

# Board Composition (Japan)

## Background and Overview

Until recently, all-insider boards were common in Japan, and few boards had more than one outside director. However, in the last several years there has been a significant increase in the number of boards with two or more outside directors, driven by increasing pressure from investors as well as the Corporate Governance Code which took effect in June 2015. Since 2013, ISS Japan policy has recommended votes against the top executive of companies whose boards do not include at least one outsider, and in 2015 ISS signaled to the market that the policy would be strengthened in 2016 to call for multiple outside directors on Japanese boards. Most Japanese companies do not have independent nominating committees, and the executive directors – particularly the most senior executives – are responsible for the composition of the board.

## Key Changes Under Consideration

The proposed new policy would result in negative recommendations against top executive(s) where the board, following the shareholder meeting, will not include at least two outside directors.

## Intent and Impact

The new policy is intended to encourage the trend toward increasing outside oversight on Japanese boards. Based on data from annual meetings held between January and June 2015, 55 percent of the companies in the ISS Japanese coverage universe had at least two outside directors. (The comparable figure for 2014 was 30 percent.) Among large companies, the percentage was much greater: 91 percent of the Nikkei 225, and 82 percent of the JPX 400, had appointed at least two outsiders. It is believed that by 2016, many of the mid-cap companies will follow the lead of the large-caps, and the number of companies affected by this policy will be significantly reduced.

Consideration was given to specifying that companies should appoint at least one *independent* outside director. However, concerns have been raised by investors that some companies are prioritizing formal independence over the nominees' backgrounds and qualifications, and in many cases are appointing academics, retired public servants, or celebrities with no corporate experience. Investors and media commentators have also questioned whether such directors are capable of exercising oversight or playing a meaningful role in the board's deliberations on strategic matters.

## Request for Comment

- As thousands of Japanese companies add outsiders to their boards in a relatively short time, what is the best way to balance the need for independent oversight of management with the need for well-qualified directors with corporate management experience?