the Roles and Functions of the Board of Directors	Corporate executives and other managers in charge of corporate governance
Appendix 2	Points of View in Utilization of Outside Directors	
Appendix 3	Points of View in Utilization of the Nominating Committee and the Compensation Committee	
Appendix 4	Points of View in Formulation and Administration of a Succession Plan for a President/CEO	

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CONTENTS

1. Significance of Corporate Governance

- 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 can be facilitated through creation of added value and productivity enhancement 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. Main Text 1.1
- 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. 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. Main Text 1.2
- 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.
- 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. Main Text 1.3

2. Ideal Approaches to the Board of Directors

Roles and Functions of the Board of Directors

Main Text 2.1
Appendix 1

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

  - The functions of a board of directors include a monitoring function and a decision-making function.

Monitoring function	Function of monitoring by evaluating business execution through nomination of management members (among others, a president/CEO who is at the top of management) and determination of their compensation
Decision-making function	Function of making specific decisions on individual business execution

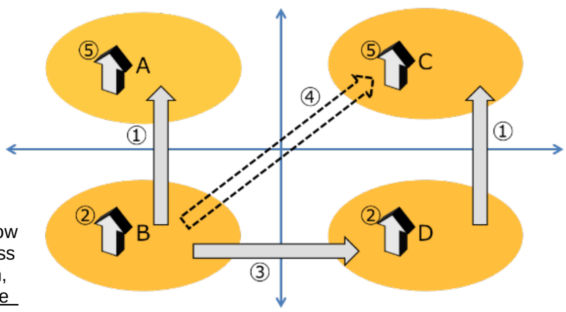
  - In order to ensure that a board of directors effectively functions, it is important for it to fulfill not only the decision-making function but also the monitoring function, as well as to decide basic management strategies and plans underlying the functions.

  - In considering the rules and functions of a board of directors, as illustrated in Figure 1 below, such rules and functions can be categorized into the following quadrants: [1] whether the number of decisions on individual business execution by the board of directors is small or large (vertical axis), and [2] whether the powers of the president/CEO are centralized or decentralized (horizontal axis). Efforts to enhance the monitoring function of the board of directors (I axis) are necessary in each quadrant.

Roles and Functions of the Board of Directors

Makes less decisions (specializes in the monitoring function)

Decentralized



Centralized

* Vertical axis does not show the strength and weakness of the monitoring function, and <u>efforts to enhance the monitoring function</u> are necessary in each quadrant.

Makes more decisions (also places a focus on the decision-making function)

Vertical axis	・ The vertical axis shows the categorization of whether a board of directors makes many decisions on individual business execution (whether a focus is also placed on the decision-making function) or whether a board of directors makes only few decisions on individual business execution (whether the board specializes in the monitoring function). ・ The vertical axis does not indicate the strength and weakness of the monitoring function (specializing is not the same as strengthening).
Horizontal axis	・ The horizontal axis shows the categorization of whether the powers of the president/CEO in execution of business are decentralized or centralized.
Dimensional axis	・ The dimensional axis shows the categorization of whether or not the monitoring function of the board of directors is strong (i.e., effective).

- 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. Main Text 2.2 Appendix 1

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. Main Text 2.4

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 its 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. Main Text 2.5.1

Development of Organizations Handling Corporate Governance

- A company should consider developing a framework for taking internal and external corporate governance-related actions effectively. Main Text 2.5.4

3. Ideal Approaches to Utilization of Outside Directors

Toward Utilization of Outside Directors

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

Main Text 3.2
Appendix 2

[Points of View in Utilization of Outside Directors]

❶ Scene of considering whether outside directors are necessary and the image of desired outside directors

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.

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.

Examples of roles and functions expected	Examples of roles and functions not expected
・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	・Provision of detailed guidance on individual business execution ・Preparation of the original plans of management strategies ・Active search for and detection of clues to unfair practice carried out at the level of corporate personnel in charge

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.

❷ Scene of looking for outside director candidates and asking them to assume office as such

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

Step 5: Check the eligibility of outside director candidates

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.

❸ Scene of having outside director candidates assume office as such and play active roles at the company

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.
- 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 what the board of directors should be and what the company expects from outside directors.
- 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.
- A company should consider electing a lead independent outside director so that outside directors can have a smooth dialogue with management members or with shareholders and other stakeholders.

❹ Scene of evaluating the performance of outside directors and considering reappointing or dismissing them

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

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

- A company should consider reappointing or dismissing outside directors based on evaluation of outside directors.
- 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 company should consider utilizing its nominating committee consisting chiefly of outsiders, when it examines the reappointment or dismissal of an outside director.
- A company should consider establishing standards for reappointment of outside directors, which 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.

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.
- 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.

Main Text 3.3

4. Ideal Approaches to Nomination and Compensation of Management Members

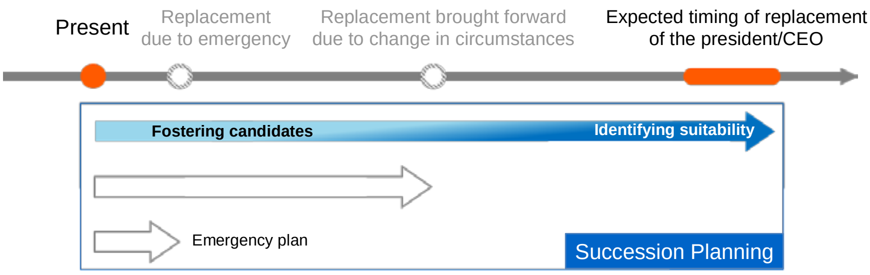
Nomination and a Succession Plan of a President/CEO

- 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 a Succession Plan with sufficient time and resources allocated for such planning, in order to ensure that the nomination of excellent successors takes place at optimal times. (Main Text 4.1.1, Appendix 4.1)

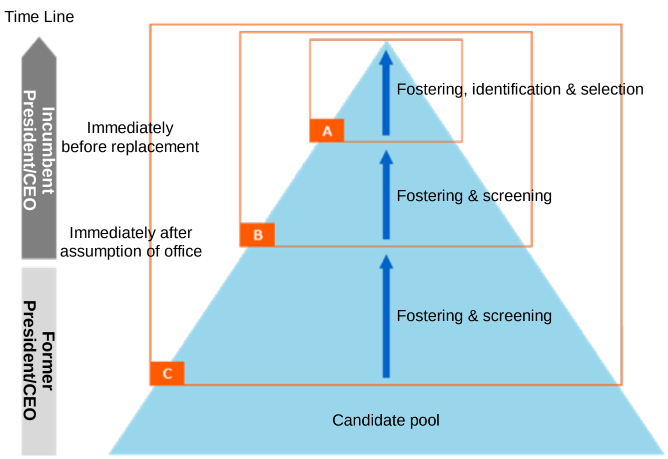
  - In comparison with the past in which the Japanese economy as a whole could expect a constant growth, the present age has seen the advancement of dynamic and aggressive — also often considered as “revolutionary” — changes in the management environment due to globalization and digitalization among others. Against this backdrop, issues concerning management have become complex, for which the mere continuity of existing policies or an extension of existing measures are not sufficient, and the implementation of fearless management reforms that defy the 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.

  - It is one of the responsibilities of listed companies to appropriately handle future 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 under unforeseen circumstances. Accordingly, it is desirable for companies to assume various different scenarios and engage in a Succession Plan on multiple time lines.

  - From the perspective of selecting the most prominent successors, there may be cases in which it is appropriate to consider appointing successors from the outside, depending on the circumstances of each company. (Appendix 4.6)



- 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 a Succession Plan as an important part of his/her own responsibilities.
  Each president/CEO should consider embarking on a Succession Plan right from the time of assumption of the office of president/CEO, in anticipation of his/her own replacement. (Main Text 4.1.1, Appendix 4.2)



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

Step 1	Drawing up a roadmap for a Succession Plan
Step 2	Formulating an "ideal image of a president/CEO" and evaluation standards ▌ The nominating committee should deliberate on and clarify the "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.
Step 3	Selecting successor candidates
Step 4	Formulating and implementing a fostering plan
Step 5	Evaluating, narrowing down and, if applicable, replacing the successor candidates
Step 6	Evaluating the final candidates and nominating the successful successor
Step 7	Supporting the successor after nomination

Main Text 4.1.3
Appendix 4.3

Division of Roles between Insiders and Outsiders

- The nominating committee of a company should consider making efforts to appropriately supervise the company's a Succession Plan 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 a Succession Plan processes for nomination of a successor.

Main Text 4.1.4
Appendix 4.4.1

Board of Directors and Nominating Committee

- A board of directors should appropriately supervise a Succession Plan and consider implementing the replacement of a president/CEO and the nomination of a successor through highly objective and transparent procedures. Main Text 4.1.2

- 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. Appendix 4.4.2

- 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.

Verbalization and Documentation of a Succession Plan

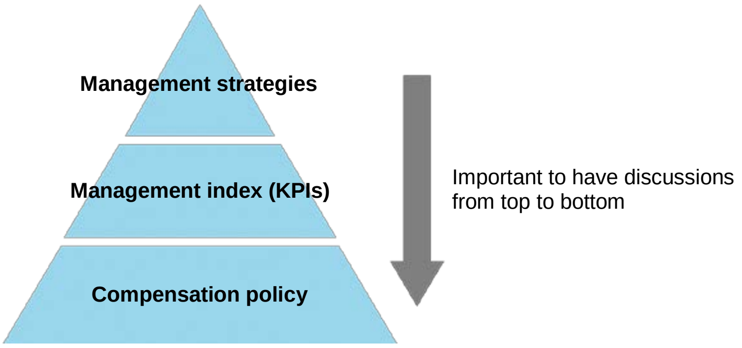
- A company should consider verbalizing and documenting important matters pertaining to a Succession Plan so as to be able to share such matters with the nominating committee responsible for supervision. Appendix 4.5

Information Provision

- A company should consider providing information on a Succession Plan 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 a Succession Plan for its presidents/CEOs and the nomination of successors are significant matters of concern for them. Appendix 4.8

Main Text 4.2

- In designing its executive compensation system, a company should consider introducing performance-linked compensation and stock-based compensation.
  - In considering a compensation policy, a company needs to have its management strategy in effect. It is important to proceed in the following sequence: on the basis of the management strategy, set up Key Performance Indicators (KPIs) that are to serve as specific goals, and then consider compensation systems that help achieve such goals. Considering a compensation policy without any management strategy will not provide management members with an appropriate incentive.



- 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 consider actively 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.

5. Ideal Approaches to Utilization of the Nominating Committee and the Compensation Committee

Utilization of the Nominating Committee and the Compensation Committee

- A company should consider utilizing a statutory or voluntary nominating committee for appointment or dismissal of a president/CEO and supervision of a Succession Plan.
- In order to improve the effectiveness of appointing or dismissing a president/CEO, a company should consider utilizing a statutory or voluntary compensation committee in tandem with its nominating committee.
- 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.

Main Text 4.3

Advice Targets and Advised Matters [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.
- 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.
- 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) even during ordinary times.

Appendix 3.2.1

Advice Targets and Advised Matters [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.
- 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.

Appendix 3.2.2

Advice Targets and Advised Matters [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. Appendix 3.2.3
- 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.

Composition 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. Appendix 3.3.1
  Furthermore, a company may consider utilizing outside auditors on a supplemental basis to increase the ratio of outsiders.
- 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. Appendix 3.3.2
- If the president/CEO is included as a member of a committee that gives advice on the appointment and dismissal of presidents/CEOs and/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. Appendix 3.3.4

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. Appendix 3.4
  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.

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. Appendix 3.5

6. Ideal Approaches to the Leadership of Management Members

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

Main Text 5.1.2

- 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.
- 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.
- 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 experiences, from the standpoint of contribution to society.

Ideal Approaches to the Chairman of the Board

Main Text 5.2

- 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.

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