Poison Pills (Japan)

Background and Overview

The current ISS Japan poison pill policy was formulated at the time when Japanese companies first started to introduce pills. Given the potential for pills to be misused, particularly by insider-dominated boards, the policy was intended to set a reasonably stringent threshold for Japanese companies, factoring in corporate governance and information disclosure practices at that time.

Today, the situation is different from what it was a decade ago. There is a noticeable trend toward accepting outside oversight at Japanese companies and an increasing number of companies have started to make their proxy circulars available to shareholders on the stock exchange websites in recent years.

Key Changes Under Consideration

ISS Japan policy specifies a number of conditions which must be met before ISS will consider recommending support for a takeover defense. Those conditions are composed of five components: plan features, board practices, special committee, other defenses, and information disclosure. Updates are proposed on the following three components:

Board practices

Require boards to have at least <u>one-third</u> independent directors who meet ISS guidelines on attendance, instead of the current <u>20 percent</u> threshold.

Special committee

Require all members of the special committee charged with evaluating a bid to be either independent directors or independent statutory auditors who meet ISS guidelines on attendance. The current policy requires all committee members to be independent, but not necessarily directors or statutory auditors of the company.

Information disclosure

Require proxy circulars to be disclosed on the stock exchange website at least four weeks prior to the meeting. The current policy requires printed proxy circulars to be mailed at least three weeks prior to the meeting.

Intent and Impact

This change is intended to update the current policy to reflect the changing corporate governance profile and information disclosure at Japanese companies and to reflect the best practices defined under Japan's newly established Corporate Governance Code.

- **Board practices**
  - Board composition of Japanese companies has improved significantly in the past several years. The code recommends that companies appoint at least two independent outside directors (based on the Tokyo Stock Exchange independence definition) and encourages one-third independent boards.
- **Special committee**
  - A decade ago, the average number of outside directors and statutory auditors combined was less than three, which made it difficult for companies to set up a special committee composed entirely of outside directors or statutory auditors. However the average is now more than four. Some investors have raised concerns that special committee members who are not directors or statutory auditors cannot be held accountable through a shareholder vote or a derivative suit for their actions taken as members of the special committee. The code requests directors and statutory auditors to carefully examine the pill in light of their fiducial responsibility to shareholders.
- **Information disclosure**
  - In 2015, on average, circulars are mailed 19 days prior to the meeting date. The code recommends that companies disclose electronic versions of their circulars prior to the official release of the printed version. Because circulars are usually finalized more than a week before they are printed and mailed, requiring disclosure of the electronic version of the finalized circular 28 days before the meeting should not be an unreasonable burden for issuers. It is an easy way to see how seriously companies take the issues of disclosure and overall shareholder friendliness.

Request for Comment

- Does your organization consider the proposed policy changes appropriate? If not, why not?
- Does your organization consider statutory auditors (who are responsible mainly for compliance and not for business judgment) qualified to be members of special committees charged with evaluating takeover offers?