Japan Revitalization Vision

(Table of Contents, and Sections Regarding Corporate Governance)

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Seven Pillars of "Japan Revitalization Vision" by the LDP and the Headquarters for Japan's Economic Revitalization

1. Revitalization of Japan by healthy and trustworthy businesses

2. Public funds reform for the improvement of well-being

3. Enhancement of "human power"

4. Drastic financial reform to revitalize Japan

5. Becoming the No.1 country for entrepreneurship

6. Promotion of involvement by active women

7. Achieving results that are tangible, starting from regional economies

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1. Revitalization of Japan by Healthy and Trustworthy Businesses

In order for Japanese businesses to overcome their issues of low profitability and productivity and to regain world-leading competitiveness, it is extremely important that the government and politics develop an environment that makes it easier for companies both to exert their full strength in order to improve their competitiveness, as well as to endeavor autonomously to achieve their potential.

As the concrete means for accomplishing these things, the following are our proposals, which are far more in-depth than the existing ones, concerning such matters as introducing measures to unwind and restrict cross-shareholdings, the promotion of independent outside directors, and the adoption of a Corporate Governance Code.

(1) Corporate Tax

- Growth Oriented Corporate Tax Reform

In our "2012 Campaign Pledges" and the "Campaign Pledges for the Upper House Elections in 2013", the LDP pledged a "drastic reduction of corporate tax" from the standpoint of strengthening Japan's locational competitiveness.

Among OECD member countries, Japan is said to impose both a higher corporate tax rate as well as a higher corporate tax burden ratio. In order to encourage both Japanese and foreign corporations to make new investments, hire more people, and expand their business in Japan, we need to press forward with corporate tax reform in a way that both the timeframe and targets are predictable to some extent.

As for corporate taxation, a structural reform to "lower tax rates while expanding taxable bases," as seen in other countries, will be undertaken. Through these reforms, a "growth-oriented corporate tax system" will be established while also pursuing fiscal health.

(2) Corporate Governance Reform to Enhance Competitiveness

In the "interim proposal" prepared by LDP last year, we pointed out that one of the major reasons why Japanese corporations are losing ground in international competitiveness is insufficient corporate governance functionality and the low profitability, from an international perspective, resulting from that. This has resulted in a sluggish level of inward direct investment. In order as well to realize our plan to double inward direct investment by 2020, which is part of our "Japan Revitalization Strategy," we made it clear that corporate governance reform was essential. Is it not an important mission of government and politics to

develop an environment that makes it easier for companies both to exert their full strength in order to improve their competitiveness, as well as to endeavor autonomously to achieve their potential?

To be more concrete, the LDP has suggested a number of reforms relating to corporate governance in the broad sense, namely: promoting the definite addition of at least one independent outside director; doing away with "cross-shareholdings" and "inactive shareholders"; stricter regulation of equity holdings by banks; and, through drastic reform of such things as public and quasi-public fund management, such as at the GPIF, aiming to improve corporate profitability, fund management results and ultimately pension fund finances through constructive dialogue as fund managers.

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Following active discussions within the LDP, the government first made changes to the government's initial bill for the revision of the Company Law, and submitted the bill to the extraordinary Diet session last autumn. The bill included a de-facto obligation [to have] at least one outside director, while retaining the "comply-or-explain" framework. Also, by means of a reform [policy] based on "The Report Compiled by the Expert Panel on Fund Management Policy and Organizational Reforms of Pension Funds including the GPIF (November 2013)", actions were taken to pursue more advanced management and risk management, while also pursuing greater diversification of investment. Now is the time when establishing strong corporate governance structures at the GPIF based on the proposals expressed in the report, which are appropriate for supporting the management policy changes described above, should be undertaken quickly, and we call on the government to accelerate its consideration of it (including considering the need to change the laws).

During this period, the need to promote the dissolution of "cross-shareholdings" and "inactive shareholders" increased all the more. Especially with regard to the issue of some mega-banks' lending to anti-social entities, the role for independent directors has been brought into greater focus, and it is increasingly noted that given the role that banks play in society, their corporate governance should be of a higher quality than that of general corporations..

Therefore, the LDP and the Headquarters for Japan's Economic Revitalization are proposing the implementation of further reforms to strengthen corporate governance, as follows.

Rules on independent directors of listed companies

			Japan	UK	Germany	France	US	Korea
Mandatory Rule			–	–	–	–	**Majority** of the board (Listing Rules)	**Not less than 1/4** (Commercial Act)
Comply or Explain Rule	Comply Rule on independent directors		**At least one or more** (Amended Listing Rules)	**At least half** of the board, excluding the chairman (Corporate Governance Code)	**Adequate number** (Corporate Governance Code)	**Half** of the board (Corporate Governance Code)	–	–
		Legal Basis	Amended Listing Rules	Corporate Governance Code	Corporate Governance Code	Corporate Governance Code		
		Regulatory Body	Stock Exchange	Independent Legal Entity	Government Commission	Enterprise Association		
	Explain Rule		Verbal explanation at the shareholders' meeting	Disclosure	Disclosure	Disclosure		
		Legal Basis	Amendment Bill of the Companies Act	Listing Rules	Stock Corporation Act	Commercial Code		
(Reference)	Corporate Governance Code		–	✓	✓	✓	–	–
	Stewardship Code		✓ (Feb.2014)	✓	–	–		

"Comply or Explain"… Under this regulatory approach, regulators set out a rule, which companies may either comply with, or if they do not comply, explain publicly why they do not. The purpose of this approach is to let the stakeholders decide whether the companies' determination is appropriate or not.

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Ranking by Patent Acquisitions in the US and ROE (2013)			
Ranking	Company (nationality)	No. patents obtained	ROE (%)
1	IBM (US)	6809	79.1
2	Samsung Electric(Korea)	4676	18.8*
3	Canon (Japan)	3825	8.7*
4	Sony (Japan)	3098	2
5	Microsoft (US)	2660	30.1
6	Panasonic (Japan)	2601	-47.2
7	Toshiba (Japan)	2416	8.2
8	Hon Hai Precision Industry （Taiwan）	2279	15.5*
9	Qualcomm（US）	2103	19.7
10	LG Electric（Korea）	1947	0.5*
	*No. of patents obtained in the US ： USPTO data ROE: Thomson One Banker ＊ 2012 data		

● Unwinding of Cross-Shareholdings, and Stricter Regulation of Equity Holdings by Banks and Other Financial Institutions

As suggested in the [2013] "interim proposal," cross-shareholdings and equity holdings by banks and other financial institutions have been one of the reasons for the stagnating "metabolism" of industry, by removing a sense of tension from corporate management, in Japan for a long time. Reflecting on this, with regard to institutional investors, through such means as the introduction of a "Japanese-Version Stewardship Code" in February of this year we are enhancing our efforts to clarify things such as the general rules regarding their responsibility as fiduciaries to explain to their own investors about how they exercised equity ownership rights, including voting rights.

However, while this is achieving a certain level of improvement, in order to further raise the profitability of Japanese companies, and to boost their latent growth potential across the board by speeding up economic "metabolism" and promoting more economic activity, "cross-shareholdings" and "equity holdings by inactive investors" need to be done away with as part of corporate governance reform.

● Introduction of Measures to Restrict Cross-Shareholdings and Consideration of Mandatory Disclosure

The current state of exercise of voting rights regarding cross-shareholding equities should be considered. Similarly, banks should be made to have a higher sense of "stewardship" (fiduciary responsibility) by requiring them, when disclosing in their annual securities reports why they own "strategic equity holdings," reasons that are more specific than just the fact that they are lending clients. Furthermore, in order to avert "conflicts of interest" arising from their being both creditor or business counterparty on the one hand, and general shareholder on the other, the current state of equity holdings by banks in listed companies or their group companies to which they are lending money should be considered. Moreover, to further promote such trends, measures taken in other countries to encourage the dissolution of cross-shareholdings and to develop the individual investor base should be studied. In addition, with respect to the NISA system introduced at the beginning of this year, by seeking to understand the status of its usage and evaluating its impact, we will continue to consider such things as its effectiveness in developing the individual investor base.

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● Measures to Mitigate the Impact on Share Prices from the Unwinding of Cross-Shareholdings

Unwinding cross-shareholdings or decreasing "strategic equity holdings" by banks, may lead to an increase in the amount of shares sold in the stock market, which may impact stock prices. In order to avoid this, we need to simultaneously consider structures to enable selling outside of the market. In particular, it is thought that banks have a strong desire to avoid equity selling that may cause price declines of shares of companies to which they extend loans. Therefore, in addition to developing plans for orderly dispositions over time, design of a framework (including utilization of a Banks' Shareholdings Purchasing Corporation, and efforts to improve the attractiveness of the sold equities as an [investment] product) to absorb such shares are indispensable.

● Promotion of Independent Outside Directors

For the enhancement of corporate governance, in addition to adequately reflecting the voices of shareholders, strengthening supervision from within the company, by its directors, of management is also important.

To this end, further steps should be taken to promote the introduction of independent outside directors, starting with the Corporate Governance Code discussed later below. This should be done with due consideration of the intent of the government and ruling parties in drafting the requirement, made part of the most recent amendment to the Company Law, to undertake a review of various items, including possibly requiring outside director(s)[on a mandatory basis], within two years after the amendment took force.

Especially with banks, the problems related to loans to anti-social forces by certain mega-banks have led many to focus once again on strengthening corporate governance at banks. First of all, this issue should be considered sufficiently in light of the role that banks play in society, including the fact that ① financial institutions should be "mentors" for their lending customers, including being role models for corporate governance; ② banks are social entities protected by the deposit guarantee system, which may require possible infusions of taxpayer money to protect depositors; and ③ as they may, for example, have to deal with anti-social forces, financial institutions have greater social responsibilities than general companies. On top of that, the meaning of the provision in the amendment of the Company Law requiring a review within two years of the rules regarding outside directors should also be considered.

Therefore, to be more explicit, if results are insufficient by the second anniversary of the revised Company Law becoming effective, both "listed financial holding companies" and "listed banks" should be strongly encouraged to add at least one, and where possible multiple, independent outside directors. This should be done while keeping in mind the possibility of requiring multiple outside directors by revising the Banking Act. Also, the appointment of independent outside directors at "100% owned bank subsidiaries" should be considered.

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● Adoption of a Corporate Governance Code

In February of this year, as suggested in the "Japan Revitalization Strategy," the "Japan Version Stewardship Code" was introduced, defining the responsibility of fiduciaries, including how institutional investors should engage with the companies in which they invest. Through good dialogue, actions of corporate management and institutional investors became more sophisticated. However, in European counties such as the UK, France and Germany, a "Corporate Governance Code" sets forth the best practices for corporate governance, including the introduction of independent board directors, and standardized disclosure regarding such matters, under the principle of "comply or explain." Such "Codes" give a concrete picture of corporate governance.

In Japan, we propose the creation of a similar Corporate Governance Code. This Code should set forth concretely how corporate governance of Japanese listed companies should be conducted, including the following: introduction of independent directors; ensuring transparency in the procedures for nominating senior personnel such as directors and in

determining compensation; separating the management supervision function from the execution function; and rules regarding director/executive training. Companies would then have to give due regard to those principles, under the rule of “comply or explain”.

To be concrete, first, a panel of various experts, with the support of the Tokyo Stock Exchange (TSE) and the FSA serving as joint secretariats, would prepare the basic concept of the Corporate Governance Code by this autumn, based upon best practices and OECD principles. Based on that, the TSE would promulgate the actual Corporate Governance Code in time for the general shareholders’ meetings season next year, while the FSA would request the TSE to clearly specify the “comply or explain” rules for the Corporate Governance Code in its TSE listing standards.

In this process, the status of executive officers and their duty of loyalty - which are not set forth in the existing Company Law - will be clarified. Furthermore, effectiveness of corporate governance will be improved by requiring directors who are well-balanced in terms of experience, independence and knowledge, and by requiring management to disclose and explain their corporate governance arrangements. It is also necessary to design systems for enhancing whistleblower systems or for using them, through such means as making a joint committee comprising outside directors and statutory auditors receive whistleblower reports.

● For Instance, the Following Items Could be Mentioned in the Corporate Governance Code:

① Independent outside directors

For instance, in a Corporate Governance Code that reflects best practices (or a concrete picture of how corporate governance should be), the “effort” to select an independent outside director that is presently required by the TSE listing standards should be made a “duty,” and companies unable to meet the requirement will be required to disclose their reasons for not meeting the requirement.

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（Code proposal）

- Issuers of listed stocks must secure at least two independent directors.
- If a company does not have at least two independent directors, the company’s reasons for not having more than two independent directors must be explained at the general shareholders’ meeting for that business year.

② Shareholders’ voice

Corporate governance mainly regulates the relationship between shareholders and corporate management. However, often the discussion has been about how to discipline management.

In order to improve the effectiveness of reinforced governance, it is necessary that shareholders also fulfill their role. In other words, institutional investors should raise their self-awareness as shareholders, and should express their voices more so as to improve corporate earnings. [In turn], listed companies should not be substantially different from institutional investors in the sense that they have responsibility as fiduciaries to their shareholders.

（Code proposal）

- To enhance corporate value in a sustained manner and encourage corporate growth, shareholders should exercise their rights in a responsible manner. Specifically, shareholders should do the following when exercising voting rights:
  -- when selecting a director, shareholders should carefully review the qualifications and independence of the candidate to ensure that the director will fulfill his or her responsibilities
  -- in order to encourage medium to long-term growth of the company, sophisticated decisions should be made, balancing investing in improving productivity and providing returns to shareholders,
  -- issuers of listed stocks must sufficiently disclose information that is needed for the above purposes

- In particular, institutional investors should accept the principles for satisfying their fiduciary responsibilities (i.e., the "Japan Version of Stewardship Code"), and disclose their policies for voting and past voting record.

③ Cross-shareholdings

In the Cabinet Office Ordinance, when listed shares with voting rights are held for "strategic" purposes (i.e., purposes other than pure investment), and when the book value of the shares of a given company exceeds 1% of capital stock, disclosure of the number of shares, their book value, as well as the specific purpose of the holding is required. However, the requirement only goes as far as "disclosure".

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In addition to the disclosure requirement set forth in the Cabinet Office Ordinance, we could provide as follows in order to add an obligation to explain why they are holding the shares, as well as to clarify the requirement (i.e., the foundation for "comply").

（Code proposal）

- So-called cross-shareholdings for strategic purposes risk hindering appropriate governance with respect to such matters as pursuing profit and providing returns to

shareholders, and create a latent conflict of interest with general shareholders. Therefore, such strategic cross-shareholding should be minimized as much as possible, unless there is a reasonable reason.

- Where shares are cross-held for strategic purposes, in addition to the specific strategic purpose, the rationality of holding of the stocks should be explained (e.g., banks providing new capital to "intensive control" (*hatan kenen-saki*) companies for revitalization, or the need to increase capital to raise corporate value in a DIP situation or where a debt-equity swap will be conducted if necessary).

- Review of the Legal System for Business Revitalization and the Practical Application Thereof

To further enhance the "metabolism" of businesses and industries in Japan, the legal system for business revitalization and the practical application thereof should be reviewed from the perspective of realizing early business revitalization. This would include: examining the status of related laws and rules (including those relating to voluntary liquidations) so that business revitalizations are not hindered by unreasonable opposition from minority creditors; promoting usage of the "Guidelines for the Guarantee by Business Owners," which supports attempts to smoothly change business lines or to discontinue operations; and expanding the scope of "Specified Monetary Claims" under the Servicer Law, so that servicers can more flexibly engage in corporate revitalization operations.