



Governance  
for Owners

ガバナンス・フォー・オーナーズ・ジャパン株式会社

〒100-0013 東京都千代田区霞が関 3-7-1  
[www.g4owners.com](http://www.g4owners.com)

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*Original Draft*

Counselor's Office,  
Civil Affairs Bureau, Ministry of Justice  
Post: 1-1-1 Kasumigaseki, Chiyoda-ku, Tokyo 100-8977, Japan  
Email: [minji27@moj.go.jp](mailto:minji27@moj.go.jp)

31 January 2012

**Public Comments on the Interim Proposal concerning Revision of Companies Act**

Thank you for the opportunity to submit our comments in relation to the above-mentioned consultation.

By way of back ground, please find the following as co-signatories to this submission in alphabetical order.  
You can see the details about them in an Appendix.

California Public Employees' Retirement System, USA (CalPERS)  
California State Teachers' Retirement System, USA (CalSTRS)  
Co-operative Asset Management, UK  
F&C Asset Management, UK  
Florida State Board of Administration, USA (SBA)  
Fourth Swedish National Pension Fund, Sweden (AP4)  
Governance for Owners Japan, Japan  
PGGM Investments, The Netherlands  
PRMI Railway Pension Investments, UK (Railpen Investments)  
Standard Life Investments, UK  
Universities Superannuation Scheme, UK (USS)

As a group of long-term global investors, we continue to believe strongly that a company's directors should be accountable to shareholders who can reasonably expect the directors to pursue the creation of long-term corporate value.

We understand that there is no one perfect corporate governance structure for all countries; however we believe that directors' accountability to shareholders is the basic principle that has universal applicability beyond the peculiarities of each country's corporate governance regime.

We also support the Organisation for Economic Co-operation and Development (OECD hereafter) Principles of Corporate Governance stressing that minority shareholders should be protected from abusive actions by, or in the interest of, controlling shareholders. Minority shareholders are eventually citizens who have their pensions and life savings invested either directly or indirectly through long-term investors like us.



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We were very disappointed by the string of corporate scandals at Japanese listed companies in 2011, including Olympus Corporation and Daio Paper Corporation. We recognize that financial markets in the US, Europe and Asia have also undergone such scandals, and we note that those unfortunate cases have always brought corporate governance reforms, such as:

- 1970s: Financial misreporting and corporate collapses in the US led to “independent” outside directors and audit committees.
- 1980s: Corporate collapses in the UK led to the “Cadbury Report”.
- 1997: The Asian Financial Crisis led to sweeping regulatory change.
- 2002: The Enron and WorldCom fraud led to passage of the Sarbanes-Oxley Act, which brought about reform of company-auditor relationships, accountability for financial reports, greater board oversight.

Corporate scandals and the associated governance reforms have also stressed the benefits of good governance rather than focus purely on the negatives. The lessons learned from these experiences encourage global investors to fix our eyes on corporate governance reforms that can emerge in Japan following recent corporate scandals.

We would like to stress that some of the benefits which Japan and Japanese companies would gain from improved governance would be helpful

We would like to express our views in this regard as follows.



## Part 1 Corporate Governance

### I. Supervisory Function of Board of Directors

#### 1. Obligation to Appoint Outside Directors

Proposal A will obligate companies with a board of auditors (limited to public companies that are also large companies) to appoint one or more “outside” directors.

Proposal B will obligate companies that are required to submit annual securities reports pursuant to the provisions of Article 24(1) of the Financial Instruments and Exchange Act to appoint one or more “outside” directors, while Proposal C will have no changes.

For the board of directors to be accountable, it should be able to exercise objective independent judgment on corporate affairs, as described in the OECD Principles of Corporate Governance.

We will discuss the definition of “independent” in later paragraphs. In general, our concerns about “outside” directors and “outside” statutory auditors focus on whether outside statutory auditors or outside Kansayaku, even if they are truly independent, can provide the independent judgment that shareholders expect.

We understand that they can play a useful role in Japan, especially if they are truly independent. However, as with other signatories to 2009 “Asian Corporate Governance Association (ACGA hereafter) Statement on Corporate Governance Reform in Japan,” we see the role of independent directors and independent statutory auditors as complementary, but different. A director is a full member of the board and has commensurate powers and responsibilities, including the right to vote. A statutory auditor is not a member of the board and is there to audit the board, not to provide strategic business advice and guidance legally.

In this context, our logic would naturally lead to Proposal A requiring any company with board of auditors to have at least one “outside” director. Meanwhile, we understand that Proposal B would be a better coverage of listed companies which global investors are interested in. Therefore we would support Proposal B as a practical solution for us.

However we are not convinced that either Proposal A or B is an optimal proposal.

We agree with OECD Principles suggesting that boards should consider assigning a “sufficient” number of non-executive board members capable of exercising independent judgment.

Their annotations mention that board independence usually requires that a sufficient number of board members will need to be independent of management.

When it comes to a “sufficient” number, it would be natural to take it for at least “plural” or no less than three as the “ACGA White Paper on Corporate Governance in Japan” in 2008 suggests.



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We are concerned that the requirement of “at least one outside” directors in proposal A and B would be interpreted as a mere formality.

We, therefore, suggest that Japanese stock exchanges should require a “substantial” minimum to ensure that independent judgment is reinforced in the boardroom of a listed company.



## 2. Companies with Audit and Supervisory Committee

There are two legal systems of board governance in Japan - two-tiered structure of voting directors and non-voting statutory auditors adopted by 98% of listed companies and a three-committee unitary board structure adopted by just 2% of those.

The Interim Report proposes a third system of a supervisory committee unitary board structure. The proposed new system may have the merit of mitigating our concerns, as described in the above, that statutory auditors are complementary to but different from directors having commensurate powers and responsibilities, including the right to vote.

Our interests are always in the substance rather than the formality. In this regard, our concerns are that the new system is not mandatory; therefore relatively few companies may adopt it, as they have avoided the three-committee unitary board structure.

If that is the case, we are afraid that global investors may regard it as a mere formality and view Japanese companies which will not adopt either committee structure more skeptically.

In order to avoid such worry, it might be a good idea for a unitary board structure either of a three-committee or a newly introduced supervisory committee to be mandatory, rather than voluntary, for companies of a certain large size.

Another concern for us is how the new system will ensure independent judgment is applied in cases where there is a potential for conflict of interest.

OECD Principles refer to areas of potential conflict of interest, including the nomination of board members and key executives, board remuneration, the review of related party transactions, and ensuring the integrity of financial and non-financial reporting.

In this regard, we do not support any proposals that would prohibit a company with a supervisory committee from having a legal nomination committee or a legal remuneration committee, either of which should be dominated by independent “outside” directors.



### 3. Rules Concerning Outside Directors and Outside Company Auditors

Proposal A will propose the change to definition of “outsider” while Proposal B will not.

We would like to repeat that independent judgment is the key for directors’ accountability to shareholders. In this regard, the definition of “outsider” is the heart of corporate governance.

As with other signatories to 2009 “ACGA Statement on Corporate Governance Reform in Japan”, we believe that the definition of “outsider” in Japan’s Companies Act is weak and often confusing to global investors.

“Outside” directors and “outside” statutory auditors should be free from conflicts of interest as 2008 “ACGA Japan White Paper” and 2009 “ACGA Statement” reiterate.

Without amendment on the definition of “outsider”, we believe that independent judgment will not be able to be exercised by “outside” directors in a Japanese context.

We have to stress that the fact that there were three “outside” directors at Olympus Corporation is the unfortunate proof of the weak definition of “outsider” in Japan’s Companies Act and the failure to ensure that outsiders can render independent judgment.

We prefer a principles-based definition to artificial quantitative criteria as we believe that a principles-based definition will substantially contribute to the identification of independent directors who can add value to company boards. In this regard, proposal A is too partial to define independency.

We believe that at a minimum, the definition of “outsider” should be strengthened so that related persons of a subsidiary of the parent company (described in note 1) and a related person of an important business counterparty (described in note 2) are excluded.



## II. Audit Function of Statutory Auditors

### 1. Decisions on Proposals, etc., concerning the Selection and Dismissal of Accounting Auditors and their Compensation, etc.

Proposal A will permit statutory auditors (or the board of statutory auditors in the case of a company with board of statutory auditors) and the audit committee to have decision-making authority with respect to proposals and other matters concerning the selection and dismissal of external accounting auditors and their compensation, etc.

Proposal B will permit statutory auditors (or the board of statutory auditors in the case of a company with board of statutory auditors) and the audit committee to have authority concerning the selection and dismissal of external accounting auditors and to have concurring authority with respect to their compensation, etc. while Proposal C will not.

The Olympus scandal has highlighted the malfunctioning of their external accounting auditors, among other failures. Independence from management is crucial if auditors are to play the role shareholders expect them to play. To secure their independence from management, we support proposal A, which provides statutory auditors (or the board of statutory auditors in the case of a company with board of statutory auditors) and the audit committee with the full authority including remuneration of an external accounting auditor.

## III. Corporate Governance in Financing Activities

### 1. Issue etc. of Shares for Subscription through a Private Placement in conjunction with a Change in the Controlling Shareholder

#### (1) Necessity of Resolution of a Shareholders Meeting

Proposal A will require an ordinary resolution of a shareholders meeting in principle.

Proposal B will require one only if shareholders holding a number of voting rights exceeding one fourth (1/4) the voting rights of all shareholders make known their opposition to the issue etc. of the shares for subscription within a specified period, while Proposal C will not.

As a private placement could be used to ward off unwelcome corporate bidders or to change their ownership structure, causing substantial risk of conflict of interests between existing shareholders and the management or new shareholders, we believe existing shareholders deserve higher protection. In this regard, we support proposal A.

Apart from a case of change in the controlling shareholder, most global institutions may object to placements that exceed 10% in any one year as the 2009 “ACGA Statement on Corporate Governance Reform in Japan” suggests. Meanwhile, the level of dilution should be reasonable not only for third party allotments but for follow-on public offerings. Therefore we suggest that Japanese stock exchanges should have adequate rules to guard against excessive dilution both in third party allotments and follow-on offerings.



## Part 2 Rules concerning Parent and Subsidiary Companies

As mentioned in the preface, we believe that minority shareholders should be protected and we appreciate your proposals for protection of parent company shareholders and subsidiary minority shareholders.

We believe, however, that further consideration is needed on treatment of conflicted related parties as this is globally recognized as a serious issue on corporate governance. This should include excluding interested related parties from voting on a major related party transaction as is the case in many other jurisdictions.

### I. Protection of Parent Company Shareholders

#### 1. Multiple Derivative Action

Proposal A will establish a system allowing a shareholder of the parent company of a stock company to file an action (a multiple derivative action) for holding the directors etc. of that stock company liable while proposal B will not.

We have been concerned about corporate group structures where the parent company has limited supervisory authority over business activities of subsidiaries. While those may impact the group, the shareholders of its parent company do not reserve enough protection.

We would expect proposal A to provide such protection for the shareholders of a parent company.

#### 2. Assignment by a parent company of shares etc. of a subsidiary

This proposal will basically require a stock company to obtain approval for the assignment agreement by a special resolution of shareholders meeting prior to the effective day if it assigns all or some of the shares of its subsidiary.

We would support this however approval by shareholders of a parent company should be required not only for assignment of shares of its subsidiary but for other significant decisions such as restructuring or allocation of new shares to a third party by its subsidiary as they may impact the group.



## II. Protection of Subsidiary Minority Shareholders

### 1. Liability of Parent Companies, etc.

Proposal A will establish the written rule obligating a parent company to pay to its subsidiary an amount equivalent to the disadvantage if it incurred a disadvantage as a result of the transaction as compared to a hypothetical situation where that transaction did not take place.

Proposal B will not establish such written rules.

With respect to the listing of a company that has a parent company, we may be willing to invest in such companies as long as the rights of minority shareholders are appropriately secured.

As there may be inherent potential for conflicts of interest between the parent company and the minority shareholders of its listed subsidiary, we believe minority shareholders deserve higher protection.

We would expect proposal A to provide such protection for minority shareholders of a listed subsidiary.

## III. Cash Out

This proposal will permit the special controlling shareholder, who holds nine-tenths or more of the voting rights of a stock company, to make demand to all shareholders of the company for sale of all their shares to the special controlling shareholder.

Cash-out unilaterally relinquishes shareholders of their status as shareholders against their free will. This can, however, be done in principle with a special resolution requiring a two-thirds majority at a shareholders meeting in Japan. We believe that minority shareholders would need higher protection, for instance, to require nine-tenths majority.

## V. Request for Injunction on a Reorganization, etc.

Proposal A will establish the written rules specifying that in addition to a summary reorganization, in other reorganizations (excluding cases where the requirements for a simplified reorganization are satisfied), too, shareholders may request that the reorganization be stopped if the reorganization is in violation of laws and regulations or the articles of incorporation and there is danger of the shareholders of an absorbed company suffering a disadvantage. Proposal B will not establish such written rules.

We have no reason to oppose proposal A as it would provide existing shareholders with higher protection than proposal B.

Yours sincerely



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Anne Simpson  
Senior Portfolio Manager, Investments Head of Corporate Governance  
California Public Employees' Retirement System  
400 Q Street, Suite 4800 Sacramento, CA 95814  
United States

Anne Sheehan  
Director Corporate Governance  
California State Teachers' Retirement System  
100 Waterfront Place, MS-04 West Sacramento, CA, 95605-2807  
United States

Abigail Herron  
Corporate Governance Manager  
Co-operative Asset Management  
22nd Floor, CIS Tower, Miller St, Manchester M60 0AL  
United Kingdom

Mirza Baig  
Consultant Director Governance & Sustainable Investments  
F&C Asset Management  
Exchange House, Primrose Street, London, EC2A 2NY  
United Kingdom

Mike McCauley  
Senior Officer, Investment Programs & Governance  
Florida State Board of Administration  
1801 Hermitage Blvd., Suite 100 / Tallahassee, FL 32308  
United States

Annika Andersson  
Head of Corporate Governance  
Fourth Swedish National Pension Fund  
P.O. Box 3069 Regeringsgatan 30-32 SE 103 61, Stockholm  
Sweden

Toshiaki Oguchi  
Representative Director  
Governance for Owners Japan  
3-7-1 Kasumigaseki, Chiyoda-ku, Tokyo 100-0013  
Japan

Marcel Jeucken  
Managing Director Responsible Investment  
PGGM Investments  
Noordweg Noord 150, P.O. Box 117, 3700 AC Zeist,  
The Netherlands



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Frank Curtiss  
Head of Corporate Governance  
PRMI Railway Pension Investments  
2nd Floor, Camomile Court, 23 Camomile Street, London EC3A 7LL  
United Kingdom

Alison Kennedy  
Governance & Stewardship Director  
Standard Life Investments  
1 George Street, Edinburgh EH2 2LL  
United Kingdom

Dr Daniel Summerfield  
Co-Head of Responsible Investment  
Universities Superannuation Scheme  
6th Floor, 60 Threadneedle Street, London, EC2R 8HP  
United Kingdom



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#### Appendix : About the Co-signatories

##### **California Public Employees' Retirement System, USA (CalPERS)**

CalPERS is the largest public pension fund in the US whose mission is to advance the financial and health benefit security for approximately 1.6 million California public employees, retirees, and their families. CalPERS has more than US\$229 billion in assets under management as of January 18, 2012, comprised of a global portfolio of investments, including real estate, private and public equities, fixed income, inflation linked assets and cash. CalPERS firmly embraces the belief that accountable corporate governance will optimize long-term sustainable shareowner investment returns and implements a number of initiatives to improve corporate governance at companies in the global marketplace. ([www.calpers.ca.gov](http://www.calpers.ca.gov))

##### **California State Teachers' Retirement System, USA (CalSTRS)**

CalSTRS is the second largest public pension fund in the United States with approximately US\$150 billion in assets under management. CalSTRS administers retirement, disability and survivor benefits for California's 850,000 public school educators and their families from the state's 1,400 school districts, county offices of education, and community college districts. ([www.calstrs.com](http://www.calstrs.com))

##### **Co-operative Asset Management, UK**

The Co-operative Asset Management is a global investor with significant exposure to Japan. We operate a responsible investment approach and have AUM of £21.2Bn. ([www.co-operativeassetmanagement.co.uk](http://www.co-operativeassetmanagement.co.uk))

##### **F&C Asset Management, UK**

F&C Asset Management plc is a global asset management group based in United Kingdom. As at 30th of September 2011 assets under management (AUM) was £103 billion. In addition, F&C has been mandated to vote and/or engage in dialogue on behalf of a further 20 investment institutions whose assets, including equities and corporate bonds, total £59.billion. ([www.fandc.com](http://www.fandc.com))



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#### **Florida State Board of Administration, USA (SBA)**

The statutory mission of the SBA is to invest, manage and safeguard assets of the Florida Retirement System (FRS) Trust Fund and a variety of other funds for state and local governments. As of September 30, 2011, the net asset value of total funds under SBA management was approximately \$142billion. The FRS Pension Plan provides defined pension benefits to 1.1 million beneficiaries and retirees. The strong long-term performance of the FRS Pension Plan, the fourth-largest public pension fund in the nation, reflects our commitment to responsible fiscal management. The SBA strives to meet the highest ethical, fiduciary and professional standards while performing its mission, with a continued emphasis on keeping operating and investment management costs as low as possible for the benefit of Florida taxpayers. ([www.sbafla.com](http://www.sbafla.com))

#### **Fourth Swedish National Pension Fund, Sweden (AP4)**

AP4's belief is to manage Fund capital so as to generate the best possible return over time for Swedish pensioners and thus support the stability of the pension system. The Board has decided that AP4 will best fulfill its long-term asset management belief by holding a large proportion of publicly quoted equities, Swedish and foreign. Fund capital totaled SEK 216 billion at 30 June 2011. Equities accounted for more than 59% of assets and fixed income securities accounted for 34% of assets. The remaining 6% was invested in other assets such as real estate, private equity funds, and other alternative investments. ([www.ap4.se](http://www.ap4.se))

#### **Governance for Owners Japan, Japan**

Governance for Owners (GO) is an independent partnership between its executives and long term investors. ([www.g4owners.com](http://www.g4owners.com)) Its Japanese subsidiary GO Japan offers the Japan Engagement Consortium (JEC) to engage with major Japanese quoted companies to improve long-term shareholders' returns. Its members currently include Railpen Investments, USS and Tokio Marine Asset Management.

#### **PGGM Investments, The Netherlands**

PGGM is a Dutch pension administrator and asset manager acting on behalf of several Dutch pension funds, amongst which PFZW, the Dutch pension fund for the healthcare and welfare sector and second largest pension fund in Europe. PGGM currently manages over € 109 billion of pension assets for more than 2.5 million participants. Acting on the belief that financial and social returns go largely hand in hand, PGGM sees it as its duty to incorporate responsible investment principles into its investment process, thereby helping to secure a high and stable return. ([www.pggm.nl](http://www.pggm.nl))



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#### **PRMI Railway Pension Investments, UK (Railpen Investments)**

RPMI, through its wholly owned subsidiary Railway Pension Investments Limited (“Railpen Investments”), carries out investment management for the Railways Pension Trustee Company Limited, the corporate trustee of the railways pension schemes with £18 billion in assets at 31 December 2010. Railpen Investments is authorised by the FSA. RPMI provides nationwide coverage from its offices in Coventry, Darlington and London, currently looking after the pension interests of around 500,000 people in the UK on behalf of over 200 clients. The Trustee Company and its subsidiaries are long-term supporters of better corporate governance and responsible investment. We believe as a responsible investor that companies with interested and involved shareholders are more likely to achieve superior long-term financial performance than those without. Further details of our responsible investment policies, including our Japan Corporate Governance and Voting Policy, can be found at [www.rpmi.co.uk](http://www.rpmi.co.uk).

#### **Standard Life Investments, UK**

Standard Life Investments Limited, which is a subsidiary of Standard Life plc, is a major global investor, based in Edinburgh, with assets under management of £150 billion as at 30 September 2011. For Standard Life Investments, governance, stewardship and sustainability are integral to our investment process. Indeed, a cornerstone of our ‘Focus on Change’ philosophy and investment process is our belief that corporate stewardship has a fundamental impact on the achievement of long-term investment returns. As a global investor and shareholder, Standard Life Investments actively encourages best-practice standards in companies’ management of environmental, social and governance issues. ([www.standardlifeinvestments.com](http://www.standardlifeinvestments.com))

#### **Universities Superannuation Scheme, UK (USS)**

USS is the principal final salary pension scheme provided for academic and senior administrative staff in UK universities and other higher education and research institutions. The fund is the second largest pension scheme in the UK, managing in excess of £32 billion of assets on behalf of nearly 400 participating institutions and over 270,000 members. ([www.uss.co.uk](http://www.uss.co.uk))