

Japan



GLASS LEWIS

2025 Benchmark Policy Guidelines

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About Glass Lewis

Glass Lewis is the world’s choice for governance solutions. We enable institutional investors and publicly listed companies to make informed decisions based on research and data. We cover 30,000+ meetings each year, across approximately 100 global markets. Our team has been providing in-depth analysis of companies since 2003, relying solely on publicly available information to inform its policies, research, and voting recommendations.

Our customers include the majority of the world’s largest pension plans, mutual funds, and asset managers, collectively managing over \$40 trillion in assets. We have teams located across the United States, Europe, and Asia-Pacific giving us global reach with a local perspective on the important governance issues.

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The research team engages extensively with public companies, investors, regulators, and other industry stakeholders to gain relevant context into the realities surrounding companies, sectors, and the market in general. This enables us to provide the most comprehensive and pragmatic insights to our customers.

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info@glasslewis.com | www.glasslewis.com

Guidelines Introduction

Regulatory and Corporate Governance Background

Japanese corporate governance is centered primarily on the Companies Act, the Financial Instruments and Exchange Act, the Tokyo Stock Exchange (TSE) Listing Rules (Listing Rules), Japan's Stewardship Code (Stewardship Code), and Japan's Corporate Governance Code (CG Code).

The Companies Act and the Listing Rules provide the primary legislative framework for Japanese corporate governance. Best practices are centered on the recommendations contained in the CG Code, which operates on a comply-or-explain basis, whereby publicly listed companies¹ are required to submit to the stock exchange, statements detailing their adherence to the CG Code.

In June 2021, the Japan Financial Services Agency (FSA) and the TSE announced Japan's revised 2021 CG Code, designed to have different standards depending on the new TSE market segments, which became effective in April 2022.

The new market segments are divided into three categories: Prime, Standard and Growth. Companies listed on the Prime Market are required to meet conditions such as a minimum market capitalization of ¥10 billion for tradable shares and a minimum tradable share ratio of 35%, which are higher standard than the requirement for the previous First Section. In addition, under the 2021 CG Code, companies listed on the Prime Market are required to build a higher standard of corporate governance system than the other two markets.

The key changes in the 2021 CG Code are as follows:

Board Independence

Under the 2021 CG Code, at least one-third of a board of a company listed on the Prime Market is recommended to consist of independent directors while a board of a company listed on the other markets is recommended to have at least two independent outside directors.

As for controlled companies listed on the Prime Market, a majority of the board of a company is recommended to consist of independent outside directors while controlled companies listed on the other markets are recommended to have at least one-third of a board of directors comprised of independent outside directors. However, if such controlled companies are unable to ensure the independence of their boards of directors as described above, they are required to establish a special committee comprised of entirely independent members to deliberate and review material transactions or actions that conflict with the interests of the controlling shareholders and minority shareholders.

¹ The Code will apply to all companies listed on the Tokyo Stock Exchange (TSE) and other stock exchange in Japan.

Attention to Sustainability and ESG

Companies listed on the Prime Market are recommended to collect and analyze the necessary data on the impact of climate-related risks and opportunities on their business activities and profits, and enhance the quality and quantity of disclosure based on the Task Force on Climate-related Financial Disclosures (TCFD) recommendations.

Disclosure in English

Companies listed on the Prime Market are recommended to disclose and provide necessary information in their disclosure documents in English².

Diversity Policy Disclosure

Companies are recommended to present their policies and measurable goals for ensuring diversity as well as disclosing their status. Companies are also recommended to establish their policies on the development of human resources and internal environment to ensure diversity, as well as disclosure of their implementation status.

Summary of Changes for 2025

Glass Lewis evaluates these guidelines on an ongoing basis and formally updates them on an annual basis. This year we've made noteworthy revisions in the following areas, which are summarized below but discussed in greater detail in the relevant sections of this document:

Board Gender Diversity

From shareholder meetings held on or after January 2025, we will no longer provide an exemption under our benchmark policy for companies listed outside the Prime Market in cases where they fail to meet the requisite board gender diversity requirements.

Furthermore, beginning in 2026, our benchmark policy will require Prime Market-listed companies to have a board comprised of at least 20% gender diverse directors. Additionally, from 2026, our benchmark policy will also require companies listed outside the Prime Market to appoint at least one gender diverse member to the board of directors regardless of board structure. Under our benchmark policy we will generally recommend voting against the chair of the board under a two-tier board or one-tier with one-committee structure; or the nominating committee chair under a one-tier with three-committee structure of a board that does not meet these requirements.

² Based on the revision of the listing rules by the Tokyo Stock Exchange, companies listed on the Prime Market will be required to disclose their financial results and timely disclosure information in English simultaneously with Japanese from April 1, 2025.

Excessive Strategic Shareholding

Beginning in January 2025, our benchmark policy will implement stricter requirements for companies when providing an exemption to our policy guidelines for this issue.

From 2025, under our benchmark policy, we may refrain from recommending shareholders vote against directors for this issue in cases where the company has disclosed a clear plan that outlines the specific scale and timeframe for reducing the size of its strategic shareholdings to 20% or less of its net assets by the conclusion of the fiscal year ending in 2030.

Furthermore, if the size of strategic shares held by the company falls in the range between 10% and 20% of its net assets, we may refrain from recommending shareholders vote against directors for this issue in cases where the company has disclosed a clear plan that outlines the specific scale for further reducing the size of its strategic shareholdings.

Additionally, we may also refrain from recommending voting against directors for this issue when the company has posted an average return on equity (ROE) of 8% or more over the past five fiscal years, or 8% or more in the most recent fiscal year³, if the size of strategic shares held by the company falls in the range between 10% and 20% of its net assets.

Board Composition and Refreshment

For shareholder meetings held on or after January 2025, we will implement a new benchmark policy on board composition and refreshment for companies that have displayed a significant lack of commitment to the area of board refreshment.

Under our benchmark policy, we may recommend voting against the chair of the board under a two-tier board or one-tier with one-committee structure; or the nominating committee chair under a one-tier with three-committee structure of a board when all outside directors, or all external statutory auditors under a two-tier board structure, have a tenure in excess of 12 consecutive years of service.

Board Oversight of AI

We have included a new discussion on our approach to artificial intelligence (AI)-related risk oversight. In recent years, companies have rapidly begun to develop and adopt uses AI technologies throughout various aspects of their operations. Deployed and overseen effectively, AI technologies have the potential to make companies' operations and systems more efficient and productive. However, as the use of these technologies has grown, so have the potential risks associated with companies' development and use of AI. Given these potential risks, the benchmark policy takes the view that boards should be cognizant of, and take steps to mitigate exposure to, any material risks that could arise from their use or development of AI.

In the absence of material incidents related to a company's use or management of AI-related issues, our benchmark policy will generally not make voting recommendations on the basis of a company's oversight of, or disclosure concerning, AI-related issues. However, in instances where there is evidence that insufficient oversight and/or management of AI technologies has resulted in material harm to shareholders, Glass Lewis will

³ Ito Review published by the Ministry of Economy, Trade and Industry (METI) in 2014 included a target of 8% in ROE for Japanese companies ("[Ito Review of Competitiveness and Incentives for Sustainable Growth](#)". METI. August 2014).

review a company's overall governance practices and identify which directors or board-level committees have been charged with oversight of AI-related risks. We will also closely evaluate the board's response to, and management of, this issue as well as any associated disclosures and the benchmark policy may recommend against appropriate directors should we find the board's oversight, response or disclosure concerning AI-related issues to be insufficient.

A Governance Structure that Serves the Interests of Shareholders

Election of Board of Directors and Statutory Auditors

The purpose of Glass Lewis' proxy research and advice is to facilitate shareholder voting in favor of governance structures that will drive performance, protect shareholder value and maintain a proper tone at the top. Glass Lewis looks for talented boards with a record of protecting shareholders and delivering value over the medium- and long-term. We believe that boards working to protect and enhance the best interests of shareholders are independent, have a record of positive performance and have members with a breadth and depth of experience.

Board Independence

The independence of directors or statutory auditors, or lack thereof, is ultimately demonstrated through the decisions they make. In assessing the independence of these individuals, we will take into consideration, where appropriate, whether he or she has a track record indicative of making objective decisions. We will also look at the other boards where they sit, if any, and whether their overall conduct is representative of an objective officer. Ultimately, our determination of a board member's independence must and will take into consideration both compliance with the applicable independence listing requirements and past decisions.

We look at each board member to examine their relationships with the company, the company's executives and other board members. The purpose of this analysis is to determine whether pre-existing personal, familial or financial relationships (apart from remuneration as a board member) are likely to impact the decisions of that individual. We believe the existence of such relationships can make it difficult for a board member to put the concerns of shareholders above either their own interests or those of a related party. We also believe that an individual who owns more than 10% of a company can exert disproportionate influence on the board.

Thus, we put directors and statutory auditors into three categories based on an examination of the type of relationship they have with the company:

Independent Director/Statutory Auditor — Glass Lewis considers an outside director or statutory auditor to be independent⁴ if we find no evidence of material, financial, familial or other current

⁴ The Companies Act prohibits a judicial person who controls the management of the company (Parent Company) or a director, executive or employee of the Parent Company or spouses and relatives within two degrees of kinship of the Parent Company to be considered outsiders. Further, pursuant to the Listing Rules, a director and/or statutory auditor can be classified as independent if the individual (i) has never been an executive of the company's Parent Company, sister companies or major business affiliates; (ii) does not receive significant monetary benefits from the company for professional services rendered, apart from his/her service as a board member; (iii) does not hold significant equity stake in the company; or (iv) is not a relative of the company's executives, its affiliates, major shareholders or professional services providers.

relationships with the company,⁵ executives, major lenders, other board members or shareholders that hold 10% or more of the Company's voting common stock.

Affiliated Director/Statutory Auditor — Glass Lewis considers an outside director or statutory auditor who has a material financial, familial or other relationship with the company or its executives but is not an employee of the company as affiliated. This includes those whose employers have a material financial relationship with the company, as well as any director or statutory auditor who owns or controls 10% or more of the company's voting stock. In addition, if we find evidence of cross-shareholding relationships, we will consider insiders and affiliates of such arrangements not independent.

Glass Lewis applies a three-year look back period to all directors and statutory auditors who have an affiliation with the company other than former employment, for which we apply a ten-year look back.⁶ Where the timing of the cessation of a relationship is not disclosed, as a general rule we treat such relationship as recent.

Definition of "**Material**": A material relationship is one in which the monetary value exceeds:

- ¥5,000,000 (or where no amount is disclosed) for individuals who are paid for a service they have agreed to perform for the company, outside of their service as a director or statutory auditor, including professional or other services;
- ¥12,000,000 (or where no amount is disclosed) for individuals employed by a professional services firm such as a law firm, investment bank, or consulting firm, where the company pays the firm, not the individual, for services. In addition, we may deem such a transaction to be material where the amount represents more than 1% of the firm's annual revenues and the board does not provide a compelling rationale as to why the individual's independence is not affected by the relationship. This value limit would also apply to charitable contributions to schools where a board member is a professor; or charities where the board member serves on the board or is an executive; or
- 1% of either company's consolidated gross revenue for other business relationships (e.g., where the director or statutory auditor is an executive officer of a company that provides services or products to or receives services or products from the company).

Inside Director/Statutory Auditor — An inside director or internal statutory auditor is someone who serves as a director or statutory auditor and is or has been a full-time director, executive or employee of the company, its parent company or any of its subsidiaries. This category may include a board chair who acts as an employee of the company or is paid as an employee of the company.⁷

⁵ "Company" includes any parent or subsidiary in a consolidated group with the company or any entity that merged with, was acquired by, or acquired the company.

⁶ Under the amended Companies Act, a person who has not been a director of a company or its subsidiaries in the last ten years is eligible to be appointed as an outsider of such company, because such person is no longer deemed to be influenced by the current management.

⁷ When a director or statutory auditor is not classified as an outsider or independent, we will classify him/her as an insider.

Japanese Board Structures

Under the Companies Act, there are three types of board structures: (i) two-tier board with statutory auditor board; (ii) one-tier board with three committees; and (iii) one-tier board with one committee.

Below, we provide an overview of board structures and requirements under the revised TSE market segmentation, which became effective in April 2022.

Types of Japanese Board Structures and Requirements: From April 2022

	Two-Tier Board w/ Statutory Auditor (SA) Board	One-Tier Board w/ Three Committees	One-Tier Board w/ One Committee
Committee or SA Board	SA Board	Audit, nominating and compensation committees	Only audit committee
Minimum Requirement of Committee or SA (Companies Act)	Minimum of 3 SAs (50% must be outside SAs)	Minimum of 3 directors (majority must be outside directors)	Minimum of 3 directors (majority must be outside directors)
Independence Best Practice (Prime w/o Controlling Shareholders)	One-third board independence	One-third board independence	One-third board independence
Independence Best Practice (Prime w/ Controlling Shareholders)	Majority independent board	Majority independent board	Majority independent board
Independence Best Practice (Non-Prime w/o Controlling Shareholders)	2 independent outside directors	2 independent outside directors	2 independent outside directors
Independence Best Practice (Non-Prime w/ Controlling Shareholders)	One-third board independence	One-third board independence	One-third board independence

Voting Recommendations on the Basis of Board Independence

We believe that a board will most effectively perform the oversight necessary to protect the interests of shareholders if it has a sufficient level of independence. While we strongly believe that a substantial proportion of a board should consist of independent directors, we understand that is common practice among Japanese companies to only have minimal representation by independent members. Therefore, recommending a level of independence that far exceeds the market standard may not be effective in convincing Japanese boards to adopt governance structures that better protect shareholder interests. We therefore believe that shareholders should demand a basic level of independence that serves as a minimal safeguard of shareholder rights.

We will, however, always review a board's independence on a case-by-case basis and, where justified, we may make exceptions to our general rule. We are of the view that no single model of governance is ideal for all listed entities, and so we encourage issuers to explain their system of corporate governance and how it will be effective in protecting shareholder value.

- **Two-Tier Board — Board of Directors** — Given due consideration of the role of statutory auditors under a two-tier board structure, we believe that for companies listed outside the Prime Market without controlling shareholders should have one-third independence of the combined board of directors and statutory auditors and have also at least two independent outside directors.

For companies either listed on the Prime Market without controlling shareholders or listed outside the Prime Market with controlling shareholders, we will require such companies to have one-third independence of the board of directors. For companies listed on the Prime Market with controlling shareholders, we believe that such companies should maintain at least majority independence of the board of directors.

In case where the combined number of directors and statutory auditors on the boards or the number of directors on the board fails to meet our independence threshold, we generally recommend voting against the necessary number of inside directors, internal statutory auditors or affiliates in order to satisfy the level of independence we believe is appropriate. In addition, we will hold the chair of the board accountable for the lack of board independence.

- **Two-Tier Board — Board of Statutory Auditors⁸** — The Companies Act requires that corporations over a certain size⁹ have a minimum of three statutory auditors, at least one of whom must be fulltime, and at least half of this group must consist of external statutory auditors.¹⁰ Also, a statutory auditor may not serve concurrently as a director of the company. Given the important role that statutory auditors play,

⁸ Although the board of statutory auditors has a similar function to an audit committee in the U.S., according to the Companies Act, the main responsibility of a statutory auditor is to audit the execution of directors' duties.

⁹ A large company is defined by the Companies Act as a company having legal capital of ¥500 million or more, or total balance-sheet liabilities of ¥20 billion or more.

¹⁰ Under the Companies Act, an external statutory auditor is defined as an individual who: (i) is not a director, accounting adviser, executive officer or employee of the company, or any of its subsidiaries; (ii) is not a director's executive officer, statutory auditor or employee of the parent company; (iii) is not an executive director, executive officer or employee of any of the parent company's subsidiaries; and (iv) has never occupied the position of director, accounting adviser, executive officer or employee in the company or any of its subsidiaries in the past ten years.

we believe that a majority should be independent, external statutory auditors who are free of any material, financial, familial or other affiliations that may cause conflicts of interest.

When evaluating the independence of a statutory auditor, we apply the same standards as we do in reviewing director independence. Should we find any evidence that may bring into question the independence of an external statutory auditor, we will consider that statutory auditor to be affiliated. If the board of statutory auditors does not have a sufficient level of independent representation, we will recommend voting against the necessary number of candidates in order to satisfy the independence level we believe is minimally necessary. We also strongly discourage the practice of insiders serving on this board as the primary responsibility of the board of statutory auditors is to oversee the board of directors.

We believe the interests of holders of more than 20% of a company's stock differ from the interests and financial needs of other shareholders. The area of financial disclosure is critical to shareholders. Any potential conflict between a statutory auditor's own interests and those of shareholders should be strictly monitored as the board of statutory auditors oversees accounting and disclosure. As such, we will recommend voting against any statutory auditors who own 20% or more of the company's stock or is affiliated with a substantial shareholder that owns 20% or more of the company's stock.

- **One-Tier Board with Three Committees** — We believe that for companies that have adopted a one-tier board with three committee structure, at least one-third of the board should be independent. However, for companies listed on the Prime Market with controlling shareholders, we believe that such companies should maintain at least majority independence of the board of directors. In case where director independence fails to meet our independence threshold we typically recommend voting against the necessary number of inside directors or affiliates in order to satisfy the level of independence we believe is appropriate. In addition, we will hold the nominating committee chair accountable for the lack of board independence.
- **One-Tier Board with One Committee** — We believe that for companies that have adopted a one-tier board with one committee structure, at least one-third of the board should be independent. However, for companies listed on the Prime Market with controlling shareholders, we believe that such companies should maintain at least majority independence of the board of directors. In case where director independence fails to meet our independence threshold, we generally recommend voting against the necessary number of inside directors or affiliates in order to satisfy our expectation of one-third independence. In addition, we will hold the chair of the board accountable for not meeting our expected threshold of board independence.

Glass Lewis Board Independence Requirements

	Two-Tier Board	One-Tier Board (1 or 3 committees)
Prime w/o Controlling Shareholder	One-third	One-third
Prime w/ Controlling Shareholder	Majority	Majority
Non-Prime w/ Controlling Shareholder	One-third	One-third
Non-Prime w/o Controlling Shareholder	A combined one-third independence of the board of directors and the board of statutory auditors, at least two independent outside directors	One-third

We expect a majority of the board of statutory auditors to be independent, regardless of market segment.

Board Independence for Controlled Companies

- Board of Directors** — The board’s function is to protect shareholder interests; however, when an individual or entity owns more than 50% of the voting shares, their individual interests may be disproportionately represented. That said, Japanese boards are often dominated by insiders. While we may make exceptions to our policies for a few controlled companies on a case-by-case basis, given the unique nature of the traditional board structure of Japanese companies, Glass Lewis believes that minimal independence even at controlled companies is essential in making sure that minority shareholders’ interests are protected. In general, we therefore do not make any board independence exceptions for controlled companies.
- Audit Committee and Board of Statutory Auditors** — We do not make independence exceptions for audit committee members and the board of statutory auditors at controlled companies. Audit committees and the board of statutory auditors should be majority independent. Regardless of a company’s controlled status, the interests of all shareholders must be protected by ensuring the integrity and accuracy of the company’s financial statements. Allowing insiders and affiliates to discharge the duties of audit oversight could present a conflict of interest.

Director Performance

The most crucial test of a board's commitment to the company and its shareholders lies in the actions of the board and its members. We look at the performance of the directors and executives at the subject company, as well as other companies where they have served.

Voting Recommendations on the Basis of Director Performance

We disfavor directors who have a track record of poor performance in fulfilling their responsibilities to shareholders as a director or executive. We typically recommend voting against:

- A director who is also the chief executive, or who holds an equivalent position,¹¹ of a company where a material restatement has occurred after the chief executive certified the pre-restatement financial statements.
- All members of the board when a company's financial performance has been consistently below that of its peers and the board has not taken reasonable steps to address sustained under performance.¹²
- The chair of the board if the company adopted a takeover defense measure without shareholder approval within the last 12 months, and where such adoption is not presented to shareholders for ratification.

Statutory Auditor Performance

Japanese companies are not required to seek shareholder approval for the appointment of third-party accounting auditors. Should we identify any concerns regarding the independence of a third-party accounting auditor, and their appointment has not been presented for shareholder approval, we will recommend voting against statutory auditor nominees whom we believe are responsible for the appointment of the problematic accounting auditor.

In addition, under the 2003 Revised Certified Public Accountants Law, accountants are prohibited from auditing the same company for more than seven consecutive years, commencing from the year of enforcement. Under this law, only the individual accountants, not the firm, are prohibited from continuing to audit a company for more than seven years.

Voting Recommendations on the Basis of Statutory Auditor Performance

We will recommend voting against certain proposed statutory auditors in the following cases:

- Statutory auditors who are up for election and served on the board at the time of the audit, if audit and audit-related fees total less than 50% of overall fees billed by the auditor.¹³
- All statutory auditors if non-audit fees include fees for tax services for senior executives of the company or involve services related to tax avoidance or tax shelter schemes.

¹¹ The president of a company usually has similar authority and duties as the CEO.

¹² In accordance with the proxy voting principles of the Japan Pension Fund Association, we may consider voting against all directors who are up for re-election when shareholder value is obviously impaired because the company is operating at a loss and has not paid dividends for the past three consecutive fiscal years, including the current fiscal year, or has aggregated current losses for the past five fiscal years.

¹³ In Japan, the breakdown of audit fees versus non-audit fees is rarely disclosed within the notice of meeting.

- Statutory auditors who re-appointed an auditor that we no longer consider to be independent for reasons unrelated to fee proportions.
- Statutory auditors who served at a time when accounting fraud occurred in the company.
- Statutory auditors who served at a time when financial statements had to be restated due to negligence or fraud.
- All statutory auditors if the company has repeatedly failed to file its financial reports in a timely fashion.
- All statutory auditors if the company has failed to report or to have its auditors report material weaknesses in internal controls.
- All statutory auditors if the statutory auditor board did not meet at least four times during the year.

Director and Statutory Auditor Attendance

We note that existing Japanese laws and regulations only require companies to disclose board meeting attendance for outside directors and external statutory auditors, while companies are not obligated to report on the attendance of insiders. We believe that attendance at board meetings is one of the fundamental responsibilities of a board member, and that all directors and statutory auditors should attend meetings regularly to review the company's performance and ensure the protection of shareholder interests.

In Japan, companies typically hold board meetings on a monthly basis, if not more frequently, which may make it burdensome for outsiders to attend all board meetings. We are concerned that voting against outside directors and statutory auditors for failing to attend such frequent board meetings may unfairly punish outside board members. However, given the important role of outside board members within their respective boards, we believe their attendance at board meetings to be crucial. Accordingly, if a director fails to attend a minimum of 75% of board meetings or applicable board meetings and committee meetings calculated in the aggregate, we will recommend voting against the director. If a statutory auditor fails to attend a minimum of 75% of board of director meetings and/or board of statutory auditor meetings, we will recommend against the statutory auditor.¹⁴

Experience

We believe that boards should have diverse backgrounds and members with a breadth and depth of relevant experience. We believe that the board or the nominating committee should consider diversity when making director nominations within the context of each specific company and its industry. In our view, shareholders are best served when boards make an effort to ensure a constituency that is not only reasonably diverse on the basis of age, race, gender and ethnicity, but also on the basis of geographic knowledge, industry experience, board tenure and culture. In addition, we believe that at least one of the outside directors should have relevant industry experience.

We find that a director's past is often indicative of future conduct and performance. We often find directors with a history of overpaying executives or of serving on boards where avoidable disasters have occurred

¹⁴ However, where a director or statutory auditor has served for less than one full year, we will not typically recommend voting against him for failure to attend 75% of meetings. Rather, we will note the failure with a recommendation to track this issue going forward. We will also refrain from voting against directors or statutory auditors when the proxy discloses that the director missed the meetings due to serious illness or other reasonable extenuating circumstances.

appearing at companies that follow these same patterns. Glass Lewis has a proprietary database that tracks the performance of directors across companies worldwide and may recommend voting against directors with problematic governance and/or material performance concerns at all companies where they serve.

Voting Recommendations on the Basis of Experience

We typically recommend that shareholders vote against directors who have served on boards or as executives of companies with a track record of poor performance, overcompensation, audit-or accounting-related issues and/or other indicators of mismanagement or actions against the interests of shareholders.¹⁵

Similarly, we look carefully at the backgrounds of those who serve on the key committees of the board to ensure that they have the required skills and diverse backgrounds to make informed and well-reasoned judgments about the subject matter for which the committee is responsible.

Director Commitments

We believe that directors and statutory auditors should have the necessary time to fulfill their duties to shareholders. In our view, an overcommitted board member can pose a material risk to a company's shareholders, particularly during periods of crisis. Research indicates that the time commitment associated with being a director has been on a significant upward trend in the past decade.¹⁶ We believe this limits the number of boards on which directors and statutory auditors can effectively serve, especially executives at other companies.

Voting Recommendations on the Basis of Director Commitments

We will generally recommend that shareholders vote against a director or statutory auditor who serves as an executive officer of any public company while serving on more than two public company boards and any other director or statutory auditor who serves on more than five public company boards. We will also count individuals who serve as board chair of boards in select other non-Asian markets, per our global policies, as two board seats given the time commitment of directorship in those markets.

Because we believe that executives will primarily devote their attention to executive duties, we generally will not recommend that shareholders vote against overcommitted directors at the companies where they serve as an executive.

When determining whether a director's or statutory auditor's service on an excessive number of boards may limit the ability of the individual to devote sufficient time to board duties, we may consider relevant factors such as the size and location of the other companies where the individual serves on the board, their roles at the companies in question, whether the individual serves on the board of any large privately-held companies, their tenure on the boards in question, and the attendance record at all companies.

¹⁵ We typically apply a three-year look-back period to such issues.

¹⁶ For example, the 2015-2016 NACD Public Company Governance Survey states that, on average, directors spent a total of 248.2 hours annual on board-related matters during the past year, which it describes as a "historically high level" that is significantly above the average hours recorded in 2006. Additionally, the 2020 Spencer Stuart Board Index indicates that, while 39% of S&P 500 CEOs serve on one additional public board, just 2% of S&P 500 CEOs serve on two additional public boards and only one CEO serves on three.

We may also refrain from recommending against certain directors and statutory auditors if the company provides sufficient rationale for their continued board service. The rationale should allow shareholders to evaluate the scope of the individual's other commitments as well as their contributions to the board, including specialized knowledge of the company's industry, strategy or key markets, the diversity of skills, perspective and background they provide, and other relevant factors. We will also generally refrain from recommending to vote against a director or statutory auditor who serves on an excessive number of boards within group of companies.¹⁷ We will also count boards within the group companies as one board membership. Furthermore, we will generally exempt individuals that represent a firm whose sole purpose is to manage a portfolio of investments which include the company.

Board Accountability for Environmental and Social Performance

Glass Lewis carefully monitors companies' performance with respect to material environmental and social issues, including those related to climate and human capital management. In situations where we believe that a company has not properly managed or mitigated material environmental or social risks to the detriment of shareholder value, or when such mismanagement has threatened shareholder value, Glass Lewis may recommend that shareholders vote against the members of the board who are responsible for oversight of environmental and social risks. In the absence of explicit board oversight of environmental and social issues, Glass Lewis may recommend that shareholders vote against chair of the board. In making these determinations, Glass Lewis will carefully review the situation, its effect on shareholder value, as well as any corrective action or other response made by the company.

For more information on how Glass Lewis evaluates environmental and social issues, please see Glass Lewis' Overall Approach to ESG as well as our comprehensive *Benchmark Policy Guidelines for Shareholder Proposals & ESG-Related Issues* available at www.glasslewis.com/voting-policies-current/.

Board Accountability for Climate-Related Issues

Given the exceptionally broad impacts of a changing climate on companies, the economy, and society more broadly, we view climate risk as a material risk for all companies. We therefore believe that boards should be considering and evaluating their operational resilience under lower-carbon scenarios. While all companies maintain exposure to climate-related risks, we believe that additional consideration should be given to, and that disclosure should be provided by, those companies whose own greenhouse gas (GHG) emissions represent a financially material risk.

We believe that companies with this increased risk exposure should provide clear and comprehensive disclosure regarding these risks, including how they are being mitigated and overseen. We believe such information is crucial to allow investors to understand the company's management of this issue as well as the impact of a lower carbon future on the company's operations.

In line with this view, at Nikkei 225 companies with material exposure to climate risk stemming from their own operations¹⁸ as well as companies where we believe emissions or climate impacts, or stakeholder scrutiny

¹⁷ We will consider consolidated subsidiaries and affiliated entities as part of the group.

¹⁸ This policy will generally apply to companies in the following SASB-defined industries: agricultural products, air freight & logistics, airlines, chemicals, construction materials, containers & packaging, cruise lines, electric utilities & power

thereof, represent an outsized, financially material risk, Glass Lewis will carefully assess whether climate-related disclosures are aligned with the recommendations of the Task Force on Climate-related Disclosures (TCFD) or IFRS S2 Climate-related Disclosures. We will also assess whether these companies have disclosed explicit and clearly defined board-level oversight responsibilities for climate-related issues.

In instances where we find either (or both) of these disclosures to be absent or significantly lacking, we may recommend voting against the chair of the committee (or board) charged with oversight of climate-related issues, or if no committee has been charged with such oversight, the chair of the governance committee. Further, we may extend our recommendation on this basis to additional members of the responsible committee in cases where the committee chair is not standing for election due to a classified board, or based on other factors, including the company's size and industry and its overall governance profile.

In 2023, our policy on this topic was applied to the largest, most significant emitters; then, since February 2024, Glass Lewis has applied this policy to companies in the Nikkei 225 index operating in industries where the Sustainability Accounting Standards Board (SASB) has determined that the companies' GHG emissions represent a financially material risk, as well as companies where we believe emissions or climate impacts, or stakeholder scrutiny thereof, represent an outsized, financially material risk.

Conflicts of Interest

In addition to the key characteristics described above — independence, performance, experience and board commitments — that we use to evaluate board members, we consider conflict of interest issues in making our voting recommendations.

We believe that a board should be wholly free of people who have an identifiable and substantial conflict of interest, regardless of the overall presence of independent directors on the board. Accordingly, we recommend that shareholders vote against the following types of affiliated or inside directors/statutory auditors:

- **Professional Services** — A board member who provides consulting or other material professional services to the company, or who has an immediate family member who provides such services. These services may include legal, consulting, or financial services. We question the need for the company to have consulting relationships with its board members. We view such relationships as creating conflicts for directors and statutory auditors, since they may consider their own interests ahead of shareholders when making board decisions. In addition, a company's decisions regarding where to turn for the best professional services may be compromised when doing business with the professional services firm of one of the company's board members. However, if we find the monetary value of the relationship to be non-material, we will refrain from making voting recommendations on this basis.¹⁹

generators, food retailers & distributors, health care distributors, iron & steel producers, marine transportation, meat, poultry & dairy, metals & mining, non-alcoholic beverages, oil & gas, pulp & paper products, rail transportation, road transportation, semiconductors, waste management.

¹⁹ A non-material, professional services relationship is one in which the monetary value is less than ¥5,000,000 (or if no amount is disclosed) for board members who are paid for a service they have agreed to perform for the company, outside their service as a director or statutory auditor, including professional or other services; or (ii) ¥12,000,000 (or if no amount is disclosed) for those individuals who are employed by a professional services firm, such as a law firm, investment bank, or consulting firm and the company pays the firm, not the individual, for services. This value limit would also apply to

- **Business Transactions** — A board member who is affiliated with an entity that has business transactions with the company worth more than 1% of either company’s consolidated gross revenue. We question the need for the company to engage in business relationships with its board members. We view such relationships as potentially creating conflicts for directors and statutory auditors, as they may be forced to weigh their own interests in relation to shareholder interests when making board decisions. In addition, a company’s decision regarding where to turn for the best products and services may be compromised when doing business with the firm of one of the company’s directors. However, if we find the monetary value of the relationship to be non-material, we will refrain from making voting recommendations on this basis.
- **Interlocking Directorships** — Chief executives or other top executives who serve on each other’s boards create an interlock that poses conflicts that should be avoided to ensure the promotion of shareholder interests above all else.²⁰

Board Size

While we do not believe that there is a universally applicable optimum board size, we do believe that boards should have at least five directors to ensure sufficient diversity in decision-making and enable the formation of key board committees with independent directors. Conversely, we believe that boards with more than 20 members will typically suffer under the weight of “too many cooks in the kitchen” and have difficulty reaching consensus and making timely decisions. Sometimes the presence of too many voices makes it difficult to draw on the wisdom and experience in the room by virtue of the need to limit the discussion so that each voice may be heard.

To that end, we will typically recommend voting against the nominating committee chair if a board has more than 20 directors. However, for boards with fewer than five members, while we will note our concern that the board may not have a sufficient number of members to function at an optimal level, we will refrain from recommending a vote against the nominating committee chair²¹ unless there are other pre-existing issues with that nominee. This is to ensure that the number of directors does not dip any lower and to encourage the appointment of additional directors to maintain a sufficient number of directors on the board.

Declassified Boards

Under the Companies Act, directors at firms with a two-tier board structure shall have terms of office of no more than two years; for one-tier boards with three committee structure, such terms shall be no more than one year. In addition, as for companies with one-tier board with one committee, a director who serves as an audit committee member will have a term of two years while a director who does not serve as an audit committee member will be limited to a term of one year.

Glass Lewis favors the elimination of staggered boards in favor of the annual election of directors. We believe staggered boards are less accountable to shareholders than boards that are elected annually. Furthermore, we

charitable contributions to schools where an individual is a professor; or charities where an individual serves on the board or is an executive.

²⁰ We do not apply a look-back period for this situation.

²¹ In both cases, in the absence of a nominating committee, we will recommend voting against the chair of the board.

feel the annual election of directors encourages board members to focus on shareholder interests. Moreover, empirical studies have shown: (i) companies with staggered boards reduce a firm's value; and (ii) in the context of hostile takeovers, staggered boards operate as a takeover defense, which entrenches management, discourages potential acquirers and delivers a lower return to target shareholders.

Given the empirical evidence suggesting staggered boards reduce a company's value and the increasing shareholder opposition to such a structure, Glass Lewis supports the declassification of boards and the annual election of directors.

Board Composition and Refreshment

Glass Lewis strongly supports routine director evaluation, including independent external reviews, and periodic board refreshment to foster the sharing of diverse perspectives in the boardroom and the generation of new ideas and business strategies. Further, we believe the board should evaluate the need for changes to board composition based on an analysis of skills and experience necessary for the company, as well as the results of director evaluations, as opposed to relying solely on age or tenure limits. When necessary, shareholders can address concerns regarding proper board composition through director elections.

In our view, a director's experience can be a valuable asset to shareholders because of the complex, critical issues that boards face. This said, we recognize that in rare circumstances, a lack of refreshment can contribute to a lack of board responsiveness to poor company performance.

On occasion, age or term limits can be used as a means to remove a director for boards that are unwilling to police their membership and enforce turnover. Some shareholders support term limits as a way to force change in such circumstances.

While we understand that age limits can aid board succession planning, the long-term impact of age limits restricts experienced and potentially valuable board members from service through an arbitrary means. We believe that shareholders are better off monitoring the board's overall composition, including the diversity of its members, the alignment of the board's areas of expertise with a company's strategy, the board's approach to corporate governance, and its stewardship of company performance, rather than imposing inflexible rules that don't necessarily correlate with returns or benefits for shareholders.

However, if a board adopts term/age limits, it should follow through and not waive such limits. If the board waives its term/age limits, Glass Lewis will consider recommending shareholders vote against the nominating and/or governance committees, unless the rule was waived with sufficient explanation, such as consummation of a corporate transaction like a merger.

Outside Director Board Tenure

Given the trend in corporate governance practices to otherwise limit outside director board tenure, we believe that companies should have policies in place to refresh their outside directors after a long period of service.

Accordingly, beginning in 2025, we will implement a policy on board composition and refreshment for companies that have demonstrated a significant lack of commitment to the area of board refreshment. We believe that such a significant lack of board refreshment may contribute to poor financial performance, lax risk

oversight, misaligned remuneration practices, lack of shareholder responsiveness, and reduction of shareholder rights, among other governance concerns.

As such, from 2025 we may recommend voting against the chair of the board under a two-tier board or one-tier with one-committee structure; or the nominating committee chair under a one-tier with three-committee structure of a board when all outside directors, or all external statutory auditors under a two-tier board structure, have a tenure in excess of 12 consecutive years of service.

Gender Diversity on Boards

Glass Lewis recognizes the importance of ensuring that the board is composed of directors who have a diversity of skills, thought and experience, as such diversity benefits companies by providing a broad range of perspectives and insights. Glass Lewis closely reviews the composition of the board for representation of diverse director candidates.

For companies listed on the Prime Market, we will generally recommend voting against the chair of the board under a two-tier board or one-tier with one-committee structure; or the nominating committee chair under a one-tier with three-committee structure of a board that does not comprise of at least 10% gender diverse directors.

However, given the higher standards of corporate governance required for companies listed on the Prime Market, in 2026 we will require the board of companies on the Prime Market to comprise at least 20% gender diverse directors.

As such, from 2026, we will generally recommend voting against the chair of the board under a two-tier board or one-tier with one-committee structure; or the nominating committee chair under a one-tier with three-committee structure of a board that does not comprise of at least 20% gender diverse directors.

For companies listed outside the Prime Market,²² we will generally recommend voting against the chair of the board under a two-tier board or one-tier with one-committee structure; or the nominating committee chair under a one-tier with three-committee structure of a board that has not appointed at least one gender diverse director.

For a company with a two-tier board structure listed outside the Prime Market, we will examine the combined composition of the board of directors and board of statutory auditors when considering a company's approach to gender diversity. While for all companies with a one-tier with three-committee structure, we will take into account executive officers in addition to directors when applying our board gender diversity policies.

However, from 2026, we will generally recommend voting against the chair of the board under a two-tier board or one-tier with one-committee structure; or the nominating committee chair under a one-tier with three-committee structure of a board that has not appointed at least one gender diverse member to the board of directors regardless of board structure.

²² Our benchmark policy approach to board gender diversity shall not apply to Real Estate Investment Trusts (REITs).

Excessive Strategic Shareholding

Strategic shareholding – when companies hold shares of business partners, creditors and listed companies for the purpose of maintaining business relationships - separates economic interest from voting rights and shields management from the corrective pressure of the capital market. In most cases, companies in which the company holds strategic shares also in turn hold shares of the company, a phenomenon commonly labeled as “cross-shareholding.”

Given the nature of the strategic or cross-shareholding relationship between the companies, the relationship is the best describe as “You scratch my back and I’ll scratch yours.” For example, say Company A is facing a hostile takeover or anticipating a significant number of against votes to the top managements, and a 20% of the Company A’s shares is held by strategic shareholders (or cross-shareholders). In this case, Company A can safely assume that it would receive at least 20% voting support for the management from their strategic shareholders (or cross-shareholders) and vice versa. As such, the strategic shareholding or cross-shareholding is considered as one of takeover defense mechanisms among Japanese companies.

Such practices have been attributed to decrease management accountability, lax risk management and inefficient capital management policy, and have been additionally shown to limit potential hostile approaches. Though companies often attempt to justify these cross-shareholding relationships as strategically important, the benefits of such relationships, if any, are generally both unquantifiable and ambiguous in nature.

While it may seem plausible that some level of shareholder value may be derived from mutual equity ownership, academic research actually shows evidence to the contrary. Empirical research has found a correlation between a decrease in cross-shareholding relationships and corporate performance, suggesting that cross-shareholding relationships are more likely to suppress shareholder value than enhance it.

The practice of strategic shareholding not only exposes shareholders to undisclosed risks, but also enables management to utilize shareholder’s capital for their own self-preservation. Under Japanese accounting rules, if the market value of securities in which a company has invested falls below 50% of the purchase price, the company is required to record the loss on its balance sheet. Often the returns on these investments are disproportionate to the risks, as evidenced by a number of companies which have recorded or are expected to record losses related to their recent securities investments due to market volatility. Thus, management effectively creates fiscally nonsensical, relationship-building partnerships using shareholder capital -- from which, although the board might personally benefit, shareholders do not derive any value.

In response to the criticisms of strategic shareholding, the CG Code now suggests companies conduct annual reviews regarding the rational and objectives of their strategic shareholdings and disclose their general policy for strategic shareholdings. Furthermore, in January 2019, the Financial Service Agencies amended the Cabinet Office Order on Disclosure of Corporate Affairs (Amended Cabinet Office Order), to require companies to disclose the 60 largest equity holdings as well as the reason for such holdings and the state of any cross-shareholding relationships in the securities report effective from the end of the March 2019 fiscal year.

Given the aforementioned concerns regarding both general security investment practices and cross-shareholding relationships in Japan, Glass Lewis will generally recommend voting against the chair of the board when the size of strategic shares held by the company is 10% or more of its net assets as disclosed in the securities report for the previous fiscal year.

However, beginning in 2025, we will implement stricter requirements for companies when granting an exemption to our policy guidelines in relation to this issue.

From 2025, we will carefully review a company's disclosure of its strategic shareholding policies and practices and may refrain from recommending shareholders vote against directors for this issue when the company has disclosed a clear plan that outlines the specific scale and timeframe for reducing the size of its strategic shareholdings to 20% or less of its net assets by the conclusion of the fiscal year ending in 2030.

Furthermore, if the size of strategic shares held by the company falls in the range between 10% and 20% of its net assets, we may refrain from recommending shareholders vote against directors for this issue in cases where the company has disclosed a clear plan that outlines the specific scale for further reducing the size of its strategic shareholdings. In addition, we may also refrain from recommending voting against directors for this issue when the company has posted an average return on equity (ROE) of 8% or more over the past five fiscal years, or 8% or more in the most recent fiscal year²³ if the size of strategic shares held by the company falls in the range between 10% and 20% of its net assets.

Separation of the Roles of Board Chair and CEO

In Japan, the Companies Act does not require the separation of the roles of chair and CEO/president. At a company that adopts a two-tier board structure, the board of directors appoints representative director(s) from amongst themselves. In a company that adopts a committee-system-type board structure, the board appoints: (i) executive officers who run the day-to-day business of the company; and (ii) the representative executive officers, who represent the company and can legally bind it. Customarily, one of the representative directors is the president. The role of board chair in Japan is often unclear and may be considered ceremonial than of practical significance. Furthermore, the roles of board chair and company chair and/or CEO is often held by the same individual.

Glass Lewis believes that separating the roles of chief executive officer and chair creates a better governance structure than that of a combined executive/chair position. An executive carries out the company's objectives as crafted by the board. Over time, executives will report their progress and performance in achieving the company's objectives to the board. This process is needlessly complicated when a CEO sits on or chairs the board, as a CEO presumably will have a significant influence over the board.

It can become difficult for a board to fulfill its role of overseer and policy-setter when a CEO/chair controls the agenda and the boardroom discussion. Such power can allow a CEO to have an entrenched position, leading to longer-than-optimal terms, fewer checks on management, less scrutiny of the business operation and limitations on independent, shareholder-focused goal-setting by the board.

A CEO should set the strategic course for a company, with the board's approval, and the board should enable the CEO to carry out the CEO's vision for accomplishing the board's objectives. The failure to achieve the board's objectives should lead it to replace that CEO with someone in whom the directors have more confidence.

²³ Ito Review published by the Ministry of Economy, Trade and Industry (METI) in 2014 included a target of 8% in ROE for Japanese companies ("[Ito Review of Competitiveness and Incentives for Sustainable Growth](#)"). METI. August 2014).

Similarly, an independent chair can better oversee executives and set a pro-shareholder agenda without the management conflicts that a CEO or other executive insider may face. Such oversight and concern for shareholders allows for a more proactive and effective board of directors that is better able to look out for the interests of shareholders.

We do not recommend that shareholders vote against CEOs who serve on or chair the board. However, we typically encourage our clients to support separating the roles of chair and CEO whenever that question is posed in a proxy (typically in the form of a shareholder proposal), as we believe that it is in the long-term best interests of the company and its shareholders.

Glass Lewis strongly supports the existence of a presiding or lead director with the authority to set the agenda for the meetings and lead sessions outside the presence of the insider chair.

Environmental and Social Risk Oversight

Glass Lewis recognizes the importance of ensuring the sustainability of companies' operations and believes that inadequate oversight of material environmental and social issues can present direct legal, financial, regulatory and reputational risks for companies that could serve to harm shareholder interests. Therefore, we believe that these issues should be carefully monitored and managed by companies and that companies should have an appropriate oversight structure in place to ensure that they are mitigating attendant risks and capitalizing on related opportunities to the best extent possible.

Glass Lewis believes that companies should ensure appropriate, board-level oversight of material risks to their operations, including those that are environmental and social in nature. Accordingly, for large-cap companies in instances where we identify material oversight issues, Glass Lewis will review a company's overall governance practices and identify which directors or board-level committees have been charged with oversight of environmental and/or social issues.

When we believe that companies have not properly managed or mitigated environmental or social risks to the detriment of shareholder value or when such mismanagement has threatened shareholder value, Glass Lewis may consider recommending that shareholders vote against members of the board who are responsible with oversight of environmental and social risks. In the absence of explicit board oversight of environmental and social issues, Glass Lewis may recommend that shareholders vote against certain members of the board whom we believe responsible. In making these determinations, Glass Lewis will carefully review the situation at hand, its effect on shareholder value, as well as any corrective action or other response made by the company.

Cyber Risk Oversight

Companies and consumers are exposed to a growing risk of cyber-attacks. These attacks can result in customer or employee data breaches, harm to a company's reputation, significant fines or penalties, and interruption to a company's operations. Further, in some instances, cyber breaches can result in national security concerns, such as those impacting companies operating as utilities, defense contractors, and energy companies.

In response to these issues, regulators have increasingly been focused on ensuring companies are providing appropriate and timely disclosures and protections to stakeholders that could have been adversely impacted by a breach in a company's cyber infrastructure.

Given the potential adverse outcomes from cyber-related issues, it is our view that cyber risk is material for all companies. We therefore believe that it is critical that companies evaluate and mitigate these risks to the greatest extent possible. With that view, we encourage all issuers to provide clear disclosure concerning the role of the board in overseeing issues related to cybersecurity, including how companies are ensuring directors are fully versed on this rapidly evolving and dynamic issue. We believe such disclosures can help shareholders understand the seriousness with which companies take this issue.

In the absence of material cyber incidents, we will generally not make voting recommendations on the basis of a company's oversight or disclosure concerning cyber-related issues. However, in instances where cyber-attacks have caused significant harm to shareholders, we will closely evaluate the board's oversight of cybersecurity as well as the company's response and disclosures.

Moreover, in instances where a company has been materially impacted by a cyber-attack, we believe shareholders can reasonably expect periodic updates communicating the company's ongoing progress towards resolving and remediating the impact of the cyber-attack. We generally believe shareholders are best served when such updates include (but are not limited to) details such as when the company has fully restored its information systems, when the company has returned to normal operations, what resources the company is providing for affected stakeholders, and any other potentially relevant information, until the company considers the impact of the cyber-attack to be fully remediated. These disclosures should focus on the company's response to address the impacts to affected stakeholders and should not reveal specific and/or technical details that could impede the company's response or remediation of the incident or that could assist threat actors.

In instances where a company has been materially impacted by a cyber-attack, we may recommend against appropriate directors should we find the board's oversight and disclosures concerning cybersecurity-related issues to be insufficient, or are not provided to shareholders.

Board Oversight of Artificial Intelligence

In recent years, companies have rapidly begun to develop and adopt uses for artificial intelligence (AI) technologies throughout various aspects of their operations. Deployed and overseen effectively, AI technologies have the potential to make companies' operations and systems more efficient and productive. However, as the use of these technologies has grown, so have the potential risks associated with companies' development and use of AI. Given these potential risks, we believe that boards should be cognizant of, and take steps to mitigate exposure to, any material risks that could arise from their use or development of AI.

Companies that use or develop AI technologies should consider adopting strong internal frameworks that include ethical considerations and ensure they have provided a sufficient level of oversight of AI. As such, boards may seek to ensure effective oversight and address skills gaps by engaging in continued board education and/or appointing directors with AI expertise. With that view, we believe that all companies that develop or employ the use of AI in their operations should provide clear disclosure concerning the role of the board in overseeing issues related to AI, including how companies are ensuring directors are fully versed on this rapidly evolving and dynamic issue. We believe such disclosure can help shareholders understand the seriousness with which companies take this issue.

While we believe that it is important that these issues are overseen at the board level and that shareholders are afforded meaningful disclosure of these oversight responsibilities, we believe that companies should determine

the best structure for this oversight. In our view, this oversight can be effectively conducted by specific directors, the entire board, a separate committee, or combined with the responsibilities of a key committee.

In the absence of material incidents related to a company's use or management of AI-related issues, we will generally not make voting recommendations on the basis of a company's oversight of, or disclosure concerning, AI-related issues. However, in instances where there is evidence that insufficient oversight and/or management of AI technologies has resulted in material harm to shareholders, Glass Lewis will review a company's overall governance practices and identify which directors or board-level committees have been charged with oversight of AI-related risks. We will also closely evaluate the board's response to, and management of, this issue as well as any associated disclosures and may recommend against appropriate directors should we find the board's oversight, response or disclosure concerning AI-related issues to be insufficient.

Board Committees

(Applies to One-Tier Board with Three Committees and One-Tier Board with One Committee)²⁴

Committee Independence

The Companies Act stipulates that, for firms with a one-tier board with three committees, each of the audit, nominating and compensation committees should consist of three or more directors, a majority of whom should be outside directors.²⁵ We believe that a majority of the members of each of these committees should be independent outside directors.²⁶ In addition, we believe that the chair of the audit committee should be an independent director and the chair of the nominating and compensation committees should be a non-inside director. We will also apply this standard to the audit committee of a one-tier board with one committee.

We typically recommend that shareholders vote against inside and/or affiliated directors seeking appointment to an audit, compensation or nominating committee when the committee does not meet our independent standards.

Further, we believe the interests of holders of more than 20% of a company's stock differs from the interests and financial needs of other shareholders. Financial disclosure is critical to shareholders, and any potential conflict between a director's own interests and those of shareholders should be strictly monitored. Therefore, we believe substantial shareholders should not serve on the audit committee. As such, we will recommend voting against any member of audit committee who owns at least 20% of the company's stock or is affiliated with a substantial shareholder that owns at least 20% of the company's stock.

²⁴ If our recommendation would be to vote against the committee chair and the chair is not up for election because the board is staggered, we will express our concern regarding the committee chair and recommend voting against this individual as appropriate in the next election. In all cases, if the chair of the committee is not specified, but our policy calls for voting against the committee chair, we will recommend voting against the director who has been on the committee the longest as the de facto chair.

²⁵ Article 400 of the Companies Act.

²⁶ If the company fails to disclose the details regarding the committee membership and composition, we will recommend shareholders hold the chair of the board accountable for the failure to disclose the committee composition.

Glass Lewis Committee Independence Requirements

	Committee Independence	Committee Chair
Audit Committee	Majority	Independent director
Compensation Committee	Majority	Non-inside director
Nominating Committee	Majority	Non-inside director

Audit Committee Performance

Audit committees play an integral role in overseeing the financial reporting process because “[v]ibrant and stable capital markets depend on, among other things, reliable, transparent and objective financial information to support an efficient and effective capital market process. The vital oversight role audit committees play in the process of producing financial information has never been more important.”²⁷

When assessing an audit committee’s performance, we are aware that an audit committee does not prepare financial statements, is not responsible for making the key judgments and assumptions that affect the financial statements, and does not audit the numbers or the disclosures provided to investors. Rather, an audit committee member monitors and oversees the process and procedures that management and auditors perform. The 1999 Report and Recommendations of the Blue Ribbon Committee on Improving the Effectiveness of Corporate Audit Committees stated it best:

A proper and well-functioning system exists, therefore, when the three main groups responsible for financial reporting — the full board including the audit committee, financial management including the internal auditors, and the outside auditors — form a “three-legged stool” that supports responsible financial disclosure and active participatory oversight. However, in the view of [this committee], the audit committee must be “first among equals” in this process, since the audit committee is an extension of the full board and hence the ultimate monitor of the process. For an audit committee to function effectively on investors’ behalf, it must include members with sufficient knowledge to diligently carry out its responsibilities. In its audit and accounting recommendations, the Conference Board Commission on Public Trust and Private Enterprise said “members of the audit committee must be independent and have both knowledge and experience in auditing financial matters.”²⁸

We are skeptical of audit committees where there are members that lack expertise in finance and accounting, or in any other equivalent or similar areas of expertise. While we will not necessarily recommend voting against

²⁷ “Audit Committee Effectiveness — What Works Best.” PricewaterhouseCoopers. The Institute of Internal Auditors Research Foundation. 2005.

²⁸ Commission on Public Trust and Private Enterprise. The Conference Board. 2003.

members of an audit committee when such expertise is lacking, we are more likely to vote against committee members when a problem such as a restatement occurs and such expertise is lacking.

Glass Lewis generally assesses audit committees by reviewing the decisions they make with respect to their oversight and monitoring role. The quality and integrity of the financial statements and earnings reports, the completeness of disclosures necessary for investors to make informed decisions and the effectiveness of the internal controls should provide reasonable assurance that the financial statements are materially free from errors. The independence of the external auditors and the results of their work all provide useful information by which to assess the audit committee.

When assessing the decisions and actions of the audit committee, we typically defer to its judgment and vote in favor of its members, but we would recommend voting against the following members under the following circumstances:²⁹

- All members of an audit committee who are up for election and who served on the committee at the time of the audit, if audit and audit-related fees total less than 50% of overall fees billed by the auditor.
- All members of an audit committee if non-audit fees include fees for tax services for senior executives of the company or involve services related to tax avoidance or tax shelter schemes.
- All members of an audit committee that re-appointed an auditor that we no longer consider to be independent for reasons unrelated to fee proportions.
- All members of an audit committee who served at a time when accounting fraud occurred.
- All members of an audit committee who served at a time when financial statements had to be restated due to negligence or fraud.
- All members of an audit committee if the company has repeatedly failed to file its financial reports in a timely fashion.
- All members of an audit committee at a time when the company fails to report, or to have its auditors report, material weaknesses in internal controls.
- The audit committee chair if the committee did not meet at least four times during the year.

We also take a dim view of audit committee reports that consist of boilerplate language and provide little or no information or transparency to investors. When a certain type of problem occurs, such as a material weakness, restatement or late filing, our judgment of the audit committee's performance takes into account the transparency of the audit committee report.

Compensation Committee Performance

Compensation committees have the final say in determining the compensation of executives. This includes deciding the bases on which compensation is determined, as well as the amounts and types of compensation to be paid. This process begins with the hiring and initial establishment of employment agreements, including the terms for such items as base pay, pensions and severance arrangements. It is important that compensation be

²⁹ If our recommendation would be to vote against the committee chair and the chair is not up for election because the board is staggered, we do not recommend voting against any members of the committee who are up for election; rather, we will express our concern regarding the committee chair. In the absence of an audit committee, we will recommend voting against the chair of the board.

consistent with, and based on, the long-term economic performance of the company's long-term shareholder returns.

Compensation committees are also responsible for the oversight of the transparency of compensation packages. This oversight includes the disclosure of compensation arrangements, the matrices used in assessing pay-for-performance and the use of compensation consultants. It is important for investors to have clear and complete disclosure of all the significant terms of compensation arrangements in order to reach informed opinions as to the performance of the compensation committee. Finally, compensation committees are responsible for the oversight of internal controls in the executive compensation process. This includes controls over gathering information used to determine compensation, the establishment of equity award plans and the granting of equity awards. Lax controls can contribute to conflicting information being obtained, possibly through the use of nonobjective consultants, for example. Lax controls can also contribute to improper awards, such as those made through the granting of backdated or spring-loaded options, or through the granting of bonuses when the triggers for such payments have not been met.

We evaluate compensation committee members on the basis of their performance while serving on the compensation committee in question, and not for actions taken solely by prior members who are no longer serving on the committee. When assessing the performance of compensation committees, we will recommend voting against the following members under the following circumstances:³⁰

- All members of the compensation committee (from the relevant time period) if excessive employment agreements and/or severance agreements were entered into.
- All members of the compensation committee if performance goals were changed (i.e., lowered) when employees failed to meet — or were unlikely to meet — original goals, or performance-based compensation was paid despite goals not being attained.
- All members of the compensation committee if excessive employee perquisites and benefits were allowed.
- The compensation committee chair if the committee did not meet during the year, but should have (e.g., executive compensation was restructured).

Nominating Committee Performance

The nominating committee, as an agent for shareholders, is responsible and accountable for the selection of objective and competent board members. We will recommend voting against the following members of the nominating committee under the following circumstances:³¹

³⁰ If our recommendation would be to vote against the committee chair and the chair is not up for election because the board is staggered, we do not recommend voting against any members of the committee who are up for election; rather, we will express our concern regarding the committee chair. In the absence of a compensation committee, we will recommend voting against the chair of the board.

³¹ If the committee chair is not disclosed, we will go against the most senior member on the committee. If the disclosure is so poor as to the composition of the committee(s), we will recommend voting against the chair of the board. If the board does not have a nominating committee (or a committee that serves such a purpose), we recommend voting against the chair of the board on this basis.

- All members of the nominating committee when the committee nominated or re-nominated an individual who had a significant conflict of interest, or whose past actions demonstrated a lack of integrity or inability to represent shareholder interests.
- The nominating committee chair if the nominating committee did not meet during the year, but should have (i.e., new directors were nominated).
- The nominating committee chair if the committee re-nominated a director who has not attended any board meetings.
- The nominating committee chair if: (i) the board of directors does not meet the necessary independence threshold Glass Lewis has set for the different board structures; (ii) there are more than 20 members on the board; or (iii) there are less than five members on the board.

Investment Trusts and Investment Corporations

Board Structure

Investment trusts and investment corporations are governed under the Japanese Investment Trust and Investment Corporation Act (the Act), and the Financial Instruments and Exchange Law. Pursuant to the Act, an investment trust/investment corporation is required to have a board of directors, which must be comprised of at least one executive director and at least two supervisory directors. The board must consist of one or more executive directors and the number of supervisory directors must be greater than, but not equal to, the number of executive directors. The boards of investment trusts and investment corporations typically consist of three directors: one executive director and two supervisory directors. Investment trusts and corporations are required to hold general meetings of shareholders once every two years.

Election of Directors

Executive directors on the boards of Japanese investment trusts and investment corporations are in charge of managing the company. Supervisory directors have the authority and responsibility to supervise the executive directors. In addition, the Act provides that a supervisory director must not be: (i) a founding member of the investment trust/investment corporation; (ii) an executive officer or employee of a founding organization of the investment trust/investment corporation or any of their subsidiaries; (iii) an executive director of the investment trust/investment corporation; (iv) an executive director or employee of the investment trust/investment corporation's affiliated security firms; and (v) a person who has a material, financial, familial or other relationship with the founding organization or the executive directors of the investment trust/investment corporation.³² Thus, if we believe that a supervisory director does not meet the above requirements, or if we find any evidence that may call into question the director's independence, we will recommend shareholders vote against such a nominee. In addition, we will oppose supervisory directors during whose tenure accounting fraud occurred in the company or serious fraud was conducted by the executive directors.

The terms of office of both executive directors and supervisory directors of the investment trust/investment corporation are two years.

³² Article 100 of the Ordinance for Enforcement of Act on Securities Investment Trust and Securities Investment Corporations.

Transparency and Integrity in Financial Reporting

Accounts and Reports

In most countries, companies routinely submit annual financial statements and director and auditor reports for shareholder approval. In Japan, shareholders generally do not vote on financial statements, as most companies are required only to report the statements to the shareholders and shareholder approval is not necessary for them to be valid.

However, the Companies Act states that companies with less than ¥500 million in total assets are exempt from appointing an independent auditor or establishing a board of statutory auditors. If a company chooses not to appoint an independent auditor, the company is required to obtain shareholder approval of its financial statements at the annual meeting of shareholders. In such cases, financial statements are audited only by the statutory auditors.

We believe that the independent auditor's role as gatekeeper is crucial in ensuring the integrity and transparency of the financial information necessary for protecting shareholder value. The roles of statutory auditors and independent auditors are not the same and a proper and well-functioning auditing system exists only when the three main groups responsible for financial reporting — the board of directors, the statutory auditors and the outside independent auditors — form a “three-legged stool” that supports responsible financial disclosure and active participatory oversight. As such, we strongly believe that every listed company, regardless of its size, should appoint an independent auditor to ensure a fair and objective financial reporting process.

However, we believe that a disapproval of financial statements may not be in the best interests of shareholders. If the statements fail to obtain the necessary shareholder support, the company will be required to reexamine its statements to check for any inaccuracies and resubmit them at another general meeting of shareholders. Such a process could not only be costly for the company, but will also likely create a period of uncertainty, potentially harming investor confidence in the company.

Therefore, while we are hesitant to support any financial statements that have not been scrutinized by an independent auditor, we would generally support a proposal to approve such financial statements, provided that there has been no indication of inaccuracy.

In addition, if we are unable to obtain all the necessary documents (i.e., annual financial statements and statutory auditor reports), we will recommend shareholders abstain from voting on the proposal.

Allocation of Profits/Dividends

In general, many Japanese companies prefer to distribute stable dividends year on year, rather than dividends that reflect performance or future capital needs. However, there has been growing criticism regarding insufficient capital efficiency and shareholder returns prevalent among Japanese companies. Issues such as

excessive cash on balance sheets, maintaining significant levels of cross-shareholdings, low return on equity and other capital allocation issues, all contribute to insufficient capital efficiency and shareholder returns.

In our view, shareholders should expect more than a stable dividend from their investment. Investors typically purchase a company's common shares to gain value from the potential growth and upside in the business.

When the company has a good year, shareholders should expect to see the excess profit in their dividend checks, unless the company plans to utilize the capital to fund its growth and expansion, or if it needs the additional cash due to a capital shortage.

We generally support a company's policy when it comes to the payment of dividends (or the absence thereof). In most cases, we believe the board is in the best position to determine whether a company has sufficient resources to distribute a dividend or if shareholders would be better served by forgoing a dividend to conserve resources for future opportunities or needs. In addition, when we evaluate allocation of profits and dividends proposals, we will consider the financial condition of the company for the last few years by taking into consideration factors such as, but not limited to, the level of cash holding, capital structure, financial performance, and shareholder returns to determine whether the dividend payment is reasonable.

Further, the Japanese Companies Act grants companies the right to allocate profits without shareholder approval if they fulfill the following conditions: (a) the company has an independent auditor; (b) the company's board structure is a two-tier board, a one-tier with one committee board or a one-tier with three committees board; (c) the term of directors is one year (excluding audit committee directors who have two-year terms); (d) the company's articles stipulate that the board has the authority to determine the allocation of profits without shareholder approval; and (e) there are no issues regarding the independent auditor's report. If the company has granted the board authority to allocate dividends at its discretion, Glass Lewis will review the company's dividend policy and, where applicable, we may hold certain directors accountable for the company's dividend policy.

We will, however, always review the proposals on a case-by-case basis and, when making these voting recommendations, we will carefully review factors including the length of time since the company's initial listing, the economic environment, the company's financial momentum, and the level of disclosure provided regarding its dividend policy; based on these factors, we may refrain from recommending shareholders vote against the proposal.

Appointment of Auditor and Authority to Set Fees

The auditor's role as gatekeeper is crucial to ensure the integrity and transparency of the financial information necessary for protecting shareholder value. Shareholders rely on the auditor to ask tough questions and thoroughly analyze a company's books to ensure that the information provided to shareholders is complete, accurate and fair, and that it is a reasonable representation of a company's financial position. The only way shareholders can make rational investment decisions is if the market is equipped with accurate information about a company's fiscal health.

As such, shareholders should demand an objective, competent and diligent auditor who performs at or above professional standards at every company in which the investors hold an interest. Similar to directors, auditors should be free from conflicts of interest and avoid situations requiring a choice between the auditor's interests

and those of the public. Almost without exception, shareholders should be able to annually review an auditor's performance and ratify a board's auditor selection. However, in the case of Japan, shareholders are not able to ratify the appointment of the company's auditor on an annual basis. Pursuant to the Companies Act, the auditor's term of office shall continue until the conclusion of the annual shareholder meeting for the last business year which ends within one year from the time of their election. Furthermore, unless the company seeks to change the auditor at the annual shareholder meeting, the incumbent auditor shall be deemed to have been re-elected.³³ Under the 2004 Revised Certified Public Accountants Law, accountants are prohibited from auditing the same company for more than seven consecutive years, commencing from the year of enforcement. Under this law, only the accountants, not the firm, are prohibited from continuing to audit a company for more than seven years.

If we have concerns regarding the independence of an auditor and the appointment of the auditor is not presented for shareholder approval, we will raise our concern in the elections of statutory auditors or audit committee members.

We note that Japanese companies rarely disclose the amount paid in non-audit fees in a timely manner. Most often, only the aggregate amount paid to auditors are disclosed in the business reports.

Voting Recommendations Based on Auditor Ratification

We generally support management's choice of auditor, unless we believe the auditor's independence or audit integrity has been compromised. If there have been material restatements of annual financial statements or a material weakness in internal controls, we usually recommend voting against the auditor. If the audited financial statements have not yet been disclosed, we base our voting recommendations on the company's financial statements for the previous year. We do not hold a company's auditor responsible for what may be the company's failure to comply with reporting obligations or a lack thereof, depending on the jurisdiction.

Reasons why we may not recommend in favor of the ratification of an auditor include:

- When the sum of audit fees and audit-related fees total less than 50% of overall fees paid to the auditor.³⁴
- When there have been any recent restatements or late filings by the company and the auditor bears some responsibility for the restatement or late filing (e.g., a restatement due to a reporting error).³⁵
- When the company has aggressive accounting policies.
- When the company has poor disclosure or a lack of transparency in financial statements.
- When there are other relationships or issues of concern with the auditor that might suggest a conflict between the interests of the auditor and those of shareholders.

³³ Article 338 of the Companies Act.

³⁴ If the company does not disclose a breakdown of audit and non-audit fees, we generally support the board of director's recommendation, except in cases where we believe the independence of the returning auditor or the integrity of the audit has been compromised.

³⁵ An auditor does not perform an audit of interim financial statements and, accordingly, we generally do not believe should be opposed for a restatement of interim financial statements, unless the nature of the misstatement is clear from a reading of the incorrect financial statements.

- When the company is changing auditors as a result of a disagreement between the company and the auditor on a matter of accounting principles or practices, financial statement disclosures or auditing scope and procedures.
- When the company does not disclose sufficient information regarding the appointment or ratification of the auditor (e.g., the name of the auditor), we will recommend shareholders abstain from voting on the measure.

The Link Between Compensation and Performance

Director and Statutory Auditor Compensation

Glass Lewis believes that non-employee directors and statutory auditors should receive reasonable amounts and types of compensation for the time and effort they spend serving on the board and its committees. We will consider recommending support for compensation plans that include option grants or other equity-based awards that help to align the interests of board members with those of shareholders. Director and statutory auditor fees should be reasonable in order to retain and attract qualified individuals. However, excessive fees represent a financial cost to the company and threaten to compromise the objectivity and independence of non-employee directors and external statutory auditors.

Bonuses for Directors and Statutory Auditors

Japanese companies may pay bonuses to their directors and statutory auditors. We believe that it is appropriate to make bonus payments to executive directors when there is a track record of strong performance and the proposed bonus is reasonable, taking into consideration the company's size and performance.

In general, we will recommend voting against bonus payments and other performance-based short-term incentives for outside directors and all statutory auditors since we believe performance compensation may align the interests of outsiders and statutory auditors with those of management, rather than shareholders. Outside directors, audit committee directors and statutory auditors have the duty and responsibility to monitor the conduct of management for the protection of shareholder interests and maximization of shareholder returns. Performance-based bonuses and short-term incentives could be strong disincentives for such individuals to exercise careful oversight of performance of management. Moreover, such types of compensation could threaten to compromise the integrity of a company's financial statements, as audit committee directors and statutory auditors may be forced to weigh their own interests in relation to those of shareholders when overseeing the company's financial reporting. In short, we believe that these types of grants could create a situation wherein outside directors, audit committee directors and statutory auditors are no longer independently representing the best interests of shareholders.

While we note that the payment of bonuses to outsiders is still a common practice in Japan and that the actual amounts of such payments generally make up a small percentage of an outsider's total compensation package, an increasing number of companies are voluntarily refraining from granting bonuses to outside directors, audit committee directors and statutory auditors. As more companies appoint outside directors and the role of outside directors, audit committee directors and statutory auditors becomes more critical, we believe that a better framework should be laid out for those in the position to satisfy oversight and supervisory roles. We therefore recommend that shareholders vote against proposals that award bonuses to outside directors, audit committee directors and statutory auditors regardless of the size of the payment.

Additionally, we may recommend shareholders vote against a proposal to grant bonuses to inside directors if: (i) we believe that the company's performance does not justify the payment; or (ii) if the bonus is set to be paid to a director who had acted contrary to the interests of shareholders within the previous 12 months.

Retirement Bonuses for Directors and Statutory Auditors

A majority of companies have already eliminated the retirement bonus system, which is based on seniority rather than an individual's contribution or the performance of a company. However, given the traditional practice of such payments, these proposals continue to be put forward for consideration by shareholders. Retirement bonuses make up a large portion of compensation for directors and statutory auditors in Japan and the amount of compensation is usually left to the discretion of the board of directors or board of statutory auditors.

In our opinion, executive compensation should be linked to personal contributions or company performance, not merely length of service. We therefore strongly encourage the abolition of seniority-based retirement allowance systems and the adoption of performance-based compensation. We note that both domestic and overseas investors view retirement allowances with great skepticism and vote against these proposals routinely. Additionally, given that most companies have already abolished the retirement bonus system, we no longer support retirement grants and/or any related proposals. We will, however, always review the proposed retirement bonuses on a case-by-case basis and may support the payment when we believe it has been structured in an appropriate manner.

Equity-Based Compensation Plans

We believe that equity compensation awards are useful, when not abused, for retaining employees and providing them with an incentive to act in a way that will improve company performance.

Equity-based compensation programs have important differences from cash compensation plans and bonus programs. Accordingly, our analysis takes into account factors such as plan administration, the method and terms of exercise, and express or implied rights to re-price.

Our analysis is both quantitative and qualitative. In particular, we examine the potential dilution to shareholders, the company's grant history and compliance with best practice recommendations.

We evaluate and make voting recommendations of equity-based incentive plans based on the following principles:

- Total potential dilution to current shareholders should be reasonable and in line with a company's peers. We will consider annual grant limits to all plan participants and individual senior executives when making this assessment, and particularly whether such limits have been set and disclosed.
- Companies should have a demonstrated history of making reasonable equity incentive grants over the past three fiscal years.
- Plans should not permit re-pricing of stock options without shareholder approval.

- Vesting period under the equity compensation plan should be two or more years. However, if the awards will vest upon their retirement from their respective boards, we will refrain from recommending against based solely on the vesting period.
- Outside directors, audit committee directors under a one-tier board with one committee structure and/or statutory auditors should not be recipients of performance-based incentive awards. However, when the proposed equity awards for the above-mentioned participants are simply time-based, we will refrain from recommending against based solely on the eligible recipients.

Furthermore, when evaluating equity-based compensation proposals, we will look for companies to provide complete disclosure surrounding the proposed equity grants. In the absence of complete disclosure, we may recommend shareholders oppose either the adoption of an equity-based compensation plan or the granting of equity grants where:

- The number of share options or shares to be granted has not been disclosed by the company.
- The exercise price or discount rate of stock options is not disclosed or is determined at the discretion of the plan administrator.

Directors' and Statutory Auditors' Fees

Japanese companies are required to seek shareholder approval when changing the aggregate amount of fees that are payable to directors or statutory auditors. However, details regarding the compensation package of a director or the remuneration policy of an executive are generally not disclosed; only the aggregate amount of the compensation paid to directors and statutory auditors is disclosed.

We will generally support a proposal to change the aggregate amount of fees payable to directors and/or statutory auditors, so long as the proposed fees are not excessive, in particular relative to the company's peers. Companies may propose incorporating stock option schemes or other equity-based compensation plans into directors and/or statutory auditors' fees. In such circumstances, we generally evaluate the overall cost of the plan and potential dilution to shareholders, and we will support the compensation plan if we find it to be reasonable.

In the past few years, an increasing number of companies have introduced performance-linked compensation plans, which we view positively. However, as performance metrics are not disclosed based on either single metrics or absolute performance hurdles, when a company amends the remuneration level in conjunction with the introduction of pay for performance, we will examine the proposed policy closely. Additionally, Glass Lewis believes that outside directors' and statutory auditors' remuneration should not be linked to performance; if the two are linked together, we will recommend shareholders vote against such proposals. We also believe that shareholders are entitled to review how participants' performance is measured and linked to compensation in detail. If the disclosure is vague and a link to performance is unclear, we may recommend that shareholders voice their concerns by voting against such proposals.

Executive Compensation³⁶

As a general rule, Glass Lewis believes that shareholders should not be involved in setting executive compensation. Such matters should be left to the board or its compensation committee. We view the election of directors — specifically, the election of those who sit on the compensation committee or a committee that serves a similar function — as the appropriate mechanism for shareholders to express their disapproval or support of board policies on this issue. Further, we believe that companies whose compensation practices are in line with performance and the compensation of their peers should be granted the flexibility to compensate their executives in a manner that drives growth and profit.

However, Glass Lewis favors performance-based compensation as an effective means of motivating executives to act in the best interests of shareholders. Performance-based compensation may be limited if a chief executive's pay is capped at a low level rather than flexibly tied to the performance of the company.

³⁶ Pursuant to the Cabinet Office Ordinance on Disclosure of Corporate Affairs released by the Financial Services Agency, listed companies are only required to disclose the details of executive compensation when an executive earns ¥100 million or more during the relevant fiscal year. The disclosure entails a breakdown of total compensation by type of payment including bonuses and stock options.

Financial Structure and the Shareholder Franchise

Anti-Takeover Measures

Takeover defenses were virtually non-existent in Japan as recently as 2004; however, by the end of June 2007, nearly 10% of all listed companies in Japan had adopted a takeover defense plan. While many companies continue to renew their takeover defense plans, the number of companies that have abolished them has outnumbered those that adopted them in recent years. Generally, there are three different types of poison pills in Japan: (i) the advanced warning type; (ii) the trust type; and (iii) the EGM type. While this categorization is useful in identifying the way in which a defense plan may be adopted or activated, the basic functionality of all three types of takeover defense plans is essentially the same.

Types of Poison Pills

Advanced Warning Defense Plan

The vast majority of Japanese companies that have adopted takeover defense measures have adopted the advanced warning type of plan. This plan sets out general rules and policies for potential hostile takeovers in advance of a hostile offer. Some companies have adopted takeover defense measures even in the complete absence of any hostile offer. If an acquirer does not meet the rules established by the target company, the target company may implement certain measures, such as the free allotment of stock acquisition rights and/ or a stock-split, to prevent the takeover. The benefit of this type of plan is that it presents a minimal financial burden to the company and is generally transparent, as it outlines the rules and processes of the defense measure. The board, or sometimes an independent third party, generally has the final authority on whether or not to activate the defensive measure.

The advanced warning plan can be adopted by the board without shareholder approval. However most companies voluntarily present the adoption or renewal of this type of takeover defense plan to shareholders for their approval, usually as an ordinary resolution that requires a simple majority support to pass.

EGM Defense Plan

The so-called EGM defense plan is a variation of the advanced warning type. As with the advanced warning type, the EGM type sets out general rules and policies for a potential hostile takeover in advance, and in the absence of, a hostile offer. If a hostile offer is launched, the board would then require the bidder to comply with certain rules. If the bidder does not meet the requirements, the board may take measures to dilute the interests of the acquirer.

The EGM type is unique in that if the bidder meets the specified rules, the board would call an extraordinary meeting of shareholders (or a similar meeting that is not a shareholders' general meeting) to determine whether or not to activate the defense measure. Usually, shareholders can vote for or against the activation of the

takeover measure at such a meeting. If shareholders reject the activation of the measure, then the offer can proceed. However, the board generally reserves the right to activate the defense measure without holding a shareholder's meeting if it deems the offer to not be in the best interests of the company and its shareholders.

This type of takeover defense is usually adopted without shareholder approval, as most companies that adopt this type of measure believe that it is sufficient to seek shareholders' opinion at the time of the hostile bid.

Trust Defense Plan

The trust type defense plan involves the issuance of non-transferable stock acquisition rights — usually free of charge — to a trust bank. When a hostile offer is made, these rights may be distributed to all shareholders except for the acquirer. The shareholders can then exercise these rights (usually at ¥1 per share) to dilute the interest of the acquirer.

The trust type rights plan represents certain financial costs to the company upon adoption, and the adoption of this type of defense measure requires a two-thirds supermajority vote of shareholders. Due to these restrictions, this type of plan is rare in Japan. The decision regarding the activation of the stock acquisition rights is generally reserved for the board, although the board may be required to obtain advice from an independent third party.

Glass Lewis' Approach to Takeover Defense Plan

Glass Lewis believes that takeover defenses generally are not conducive to good corporate governance. Specifically, they can substantially limit opportunities for corporate takeovers and reduce management accountability. Studies have found that companies with greater protection from takeovers are associated with poorer operating performance that may lead to a decrease in firm value.³⁷ Other studies have shown that an increase in protection through anti-takeover statutes is associated with a decrease in management accountability.³⁸

While a board should be given wide latitude in directing the activities of the company and charting its course, we believe that shareholders should have a direct say in a matter as important as a takeover defense measure. This issue is different from other matters that are typically left to the board's discretion because there is a greater likelihood of a divergence of views between managers and shareholders on this issue. Managers are often motivated to preserve their own jobs or arrange for substantial payouts and, as a result, their actions following a takeover bid may not always be in the best interests of shareholders. A recent study found that target CEOs are willing to accept lower acquisition premiums if they stand to earn personal, monetary or professional gains from the proposed deal.³⁹

³⁷ Paul A. Gompers, Joy L. Ishii and Andrew Metrick. "Corporate Governance and Equity Prices." *NBER Working Paper No. 8449*. 2001; R. Bauer, B. Frijns, R. Otten and A. Tourani-Rad. "The Impact of Corporate Governance on Corporate Performance: Evidence from Japan." *GMI Governance and Performance Studies*, May 2005.

³⁸ Marianne Bertrand and Sendhil Mullinathan. "Is there Discretion in Wage Setting? A Test Using Takeover Legislation." *Rand Journal of Economics*. 1999, page 535; Gerald T. Garvey and Gordon Hanka. "Capital Structure and Corporate Control: The Effect of Antitakeover Statutes on Firm Leverage." *Journal of Finance*. 1999, pages 519, 520.

³⁹ Jay Hartzell, Eli Ofek, and David Yermack. "What's In It For Me?: Personal Benefits Obtained by CEOs Whose Firms Are Acquired." *Working Paper*. 2000, page 21.

One of the main justifications made by Japanese issuers for adopting a takeover defense plan is that it ensures the board and shareholders will have sufficient information to make an informed judgment by requiring the bidder to disclose certain information. However, the Financial Instruments and Exchange Law grants companies that are the target of a takeover bid a right to demand information from the bidder. Pursuant to said law, the target company can request that the bidder answer any questions it deems relevant, and the bidder must send replies to the target company and the Financial Services Agency. The bidder can choose not to answer specific questions; however, the bidder must provide a rationale for choosing to not answer the question.

The right to demand information provided by the Financial Instruments and Exchange Law provides the target board a tool to obtain information that it believes is necessary for shareholders to evaluate the offer, thereby reducing the necessity of a takeover defense. While this right is relatively limited compared to an authority granted under a typical takeover defense, as the target company is not entitled to request additional information or to demand further explanation on the bidder's answers, we believe that this right under the law is generally sufficient for shareholders to obtain information that they may need to make an informed judgment.

In certain circumstances, however, we will support the adoption of a poison pill or similar takeover defenses that are limited in scope, provide reasonable protections to shareholders and are designed to provide the board and shareholders with adequate time to pursue value-maximizing alternatives. These defense plans, when drafted properly, encourage a potential acquirer to negotiate with the board directly. In general, we believe that a reasonable takeover defense plan in Japan must satisfy all of the following requirements:

- Shareholder approval is required for adoption and renewal.
- The term of the takeover defense plan is no more than three years.
- The takeover defense plan can be abolished by a resolution submitted by shareholders.
- The trigger threshold of the plan is 20% or higher.
- Regardless of the type of board structure, the board of directors must be majority independent.
- The administration of the defense plan is monitored by an independent third party.
- The information disclosure requirement, if any, is reasonable with respect to amount, timing and type of information required.
- The total consideration period, if any, of the information disclosed pursuant to the defense plan does not exceed 120 calendar days, given that the initial consideration period does not go over 90 calendar days.
- There is no unreasonable "exceptions clause."
- There is no clause that allows for the provision of monetary compensation to the bidder.
- There is no evidence of the board's abuse of a prior takeover defense plan, gross negligence, and egregious lack of oversight or disregard of shareholder value.

Where these requirements are met, we typically feel comfortable that shareholders will have the opportunity to voice their opinion on any legitimate offer.

Adoption, Renewal, and Revocation of a Takeover Defense Plan

We believe the adoption and renewal of a takeover defense plan should require shareholder approval at a general meeting of shareholders, and that the plan should clearly state that shareholders have the right to abolish it through a resolution. In some cases, a defense plan stipulates that shareholders can vote on such

matters as adoption, renewal and/or revocation through the votes cast for the election of directors. We believe that regardless of the directors' terms and election process, the adoption and renewal of a defense plan should be a matter on which shareholders can vote directly. Further, shareholders should be granted the right to revoke the defense plan through a shareholder resolution. It is unclear as to how the votes cast in the election of directors would be reflected in the decisions concerning the defense plan.

One exception to this policy is when a takeover defense plan is adopted by board resolution but is presented to shareholders at a general meeting for ratification and approval. While we prefer that companies seek shareholder consent prior to the adoption of a takeover defense plan, we generally do not oppose the adoption of a takeover defense plan solely on this basis, as the adoption of most types of takeover defense plans does not require shareholder approval under Japanese laws and regulations. We support a board's decision to seek shareholder approval, even if it is after the fact, absent any evidence of abuse.

To this end, we would generally recommend voting against takeover defense plans if: (i) the term of the plan is longer than three years; (ii) the renewal of the plan does not require shareholder approval;⁴⁰ or (iii) the plan does not state that it can be abolished by shareholders through a resolution at a shareholders' meeting.

If a takeover defense plan is adopted or renewed by the board without shareholder approval and is not, or has not been presented to shareholders for ratification,⁴¹ we generally recommend shareholders vote against the re-election of the chair of the board for his/her failure to seek shareholder consent for the adoption or renewal of a poison pill.⁴²

Trigger Threshold

We believe that the trigger threshold of a takeover defense plan should not be lower than 20% of a company's outstanding ordinary shares. A lower threshold may limit investors' ownership in companies, potentially discouraging institutional investors from taking advantage of investment opportunities, especially in smaller companies. In our opinion, a 20% or higher trigger threshold is appropriate, as investors seeking such a large share in a company are more likely to be seeking control of the company.

Accordingly, we would recommend shareholders vote against any takeover defense plan with a trigger threshold of less than 20%. In limited circumstances, however, we may support takeover defense plans with a lower trigger threshold if they exempt institutional and/or passive investors.

Board Independence

We believe that some level of board independence is imperative for ensuring the protection of minority shareholders' interests in the event of a hostile approach. A lack of sufficient board independence can raise significant concerns regarding the board's objectivity, independence and ability to protect all shareholders' interests in evaluating a takeover offer and whether to employ the takeover defense to prevent the takeover.

⁴⁰ If the plan fails to specify the manner in which it can be renewed, we will indicate this but will not recommend voting against the plan solely on this basis.

⁴¹ We apply a 12-month look-back period for the adoption and renewal of a takeover defense plan without shareholder approval.

⁴² In the absence of a board chair, we would recommend shareholders vote against the president or CEO.

Without sufficient independent board representation, we do not believe that shareholders should entrust the board to make decisions in the context of hostile takeover attempt.

Regardless of the board structure, if the board of directors is not majority independent, we will recommend that shareholders vote against the takeover defense plan.⁴³

Independent Third Party Oversight

In order to minimize the risk of a takeover defense plan being used by management for their own interests rather than shareholders', we believe that a party free of any affiliation to the company that may result in a conflict of interest should oversee the administration of the takeover defense plan. The independent third party should, in our opinion, consist of a group of solely non-executive outsiders, such as outside directors and external statutory auditors, all of whom should be independent.⁴⁴ The company must demonstrate the independence of the third party through public disclosure.

If the independent third party is not entirely independent, or if the company does not disclose sufficient information to allow shareholders to evaluate the independence of the third party, we will recommend that shareholders vote against the takeover defense plan.

Information Disclosure Requirement

In Japan, we typically see a provision requiring the acquirer to disclose to the target company: (i) the details of the acquirer; (ii) the purpose, method and terms of the acquisition; (iii) the basis for the calculation of the offer price; and (iv) a post-acquisition management policy. We generally believe that it is reasonable to require some level of disclosure of this type of information.

However, we understand that there is a limit to the amount of information the acquirer can disclose. Therefore, we believe that the acquirer should either be given the option to withhold information, or the information requested should not be excessive.⁴⁵ In addition, we believe that in the event of an all-cash offer with the intent to acquire all outstanding shares of a company, shareholders do not require such exhaustive information to make an informed judgment. We will, accordingly, view takeover defense plans more favorably if they exempt this type of offer from some of the information disclosure requirements.

We are generally concerned with provisions requiring the disclosure of what we believe is unnecessary, excessive or irrelevant information. Examples of such extraneous information include: (i) details of similar types of transactions sought by the acquirer; (ii) the probability of the success of the acquisition; (iii) the existence of

⁴³ For a company with a two-tier board structure, while we assess the independence of the board of directors in conjunction with the board of statutory auditors for election proposals, in the context of evaluating a takeover defense plan we evaluate the independence of the board of directors without including the board of statutory auditors.

⁴⁴ We generally prefer the independent third party to be composed of independent directors and/or independent statutory auditors, as they can be held accountable to shareholders through the election process.

⁴⁵ In its report entitled "[The Proper Role of Takeover Defense Measures in Light of Changes in Various Environments]" issued on June 30, 2008, the Corporate Value Study Group, a special task force organized under the Ministry of Economy, Trade and Industry, states that demanding an exhaustive disclosure of underlying assumptions and facts used in calculating the offer price, or of detailed management plans, and then to activate a defensive measure on the basis of the absence of some of the requested information is unreasonable and inappropriate.

communication with third parties, such as financial advisors, consultants and affiliated parties, and its contents; (iv) the planned treatment of and/or effects upon such stakeholders as local communities, business partners and clients; and (v) the measures for sustainable and continuous improvement of the company's corporate value and the grounds that prove such measures will be effective. Some of the requested disclosure items may be extremely difficult, if not impossible, to accurately assess. We therefore do not believe that the acquirer should be required to disclose such information. These additional disclosure requirements can be so arduous to fulfill that they potentially would serve to deter an acquirer from acquiring the company.

Accordingly, we generally recommend shareholders vote against takeover defense plans that require the disclosure of the types of inappropriate or excessive information discussed above.

Further, we generally do not approve of provisions that authorize the board and/or an independent third party to request, after receiving the disclosed information from the acquirer, any additional information without limitation or a clear timeframe should they deem the previously disclosed information to be insufficient or inappropriate. While we understand that a request for additional disclosure may be needed in some limited circumstances, there should be a clear timeframe and a limit to how much and how many times such a disclosure can be requested. As the consideration of the offer will not commence until the board and/or independent committee has determined that all information has been submitted in a satisfactory manner, the offer could be suspended indefinitely. Such a provision could be used to thwart potentially beneficial offers and goes beyond what we believe is necessary and/or appropriate. We therefore do not support takeover defenses that contain a provision granting the right to request additional information without limitation.

Consideration Period

The typical Japanese takeover defense plan provides the board and/or independent third party with 60-to-90 calendar days to consider the information disclosed by the acquirer pursuant to the information disclosure requirement. This period is also to allow for the board and/or independent party to review and consider the offer, form its opinion, negotiate the terms of offer or seek better alternatives. During this period of consideration, the bidder is generally prohibited from acquiring any additional shares in the company or from initiating a takeover bid. Should the bidder violate this rule, the board is generally authorized to activate a defensive measure to thwart the bid. Moreover, if the board and/or independent third party determines during the consideration period that the offer is "abusive" in accordance with the terms of an exceptions clause, as discussed below, the board may take the necessary steps to activate defensive measures.

We generally prefer short consideration periods. In our opinion, 90 days is sufficient time to consider an offer, formulate counter-offers or negotiate terms.⁴⁶ However, we will permit the board and/or administrator to extend the consideration period to up to 120 days, including the initial consideration period. A longer

⁴⁶ Generally, takeover defense plans in Japan grant the board 60 calendar days to consider an all-cash offer and 90 days for any other type of offer. The board will determine, with reference to the independent third party's opinion, whether the offer would harm the corporate and shareholder values of the company. In some cases, the independent third party may grant the board as many as 60 calendar days to consider the offer and form its opinion. Upon the completion of the board's consideration period, the independent third party will have an additional 60 days to review the information disclosed by both the board and bidder. In practice, this grants the company a total of 120 calendar days to consider the offer and seek alternatives. As such, we almost always oppose this type of plan.

consideration period may discourage a potential acquirer, as the offer will be subject to a greater period of uncertainty.

We therefore generally oppose any takeover defense plan where the initial consideration period granted to the target company exceeds 90 calendar days, or when added together with extension period exceeds 120 days. We are also wary of provisions that allow the extension of the consideration period to any such length as deemed necessary by the board and/or independent third party.

Exceptions Clause

Most takeover defense plans adopted by Japanese companies contain a provision we call an “exceptions clause.” The exceptions clause generally allows for the activation of takeover defenses if the offer is deemed by the board and/or independent third party to pose an imminent threat to corporate and shareholder value, even when the offeror diligently follows the rules stipulated under the takeover defense plan. We will support takeover defense plans with an exceptions clause only when the conditions under such clause are limited and reasonable, and the evaluation of the offer to determine whether the offer presents an “imminent threat” will not be carried out by the board and/or a party dominated by insiders and affiliates.

Taking into consideration court rulings in Japan, we believe that a provision authorizing the activation of a defensive measure in the following types of offer situations provides reasonable protection to shareholders: (i) coercive two-tier tender offers; (ii) acquiring shares with the intent of requiring the company or its associates to repurchase them at an inflated price; (iii) temporarily taking control of the company’s management to transfer the company’s valuable assets at an unfair price for the benefit of the acquirer; (iv) pledging assets of the company as collateral for the debts of the acquirer or its group, or using the company’s funds to repay such debts; and (v) temporarily taking control of the company’s management and causing the company to dispose of valuable assets unrelated to its core business for the purpose of declaring high dividends, or to sell the company’s shares at a higher price by taking advantage of the appreciation in stock price caused by the declaration of high dividends.⁴⁷

We generally do not support any takeover defense plans that allow management to activate a defensive measure for any reasons other than those described above. The commonly used provisions that we find to be problematic include, among others, measures that grant the board and/or independent third party the ability to activate a defensive measure if: (i) the company, board, independent third party and/or shareholders are not provided with sufficient time and information to consider the offer; (ii) the terms and conditions of the offer are inadequate or insufficient considering the company’s intrinsic value; (iii) the offer is not in the best interest of the company, taking into account the interests of its shareholders, employees, business partners, clients, local community and other stakeholders; (iv) the acquisition threatens to materially harm the company’s corporate value by destroying the company’s corporate culture, brand image and/or its relationship with its shareholders, employees, partners and/or local communities; (v) the mid- to long-term corporate value of the company under

⁴⁷ The Corporate Value Study Group believes that the board of a target company should not assert that the activation of a takeover defense is necessarily based on the fact the acquirer likely will pledge the target company’s assets or distribute high dividends, as such actions do not necessarily harm shareholder value. While we agree with the study group that these actions do not always cause substantial harm to shareholder value, given the opinion of the Tokyo District Court in the Nippon Broadcasting case, March 23, 2005, in which the court defined buyers with intent to carry out any of the actions discussed above as potentially abusive, we accept the presence of these provisions.

the acquirer's control is considered materially subordinate to the case where the company is not under such control; and (vi) the acquirer is deemed inappropriate as a controlling shareholder of the company from the perspective of public order and morals. These vague provisions provide the board with too much discretion and could be used to thwart a potentially beneficial takeover offer. As such, we do not support the adoption of a takeover defense plan that contains any of the aforementioned provisions or similar measures.

Provision of Monetary Compensation to the Bidder

In 2007, when U.S.-based fund Steel Partners, which is widely regarded in Japan as an activist investor, proposed to buy Bull-Dog Sauce Co., the company adopted a takeover defense plan to ward off the hostile approach. Bull-Dog Sauce's poison pill included a provision that allowed the company to give the bidder cash compensation for the dilution it could have suffered as a result of the activation of the poison pill. The company's actions and its poison pill were contested in the courts and Bull-Dog Sauce won in both the Tokyo District Court and the Supreme Court. Bull-Dog Sauce activated its poison pill, diluting Steel Partners' stake, and paid the fund approximately ¥2.3 billion as a compensation for the dilution. Steel Partners is said to have made gains of approximately ¥5 billion as a result.

The Bull-Dog Sauce case prompted a number of Japanese corporations to adopt a takeover defense plan with provisions enabling the company to compensate the buyer, as such takeover defense plans are more likely to win the court's support. However, the provision of monetary compensation to the bidder has been harshly criticized by institutional investors as encouraging green-mailers rather than discouraging them, and as promoting the activation of a defensive measure rather than promoting a dialogue between the relevant parties. Such compensation can therefore result in the outflow of company capital that could have otherwise been returned to all shareholders or invested to increase shareholder value.

We strongly oppose takeover defense plans that allow for the granting of monetary compensation to the acquirer. We believe that a takeover defense should not be activated under almost all circumstances, and that such a plan should be designed to maximize shareholder value by encouraging negotiation and providing sufficient time to seek value maximizing alternatives. Given the legal precedents, we understand that the inclusion of monetary compensation in a defense plan is likely to help it win the support of the courts in Japan; however, if a board truly believes that the offer will harm shareholder value, then the company should defend its position rather than using shareholders' money to pay off the acquirer. Accordingly, we will recommend shareholders vote against all takeover defense plans that contain this provision.

Evidence of Abuse

We believe that a board's commitment to shareholder value is demonstrated through the actions taken by the board and its members. We therefore look closely at a board's past actions, and where we find a record of poor performance, gross negligence, egregious lack of oversight or disregard of shareholder value, we will recommend shareholders vote against the proposed takeover defense plan regardless of its mechanism. In our opinion, shareholders should not give the benefit of the doubt to a board that has proven to be unable or unwilling to protect shareholders' interest.

Excessive Cross-Shareholding

Mutual equity ownership among business partners, creditors and listed companies separates economic interest from voting rights and shields management from the disciplining pressure of the capital market. Such practices have been attributed to decreased management accountability, lax risk management and inefficient capital management policy, and have been shown to limit potential hostile approaches. Though companies often attempt to justify these cross-shareholding relationships as strategically important, the benefits of such relationships, if any, are generally both unquantifiable and unclear. While some level of management stability, access to capital, favorable business relationships and general synergistic value may be derived from mutual equity ownership, and while it is possible that this may ultimately add to long-term shareholder value, academic research supports the contrary. Empirical research has found a correlative relationship between a decrease in cross-shareholding relationships and a converse increase in corporate performance, suggesting that cross-shareholding relationships are more likely to suppress shareholder value than enhance it.

The practice of investing in the securities of banks, insurers and other public companies not only exposes shareholders to undisclosed risks, but also enables management to utilize shareholders' capital for its own self-preservation. Under Japanese accounting rules, if the market value of securities in which a company has invested falls below 50% of the purchase price, the company is required to record the loss on its balance sheet.

Often the returns on these investments are disproportionate to the risks, as evidenced by a number of companies which have recorded or are expected to record losses related to their recent securities investments due to market volatility. Additionally, under Japanese regulations, cross-shareholding relationships can be established at the sole discretion of the board without shareholder approval and with little or no reporting requirement depending on the size of the equity stake. Thus, using shareholder capital, the management effectively creates unsanctioned friendly partnerships from which the board benefits while shareholders may not.

While such practices are commonplace in Japan, given the aforementioned concerns regarding both general security investment practices and cross-shareholding relationships in Japan, we recommend voting against the chair of the board if the company has material strategic investments in other companies, excessive cross-shareholdings and a takeover defense plan. We believe that the most crucial test of a board's commitment to the company and its shareholders lies in the actions of the board and its members. In our opinion, extensive cross-shareholdings and placement of a takeover defense plan indicate the entrenchment of management at the company, the board's disregard for shareholder value and its willingness to protect itself at shareholders' cost.

Amendments to the Articles of Incorporation

We will evaluate proposed amendments to a company's articles of incorporation on a case-by-case basis. We are opposed to the practice of bundling several amendments under a single proposal because it prevents shareholders from judging each amendment on its own merits and is a practice which we believe negatively limits shareholder rights. In such cases, we will analyze each change individually. We will recommend voting for the proposal only when, on balance, we believe that all the amendments are in the best interests of shareholders.

Authority to Approve Dividends

Glass Lewis generally believes that the board is in the best position to determine allocation of profits and dividends in the context of the Company's business. Absent evidence of egregious conduct that may threaten shareholder value, we will generally support the board's proposed dividend distribution.

Furthermore, we note that the amended Companies Act, allows companies to amend its articles of incorporation to allow the board of directors to allocate profits without shareholder approval when a company has the following corporate governance framework in place: (i) adopted a one-tier board with one-committee structure (board and audit committee), one-tier board with three-committee structure (board with audit, compensation, nominating committees), or two-tier board structure (board and statutory auditors); (ii) director terms of one year; and (iii) has an independent auditor.

Given the governance framework required of such amendment, we will generally support proposals seeking to amend its articles to allow the board to allocate profits at its discretion. However, we note that in some cases, the amendment will go beyond providing the board with general discretion and also explicitly prohibit shareholders from voting on the allocation of profits. Glass Lewis generally views this type of amendment as an unnecessary reduction of shareholder rights; however, we will continue to evaluate such amendments on a case-by-case basis, with reference to the overall governance structure.

Supermajority Vote Requirements

Glass Lewis believes that supermajority vote requirements act as impediments to shareholder action on ballot items that are critical to shareholder interests. One key example of such a problem is in the takeover context, as supermajority vote requirements can strongly limit the voice of shareholders in making decisions on such crucial matters as selling the business.

Reduction of Quorum Requirements

Glass Lewis will generally recommend voting against this proposal due to the large concentration of share ownership in Japan. Companies may seek to lower the voting quorum requirement for special business proposals from 50% of issued shares to one-third. However, in many companies, enough shares are held by a parent company or a founding family to meet the one-third quorum requirement. Such a proposal could have the effect of disenfranchising independent shareholders.

Increase in Authorized Shares

Glass Lewis believes that adequate capital stock is important to a company's operation. When analyzing a request for additional shares, we typically review four common reasons why a company might need additional capital stock:

- **Stock Split** — We typically consider three metrics when evaluating whether we think a stock split is likely or necessary: (i) the historical stock pre-split price, if any; (ii) the current price relative to the company's most common trading price over the past 52 weeks; and (iii) some absolute limits on stock price that, in

our view, either always make a stock split appropriate if desired by management, or would almost never be a reasonable price at which to split a stock.

- **Shareholder Defenses** — Additional authorized shares could be used to bolster takeover defenses such as a “poison pill.” Proxy filings seeking additional shares often discuss the usefulness of such shares in defending against or discouraging a hostile takeover. Glass Lewis typically opposes such defenses, and we will oppose actions intended to bolster such defenses. We may, however, support such an increase in authorized shares if we find that the company’s takeover defense is reasonable.
- **Financing for Acquisitions** — We look at whether the company has a history of using stock for acquisitions and attempt to determine what levels of stock have typically been required to accomplish such transactions. Similarly, we look to see whether this is discussed as a reason for additional shares in the proxy.
- **Financing for Operations** — We review the company’s cash position and its ability to secure financing through borrowing or other means. We look at the company’s history of capitalization and whether the company has had to use stock in the recent past as a means of raising capital.

Issuing additional shares can dilute existing holders in limited circumstances. Further, the availability of additional shares, where the board has discretion to implement a poison pill, can often serve as a deterrent to interested suitors. Accordingly, where we find that a company has not detailed its plan for using the proposed shares, or where the number of shares far exceeds those needed to accomplish a disclosed plan, we typically recommend shareholders vote against the authorization of additional shares.⁴⁸

While we think that having adequate shares to allow management to make quick decisions and effectively operate the business is critical, we prefer that, for significant transactions, management asks shareholders to approve the use of additional shares, rather than asking shareholders to provide a blank check in the form of a large pool of unallocated shares available for any purpose.

Waiver of Shareholder Approval for Share Repurchase

The Companies Act allows companies, when stipulated in their articles of incorporation, to repurchase shares without prior approval from shareholders, essentially setting the upper limit on such repurchases at the same level as the cap for funds available for the payment of interim dividends. Glass Lewis does not believe that it is in the best interests of shareholders to grant full discretion over repurchases to the board.

Limit Liability of Directors and Statutory Auditors

There is no explicit provision that prohibits the company from indemnifying directors with respect to liability incurred against a third party that is incurred in their capacity as directors. If the articles of incorporation of a company contain a specific provision, the board can discharge a certain portion of the directors’ or statutory auditors’ liability to the company itself. The liable amount is calculated based upon a formula specified in the Companies Act.

⁴⁸ We typically oppose any increase in authorized shares if the proposed increase will result in authorized shares exceeding 100% of the issued and outstanding shares.

The law allows for liability ceilings of up to six years' worth of compensation for directors with representative rights, four years' worth of compensation for other executive inside directors and two years' worth of pay for non-executive inside directors, outside directors and statutory auditors. The board of directors would have the right to impose these limits after a derivative suit is filed, but, as provided by the law, the limitations would not apply to cases of gross negligence or criminal behavior, and they would further only apply if the individual acted in good faith.

To implement a limited liability of directors or statutory auditors, the company needs to obtain an ordinary resolution of the board of directors excluding the director in question and consent of statutory auditors or audit committee members. Further, the company is required to make public or private notifications and providing at least one month of opposition period for its shareholders. If shareholders representing 3% or more of issued capital vote to nullify the limits, the board's decision would have no impact. Under the Companies Act, corporations can also enter into a contract with their non-executive directors and statutory auditors limiting their liability to the company to a certain amount without the requirement to have a board resolution or the opposition period for its execution.

Glass Lewis believes that directors and statutory auditors should be held responsible when they fail to fulfill their duties to shareholders. However, with the increasing corporate governance responsibilities placed upon directors, and with recent instances of action being taken against directors of other companies, it is understandable that the company would seek to place limitations on director and statutory auditor liability to remain consistent with current general practice. We believe that in most cases, directors and statutory auditors may be indemnified to a greater extent, but they will still be held liable for fraudulent or grossly negligent actions. Thus, generally, Glass Lewis will not recommend voting against a proposal to limit directors or statutory auditors' liability.

Virtual-Only Meetings

New rules under the Industrial Competitiveness Enhancement Act (ICEA) were enacted in June 2021, allowing Japanese companies to amend their articles of incorporation and hold virtual-only shareholder meetings.

Pursuant to the ICEA, companies must always obtain permission from the Minister of Economy, Trade and Industry and the Minister of Justice to hold a virtual-only general meeting or to amend their articles of incorporation to allow for a virtual-only general meeting. The ICEA is intended to be a law that does not infringe on the rights of shareholders, except that the venue of the meeting would be a virtual space.

Glass Lewis believes that virtual meeting technology can be a useful complement to a traditional, in-person shareholder meeting by expanding participation of shareholders who are unable to attend a shareholder meeting in person (i.e., a hybrid meeting).

However, we believe that virtual-only meetings can lead to a reduction in shareholder rights unless clear procedures regarding the ability for shareholders to participate in the meeting are disclosed at the time of convocation. As such we typically expect, at a minimum, companies proposing to amend their statutes to allow for virtual-only meetings to include the following commitments in the proposed amendments or in the supporting documents:

- The procedure and requirements to participate in a virtual-only meeting will be disclosed at the time of convocation; and
- There will be a formal process in place for shareholders to submit questions to the board, which will be answered in a format that is accessible to all shareholders.

In the case of Japan, however, pursuant to the ICEA, even amendments to the articles of incorporation that would allow virtual-only general meetings to be held cannot be proposed without permission from the Ministers, and we believe that this rule would protect the rights of shareholders to the maximum extent possible.

In cases where the proposed amendments to provide sufficient safeguard to shareholder rights, Glass Lewis will generally recommend that shareholders support such amendments in order to provide flexibility to companies to navigate potential restrictions in holding in-person meetings.

However, we will generally recommend voting against the directors who are designated as the conveners of shareholders' meetings when we believe that shareholder rights are infringed.

Capital Structure

Issuance of Shares and/or Convertible Securities

Pursuant to the TSE Listing Rules, issuers must provide the wider details regarding certain issuances involving private placement of shares and convertible securities. For placements that may result in dilution of more than 25%, issuers must either obtain prior shareholder approval or an independent third party's opinion. While the rules are intended to curb private placements that are detrimental to existing shareholders, shareholders generally do not have much say in the issuance of securities and issuers rarely seek shareholder approval at general meetings.

While we think that having adequate shares to allow management to make quick decisions and effectively operate the business is critical, we prefer that, for significant transactions, management seek shareholder approval of the use of additional shares, rather than being provided with a large pool of unallocated shares available for any purpose. We will review any issuances of shares or other securities on a case-by-case basis, and if we find the proposed issuance unwarranted or its terms and conditions unreasonable, we may recommend shareholders vote against the proposed issuance.

Authority to Trade in Company Stock

A company may want to repurchase or trade in its own shares for a variety of reasons. A repurchase plan is often used to increase the company's stock price, distribute excess cash to shareholders or provide shares for employees' equity-based compensation plans. In addition, a company might repurchase shares in order to offset a dilution of earnings caused by the exercise of stock options.

We will recommend voting in favor of a proposal to repurchase and trade in company stock when the following conditions are met: (i) the company sets a maximum number of shares that may be purchased; (ii) a maximum price that may be paid for each share — as a percentage of the market price — is determined; and (iii) the authority expires in 18 months. Furthermore, the Companies Act limits the number of shares that may be repurchased to no more than 10% of the company's capital (or 5%, if the stock will be used as consideration in a merger transaction).

Sale of Broken Lots of Shares

A shareholder holding less than one voting unit of shares may request that the company sell the shareholder the number of shares needed to hold a full voting unit of shares, together with the current shares owned by the shareholder. We support this proposal, as it improves the liquidity and marketability of a company's stock.

Authority to Reduce Capital or Earned Reserve

Japanese companies are allowed to transfer any portion of the capital reserve and earned reserve that exceeds 25% of paid-in capital to its capital surplus and earned surplus, respectively, in order to implement more flexible capital policies.

We typically recommend voting for this proposal because we believe it is in the best interests of shareholders for the company to have the flexibility to use these funds for other purposes, including dividend payouts.

Overall Approach to Environmental, Social & Governance

Glass Lewis evaluates all environmental and social issues through the lens of long-term shareholder value. We believe that companies should be considering material environmental and social factors in all aspects of their operations and that companies should provide shareholders with disclosures that allow them to understand how these factors are being considered and how attendant risks are being mitigated. We also are of the view that governance is a critical factor in how companies manage environmental and social risks and opportunities and that a well-governed company will be generally managing these issues better than one without a governance structure that promotes board independence and accountability.

We believe part of the board's role is to ensure that management conducts a complete risk analysis of company operations, including those that have material environmental and social implications. We believe that directors should monitor management's performance in both capitalizing on environmental and social opportunities and mitigating environmental and social risks related to operations in order to best serve the interests of shareholders. Companies face significant financial, legal and reputational risks resulting from poor environmental and social practices, or negligent oversight thereof. Therefore, in cases where the board or management has neglected to take action on a pressing issue that could negatively impact shareholder value, we believe that shareholders should take necessary action in order to effect changes that will safeguard their financial interests.

Given the importance of the role of the board in executing a sustainable business strategy that allows for the realization of environmental and social opportunities and the mitigation of related risks, relating to environmental risks and opportunities, we believe shareholders should seek to promote governance structures that protect shareholders and promote director accountability. When management and the board have displayed disregard for environmental or social risks, have engaged in egregious or illegal conduct, or have failed to adequately respond to current or imminent environmental and social risks that threaten shareholder value, we believe shareholders should consider holding directors accountable. In such instances, we will generally recommend against responsible members of the board that are specifically charged with oversight of the issue in question.

When evaluating environmental and social factors that may be relevant to a given company, Glass Lewis does so in the context of the financial materiality of the issue to the company's operations. We believe that all companies face risks associated with environmental and social issues. However, we recognize that these risks manifest themselves differently at each company as a result of a company's operations, workforce, structure, and geography, among other factors. Accordingly, we place a significant emphasis on the financial implications of a company's actions with regard to impacts on its stakeholders and the environment.

When evaluating environmental and social issues, Glass Lewis examines companies':

Direct environmental and social risk — Companies should evaluate financial exposure to direct environmental risks associated with their operations. Examples of direct environmental risks include those associated with oil or gas spills, contamination, hazardous leakages, explosions, or reduced water or air quality, among others. Social risks may include non-inclusive employment policies, inadequate human rights policies, or issues that

adversely affect the company's stakeholders. Further, we believe that firms should consider their exposure to risks emanating from a broad range of issues, over which they may have no or only limited control, such as insurance companies being affected by increased storm severity and frequency resulting from climate change.

Risk due to legislation and regulation — Companies should evaluate their exposure to changes or potential changes in regulation that affect current and planned operations. Regulation should be carefully monitored in all jurisdictions in which the company operates. We look closely at relevant and proposed legislation and evaluate whether the company has responded proactively.

Legal and reputational risk — Failure to take action on important environmental or social issues may carry the risk of inciting negative publicity and potentially costly litigation. While the effect of high-profile campaigns on shareholder value may not be directly measurable, we believe it is prudent for companies to carefully evaluate the potential impacts of the public perception of their impacts on stakeholders and the environment. When considering investigations and lawsuits, Glass Lewis is mindful that such matters may involve unadjudicated allegations or other charges that have not been resolved. Glass Lewis does not assume the truth of such allegations or charges or that the law has been violated. Instead, Glass Lewis focuses more broadly on whether, under the particular facts and circumstances presented, the nature and number of such concerns, lawsuits or investigations reflects on the risk profile of the company or suggests that appropriate risk mitigation measures may be warranted.

Governance risk — Inadequate oversight of environmental and social issues carries significant risks to companies. When leadership is ineffective or fails to thoroughly consider potential risks, such risks are likely unmitigated and could thus present substantial risks to the company, ultimately leading to loss of shareholder value.

Glass Lewis believes that one of the most crucial factors in analyzing the risks presented to companies in the form of environmental and social issues is the level and quality of oversight over such issues. When management and the board have displayed disregard for environmental risks, have engaged in egregious or illegal conduct, or have failed to adequately respond to current or imminent environmental risks that threaten shareholder value, we believe shareholders should consider holding directors accountable. When companies have not provided for explicit, board-level oversight of environmental and social matters and/or when a substantial environmental or social risk has been ignored or inadequately addressed, we may recommend voting against members of the board. In addition, or alternatively, depending on the proposals presented, we may also consider recommending voting in favor of relevant shareholder proposals or against other relevant management-proposed items, such as the ratification of auditor, a company's accounts and reports, or ratification of management and board acts.

Connect with Glass Lewis

Corporate Website | www.glasslewis.com

Email | info@glasslewis.com

Social |  [@glasslewis](https://twitter.com/glasslewis)  [Glass, Lewis & Co.](https://www.linkedin.com/company/glass-lewis-&-co)

Global Locations

North America

United States

Headquarters
100 Pine Street, Suite 1925
San Francisco, CA 94111
+1 415 678 4110

New York, NY
+1 646 606 2345

2323 Grand Boulevard
Suite 1125
Kansas City, MO 64108
+1 816 945 4525

Asia Pacific

Australia

CGI Glass Lewis
Suite 5.03, Level 5
255 George Street
Sydney NSW 2000
+61 2 9299 9266

Japan

Shinjuku Mitsui Building
11th floor
2-1-1, Nishi-Shinjuku, Shinjuku-ku,
Tokyo 163-0411, Japan

Europe

Ireland

15 Henry Street
Limerick V94 V9T4
+353 61 534 343

United Kingdom

80 Coleman Street
Suite 4.02
London EC2R 5BJ
+44 20 7653 8800

France

Proxinvest
6 Rue d'Uzès
75002 Paris
+33 ()1 45 51 50 43

Germany

IVOX Glass Lewis
Kaiserallee 23a
76133 Karlsruhe
+49 721 35 49622

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