Revised Corporate Governance Principles

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Japan Corporate Governance Committee

Japan Corporate Governance Forum

Message from the Chairperson

A stock company is an organization that pursues the interests of all of its shareholders based upon the investments and risks that they shoulder. Companies exist in order to create value in undertaking projects using their management resources, such as labor and capital, and represent a system that is made up of the cooperative efforts of many stakeholders. A good company maximizes the profits of its shareholders by efficiently creating value, and in the process contributes to the creation of a more prosperous society by enriching the lives of its employees and improving the welfare of its other stakeholders.

Top-quality governance is essential for a good company. The Corporate Governance Committee (chaired by Tadao Suzuki), the predecessor of the Japan Corporate Governance Committee, examined the state of corporate governance in Japan for two and a half years and, in May 1998 summarized the findings of its discussions in the Corporate Governance Principles. These Principles presented a model for companies to meet the challenges brought on by globalization. Since that time, however, there have been a multitude of further changes, including a greater understanding of corporate governance in Japan, the introduction of executive officers to separate the functions of corporate boards and day-to-day management, new trends in the revision of the Commercial Code, and greater in the exercising of voting rights by institutional investors. In short, Japanese companies as well as the environment in which they operate have undergone a dramatic transformation.

The Japan Corporate Governance Committee brings together the interdisciplinary interests of scholars, journalists and economists who wish to reform corporate management. In order to keep abreast of these trends, the Committee held 31 meetings over the course of three years from November 1998 to October 2001. The Committee revised the first version of the Principles by synthesizing these discussions, including the appointment of outside directors who are professors at national universities and certain revisions to the Commercial Code.

These new Principles are part of a forward-thinking movement to improve Japanese corporate policy and are the result of earnest and vigorous debate between the practical and academic sides of this topic. The Principles are based on the understanding that good governance will create a good company and are the product of the participation and cooperation of members from a broad cross-section of disciplines, starting with Deputy Chairperson Tetsuo Suzuki, former Chairperson Tadao Suzuki, as well as Hiroyuki Yanai, Takaaki Wakasugi, and Tatsuo Uemura, who shared the task of writing the draft of these Principles. It is our pleasure to present the Revised Corporate Governance Principles, the further the development of sound corporate governance in Japan.

Yoshihiko Miyauchi

Chairperson, Japan Corporate Governance Committee

Foreword - The Economic and Managerial Positioning of Corporate Governance

1. Capitalism and the Stock Corporation System

Under capitalism, which is based on a system of private property ownership, private ownership is recognized even in the production methods of companies, and companies are also recognized as being owners.

The private property system is one in which all property is recognized as being owned by someone who has the right to control that property, but who must also bear the responsibility for any consequences of that control. The owner must bear responsibility for all such eventualities, for better or worse. This is called ownership risk. In a stock corporation system, the shareholders who provide capital and equity are recognized as owners from an economic point of view, and are entrusted with the control, namely governance, of the company that they own. Capitalism is premised on a free economy and therefore people have the freedom to establish companies and undertake a variety of projects using companies. This creates competition, and inherent in the activities of the company there is also some risk.

2. The Role of Public Companies and the Board of Directors

Shareholders who have been charged with the responsibility of governance first determine a company's objectives, and also the smaller goals that are milestones towards achieving these objectives. Next, concrete policies are determined in order to realize the goals, and the company uses its management resources to make these a reality. This is called corporate management.

The driving force behind the economies of advanced capitalist countries is, in general, the large public stock corporation, which is owned by a multitude of shareholders. Under this arrangement where there is such a vast number of people having an ownership interest, it is essentially impossible for the shareholders to directly manage the company. Therefore, in the contemporary stock corporation system, the shareholders in general meeting appoint the directors of the company, and the board of directors is entrusted with the management of the company. The role of the meeting of the Board of Directors is to determine objectives for the company that will enable the aims of the shareholders to be achieved. Under this stewardship, projects are undertaken and goals are realized.

3. The Board of Directors as a Management Supervision Body

Based on the considerable experience of conducting a stock corporation system over many years, it is now regarded as preferable for achieving the goals of the company that the role of the executive managers and the directors, both of whom control the management resources of the company, be separated. In other words, the Board of Directors performs the role of management supervision body, which specializes in determining the direction that the executive managers should take, from the point of view of the shareholders, while the executive managers as a management body devote themselves to carrying out the business of the company. This scheme exists because, in this situation where there are many shareholders who are outside the company, and inside directors within, it would be easy for the interests of the shareholders to be neglected.

4. Regulations for the Shareholders

A company is the economic property of its shareholders. Even where the shareholders have a governance system in place, management practices that ignore economical or efficiency issues with respect to the use of precious economic resources of the company will not be tolerated. A fixed set of regulations is required by the shareholders, and in order to secure these, "transparency" is of utmost importance. As stocks are publicly listed on the market, it is desirable that the management takes place under the watchful eye of the public. These kinds of regulations are particularly necessary for large-scale public companies.

5. Independent Directors and Outside Directors

Even assuming that the shareholders abide by the company regulations, if the executive managers who actually oversee the projects do not carry out management practices that reflect these regulations, then the company cannot fulfill its role to society. Therefore, we must understand the essence and significance of the stock corporation system, and recognize the importance of independent directors who can make decisions from the point of view of a shareholder of noble spirit and profound insight. Increasingly we are seeing this method of management by the executive officers under the stewardship of the independent directors. The directors to whom we look to perform the role of independent directors are so-called outside directors.

6. Discharge of Duties and Accountability

The shareholders enter into a contractual relationship with the executive managers, who are entrusted with the management of the company, and it is through these obligations that the discipline by the shareholders is imposed on the executive managers. The executive managers, in turn, have a duty to prove that they are fulfilling the duties entrusted to them by the shareholders. This is called accountability.

The board of directors supervises the executive managers to confirm that they are properly performing their duties. However, outside directors who are external to the company and may not receive all information, cannot therefore fully monitor the executive managers. If, however, stricter rules are imposed on executive managers in order to compensate for this fact, they will be deprived of a necessary degree of freedom and inefficiencies in the company may result instead.

7. Significance of Incentive Compensation

The executive managers are therefore expected to have some autonomy. In a prosperous and liberal company, rather than putting restraints on the executive managers through laws and regulations, it is more effective to put in place a scheme where the executive managers strive to reach the objectives of the shareholders. An example of such a scheme, in which the executive managers share with the shareholders in the concept of risk and return, is the performance-based compensation system. Specifically, in this system, compensation is linked to the long-term performance of the company and may include stock options, the value of which moves with the company's share price.

In order to attain the objectives of the shareholders in a modern-day company that has valuable human resources, the diligence and hard work of not only the executive managers but also the employees is essential. That is why a performance-based compensation system that responds to the performance of the company is also adopted for company employees. This type of compensation system, which responds to the performance of the company, is of significance to the shareholders because it offers incentives to extract the best efforts from executive managers and employees, and is therefore referred to an incentive system. Although, it is believed that the larger the incentive, the greater the result, if too much incentive compensation is paid out, then the scheme will lose its merit for the shareholders. Therefore, the establishment of an appropriate compensation system is of the utmost importance from the perspective of the shareholders.

8. The Essence of Supervision by the Board of Directors

The nature of supervision by a present-day board of directors, having independent directors at the heart of its activities, is the undertaking of appropriate monitoring from the aspect of fulfilling the duties entrusted to them, while motivating the executive managers and employees with an appropriate compensation system in order to encourage independence. The balancing of this supervision (from the standpoint of the shareholders) with management (the administration of the company's business) is called governance. The independent directors do not undertake any of the actual business of supervision or in relation to compensation. These affairs are placed under the care of internal audit and human resources divisions. Governance, which is the primary role of an independent director, is to ensure the introduction and correct functioning of the internal audit and compensation systems. For this reason, this governance role can be performed by outside directors even through they may not be familiar with the intimate details of the company or the industry.

In Japan, although there is a strong bias towards requesting managerial advice from outside directors, this phenomenon is, at best, a secondary function, and managers and employees alike in Japan need to be reminded that the primary role of outside directors is that of governance.

9. Function of the Board of Directors - Appointment and Dismissal of Executive Managers and Risk Management

Another critical role that the board of directors needs to fulfill is the appointment and removal of executive managers. The board of directors must keep a close watch that the appropriate personnel are appointed as executive managers and the results that they produce. It is important that the supervision of officers is approached from a long-term perspective, as it takes a certain length of time for the executive managers to produce results. If it is determined, however, that an executive manager is not up to the task, then the board of directors should promptly dismiss that executive manager. In order to efficiently undertake these tasks, it is preferable that the authority for these functions of the board of directors be delegated to committees such as a Supervision Committee, Compensation Committee and Appointment Committee.

Risk management is yet another vital role of the board of directors. Risk management is the protection against situations that may have significant adverse consequences for the interests of the shareholders, as well as implementing appropriate measures in order to mitigate any resulting losses if such a situation were to arise. It is said that risk management in Japan is not clearly delineated and lacks a distinct foothold, yet at the very least it is necessary to ensure that executive managers and employees in Japan are aware that risk management should be viewed from the perspective of controlling risks for the shareholders.

10. Market Principles Predicated upon the Stock Corporation System

There are many kinds of stakeholders in any company. When looked at from a different perspective, rather than being seen as paying out incentives to the diversity of stakeholders that are necessary for the company, the management of the company by the executive managers to achieve the goals of the shareholders, also means undertaking transactions that will elicit contributions to the company from the stakeholders. A company is not able to exist until it is able to secure transactions with each of its stakeholders. Given that this is so, a company can be thought of as something that belongs to everyone. Despite this, the reason that it is regarded as socially fair for the shareholders to have the governance of the company is the premise that the shareholders will carry out fair transactions with all the stakeholders. Fair transactions are those which are based on market principles, which is yet another crucial principle of capitalism.

11. Significance of Disclosure

When a company is engaging in transactions with all of the stakeholders based on market principles, and is realizing a sufficient profit for its shareholders (i.e. a return that matches the risk), then the company can be said to be fulfilling its social obligations. Disclosure is the provision of information in order to secure future stakeholders and to let society know that the company is fulfilling its social obligations. It should be noted, however, that this disclosure is based on accountability and differs from the ex post facto reporting of results to the shareholders by the executive management.

12. Objectives of Executive Management - Creation of Shareholder Value

The objective of many shareholders of public companies is the long-term increase in the value of their assets through their ownership of shares. This is achieved through the continual increase in share value, which creates value for the shareholders and the company.

When a corporation decides to make a capital investment, the profits of which are expected to exceed the initial outlay, the share price of the company should rise based on those expectations, if the share market is functioning effectively. This is the creation of shareholder value or company value. If, however, after investment, the company does not actually meet the expectations, the investors will perceive this as a betrayal of their expectations, and the share value that once had been on the rise will decrease. In order to maintain the stock value, the executive managers must integrate the company's human resources, assets and information such that the anticipated profits can be realized. This is executive administration.

13. Significance of Investor Relations

The creation of shareholder value lies in continually developing good investment opportunities, and in following through with these opportunities to realize anticipated profits. The creation of shareholder value is the very thing that the shareholders have entrusted to the executive managers, and it is by doing this that the executive managers fulfill their obligations to the shareholders.

Given that the role of the executive managers is to increase the value of the company stock through creating and realizing good investment opportunities, the executive managers must be active in providing information to the stock market. Ultimately, however, this disclosure is based on forecasted results, and so if the investors do not trust the executive managers, the value of the stock will not rise regardless of how good the investment opportunity may be.

Therefore it is imperative for the executive managers, on a regular basis, to strive to communicate with the shareholders, investors and other people related with the market, and to endeavor to create and maintain a relationship of trust. This is called investor relations.

14. Essence of Corporate Governance and Particular Characteristics of these Principles

In any organization, not limited just to companies, the executive managers must carry out their role of achieving the organization's objectives in a responsible manner. The issue for those who own the organization, and who also have governance over it, is the mechanism by which that will be pursued.

Corporate governance is a scheme for ensuring that the executive managers, who have been placed in charge of the company, fulfill their duties. The building of a logical and efficient corporate governance system is one of the main responsibilities of the shareholders. It is believed that an interaction, characterized by some tension, between the executive manager with the highest degree responsibility (the CEO) and the outside directors who have received their mandate from the shareholders, will lead to the practice of good governance. When compared to the enormous power currently wielded by CEOs, however, awareness of the role of outside directors has yet to become commonplace, and so their status has not yet been established, which makes it difficult to encourage any interaction.

These Principles therefore place a great deal of emphasis on the management supervision function of the board of directors, in order to promote new and mutual reform for the outside directors and CEOs. For this reason, the focus of these Principles has been placed on those who are under supervision, while the significance of the executive management side centered around the CEO, has been given comparatively less coverage. This in itself is proof that the CEO has the most responsibility for the management of the company, which we have not covered in detail, as it is self-evident.

We would like to emphasize once again that these corporate governance principles should be practiced by directors, executive managers and shareholders.

Revised Corporate Governance Principles

Chapter I Mission and Role of the Board of Directors

Principle 1: Position and Purpose of the Board of Directors

1. **The board of directors is positioned as the management supervision body of the company.**
2. **The board of directors should supervise the management of the company by the chief executive officer (CEO). The supervisory role of the board is premised on the fact that the decisions of the management team centered on the CEO will be evaluated by the securities market with the equity share market at its core.**

Principle 2: Function and Powers of the Board of Directors

1. **The matters to be decided by the board of directors should be limited to management supervision matters, i.e. approval of high level strategic decisions, nomination of candidates for director and executive positions, appointment and removal of the CEO, review and setting of management salaries, general control of accounting and auditing, and other similar matters.**
2. **In addition to the matters prescribed by law to be decided by the board, in light of its role as a supervisory body, a requirement that the board approve certain decisions of the CEO may also be provided for.**

Principle 3: Organization of the Board of Directors

1. **The number of members in the board of directors should be set so as to allow for meaningful discussion, and accurate and prompt decision making.**
2. **The board of directors should be comprised of outside directors (directors who are not also executives or employees) and inside directors (directors who are also executives or employees).**
3. **The majority of the board of directors should be comprised of outside directors.**

Annotation: [Principle 3.3]

Considering the situation in Japan, for the next 1 - 2 years, there should be a concerted effort to appoint about half of the board as outside directors, and to recognize that the balance (again of roughly half) are performing the dual-role of director and executive.

Principle 4: Outside Directors and their Independence

1. **An outside director is someone who is not and has never been a full-time director, executive, or employee of the company or its parent company, subsidiaries or affiliates (collectively, the "Company etc.").**
2. **An independent director is someone who can make decisions completely independently from the managers of the Company etc., and therefore necessarily does not hold any interest with respect to the company.**
3. **If companies exchange directors (interdirectorships), those directors should be regarded as lacking independence.**

Annotation: [Principle 4.2]:

If an independent director falls within any of the following categories, he or she should not be regarded as being an independent director. The re-appointment of an independent director should not have any effect on his or her status as independent.

(1) A person who is or was a full-time director, executive or employee of the company, its parent, subsidiary or affiliate ("Company etc.") or a relative of a full-time director or executive. The standard for a relative's "degree of kinship" may be left to the discretion of each company (such as parent, grandparent, child, grandchild or sibling).

(2) A person who is currently providing legal, accounting, strategic or other professional services to the Company etc. (including attorneys, accountants and consultants).

(3) A person who is currently a major client or trading partner of the Company etc. (including officers of financial institutions that fall under that category). The interpretation of "major" may be left to the discretion of each company.

Annotation: [Principle 4.3]

An "interdirectorship" is a situation where director (A) of Company A becomes a director of Company B, and director (B) of Company B becomes a director of Company A.

Principle 5: The Role of the Leader of the Board of Directors

1. The leader of the board of directors should, as chairperson or leader of the meeting, which supervises the CEO and other executives, discharge his or her duties from the standpoint of good corporate governance.

Chapter II Mission and Role of the Committees Established within the Board of Directors

Principle 6: Establishment and Composition of Committees

1. **The board of directors should establish a nominating committee, compensation committee and audit committee within the board. The board may, if necessary, establish a litigation committee or any other committee for a specific purpose (a "special committee"), (each referred to as a "Committee").**
2. **Each Committee should consist of 3 or more directors.**
3. **The majority of directors on the nominating committee and the compensation committee should be outside directors, and there should be one or more independent directors. The majority of audit committee members should be independent directors.**
4. **An outside director should be appointed as the chairperson of each Committee.**

Principle 7 Role of each Committee

1. The nominating committee should:

(1) decide on candidates for directorships who meet certain pre-set qualification criteria, and propose the removal of directors at shareholders' meetings; and

(2) propose appointment, removal and related matters with respect to executives. The CEO may submit requests or opinions to the nominating committee, or may attend meetings of the Committee to present the requests or opinions.

2. The compensation committee should review the executive compensation programs and of each director's and executive's compensation pursuant to pre-set compensation principles. The objective of the compensation programs is to motivate directors and executives to work diligently, and therefore the compensation committee should respectfully review the incentive plans, which should be designed in a fair and reasonable manner. If the CEO decides to adopt incentive plans to employees, the CEO should obtain the approval of the compensation committee.

3. The audit committee should organize the overall accounting and audit functions, assess the audits conducted by certified public accountants, appoint and discharge certified public accountants, evaluate and make improvements to internal audit procedures and controls, and the internal control environment, and be responsible for related tasks.

4. Special committees should be established to enable the company to deal with situations that may significantly affect the interests of shareholders, such as derivative lawsuits, takeover bids and other serious matters.

Chapter III Leadership Responsibility of the CEO

Principle 8: The Role of the CEO

1. The CEO, while observing the law and the Articles of Incorporation and adjusting the interests of various stakeholders based on market principles, should loyally carry out his or her duties in order to meet the management goals of the company.
2. The CEO should, under the supervision of the board of directors, devise high level management strategies, employ creative thinking, and maximize the value of the company over the long term.
3. In addition to organizing a management team and achieving the above objectives, the CEO should present plans regarding his or her successor to the nominating committee on an annual basis.
4. The CEO should not be a member of the nominating, compensation or audit committees .
5. The CEO should be responsible for making explanations to the board of directors and each Committee.

Principle 9: Executive Management Committee

1. An executive management committee should be set up under the CEO.
2. The executive management committee should assist the CEO in conducting all aspects of the business of the company.
3. Each company needs to be creative in setting the structure, authority and responsibility of the executive management committee so as to facilitate efficient executive decision-making.

Chapter IV Addressing Shareholder Derivative Litigation

Principle 10:Litigation Committee

1. **The litigation committee should assess whether to commence litigation against directors or executives in respect of whom the company or the shareholders have made a claim, to hold them responsible for their conduct. When making this judgment, the committee should broadly consider whether the conduct of the director can be regarded as having been performed in the implementation of a decision made by the company as a whole, whether appropriate sanctions have already been taken against the director, and whether or not the shareholders' requests are fair.**
2. **The litigation committee can be a permanent committee or a temporary committee.**
3. **The majority of members of the litigation committee should be independent directors. None of the members of the committee should be in a relationship of interest with the directors or executives that are the subject of litigation.**

Chapter V Securing Fairness and Transparency for Executive Management

Principle 11:Internal Control

1. **In addition to ensuring the effectiveness of the internal audit and control of the company through the board of directors, various committees, certified public accountants, and a management audit department and related bodies, the CEO should realize a proper governance system, which provides for adequate internal control.**
2. **The audit committee should evaluate the CEO's policies for strengthening internal audit and control.**
3. **The CEO should prepare an annual report on the state of internal audit and control, and include that report in the business report and the securities report, and it is desirable that the report be audited by a certified public accountant.**

Principle 12:Disclosure

1. **The CEO should endeavor to promptly disclose any information which will influence the company stock price so as to ensure that price reflects its fair value, and should immediately notify the securities exchange or make the information public by other appropriate means when such information becomes available. At such times, measures should be taken so that important information is not selectively given to a particular party.**
2. **The CEO should disclose information regularly and whenever necessary in order to show shareholders, investors, employees, customers, and local communities, etc. that the corporation's business affairs have been efficient and fair.**
3. **The CEO should prepare and make public in-house administrative protocols for announcing important information and for preventing insider trading.**

Chapter VI Reporting to the Shareholders and Communicating with Investors

Principle 13: General Meeting of Shareholders

1. **The general meeting of shareholders is important because it provides an opportunity for those people who have invested in the company's shares to participate in the decision-making process of the company to a certain extent, to take part in corporate governance, to obtain information about the current state of the company by asking questions of the executives and receiving their explanations, and to evaluate the qualifications and capabilities of the executives through questions and answers.**
2. **The general meeting of shareholders also provides an opportunity for the directors and executives to report to the shareholders on the company's achievements as the result of the performance of their respective duties. The executive manager's explanations to the shareholders, however, should not be limited to matters pertaining to corporate decisions and reports, but should be comprehensive and include all matters in general that are deemed relevant to the interests of shareholders.**
3. **If executives are unable to answer any question from an investor at the general meeting of shareholders, a full and accurate answer should be forthcoming on the company's web page within a fixed period of time.**

Principle 14 Investor Relations

1. **Executives should be enthusiastic in meeting with analysts and other people who provide information to investors and shareholders, and it is desirable that these analysts and other such people convey to the investors and shareholders their assessment of the qualifications, capabilities, and vision of the executives. As information can be posted simultaneously on the Internet, it is essential that measures are taken to avoid any inequality arising among the investors and shareholders.**

JAPAN CORPORATE GOVERNANCE COMMITTEE

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Comparison of the Revised Corporate Governance Rules and the Old Version

The Corporate Governance Principles were presented after giving due consideration to the current condition of Japanese companies and proposed a two-stage corporate governance introduction. Given the recent changes in both the domestic and international landscape, an appreciation for and understanding of corporate governance has been sufficiently attained. The Revised Corporate Governance Principles are based on the model of genuine corporate governance. The relationship with the old version is as follows:

Old Version	**Revised Version**
Accountability and Disclosure	
Principle 1A	Principle 11, 12
Principle 2A	Principle 7, 11
Principle 3A	Principle 12
Principle 4A	Principle 8
Directors and the Board of Directors	
Principle 5A	Principle 3
Principle 6A	Principle 3
Principle 7A	Principle 1
Principle 8B	Principle 4
Principle 9B	Principle 2, 6
Principle 10B	Principle 5
Auditor and Board of Auditors	
Principle 11A	Principle -
Principle 12A	Principle -
Principle 13B	Principle 6, 7
General Meeting of the Shareholders	
Principle 14A	Principle 13
Principle 15A	Principle 14
Principle 16B	Principle 13

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