



Japan's Corporate Governance Code and ISS' Director Election Policy

Frequently Asked Questions

1. Where does Japan's Corporate Governance Code currently stand?

In response to a request from Prime Minister Abe, Japan's Financial Services Agency and the Tokyo Stock Exchange (TSE) jointly launched a panel in the fall of 2014 to discuss the establishment of Japan's Corporate Governance Code. The panel announced its final draft of the Code in December 2014, and this is expected to be finalized in the spring of 2015. The Code is most likely to require companies to appoint at least two independent outside directors, or else to explain their reasons for not complying with the rule.

2. How will companies react to Japan's Corporate Governance Code in the 2015 proxy season?

Based on the final draft of the Code, the TSE announced on Feb. 24, 2015 that it will amend its listing rules to require all companies listed on the TSE 1st and 2nd sections to fully adopt the code. Although the revised listing rule will take effect on June 1, 2015, just before Japan's 2015 proxy season, interim measures will be put in place, extending the deadline for companies to submit their Corporate Governance Report, that includes compliance or non-compliance (explanation) with each of the Code requirements, to December 2015.

3. Are companies likely to be in compliance with the Code and listing rules by June 2015?

Many large-cap companies have already appointed multiple outside directors, or are planning to do so by June. However, the new listing rule applies to approximately 2400 companies, and smaller companies in particular are likely to face challenges in recruiting qualified outsiders. Accordingly, a significant portion of Japanese companies will likely fail to comply by June 2015, and will instead disclose (by December) their reasons for non-compliance.

4. What is ISS policy for 2015 on board composition in Japan?

For 2015, ISS policy will continue to be to recommend votes against the top executive(s) at a company if the board after the shareholder meeting does not include at least one outside director. [See the ISS 2015 Japan Voting Guidelines for our policies regarding controlled companies and those with three-committee board structures.] As previously communicated to the market, beginning in February 2016 ISS will recommend votes against the top executive(s) at a company if the board does not include multiple outsiders*.

* "Multiple outsiders" could mean two outsiders (regardless of independence) or two outsiders (at least one of whom is independent). The definition may depend on factors such as the provisions of Japan's Corporate Governance Code, currently in the draft stage. The new policy may initially be applied only to large companies (i.e., those in major indices).

5. Will the adoption of the Code affect 2015 ISS policy on directors?

No, because the introduction of the Code prior to the 2015 proxy season was already taken into consideration during the discussions regarding ISS's 2015 policy updates which started in the summer of 2014. ISS sought comments from investors, issuers and regulators during the consultation period on changing ISS policy to require multiple outside directors. Most of the respondents pointed out that it would not be realistic to require multiple outside directors in 2015 as the vast majority of companies currently do not have multiple outside directors on the board (less than one third of Japanese boards include multiple outsiders and less than one sixth of Japanese boards include multiple independent directors), and that corporate Japan would have to find more than 3,000 new outside director candidates in less than a year. As a result, ISS decided to give companies a one-year grace period so that they can recruit qualified outside director candidates with suitable skills and backgrounds.

6. How will companies disclose their compliance or explanation for non-compliance with the Code?

Based on the proposed listing rule change, the TSE will require companies to update their corporate governance reports only after their annual shareholder meetings, even after 2016. Therefore, it is unlikely that investors will be able to make informed decisions based on the explanation of companies not complying with the Code. The TSE is seeking public comments on its revised listing rule until March 26, 2015.

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