Japan

GLASS LEWIS

2026 Benchmark Policy Guidelines

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Purpose

The purpose of the Benchmark Policy proxy research and advice is to serve as a framework that facilitates shareholder voting in favor of governance structures that will drive performance and promote and maintain long-term shareholder value.

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 companies[1] are required to submit statements detailing their adherence to the CG Code to the stock exchange.

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%. 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 companies in the other two categories.

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.

For controlled companies listed on the Prime Market, a majority of the board of a company should consist of independent outside directors while controlled companies listed on the other markets should 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

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

establish a special committee comprised entirely of independent members to deliberate and review material transactions or actions that conflict with the interests of the controlling and minority shareholders.

Attention to Sustainability and ESG

Companies listed on the Prime Market should 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

Based on the revision of the listing rules by the TSE, companies listed on the Prime Market are now required to disclose their financial results and timely disclosure information in English simultaneously with Japanese, effective April 1, 2025.

Diversity Policy Disclosure

Companies should present their policies and measurable goals for ensuring diversity as well as disclose their status. It is also recommended that companies establish their policies on the development of human resources and the internal environment to ensure diversity, and disclose the status of their implementation.

Summary of Changes for 2026

Glass Lewis evaluates these guidelines on an ongoing basis and formally updates them on an annual basis.

For 2026, the language in this document has been updated to clarify that these guidelines contain the views of the Benchmark Policy. The Benchmark Policy reflects broad investor opinion and widely accepted governance principles and is intended to provide clients with nuanced analysis informed by market best practice, regulation, and prevailing investor sentiment. This change better conveys Glass Lewis' role as a service provider to a diverse, global client base with a wide spectrum of viewpoints and objectives. The Benchmark Policy represents just one of Glass Lewis' policy offerings.

In addition, the following noteworthy revisions have been made to the Benchmark Policy, which are summarized below and discussed in greater detail in the relevant section of this document.

Board Gender Diversity

Beginning in 2026, the Benchmark Policy will require Prime Market-listed companies to have a board comprised of at least 20% gender diverse directors. Furthermore, the Benchmark Policy will require companies listed outside the Prime Market to appoint at least one gender diverse member to the board of directors, regardless of board structure. The Benchmark Policy will generally recommend voting against the chair of the board of a two-tier board or one-tier with one-committee structure; or the nominating committee chair of a one-tier with three-committee structure of a board that does not meet these requirements.

Outside Director Board Tenure

Beginning in 2026, any outside director or statutory auditor who has served for 12 or more consecutive years, including combined service as both director or statutory auditor if the role changed, will be considered affiliated (i.e., non-independent).

A Governance Structure that Serves the Interests of Shareholders

Election of Board of Directors and Statutory Auditors

The Benchmark Policy looks for talented boards with a record of protecting shareholders and delivering value over the medium- and long-term. It takes the view that a board can best protect and enhance the interests of shareholders if it is sufficiently independent, has a record of positive performance, and consists of individuals with diverse backgrounds and a breadth and depth of relevant experience.

Board Independence

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

The Benchmark Policy reviews 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. The Benchmark Policy views the existence of such relationships as making it difficult for a board member to put the concerns of shareholders above either their own interests or those of a related party. It also views the ownership of more than 10% of a company by an individual as potentially leading to disproportionate influence on the board.

Thus, the Benchmark Policy puts 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** — An outside director or statutory auditor is considered to be independent[2] if no evidence of material, financial, familial or other current relationships is found with

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[2] 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.

the company,[3] executives, major lenders, other board members or shareholders that hold 10% or more of the company's voting common stock.

Affiliated Director/Statutory Auditor — 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, is considered 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 evidence of cross-shareholding relationships is found, insiders and affiliates of such arrangements will be considered not independent. Lastly, beginning January 2026, an outside director or statutory auditor who has served a consecutive tenure of 12 or more years, including periods served as either a director or statutory auditor if the role changed, is considered affiliated.

The Benchmark Policy 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 it applies a ten-year look back.[4] Where the timing of the cessation of a relationship is not disclosed, as a general rule, the Benchmark Policy treats 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, the Benchmark Policy 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

[3] "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.

[4] 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.

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.[5]

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 is 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

[5] When a director or statutory auditor is not classified as an outsider or independent, the Benchmark Policy will classify him/her as an insider.

Benchmark Policy Recommendations on the Basis of Board Independence

Many investors expect 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 many investors expect that a substantial proportion of a board should consist of independent directors, they also understand that it 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. The Benchmark Policy, therefore, seeks a basic level of independence that serves as a minimal safeguard of shareholder rights.

The Benchmark Policy will always review a board's independence on a case-by-case basis and, where justified, it may make exceptions to its general rule. The Benchmark Policy is of the view that no single model of governance is ideal for all listed entities, and so it recommends companies 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, the Benchmark Policy expects that 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, the Benchmark Policy will require boards to be one-third independent. For companies listed on the Prime Market with controlling shareholders, the Benchmark Policy expects such companies to maintain at least majority independence of the board of directors.

  In cases where the combined number of directors and statutory auditors on the boards or the number of directors on the board fails to meet its independence threshold, the Benchmark Policy may recommend shareholders vote against the necessary number of inside directors, internal statutory auditors or affiliates in order to satisfy its independence standards.

  In addition, the Benchmark Policy may recommend that shareholders vote against the chair of the board when boards lack sufficient levels of independence.

- **Two-Tier Board — Board of Statutory Auditors**[6] — The Companies Act requires that companies over a certain size[7] have a minimum of three statutory auditors, at least one of whom must be full-time, and at least half of this group must consist of external statutory auditors.[8] In addition, a statutory auditor may

[6] 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.

[7] 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.

[8] 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

not serve concurrently as a director of the company. Given the important role that statutory auditors play, the Benchmark Policy expects 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, the Benchmark Policy applies the same standards as it does in reviewing director independence. Should any evidence be found that may call into question the independence of an external statutory auditor, the Benchmark Policy will consider that statutory auditor to be affiliated. If the board of statutory auditors does not have a sufficient level of independent representation, the Benchmark Policy may recommend shareholders vote against the necessary number of candidates in order to satisfy the recommended independence.

The Benchmark Policy assumes that shareholders holding more than 20% of a company's stock may have interests and financial priorities that differ from those of other shareholders. Financial disclosure in this regard is, therefore, 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, the Benchmark Policy may recommend against any statutory auditors who own 20% or more of the company's stock or are affiliated with a substantial shareholder who owns 20% or more of the company's stock.

- **One-Tier Board with Three Committees** — The Benchmark Policy expects that, for companies that have adopted a one-tier board with three committee structure, at least one-third of the board is independent. However, for companies listed on the Prime Market with controlling shareholders, the Benchmark Policy expects that such companies should maintain at least majority independence of the board of directors. In case where director independence fails to meet these recommended thresholds, the Benchmark Policy may recommend against the necessary number of inside directors or affiliates in order to satisfy the recommended independence thresholds. In addition, the Benchmark Policy may recommend that shareholders vote against nominating committee chair for the lack of board independence.

- **One-Tier Board with One Committee** — The Benchmark Policy expects that the boards of companies that have adopted a one-tier board with one committee structure be at least one-third independent. However, for companies listed on the Prime Market with controlling shareholders, the Benchmark Policy expects that such companies should maintain at least a majority independent board of directors. In cases where director independence fails to meet the recommended independence, the Benchmark Policy may recommend votes against the necessary number of inside directors or affiliates in order to satisfy the one-third independence threshold. In addition, the Benchmark Policy may recommend that shareholders vote against the chair of the board for not meeting the expected threshold of board independence.

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.

Benchmark Policy 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

The Benchmark Policy expects 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 the Benchmark Policy may make exceptions for a few controlled companies on a case-by-case basis, given the unique nature of the traditional board structure of Japanese companies, the Benchmark Policy expects that minimal independence even at controlled companies is essential in making sure that minority shareholders' interests are protected. The Benchmark Policy, therefore, generally does not make any board independence exceptions for controlled companies.

- **Audit Committee and Board of Statutory Auditors** — The Benchmark Policy does 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. Performance evaluations are conducted for the directors and executives at the subject company, as well as other companies where they have served.

Benchmark Policy Recommendations on the Basis of 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. The Benchmark Policy looks at the performance directors and executives at the company, as well as at other companies where these individuals have served.

A director's past conduct is often indicative of future conduct and performance. For example, directors with a history of overpaying executives or of serving on boards where avoidable disasters have occurred often serve on the boards of companies with similar problems.

The Benchmark Policy may recommend shareholders vote against the following board members:

- A director who is also the chief executive, or who holds an equivalent position,[9] 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.[10]
- 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 any concerns regarding the independence of a third-party accounting auditor be identified, and their appointment has not been presented for shareholder approval, the Benchmark Policy may recommend against statutory auditor nominees who appear to be 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.

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[9] The president of a company usually has similar authority and duties as the CEO.

[10] In accordance with the proxy voting principles of the Japan Pension Fund Association, the Benchmark Policy may recommend 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.

Benchmark Policy Recommendations on the Basis of Statutory Auditor Performance

The Benchmark Policy may recommend 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.[11]
- 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.
- Statutory auditors who re-appointed an auditor that the Benchmark Policy no longer considers 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

Current 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. Attendance at board meetings is one of the fundamental responsibilities of a board member, and the Benchmark Policy is of the view that all directors and statutory auditors should attend meetings regularly to review the company’s performance and ensure the protection of shareholder interests. 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, the Benchmark Policy recommend shareholders vote 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, the Benchmark Policy may recommend shareholders vote against the statutory auditor.[12]

Experience

Boards should have diverse backgrounds and members with a breadth and depth of relevant experience. Generally speaking, 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.

A director’s past is often indicative of future conduct and performance. For example, oftentimes directors with a history of overpaying executives or of serving on boards where avoidable disasters have occurred appearing at

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

[12] However, where a director or statutory auditor has served for less than one full year, the Benchmark Policy will not typically recommend voting against him for failure to attend 75% of meetings. Rather, the failure will be noted with a recommendation to track this issue going forward. The Benchmark Policy 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.

companies that follow these same patterns. The Benchmark Policy utilizes a proprietary database that tracks the performance of directors across companies worldwide and the Benchmark Policy may result in a recommendation against directors with problematic governance and/or material performance concerns at all companies where they serve.

Benchmark Policy Recommendations on the Basis of Experience

The Benchmark Policy may recommend 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.[13]

Similarly, the Benchmark Policy carefully reviews 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

Directors and statutory auditors should have the necessary time to fulfill their duties to shareholders, as 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.[14] Many investors consider that the number of boards on which directors and statutory auditors can effectively serve is limited, especially executives at other companies.

Voting Recommendations on the Basis of Director Commitments

The Benchmark Policy may recommend 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. The Benchmark Policy will also count individuals who serve as board chair of boards in select other non-Asian markets as two board seats, given the time commitment of directorship in those markets.

Because many investors expect executives to primarily devote their attention to executive duties, the Benchmark Policy may not recommend 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, the Benchmark Policy 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.

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[13] The Benchmark Policy typically applies a three-year look-back period to such issues.

[14] 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.

The Benchmark Policy 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. The Benchmark Policy may not recommend against a director or statutory auditor who serves on an excessive number of boards within group of companies.[15] The Benchmark Policy will count boards within the group companies as one board membership. Furthermore, the Benchmark Policy will generally exempt individuals that represent a firm whose sole purpose is to manage a portfolio of investments that includes the company.

Board Accountability for Environmental and Social Performance

The Benchmark Policy carefully monitors companies' performance with respect to environmental and social issues, including those related to climate and human capital management. In situations where 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, the Benchmark Policy 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, the Benchmark Policy may recommend that shareholders vote against members of the audit committee. In making these determinations, the Benchmark Policy 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 the Benchmark Policy evaluates environmental and social issues, please see the "Overall Approach to ESG" section of these guidelines as well as the 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 in general, climate risk can present a material risk for companies in all industries. Accordingly, it is important that boards consider and evaluate their operational resilience under lower-carbon scenarios. While all companies maintain exposure to climate-related risks, additional consideration should be given to, and disclosure should be provided by, those companies whose own GHG emissions represent a financially material risk. For companies with this increased risk exposure, the Benchmark Policy evaluates whether companies are providing clear and comprehensive disclosure regarding these risks, including how they are being mitigated and overseen. Such information is crucial to allow investors to understand the company's management of this issue as well as the potential 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 operations[16] as well as companies where their emissions, climate impacts, or stakeholder scrutiny thereof,

[15] The Benchmark Policy will consider consolidated subsidiaries and affiliated entities as part of the group.

[16] 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 generators, food retailers & distributors, health care distributors, iron & steel producers, marine transportation, meat,

represent an outsized, financially material risk, in order to assess whether they have produced disclosures in line with the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD), IFRS S2 Climate-related Disclosures, or other equivalent climate reporting framework. The Benchmark Policy will also assess whether these companies have disclosed explicit and clearly defined board-level oversight responsibilities for climate-related issues. In instances where either (or both) of these disclosures are found to be absent or significantly lacking, the Benchmark Policy 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, the Benchmark Policy may extend this 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, industry and its overall governance profile.

Conflicts of Interest

In addition to the key characteristics described above — independence, performance, experience and board commitments — that the Benchmark Policy uses to evaluate board members, the Benchmark Policy considers conflict of interest issues in making its voting recommendations.

The Benchmark Policy expects that boards 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, the Benchmark Policy may recommend 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. The Benchmark Policy views 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 the monetary value of the relationship is found to be non-material, the Benchmark Policy will not recommend against any board members on this basis.[17]
- **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. The Benchmark Policy views 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

poultry & dairy, metals & mining, non-alcoholic beverages, oil & gas, pulp & paper products, rail transportation, road transportation, semiconductors, waste management.

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

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 the monetary value of the relationship is found to be non-material, the Benchmark Policy will not recommend against any board members on this basis.

- **Interlocking Directorships** — There is a potential for conflicts of interest when chief executives or other top executives who serve on each other's boards create an interlock. The Benchmark Policy is of the view that these relationships should be avoided to ensure the promotion of shareholder interests above all else.[18]

Board Size

While there is no consensus on a universally applicable optimal board size, market best practice indicates that, absent compelling circumstances, boards should have a minimum of five directors in order to ensure that there is a sufficient diversity of views and breadth of experience in every decision the board makes. At the other end of the spectrum, boards with more than 20 directors 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, the Benchmark Policy may recommend against the nominating committee chair if a board has more than 20 directors. However, for boards with fewer than five members, while the Benchmark Policy will acknowledge the concern that the board may not have a sufficient number of members to function at an optimal level, it will not lead to a recommendation against the nominating committee chair[19] 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.

The Benchmark Policy favors the elimination of staggered boards in favor of the annual election of directors. Generally speaking, staggered boards can be less accountable to shareholders than boards that are elected annually. Furthermore, an 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;

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18 The Benchmark Policy does not apply a look-back period for this situation.

19 In both cases, in the absence of a nominating committee, the Benchmark Policy will recommend voting against the chair of the board.

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.

Board Composition and Refreshment

Routine director evaluations, including independent external reviews, and periodic board refreshment can foster the sharing of diverse perspectives in the boardroom and the generation of new ideas and business strategies. Many investors expect the board to 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.

The Benchmark Policy is of the view that a director's experience can be a valuable asset to shareholders because of the complex, critical issues that boards face. However, it also recognizes 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 it is understandable that age limits can aid board succession planning, the long-term impact of these limits restricts experienced and potentially valuable board members from service through an arbitrary means. Instead, shareholders may be 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, the Benchmark Policy is of the view that, if a board adopts term/age limits, it should follow through and not waive such limits. If the board waives its term/age limits, the Benchmark Policy may consider opposing 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

Many investors expect companies to have policies in place to refresh their outside directors after a long period of service, as a significant lack of board refreshment could contribute to poor financial performance, lax risk oversight, misaligned remuneration practices, lack of shareholder responsiveness, and a reduction of shareholder rights, among other governance concerns.

In light of concerns, the Benchmark Policy may recommend 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.

Furthermore, in beginning in 2026, to ensure continued independent representation among outside directors and statutory auditors and to promote periodic board refreshment, the Benchmark Policy will consider any outside director or statutory auditor who has served a consecutive tenure of 12 or more years, including periods served as either a director or statutory auditor if the role changed, to be affiliated (i.e., non-independent).

Gender Diversity on Boards

Many investors consider it important to ensure 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. Accordingly, the Benchmark Policy provides for close review of the board's composition for representation of diverse director candidates. Further, the Japanese government has also set a goal of increasing the proportion women in officer positions at companies listed on the Prime Market to at least 30% by 2030.

Accordingly, for companies listed on the Prime Market, the Benchmark Policy may recommend 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.

Similarly, for companies listed outside the Prime Market,[20] the Benchmark Policy may recommend 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.

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, if Company A is facing a hostile takeover or anticipating a significant number of against votes to the top management, 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 a takeover defense mechanisms among Japanese companies.

Such practices have been attributed to decreased 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.

[20] The Benchmark Policy approach to board gender diversity shall not apply to Real Estate Investment Trusts (REITs).

While it may seem plausible that some level of shareholder value may be derived from mutual equity ownership, academic research 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 that 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, the Benchmark Policy may recommend 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, the Benchmark Policy may not recommend against any 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, the Benchmark Policy may not recommend against any 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, the Benchmark Policy may not recommend against any 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 year[21] 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 among its members. For a company that adopts a committee-system-type board structure, the board appoints:

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[21] 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).

(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 are often held by the same individual.

The Benchmark Policy is of the view separating the roles of chief executive officer and chair could lead to 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.

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.

While in general, the Benchmark Policy will not recommend against CEOs who serve on or chair the board, it may support a separation between the roles of chair and CEO whenever that question is posed in a proxy (typically in the form of a shareholder proposal).

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 an 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 regulatory focus on, and the potential adverse outcomes from, cyber-related issues, many investors view cyber risk as material for all companies. Accordingly, it is critical that companies evaluate and mitigate these risks to the greatest extent possible. [22] With that view, all issuers are encouraged to provide clear

[22] CII Policies on Corporate Governance, 2.7; ICGN Global Principles, 6.2.

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. Such disclosure can help shareholders understand the seriousness with which companies take this issue.

In the absence of material cyber incidents, the Benchmark Policy 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, the board's oversight of cybersecurity as well as the company's response and disclosures will be closely evaluated.

Moreover, in instances where a company has been materially impacted by a cyber-attack, it is reasonable for shareholders to expect periodic updates communicating the company's ongoing progress towards resolving and remediating the impact of the cyber-attack. Shareholders are best served when such updates include (but are not necessarily 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 such instances, the Benchmark Policy may recommend against appropriate directors if the board's oversight, response or disclosure concerning cybersecurity-related issues is found 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, 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, 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. Such disclosure can help shareholders understand the seriousness with which companies take this issue.

While market best practice indicates that it is important that these issues are overseen at the board level and that shareholders are afforded meaningful disclosure of these oversight responsibilities, generally, companies should determine the best structure for this oversight. 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, the 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, the Benchmark Policy 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. It 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 if the board's oversight, response or disclosure concerning AI-related issues is found to be insufficient.

Board Committees

(Applies to One-Tier Board with Three Committees and One-Tier Board with One Committee)[23]

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.[24] The Benchmark Policy expects that a majority of the members of each of these committees should be independent outside directors.[25] In addition, it expects that the chair of the audit committee is an independent director and the chair of the nominating and compensation committees is a non-inside director. This standard is also applied to the audit committee of a one-tier board with one committee.

The Benchmark Policy may recommend against inside and/or affiliated directors seeking appointment to an audit, compensation or nominating committee when the committee does not meet the recommended independent standards.

Further, many investors view the interests and financial needs of shareholders who hold more than 20% of a company's stock as differing from those 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, the Benchmark Policy is of the view that substantial shareholders should not serve on the audit committee. As such, it may recommend 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.

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

[24] Article 400 of the Companies Act.

[25] If the company fails to disclose the details regarding the committee membership and composition, the Benchmark Policy will recommend shareholders hold the chair of the board accountable for the failure to disclose the committee composition.

Benchmark Policy 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."[26]

When assessing an audit committee's performance, the Benchmark Policy recognizes 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."*[27]

[26] "Audit Committee Effectiveness — What Works Best." PricewaterhouseCoopers. The Institute of Internal Auditors Research Foundation. 2005.
[27] Commission on Public Trust and Private Enterprise. The Conference Board. 2003.

Many investors are skeptical of audit committees where there are members who lack expertise in finance and accounting, or in any other equivalent or similar areas of expertise. While the Benchmark Policy may not recommend against members of an audit committee when such expertise is lacking, it is more likely to recommend against committee members when a problem such as a restatement occurs and such expertise is lacking.

The Benchmark Policy generally assesses audit committees by reviewing the decisions they make with respect to their oversight and monitoring roles. 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, the Benchmark Policy typically defers to its judgment and recommends voting in favor of its members, but the Benchmark Policy will recommend against the following members under the following circumstances:[28]

- All members of an audit committee who are up for election and 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 who re-appointed an auditor that the Benchmark Policy no longer considers 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 who served 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.

The Benchmark Policy also takes a critical view of audit committee reports that consist of boilerplate language and provide little or no information or transparency to investors. When there are significant issues, such as a material weakness, restatement or late filing, the Benchmark Policy will take 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 amount and types of compensation to

[28] If the recommendation would be to vote against the committee chair and the chair is not up for election because the board is staggered, the Benchmark Policy does not recommend voting against any members of the committee who are up for election; rather, its concern will be expressed regarding the committee chair. In the absence of an audit committee, the Benchmark Policy will recommend voting against the chair of the board.

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 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.

The Benchmark Policy evaluates 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, the Benchmark Policy may recommend against the following members under the following circumstances:[29]

- 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. The Benchmark Policy may recommend against the following members of the nominating committee under the following circumstances:[30]

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[29] If the recommendation would be to vote against the committee chair and the chair is not up for election because the board is staggered, the Benchmark Policy will not recommend voting against any members of the committee who are up for election; rather, its concern will be expressed regarding the committee chair. In the absence of a compensation committee, the Benchmark Policy will recommend voting against the chair of the board.

[30] If the committee chair is not disclosed, the Benchmark Policy will recommend against the most senior member on the committee. If the disclosure is so poor as to the composition of the committee(s), the Benchmark Policy 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), the Benchmark Policy will 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 the Benchmark Policy 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. The terms of office of both executive directors and supervisory directors of the investment trust/investment corporation are two years. 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.[31] Thus, if a supervisory director does not appear to meet the above requirements, or if there is any evidence that may call into question the director’s independence, the Benchmark Policy may recommend against such a nominee. In addition, the Benchmark Policy may oppose supervisory directors during whose tenure accounting fraud occurred in the company or serious fraud was conducted by the executive directors.

[31] 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.

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, the Benchmark Policy expects that every listed company, regardless of its size, appoint an independent auditor to ensure a fair and objective financial reporting process.

However, many investors view a disapproval of financial statements as potentially not being 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 may investors may be hesitant to support any financial statements that have not been scrutinized by an independent auditor, the Benchmark Policy will generally support a proposal to approve such financial statements, provided that there has been no indication of inaccuracy.

In addition, if it is not possible to obtain all the necessary documents (i.e., annual financial statements and statutory auditor reports), the Benchmark Policy may recommend shareholders abstain from voting on the proposal.

Allocation of Profits/Dividends

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.

The Benchmark Policy expects that shareholders will seek more than just 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.

The Benchmark Policy generally supports a company's policy when it comes to the payment of dividends (or the absence thereof). In most cases, 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 the Benchmark Policy evaluates allocation of profits and dividends proposals, the financial condition of the company for the last few years will be considered by taking into account 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, the company's dividend policy will be reviewed and, where applicable, the Benchmark Policy may recommend that shareholders vote against the directors who are accountable for the company's dividend policy.

However, the Benchmark Policy will always review these proposals on a case-by-case basis and, when making these voting recommendations, it 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, the Benchmark Policy may not recommend 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 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.[32] 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. Further, 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.

If there are concerns regarding the independence of an auditor and the appointment of the auditor is not presented for shareholder approval, the Benchmark Policy may recommend that shareholders vote against statutory auditors or audit committee members.

Voting Recommendations Based on Auditor Ratification

The Benchmark Policy generally supports management's choice of auditor, unless the auditor's independence or audit integrity appears to have been compromised. If there have been material restatements of annual financial statements or a material weakness in internal controls, the Benchmark Policy may recommend against the auditor. If the audited financial statements have not yet been disclosed, the Benchmark Policy bases its voting recommendations on the company's financial statements for the previous year. The Benchmark Policy may not recommend that shareholders address their concerns to a company's auditor for what may be the company's failure to comply with reporting obligations or a lack thereof, depending on the jurisdiction.

Reasons why the Benchmark Policy may recommend against 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.[33]
- 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).[34]
- 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.

[32] Article 338 of the Companies Act.

[33] If the company does not disclose a breakdown of audit and non-audit fees, the Benchmark Policy generally supports the board of director's recommendation, except in cases where the independence of the returning auditor or the integrity of the audit is considered to have been compromised.

[34] An auditor does not perform an audit of interim financial statements and, accordingly, should generally not 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), the Benchmark Policy will recommend shareholders abstain from voting on the measure.

The Link Between Compensation and Performance

Director and Statutory Auditor Compensation

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. The Benchmark Policy 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. Many investors see 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, the Benchmark Policy may recommend against bonus payments and other performance-based short-term incentives for outside directors and all statutory auditors, on the belief that 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, 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 the payment of bonuses to outsiders is still a common practice in Japan and 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, it may be beneficial for a better framework to be laid out for those in these positions in order to satisfy oversight and supervisory roles. The Benchmark Policy may recommend against proposals that award bonuses to outside directors, audit committee directors and statutory auditors regardless of the size of the payment.

Additionally, the Benchmark Policy may recommend shareholders vote against a proposal to grant bonuses to inside directors if: (i) 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.

The executive compensation should be linked to personal contributions or company performance, not merely length of service. As such, shareholders generally welcome the abolition of seniority-based retirement allowance systems and the adoption of performance-based compensation. 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, the Benchmark Policy no longer supports retirement grants and/or any related proposals. The Benchmark Policy will, however, always review the proposed retirement bonuses on a case-by-case basis and may support the payment when the structure is deemed appropriate.

Equity-Based Compensation Plans

Many investors view equity compensation awards as 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, the Benchmark Policy takes into account factors such as plan administration, the method and terms of exercise, and express or implied rights to re-price.

The Benchmark Policy incorporates both quantitative and qualitative considerations. It examines the potential dilution to shareholders, the company's grant history and compliance with best practice recommendations.

The Benchmark Policy evaluates and makes voting recommendations on 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. The Benchmark Policy considers 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.
- The 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, the Benchmark Policy 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, the Benchmark Policy will refrain from recommending against based solely on the eligible recipients.

Furthermore, when evaluating equity-based compensation proposals, it is generally expected that companies provide complete disclosure surrounding the proposed equity grants. In the absence of complete disclosure, the Benchmark Policy 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.

The Benchmark Policy will generally support proposals 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, the overall cost of the plan and potential dilution to shareholders are evaluated, and the Benchmark Policy will support the compensation plan if it is deemed reasonable.

In the past few years, an increasing number of companies have introduced performance-linked compensation plans, which many investors 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, the proposed policy will be examined closely. Additionally, many investors expect that outside directors' and statutory auditors' remuneration not be linked to performance; if the two are linked together, the Benchmark Policy will recommend shareholders vote against such proposals. The Benchmark Policy also expects that shareholders should be entitled to review how participants' performance is measured and linked to compensation in detail. If the disclosure is vague and the link to performance is unclear, the Benchmark Policy may recommend against such proposals.

Executive Compensation[35]

As a general rule, the Benchmark Policy is of the view that shareholders should not be involved in setting executive compensation. Such matters should be left to the board or its compensation committee. Rather, the election of directors — specifically, the election of those who sit on the compensation committee or a committee that serves a similar function — may be a more appropriate mechanism for shareholders to express their disapproval or support of board policies on this issue. The Benchmark Policy also believes that when companies compensation practices are in line with performance and the compensation of their peers, compensation committees should be granted the flexibility to compensate executives in a manner that drives growth and profit.

However, many investors favor 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.

[35] 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) advanced warning; (ii) trust; and (iii) EGM. 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 measures. 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 defense plan, an EGM defense plan 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 defense plan 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 plan 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 defense 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.

Benchmark Policy's Approach to Takeover Defense Plan

The Benchmark Policy generally views takeover defenses as 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.[36] Other studies have shown that an increase in protection through anti-takeover statutes is associated with a decrease in management accountability.[37]

While a board should be given wide latitude in directing the activities of the company and charting its course, the Benchmark Policy expects that shareholders are afforded 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. For example, a

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[36] 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.

[37] 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.

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.[38]

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 not to 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, many investors consider this right under the law to be generally sufficient for shareholders to obtain information that they may need to make an informed judgment.

In certain circumstances, however, the Benchmark Policy may 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, many investors view a reasonable takeover defense plan in Japan as one that 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.

[38] 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.

Where these requirements are met, many investors 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

Many investors expect that 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. Many investors expect 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 many investors may prefer that companies seek shareholder consent prior to the adoption of a takeover defense plan, the Benchmark Policy generally does 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. The Benchmark Policy supports a board's decision to seek shareholder approval, even if it is after the fact, absent any evidence of abuse.

To this end, the Benchmark Policy will 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;[39] 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,[40] the Benchmark Policy generally recommends 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.[41]

Trigger Threshold

The Benchmark Policy is of the view 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. A trigger threshold of 20% or higher is generally viewed as appropriate, as investors seeking such a large share in a company are more likely to be seeking control of the company.

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[39] If the plan fails to specify the manner in which it can be renewed, this will be indicated but the Benchmark Policy will not recommend voting against the plan solely on this basis.

[40] The Benchmark Policy will apply a 12-month look-back period for the adoption and renewal of a takeover defense plan without shareholder approval.

[41] In the absence of a board chair, the Benchmark Policy would result in a recommendation against the president or CEO.

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

Board Independence

Some level of board independence is generally viewed as 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. Without sufficient independent board representation, the Benchmark Policy is of the view that shareholders should not 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, the Benchmark Policy will recommend that shareholders vote against the takeover defense plan.[42]

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', many investors expect that a party free of any affiliation with the company that may result in a conflict of interest should oversee the administration of the takeover defense plan. Many investors also expect that the independent third party should consist of a group of solely non-executive outsiders, such as outside directors and external statutory auditors, all of whom should be independent.[43] 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, the Benchmark Policy will recommend that shareholders vote against the takeover defense plan.

Information Disclosure Requirement

In Japan, takeover defense plans typically include 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. Many investors generally view that it is reasonable to require some level of disclosure of this type of information.

However, there is a limit to the amount of information the acquirer can disclose. Therefore, the Benchmark Policy expects that the acquirer should either be given the option to withhold information, or the information

[42] For a company with a two-tier board structure, while the Benchmark Policy assesses 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 the Benchmark Policy evaluates the independence of the board of directors without including the board of statutory auditors.

[43] Many investors generally expect the independent third party should be composed of independent directors and/or independent statutory auditors, as they can be held accountable to shareholders through the election process.

requested should not be excessive.[44] In addition, in the event of an all-cash offer with the intent to acquire all outstanding shares of a company, shareholders may not require such exhaustive information to make an informed judgment. The Benchmark Policy may, accordingly, view takeover defense plans more favorably if they exempt this type of offer from some of the information disclosure requirements.

The Benchmark Policy is generally concerned with provisions requiring the disclosure of 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 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. The Benchmark Policy, therefore, expects that the acquirer should not 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, the Benchmark Policy may recommend against takeover defense plans that require the disclosure of the types of inappropriate or excessive information discussed above.

Further, the Benchmark Policy generally does not support 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 there is an understanding 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 many investors view as necessary and/or appropriate. The Benchmark Policy, therefore, does 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

[44] 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.

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.

The Benchmark Policy generally prefers short consideration periods. A 90-day period is generally viewed as sufficient to consider an offer, formulate counter-offers or negotiate terms.[45] However, the Benchmark Policy permits the board and/or administrator to extend the consideration period to up to 120 days, including the initial consideration period. A longer consideration period may discourage a potential acquirer, as the offer will be subject to a greater period of uncertainty.

Accordingly, the Benchmark Policy may recommend against 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. It may also raise concerns regarding 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 commonly referred to as 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. The Benchmark Policy 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, the Benchmark Policy considers that a provision authorizing the activation of a defensive measure in the following types of offer situations may provide 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.[46]

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[45] 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, the Benchmark Policy almost always opposes this type of plan.

[46] 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 these actions do not always cause substantial harm to shareholder value, given the opinion of the Tokyo District Court in the Nippon Broadcasting case,

The Benchmark Policy generally does 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 are considered problematic by many investors 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 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, the Benchmark Policy may recommend against 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.

The Benchmark Policy strongly opposes takeover defense plans that allow for the granting of monetary compensation to the acquirer. It views takeover defenses as measures that 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, 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

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March 23, 2005, in which the court defined buyers with intent to carry out any of the actions discussed above as potentially abusive, the Benchmark Policy accepts the presence of these provisions.

should defend its position rather than using shareholders' money to pay off the acquirer. Accordingly, the Benchmark Policy will recommend shareholders vote against all takeover defense plans that contain this provision.

Evidence of Abuse

A board's commitment to shareholder value is generally demonstrated through the actions taken by the board and its members. Accordingly, the Benchmark Policy will look closely at a board's past actions, and where there is a record of poor performance, gross negligence, egregious lack of oversight or disregard of shareholder value, it will recommend shareholders vote against the proposed takeover defense plan regardless of its mechanism. It expects that 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

As previously discussed (see pp. 22-23, Excessive Strategic Shareholding), extensive cross-shareholdings in Japan separate economic interests from voting rights and can insulate management from market discipline. Although often justified as "strategic," these relationships are generally opaque, expose shareholders to undisclosed risks, and may suppress long-term value. Empirical research indicates that reductions in cross-shareholding correlate with improved corporate performance. In line with these concerns, the Benchmark Policy recommends voting against the chair of the board if the company has both material strategic investments in other companies, excessive cross-shareholdings and a takeover defense plan, as these practices are widely viewed as indicators of management entrenchment and disregard for shareholder value.

Amendments to the Articles of Incorporation

Proposed amendments to a company's articles of incorporation are evaluated on a case-by-case basis. The Benchmark Policy is 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, in its view, a practice that negatively limits shareholder rights. In such cases, each change is reviewed individually. The Benchmark Policy may recommend supporting the proposal only when, on balance, all the amendments are considered to be in the best interests of shareholders.

Authority to Approve Dividends

Many investors view 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, the Benchmark Policy will generally support the board's proposed dividend distribution.

The amended Companies Act, allows companies to amend their 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, the Benchmark Policy will generally support proposals seeking to amend its articles to allow the board to allocate profits at its discretion. However, 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. This type of amendment can result in an unnecessary reduction of shareholder rights; however, such proposals will continue to be evaluated on a case-by-case basis, with reference to the overall governance structure.

Supermajority Vote Requirements

Many investors view 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

The Benchmark Policy may recommend against proposals requesting a reduction of quorum requirements 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

Ensuring adequate capital stock is important to a company’s operations. When analyzing a request for additional shares, the Benchmark Policy typically reviews four common reasons why a company might need additional capital stock:

- **Stock Split** — The Benchmark Policy typically consider three metrics when evaluating whether 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 its 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. The Benchmark Policy typically opposes such defenses, and will oppose actions intended to bolster such defenses. The Benchmark Policy may, however, support such an increase in authorized shares if the company’s takeover defense is deemed reasonable.
- **Financing for Acquisitions** — The Benchmark Policy looks at whether the company has a history of using stock for acquisitions and attempts to determine what levels of stock have typically been required to

accomplish such transactions. It also looks to see whether this is discussed as a reason for additional shares in the proxy.

- **Financing for Operations** — The Benchmark Policy reviews the company's cash position and its ability to secure financing through borrowing or other means. It also considers 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 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, the Benchmark Policy may recommend against the authorization of additional shares.[47]

It is critical that companies have adequate shares to allow management to make quick decisions and effectively operate the business is critical. However, for significant transactions, it may be preferable if 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. The Benchmark Policy views granting full discretion over repurchases to the board as not being in the best interests of shareholders.

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 a company's articles of incorporation 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.

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

[47] The Benchmark Policy may result in a recommendation against any increase in authorized shares if the proposed increase will result in authorized shares exceeding 100% of the issued and outstanding shares.

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, companies 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.

Many investors expect 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. 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, the Benchmark Policy will generally not recommend against a proposal to limit directors or statutory auditors' liability.

Virtual-Only Meetings

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.

Virtual meeting technology can serve as 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, virtual-only meetings may 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, it is typically expected that, 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 many investors expect that this rule would protect the rights of shareholders to the maximum extent possible.

The Benchmark Policy will generally support proposed amendments that provide sufficient safeguard to shareholder rights in order to provide flexibility to companies to navigate potential restrictions in holding in-person meetings.

However, the Benchmark Policy may recommend against the directors who are designated as the conveners of shareholders' meetings when shareholder rights are considered to be infringed.

Capital Structure

Issuance of Shares and/or Convertible Securities

Pursuant to the TSE Listing Rules, issuers must provide 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 having adequate shares to allow management to make quick decisions and effectively operate the business is critical, the Benchmark Policy prefers 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. Issuances of shares or other securities are evaluated on a case-by-case basis, and where the proposed issuance is deemed unwarranted or its terms and conditions unreasonable, the Benchmark Policy may recommend 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.

The Benchmark Policy 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. The Benchmark Policy typically supports these proposals, as they improve 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.

The Benchmark Policy typically recommends voting for these proposals because it views it in the best interests of shareholders when companies have the flexibility to use these funds for other purposes, including dividend payouts.

Overall Approach to Environmental, Social and Governance Issues

The Benchmark Policy evaluates all environmental and social issues through the lens of long-term shareholder value. Shareholders are best served when companies consider material environmental and social factors in all aspects of their operations and when they are provided with disclosures that allow them to understand how these factors are being considered and how attendant risks are being mitigated. Governance is a critical factor in how companies manage environmental and social risks and opportunities and the Benchmark Policy is of the view that a well-governed company will be generally managing these issues better than one without a governance structure that promotes board independence and accountability.

Part of the board's role is to ensure that management conducts a complete risk analysis of company operations, including those that have financially material environmental and social implications. Companies can 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, the Benchmark Policy expects companies to take necessary actions in order to effect changes that will safeguard shareholders' 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, the Benchmark Policy looks for 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, the Benchmark Policy will consider holding directors accountable. In such instances, it 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, the Benchmark Policy does so in the context of the financial materiality of the issue to the company's operations. Companies in all industries face risks associated with environmental and social issues. However, these risks manifest themselves differently at each company as a result of its operations, workforce, structure, and geography, among other factors. Accordingly, the Benchmark Policy places 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, the Benchmark Policy 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, 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. The Benchmark Policy looks closely at relevant and proposed legislation and evaluates 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, 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, the Benchmark Policy is mindful that such matters may involve unadjudicated allegations or other charges that have not been resolved. The Benchmark Policy will not assume the truth of such allegations or charges or that the law has been violated. Instead, it 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.

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