

Interim Proposal on Independent Director System

“Who Is Superior to a Company’s Management? -- Independent Directors Are a Demand of a Market Economy Striving for Sustained Development of Corporate Enterprises”

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Japan Association of Corporate Directors

Committee on Independent Directors

Position of this Proposal

In response to the global financial and economic crises stemming from the so-called “Lehman shock,” various questions have been raised with respect to views on a viable form of corporate governance, for which the American model is generally considered to prevail, as well as the independent director system. For the long-term, continuing and sound performance of each corporate enterprise, as a power structure comprising an organized body of human beings, is a goal. However, it is an unchangeable mandate that each governance mechanism be appropriately designed and operated in accord with the reality of human beings. In all ages and civilizations, one fundamental idea for the basic principles of corporate governance has been that within each and every organized power structure, there should be no organ, whether an individual person or a collective body, that has no substantially superior structure to report to. If it is assumed that the American model fell on some stumbling blocks, we should consider that the American principles of corporate governance, and the governance model derived from such principles, had some systematic and operational defects, which practically prevented the American model from performing its intended functions. Those defects had some inherent risk of the creation of supreme power-wielders within a company, who were not exposed to the supervisory or checking functions of anybody else, so long as they were boosting the company’s short-term results and stock price, as in the cases of CEOs of some companies.

Based on this awareness of the problem, the Committee on Independent Directors (the “Committee”) in the Japan Association of Corporate Directors sheds light on the actual conditions of management organizations of Japanese companies (mainly, listed companies), and in particular, on the respective specific situations of individuals (members of the management team, directors, corporate auditors, shareholders, etc.) who, in various positions, participate in, are involved in or related to, or have stakes in, the board of directors of a company, which is substantially the highest decision-making body of a company. By so doing, the Committee pursues the long-term, sustained and sound development of Japanese companies in the reality of global market competition. For this purpose, the Committee is committed to verify the necessity of “independent directors” and to evaluate their effectiveness, as the subject matter of our substantial discussions, and to study what we need in order to enhance the effective performance of “independent directors” in Japan’s corporate management culture and social structure. This Proposal is a proposal at an interim stage of these efforts.

Independent Directors Are Important for Supervisory and Checking Functions over a Company’s Management

The principal role required of independent directors of a company is to present an appropriate corporate posture within the company from the viewpoint of the company’s persisting and long-term development and enhancement of its enterprise value, even in cases where the internal directors are alone unable to act appropriately due to fetters and strings binding them, and other internal circumstances.

If a company’s management attempts to choose an inappropriate measure, with a view to the company’s persisting and long-term development and enhancement of its enterprise value, it will often be very difficult to expect the internal directors, who have been selected within the hierarchical structure of the company, to critically discuss the management’s action. In particular, at stages where the company or its management falls into a pathological situation, or there appear to be signs of such a situation, the logic of internal management may involve significant risks, as shown by many cases of corporate scandals and failures. Independent directors who are independent from the company management, free from fetters and strings within the company, are expected to perform a certain level of supervisory and checking functions over the company’s management. There are voices from among institutional investors and general shareholders which expect independent directors to assume, on behalf of them, certain supervisory and checking functions over the management of the relevant company. In addition, if a company is equipped with a board of directors containing some who are in an independent position, free from control of the company’s management, it will be easier for the company to obtain acknowledgement in global capital markets, and the company is more likely to receive a high evaluation for its

corporate governance, and therefore, to ensure that its share price is highly appreciated on a long-term and stabilized basis.

Of course, individual shareholders do not own a company's shares perpetually, but are destined to make demands upon the company from their respective own interest-oriented motives. If we understand that a listed company belongs to a "global market" for unlimited chains of shareholding, temporally and spatially, including future shareholders, however, we see no substantial conflicts of interest among the company's management, independent directors and shareholders in enhancing the overall enterprise value of the company on a persistent and long-term basis. Thus, "independent" directors should be regarded as a demand of "reason" of such a global market. This is also a requirement for the sustained development of the world's and Japan's market economy, where the sound and sustained growth of corporate enterprises is equally a fundamental element for both regimes of economy.

In Order for Independent Directors to Fully Perform Their Roles, the Company's Cooperation Is Necessary

Independent directors are required to speak straightforwardly to the company's management, independently from the management, and without hesitation, whenever necessary. In order for independent directors to be able to actually perform this role, it is indispensable that the company's management have the awareness that it is important for them to welcome any appropriate suggestions from the viewpoint of a third-party position, without being caught up in the logic of internal management. The management should thus endeavor to establish, maintain and improve the company's internal environment that is required for the independent directors to perform their duties. For example, it is extremely important, as a practical matter, to build up an environment that allows all necessary information to be appropriately communicated to the independent directors timely, or well in advance when necessary. Without establishing an appropriate internal environment, it is difficult for independent directors to fully perform their roles. Not only electing independent directors but providing the appropriate internal environment for them to fully perform their roles is important.

In Order to Revitalize Japan's Stock Markets, Each Stock Exchange's Self-regulation over Independent Directors Is Useful

Appropriate forms of corporate governance may vary depending on the size, business category, uniqueness and other characteristics of each listed company. In respect of independent directors, it will be helpful that each individual company determines their respective responsive measures in accordance with the relevant market requirements, for example, through self-regulations, such as each stock exchange's disclosure regulations

and listing regulations. It will be important for each listed company to fully explain to each relevant market how to respond to market requirements, through disclosure of various types of information, and by other means of accountability.

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The Committee is committed to further arrange and organize discussions for the appropriate use of independent directors and make necessary proposals, including the following points:

- Who demands independent directors, the corporate system or the markets?
 - Where the market's self-regulation (soft law) is a basic principle and the so-called "comply or explain" principle is adopted, in order to render the responsibility for explanation and proof effective, what are the tasks of the stock exchanges? Is any support pertaining to the legal system required for this purpose?
 - To what tasks can the Japan Association of Corporate Directors (the "Association") contribute?
- On whose interests should the independent directors place priority in performing their duties?
 - Who are the shareholders of the company?
- How should the timeframe be understood for short-time profits and long-term profits?
 - How should we understand the relationship between minority shareholders' interests and majority shareholders' interests?
 - Is an independent director an "agent" for the shareholders, or a "representative" for the company's overall interest?
- What human resources are required for independent directors? Where are they found?
 - With respect to the term "independent" human resources, from whom should required human resources be independent, and from what perspective should they be independent?
 - Is it necessary for us to study what specific acts independent directors should carry out, and in what cases they should be held legally liable?
 - What are the capacity requirements for independent directors to be able to perform their duties?

- Is it necessary to provide places for training and education, and furthermore, for resource pooling, in order to cause prospective human resources for independent directors to meet the capacity requirements for independent directors? What are the roles that the Association can perform in this respect?
- What ingenuities are imaginable to ensure the effectiveness of independent directors' performance of their duties? In cases of independent directors who concurrently hold a director position at several companies, for example, should the number of such companies be limited?
- How will information disparity between the independent directors and the internal directors of a company affect the effectiveness of the company's corporate governance? What are some imaginable devices to minimize such information disparity and its impact, while maintaining the independence of the independent directors?
- How should the respective roles of the independent directors and the corporate auditors (*kansayaku*) /board of corporate auditors of a company be arranged and coordinated?
 - The corporate auditors of a company are not members of the board of directors of the company, and have no voting rights in board meetings. What effects does this fact have in arranging and coordinating the respective roles of the independent directors and the corporate auditors/board of corporate auditors?
 - Japan's corporate auditor system is a unique corporate governance system in the world. In reality, does the system fully perform its required functions? Furthermore, can we bring people to understand its validity, and persuade the world's market participants?

Endorsed By

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About JACD

Founded on the highest ethical principles, the Japan Association of Corporate Directors (JACD) is a forum for practicing executives to study and experiment with corporate governance. The Association was founded on March 13th, 2002.

JACD's 250 members represent corporate executives, institutional investors, lawyers, accountants and university professors.

JACD Mission

JACD is a group of CEOs and corporate directors whose aim is to encourage Japanese companies to take an active interest in corporate governance and to become more competitive globally through the study of governance and management.

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