Corporate Governance Principles

—A Japanese View—

(Final Report)

May 26, 1998

Corporate Governance Committee

Corporate Governance Forum of Japan

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The viewpoint of these Principles

The principles listed herein are designed as a two-step formula for realizing effective corporate governance:

Principles that should be adopted as soon as possible, except parts of principles that are along with legal reforms, are "Step A Principles," and are indicated below as [Principle A].

"Step B Principles" are those, which should be aimed for in the early 21st Century, and are necessary with amendments to illuminate the path toward the globalized market, or which require legal reforms on a grand scale. They are indicated below as [Principle B].

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Letter from the Chairperson

■ The Committee of the *Corporate Governance Forum of Japan* published its *Corporate Governance Principles — Interim Report* on October 30th, 1997. Although only 7 months have passed since then, developments in the business environment have been more rapid than we anticipated: the bankruptcy of Yamaichi Securities and Hokkaido Takushoku Bank, the amendment of the Foreign Exchange Control Law, and the commencement of the Japanese Big Bang have all had significant influences on the Japanese market.

Turning to overseas developments during this period, in April the OECD, headquartered in Paris, published its report entitled *Corporate Governance: improving competitiveness and access to capital in global market*, whilst in March the Hampel Committee in the UK published its corporate governance report. Also in March, CalPERS, one of the largest pension funds in the United States published its own *Principles of Corporate Governance for Japan.* In this document CalPERS proposed that our *Corporate Governance Principles — Interim Report* should be adopted as a benchmark for Japanese corporations.

The Committee will formally announce its Corporate Governance Principles at the annual meeting of the ICGN (International Corporate Governance Network), a group of worldwide institutional investors, in San Francisco this coming July.

■ The background of the *Corporate Governance Forum of Japan* is as follows. Early in 1994, when corporate governance was still not a major topic of discussion, Mr. Kaneo Nakamura, Counselor of The Industrial Bank of Japan, invited a number of senior businessmen to debate the issues. Members of this group comprised Mr. Jiro Ushio, Chairman of Ushio Inc. and a member of the Japan Committee for Economic Development, Mr. Josei Ito, Chairman of Nippon Life Insurance Company, Mr. Takashi Imai, President of Nippon Steel Corporation, Mr. Yotaro Kobayashi, Chairman of Fuji Xerox Co., Ltd., Mr. Takeo Shiina, Chairman of IBM Japan Ltd., Mr. Seiji Tsutsumi, Chairman of Saison Corporation, Mr. Sho Nasu, Chairman of Tokyo Electric Power Co., Inc., Mr. Yoshikazu Hanawa, Vice President of Nissan Motor Co., Ltd., Mr. Yoshihiko Miyauchi, President of Orix Corporation, Mr. Ken Moroi, Chairman of Chichibu Cement

Co., Ltd., Mr. Masaharu Shinagawa, Counselor of The Nippon Fire & Marine Insurance Co., Ltd., and myself.

We stayed one weekend at Tokyo Bay Hilton Hotel in Urayasu, and discussed and exchanged views on corporate governance day and night.

Subsequently, in the middle of 1994, Mr. Hiroyuki Yanai, of Epihanie Corporation, and Mr. Hiroshi Ogino of the Ashahi Shimbun, asked me to recommend a suitable person to co-ordinate the organization of a forum for corporate governance; I immediately suggested Mr. Kaneo Nakamura as the most appropriate person to represent the business world. Fortunately, Mr. Nakamura agreed to take-up this post, and was installed as co-chairperson with Dr. Takayasu Okushima, President of Waseda University, representing the academic world. *The Corporate Governance Forum of Japan* was formally inaugurated in November 1994.

In December 1996, the forum decided to draw up and propose its *Corporate Governance Principles for Japan.* I was designated Chairperson of the *Committee for the Settlement of Corporate Governance Principles,* which comprised seventeen participants, drawn from forum members representing corporate executives, institutional investors, law and economics academics, the mass media and lawyers. The committee has met 22 times in total between January 1997 and April 1998. Twelve of these meetings were held after the publication of the *Corporate Governance Principles — Interim Report* on October 30th of 1997, their aim being to hear and consider opinions and critiques of the report from domestic and overseas bodies.

The principles have been designed as a two-step formula for realizing effective corporate governance. Principles which should be adopted immediately (or as soon as possible following necessary legal reform) are "Step A Principles" and are indicated below as [Principle A]. Principles which should be aimed for early in the 21st Century are necessary (with amendments) to illuminate the path toward the globalized market, but require legal reform on a grand scale. These are designated "Step B Principles" and are indicated below as [Principle B].

Our "16 Standard Principles" are aimed at positioning entrepreneurs and the board of directors at the heart of the corporate governance debate, and will give us appropriate standards against which we can judge ourselves. We, as members

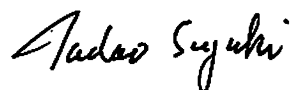
of the committee, intend to take the lead in implementing in our own companies what we are herein announcing.

Needless to say, the committee does not intend to end its activity following the announcement of these principles. By monitoring the adoption of these principles and through their periodic review, we aim to develop these principles into a "Code of Best Practice." Moreover, we intend to put these Principles into practice ourselves. Our aim is to establish an independent system of outside directors in Japan, and by establishing a market for independent directors to promote the transferability of corporate executives between companies. Also we will endeavour to have these Principles adopted as part of the requirements for Initial Public Offerings.

We appreciate the continuing support and cooperation of all shareholders, entrepreneurs, auditors, academics, regulators and overseas groups concerned with these issues.

Chairperson, Corporate Governance Committee,

Tadao Suzuki



Chapter 1 Introduction

[1-1] The globalization of the marketplace has ushered in an era in which the quality of corporate governance has become a crucial component of corporate survival. The compatibility of corporate governance practices in an international context has also become an important element of corporate success. The practice of good corporate governance has become a necessary prerequisite for any corporation to manage effectively in the globalized market.

[1-2] The publicly-owned corporation, the basic constituent of corporate society throughout the world, is actually a system of cooperative relationships between various stakeholders, including shareholders, management, employees, consumers, clients, and creditors. But shareholders in particular, the providers of equity capital, are given a special position. As they constitute the final risk-takers of the company who are entitled to claim the residual profits of the company, they are often considered the owners of the company. In this sense and under the system of private ownership, shareholders are granted the right of governance over the company for the benefit of their own interests in the form of maximized returns on their investment.

In publicly-owned corporations, the board of directors act as the representatives of shareholders and perform a corporate governance function. Shareholders, who may be widely dispersed, can elect directors, who in turn choose managers to manage the company effectively on behalf of the shareholders. Therefore managers ought to be responsible for the long term maximization of shareholders' profit and should exercise fiduciary duty towards shareholders. Moreover, managers, as the shareholders' trustees, must be fully accountable to shareholders for their actions as well as their performance.

[1-3] In the Japanese corporate system, the corporate governance function by def-

inition rests with the board of directors, who are elected to represent the shareholders. The directors are entitled to govern the company, and to supervise and monitor the company's managers in order to promote effective management and ensure accountability to the shareholders. The board of directors therefore is the primary overseer of the company, monitoring management to ensure that it continually endeavors to maximize long-term corporate value for the shareholders, and is always accountable for its actions to all stakeholders, in particular the shareholders.

In reality however, in Japan the respective roles of directors and managers have not necessarily been clearly defined. Furthermore, the distinction between the governance role of the board of directors on the one hand, and the management role of managers on the other, is complicated by the existence of a separate board of auditors, whose role is to audit the activities of the management. This body has meant that in practice the Japanese board of directors has not necessarily been equipped with sufficient governance authority or capability, while the board of auditors has been little more than a cosmetic shell.

The corporate governance principles described herewith propose that the governance powers of the board of directors be firmly established, thereby guaranteeing both the effective management and prudent accountability the company needs to survive in the global marketplace.

[1-4] It goes without saying that the workability of a corporate governance system in a market economy depends on the effective functioning of management to coordinate the various interests of all stakeholders. Profit-seeking by shareholders means, among other things, that they expect to maximize residual profits after other stakeholders have been given their fair share of company profits. Thus the role of management is to strive to maximize shareholders' profit, while simultaneously ensuring the appropriate profit level for other stakeholders. As long as the market mechanism is properly functioning, the shareholders' interests to maximize profit is justified.

In reality, however, the market mechanism does not function perfectly due to market failure and to administrative regulations, such as those relating to environmental protection. This is why management oversight of the allocation of

profit amongst stakeholders is indispensable, and should be accompanied by full disclosure of their allocation of profits to the company's various constituent stakeholders. In this sense governance by the board of directors also comprehends elements of social responsibility: through their duty of supervising management's actions, directors contribute to the transparency of the market. In an opaque market, the directors are not able to coordinate the relative interests of stakeholders in an appropriate way.

[1-5] It may be useful to provide a brief description of the unique features of the Japanese *shacho* (president), in the context of corporate governance. The Japanese *shacho* is the top management executive. As the leader of his or her company, an effective *shacho* is hard working, spirited, reliable, level-headed, a good decision-maker, with excellent communication skills and has a comprehensive grasp of where the company is headed in the future.

All these qualities, however, are insufficient unless he or she is a person of responsibility, firmly determined to maximize long-term corporate value for the benefit of shareholders. Modern corporations are on-going concerns. Their value, equivalent to the value attributed by shareholders, is expected to be at least maintained over the long term. The legitimacy of the *shacho* derives from, and is recognized only by his or her sense of dedication and responsibility to the shareholders and their representatives, the board of directors, through the pursuit of the maximization of corporate value.

[1-6] Without stable cooperation between employees and management, shareholders' value will never be maximized. To achieve smoother and more effective cooperation, Japanese companies have introduced devices such as the "bonus system" and "employees' stockholding plans", which basically share profits with employees. Stock option plans, which are examples of more long-term rewarding systems, have also been adopted recently, though their use is preliminary. The goal of these systems is to reconcile the dual aims of maximizing shareholders profit and maximizing the profit allocation for all stakeholders.

[1-7] The Principles presented in this paper have been written to present a

Japanese model of corporate governance. They place special emphasis on the obligation of directors to represent the long-term interests of shareholders as well as simultaneously to promote of the benefits of all concerned stakeholders.

Chapter 2 The Japanese Corporate Governence System — Issues to be Addressed

[2-1] The continental European and Japanese model of corporate enterprises are somewhat similar, in that a sense of corporate solidarity with social harmony is expected and actually exists. The Anglo-American model, by contrast, is based on a respect for individuality as the societal norm; a key factor defining the structure of corporate enterprise is the notion of a contractual relationship between equal individuals. In this Anglo-American model, the governance of the corporation is based on the notion that shareholders are entitled contractually to claim the residual profit as the ultimate risk-takers of the corporation. In the continental European and Japanese model however, management and employees are recognized as institutionally cooperative in the context of corporate governance.

[2-2] In the global, competitive market, corporations are increasingly obliged to dedicate themselves to providing better goods and services at lower prices. In this environment global competition might be interpreted as a survival race between two corporate systems for higher managerial efficiency: one system seeking a singular value for shareholders, and the other pursuing multiple values including those of employees. Basically, with a singular value seeking system it should be easier for the management to evaluate its own performance, but by also adopting profit-sharing devices to provide long-term incentives to satisfy employees, this system might also embrace multiple values.

[2-3] The Japanese management style has been characterised and criticized as one which preserves inefficient and unprofitable divisions only in order to maintain employment. This is declaimed as a typical defect of the non-singular value seeking system, which moreover might easily be remedied. On the other hand, however, the Anglo-American model admits that the ability to quickly dispose of workers is only "for the benefit of shareholders", which is why the system has tended to be criticized. But it is possible to avoid the damaging effects of corporate downsizing in practice through the fulfillment of management's duty to re-allocate employees to newly created profitable sectors. The Japanese style of management has not been one easily obsessed by precipitate employee lay-offs or a mergers and acquisition syndrome.

[2-4] Of course, dismissal of employees should not be proscribed either institutionally or legally, as this would result in unwarranted inefficiencies. However, the frequent adjustment of employment during each negative phase of the business cycle is regarded an irresponsible transfer of business risks to employees. It is common Japanese management practice to subscribe to such ethical principles of personnel management, and we believe this notion could add certain values to the Anglo-American model of corporate governance.

[2-5] The conventional Japanese corporate governance model consists of a dual structure: the board of directors which carries out the functions of strategy formulation as well as oversight of its execution; and the board of corporate auditors, which audits management's execution of business activities. But, in practice, the board of directors consists principally of in-house directors, loyal to the *shacho* rather than shareholders, which is inconsistent with its corporate governance role. The board of corporate auditors, too, is only able to carry out *ex post facto* auditing, and tends to be remote from the actual decision-making process of the board of directors.

Moreover the board of directors tends not to have real decision making power. Instead, important decisions are actually taken by the "management board" or the "board of managing directors." Indeed, most members of the board of directors are "executive" directors who have successfully climbed the corporate career ladder

and are actually recognized as employees' representatives. In this situation, the realization of meaningful and independent governance by such a board is very difficult.

[2-6] The function of the board of directors should be rejuvenated to cope with the increasingly complex and rapidly changing global market, through its metamorphosis into an honest and rigorous advisory body for management, which might otherwise be tempted to be complacent. In order to achieve such a goal, the board of directors might make greater use of support and information staff, for example "executive committees" which are common in the US.

[2-7] The establishment of meaningful corporate governance requires an appropriate institutional framework. But an "empty envelope without a letter" should be avoided. Thus the motivation of board of directors is a prime concern; the key importance of shareholders within the corporation, and the goal of a going concern as being the maximization of shareholders' long-term value, need to be clearly understood and strongly shared amongst all of the company's participants. In order to re-inforce these notions, a clearer framework for corporate governance should be introduced, ultimately leading to the consolidation of the functions of the conventional board of directors and the conventional board of corporate auditors. Only then might this new board be identified as playing a genuine corporate governance role.

Currently a sufficient supply of independent external directors does not exist in Japan. This limited market for independent directors as well as corporate auditors may be an Achilles' heel. But in the medium-term the uniquely Japanese system of cross-shareholding might begin to unravel, which will necessitate a system of governance more reliant on independent and external directors, in turn leading to the creation of a market for such individuals.

In a separate move, the Japanese government has been seeking to strengthen the power of independent external corporate auditors, in order to address the perceived shortcomings of the traditional cross-shareholding system with regard to the board of directors, and also to help prevent corporate misconduct. In the current circumstances, we feel that the strengthening of the conventional system

of corporate governance by both the board of directors and the board of corporate auditors might complicate the future vision of workable governance; the effective policing of corporate conduct should, if necessary, be taken care of by the management itself through a sense of ethical duty, rather than the intervention of a strong external authority.

Fiduciary Duty

[2-8] In the Japanese judicial system, the concept of fiduciary duty is not clearly enunciated. Therefore although it is argued that the board of directors who, as agents of shareholders, are expected to act in the same way as an individual shareholder would act in order to maximize his or her profit, it is not possible to define the board's legal responsibility or their rights beyond the notion that shareholders have delegated their authority to the board. However the Anglo-American concept of fiduciary duty may be covered by the Japanese legal concepts of "bona fide" loyalty duty and the duty of "honest manager's care", which are incumbent upon the board of directors.

When the interests of management and shareholders diverge, shareholders have the privilege of being able to request that management account to shareholders for their actions and provide them with detailed reports. The board of directors is motivated to carry out this duty to shareholder in return for remuneration.

Although both directors and managers are agents of shareholders, in the case of managers, their interests may diverge from those of shareholders because of various conflicting interests in the company. Independent external directors, on the other hand, are more likely to be genuinely neutral agents of shareholders and so able to govern the company more effectively.

Quality Control of Management

[2-9] The fascination with "Japanese Management" prevalent during the 1980s disappeared with the bursting of "he Bubble" in the early 1990s. Nonetheless the competitive edge of Japanese manufacturing has been maintained, and continues to be strongly supported by their particular notion of quality control. In particular

the Japanese method of quality control in manufacturing has created a high-grade "zero-defects" system in which product faults are detected continuously and systematically along the production line and not just during a final inspection process. Why not apply this concept to corporate governance? This would entail continuous monitoring by a keenly aware and authoritative board of directors, and should improve upon the conventional two-tier governance system.

Principles for Listing of Stocks

[2-10] We urge that these Principles, which place an emphasis on a more substantive role for independent directors on the board be widely adopted by Japanese companies. However this remains a matter of choice for each company to decide upon, but we are certain that the shareholders will derive the maximum benefit from the adoption of these Principles.

In order that the Principles are better understood and recognized, we strongly hope that the Stock Exchange authorities, being aware of their value, will endorse the Principles and incorporate them into the listing requirements for public companies.

Chapter 3 Accountability and Disclosure

[Principle 1A]

The board of directors should require that the management of the company be fully accountable to shareholders as well as the board of directors through the provision of accurate, substantive, practical and reliable information. It is the responsibility of the board of directors to oversee the company's entire information network in particular the shareholder relation mechanism.

[Principle 2A]

The board of directors should be aware of the vital importance of the rigorous management of company risk and the timely disclosure of information which might seriously affect shareholders' interests, including for example accidents, litigation, mergers and acquisitions and unfavorable business reports, etc.

[Principle 3A]

The board of directors should begin to report globally consolidated semi-annual accounts based on the mark to the market accounting system as soon as the "international standard" now under consideration is finalized. Quarterly reporting of accounts should also be introduced as soon as possible.

[Principle 4A]

The board of directors has the important responsibility of coordinating the various interests of all the other stakeholders, while substantively representing the immediate interests of the shareholders. Therefore, the directors should undertake wider disclosure of company information, including policy statements as well as environment-related reports, for the benefit of all stakeholders who may have divergent interests.

[Comments]

The equity of global corporations, which are generally more closely integrated into global capital markets, is increasingly being held by international institutional investors who require transparent and often standardised information regarding business activities. To improve the understanding of global institutional investors, companies need to continually up-grade and increase their efforts to provide suitable business information, as a matter of their corporate survival in the market. The board of directors needs to clearly comprehend this need for comprehensive information disclosure.

The guiding principles of such information disclosure should be transparency and continuity. Efficient internal controls are essential in order to realise an appropriate level of corporate disclosure. Disclosed information should use clearly understandable language rather than firm or industry specific jargon. Principles 1A to 4A represent the basic prerequisites to be observed by companies in this context.

Accountability and Disclosure

[3-1] Corporate management as an agent for shareholders should account to shareholders how much profit is generated out of their assets. This is basically an "offer of information" which takes the form of a statement of accounts within a closed

loop between directors and shareholders.

[3-2] On the other hand, the provision of information to outside "constituencies" comprising current and / or potential stakeholders, we term "information disclosure." Reconciliation of the divergent interests of stakeholders, if not settled through the operation of the market, has to be carried out by managers, and then duly disclosed to those stakeholders.

[3-3] The offer of information to shareholders and the disclosure of information to wider stakeholders should not to be treated as identical. The offer of information to existing shareholders in the form of a "business report", which should be kept confidential, is clearly differentiated from the information disclosure to wider constituencies named "statement on securities."

[3-4] Therefore, in our statement of Principles, "information offered to shareholders" and "information disclosure to the stakeholders" are recognized as two different concepts. The board of directors should be aware that there are certain occasions when the board is accountable only to existing shareholders.

Publication of Compliance Code

[3-5] We believe that the prevention of illegal conduct by managers or directors is not the primary concern of corporate governance, and a key assumption in our discussions is that all the key members of the company do not carry out illegal acts. In Japan, however, cases of illegal conduct are currently a major public concern, which we therefore need to address in these Principles. We propose that managers should be obliged to publish a code of management compliance. As a minimum, certain safeguards should be introduced including, for example, restrictions on the terms of service, the payment of retirement allowances and the extension of tenure with subsidiary companies, for directors and managers who have committed illegal acts.

Chapter 4 Governance Structure

4.1 Directors and the Board of Directors

[Principle 5A]

The board of directors should include independent, non-executive directors who have no direct interests in the company. A system of support to provide necessary information to these directors should be established and enhanced.

[Principle 6A]

The number of directors should be appropriate to guarantee effective discussion at board-level, and enhance articulate and timely corporate decision-making.

[Principle 7A]

The The functions of the board of directors and any management board should be separated so that corporate decision-making and business execution are clearly distinguished.

[Principle 8B]

The board of directors should consist of both executive directors and independent, non-executive directors. Independent, non-executive directors should comprise a majority on the board.

[Principle 9B]

Several committees should be established within the board, with responsibilities for the appointment of directors, setting directors' remuneration, expediting corporate governance, and so on. Non-executive directors should comprise the majority on these committees. The chairpersons of these committees should be non-executive directors. Remuneration of the *shacho* and executive directors should be decided only by non-executive directors.

[Principle 10B]

The chairperson of the board of directors, as the person ultimately responsible for the governance structure, and the shacho, as the officer ultimately responsible for business execution, should ideally not be the same person. When the combination of these two functions is unavoidable, an explanation should be offered to the shareholders.

[Comments]

It is questionable whether the Japanese board of directors actually complies with the Commercial Code's stipulation that it functions as the body which decides on corporate will and exercises corporate oversight. In many cases, the board consist of so many directors, who are for the main part also employees, that it is not possible to carry out meaningful discussion on overall company policy and strategy. Hence many companies also make use of smaller decision-making bodies, such as "the board of managing directors." It is in order to rejuvenate and strengthen the board of directors that these proposals have been made.

Suitable external persons should be included as non-executive members of the board of directors. For companies where this may be difficult to carry out immediately, we recommend the appointment of a "management advisory committee", also composed of external persons, as a transitional measure. In this case the rights and responsibilities of the advisory committee should be clearly defined.

Directors should concentrate their efforts on strategic decision-making for the

company as well as overseeing business operations carried out by managers: thus they should be a clearly distinguished from the "executive officers" whose role is to execute the business of the company. Effort will need to be made to have the status and role of "executive officers" widely understood, as this title does not have common currency in the Japanese business community as yet. The size of the board of directors needs to be practically appropriate, as stated in Principle 6A. Independence means being independent of any other stakeholders than shareholders.

Principle 8B will be realized only after a sufficient supply of eligible independent directors becomes available. It may take some time to create such a market, but this should be expedited. Principle 9B recommends the establishment of several committees within the board, which will respectively assume responsibility for many important decisions. Such decisions should be clearly stated on the proxy statement and in the annual report.

Probably, the major activity of the board of directors will comprise the oversight of management's execution of business operations. In this sense an important issue is whether the same person is appropriate to carry out the execution of business operations as well as corporate oversight, as stated in Principle 10B; this is why we recommend the separation of the two functions.

Independent directors should be carefully selected so as to ensure that the board is well balanced, and reflects the different values of society at large. Also a system which delivers timely and accurate business information to directors is vital for informed decision making.

4.2 Corporate Auitors and the Board of Corporate Auditors

[Principle 11A]

The quality of corporate auditing should be improved by the appointment of more than one independent (external) corporate auditor, and by more carefully defining the role of independent external auditors vis-à-vis internal auditors. The neutrality of the auditing function should be ensured by selecting corporate auditors only with the full consent of the board of corporate auditors itself. The "five year rule," by which an former officer of the company may be appointed as an external auditor after five years of absence from the company or related company must be abolished.

[Principle 12A]

Auditors should be free to request all information relating to the decision-making activities of managers and directors.

[Principle 13B]

An audit committee should be created within the board of directors as soon as the majority of the directors are independent and non-executive. All members of the audit committee should be non-executive directors. Its function will be to audit, in particular, the appropriateness of the company's risk management, in addition to overseeing compliance issues.

[Comments]

The oversight of management performance should be performed by independent external persons. A board of directors which includes independent, non-executive

directors is the most appropriate apparatus for this purpose, subject in particular, to its separation from day-to-day involvement in business execution carried out by the board of executive officers. Until this ideal structure is achieved, the conventional system of auditing remains important, but even so requires a majority of independent, external auditors. The effectiveness of the current auditing system is only guaranteed by the appointment of reliable and effective individuals.

Traditionally, corporate auditors have been expected to limit their oversight function to the monitoring of management's compliance with its legal obligations, rather than judging the appropriateness of management decisions and actions. But it is not easy to draw a clear line between these two issues. The auditing of directors activities necessarily requires the initial auditing of the appropriateness of these activities. Therefore, the Commercial Code should be clearly interpreted as requiring that auditors audit the appropriateness of directors strategic decision making process as well as the actual decisions themselves. We also propose an increased role for public accountants, in performing independent and impartial auditing from a professional standpoint.

The introduction of a majority of independent non-executive directors to the board will increase its effectiveness, in particular as it will enable the creation of an audit committee within the board of directors. However, companies whose situation is such that the conventional dual board system, comprising separate boards of directors and auditors, will ensure equally effective risk management may maintain this structure as long as this is accompanied by a full explanation of its rationale.

Companies which establish the proposed audit committee within the board of directors may relinquish the board of auditors, once necessary revisions to the Commercial Code have been effected. Under this new system, public accountants will also be required to submit audit reports to the board of directors.

4.3 Shareholders' Meeting

[Principle 14A]

The company Annual General Meeting should be utilized to enhance the scope of dialogue between shareholders and the board of directors. This is desirable to promote the quality of directors' accountability.

[Principle 15A]

Separately from the Annual General Meeting, open information meetings with major shareholders may be held for more detailed discussion.

[Principle 16B]

Resolutions submitted for decision at the Annual General Meeting should be limited to those which are of vital importance to the business, for example revision of corporate articles, transfer of business rights, mergers and acquisition which require a three quarter majority special resolution of the shareholders, and the election of directors and corporate auditors.

[Comments]

The Annual General Meeting should be good opportunity to exchange opinions between shareholders, directors and management. Therefore, the issues to be reported upon and discussed should be of broad scope without any rigid limitation. The timing of the Annual General Meeting should, where possible, not coincide with that of other companies.

Research analysts and fund managers of institutional investors often receive privileged information through meetings with various companies. Other major shareholders (the largest 20 or 30) should be given equal privileges. When the company holds meetings for major shareholders, it should publicise the information it gives out through, for instance, the mass media or the internet. In this

case, the offered information may be provided equally to other shareholders on request.

Issues such as allocation of company profits and executive remuneration should be excluded from the Annual General Meeting, and should be decided by the board of directors, but this will require the revision of Commercial Code. However these issues, including for example stock option plans, should be disclosed to the shareholders in the form of business statements, enabling shareholders to evaluate them.

Simplification of the Annual General Meeting must not result in the dilution of information offered to shareholders. The location of such meetings should also be given careful consideration. For instance, it may be advantageous to hold the meetings at company factories, rather than at a company's head office.

Corporate Governance Committee Members

Chairperson

Tadao Suzuki, President, Mercian Corporation

Vice-chairperson

Yoshihiko Miyauchi, President, ORIX Corporation

Members

Kenjiro Egashira, Professor of Law, University of Tokyo

Tadao Kagono, Professor, Kobe University, School of Business Administration

Hideaki Kubori, Attorney-at-law, Hibiya Park Law Offices

Koichi Minaguchi, Advisor, Nomura Research Institute, Ltd.

Kazuo Mori, Senior and Editorial Writer, Nihon Keizai Shimbun, Inc.

Tadao Nishioka, Senior Managing Director, Nippon Life Insurance Company

Hiroshi Ogino, Editorial Writer, The Asahi Shimbun

Ariyoshi Okumura, Senior Adviser, IBJ NW Asset Management Co., Ltd.

Shigeru Omori, Senior Corporate Auditor, Nippon Steel Corporation

XU Peng, Associate Professor, Department of Economics, Hosei University

Hideo Unayama, Professor,

Tak Wakasugi, Professor of Finance, University of Tokyo

Senior Advisor

Kaneo Nakamura, Advisor, The Industrial Bank of Japan

General Secretary

Hiroyuki Yanai, President, Epiphanie Corporation

Secretary

Masahiro Maruyama, Senior Researcher,
Central Research Institute of Electric Power Industry

(Alphadetical Order)

Detailed Activities of the Committee

■ The committee's first meeting took place on January 29, 1997. After the 10th meeting (October 15th, 1997), the *Corporate Governance Principles — Interim Report* was published. The committee met a further 12 times between November 18th, 1997 and the publication of this final report. Before and after the publication of the Interim Report, the committee endeavoured to collect opinions from relevant domestic and overseas bodies. We also met with eight specific individuals on six occasions to ask their opinions and critiques. We greatly appreciate their valuable feedback:

August 28, 1997 (7th)

Yotaro Kobayashi, Chairman, Fuji Xerox Co., Ltd.

December 25, 1997 (12th)

Takeo Shiina, Chairman of the Board, IBM Japan Ltd.

January 20, 1998 (13th)

Dr. Wiliam D. Crist, President Board of Administration, CalPERS

January 23, 1998 (14th)

Tetsuya Katada, Chairman of the Board, Komatsu Ltd.
Kenji Yoshihara, President, Pension Fund Association

Feburary 6, 1998 (15th)

Nobuyuki Koga, Director, Manager of the Board, The Nomura Securities Co., Ltd.
Hirotada Kokumai, Corporate Auditor, The Kansai Electric Power Co., Inc.

Feburary 26, 1998 (16th)

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