2020 PROXY SEASON PREVIEW

JAPAN

GLASS LEWIS

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Key Regulatory Updates

In 2019 the Council of Experts on the Stewardship Code (the "Council") announced a review of Japan's Stewardship Code. The Stewardship Code, originally published in February 2014 and updated in May 2017, is an effort to promote greater transparency among investor groups with respect to the handling of responsible investment activities.

The Council published the first draft of the Revised Code in December 2019, and following public consolation regarding the proposed changes, released the finalization of the Revised Code in March 2020.

The Revised Code, which maintains the existing "comply-or-explain" approach, introduces an increased focus on environmental, social, and governance ("ESG") considerations, and recommends that investors improve disclosure concerning the rationale for their voting decisions, their stewardship activities with companies, and a self-evaluation of their stewardship activities. In addition, the Revised Code introduces a new section focusing on service providers, including proxy advisors, with a focus on identifying and managing conflicts of interest, and increased engagement with companies.

Market Trends

SHAREHOLDER ACTIVISM

Changes brought about by Japan's governance and stewardship codes, including the gradual unwinding of cross-shareholding structures and decrease of stable shareholders, seem to have emboldened activist activity and encouraged other investors to offer support.

Thus far, 2020 has started out as a strong year for shareholder activism in Japan. Several meetings, including Toshiba Machine Co., Ltd. and Kirin Holdings Company, Limited, have already attracted significant interest from investors. While the activists in these cases were ultimately unsuccessful, they received significant support, which will place the companies under pressure to pay more attention to shareholder demands going forward. Meanwhile, SUN CORPORATION provided a more successful venture for activist shareholders, with the successful ousting of four incumbent directors, including the president, and the appointment of five directors nominated by the activist shareholders.

We expect to see more shareholder proposals in upcoming meetings as activists continue to take a more active role in trying to influence management decisions.

INDEPENDENT DIRECTORS

Following legislative and regulatory efforts to strengthen Japan's corporate governance practice, we have observed notable improvements and encouraging trends in the past few years. The Japan Corporate Governance Code, which was last amended in June 2018, recommends that companies appoint two independent directors; and the Companies Act, which was amended in December 2019 (changes to take effect by June 2021), will now require at least one outside director for large public companies.

However, in recent times, it has been institutional investors, both domestic and foreign, that have pushed for more independent representation on the boards of Japanese companies. These institutional investors have tighter board thresholds than those of the Corporate Governance Code, with some now seeking a minimum of one-third board independence. Given the stricter independence standards imposed by investors, we expect to observe more companies appointing multiple independent directors in response, particularly amongst large companies.

COVID-19

As a result of the nationwide state of emergency declared in April 2020, Japanese companies have already begun to delay their financial reports. Travel restrictions have made it difficult for auditors to complete their work, and companies have faced additional obstacles to accurately gathering financial information. Furthermore, a small number of companies have also delayed their annual general meeting as a result of COVID 19.

Tokyo Stock Exchange rules normally require companies to disclose their full year results within a period of 45 days from the end of their financial year. However, taking into account the impact of COVID 19, this deadline has been removed, with the disclosure to be accepted whenever they are settled. Any company which is expected to experience a significant delay is requested to consider disclosing that information in a timely manner.

Similarly, the current Financial Instruments and Exchange Act state that companies must submit their pe-

riodical financial statement report within three months of the end of their fiscal year. However, given the difficulty of gathering accurate financial information, the Financial Services Agency will revise the Financial Instruments and Exchange Act to allow for the submission of corporate securities reports to be extended to the end of September.

Companies in Japan are also considering the possibility of holding hybrid annual general meetings. This structure would allow shareholders to participate electronically in conjunction with a physical meeting. While the current corporate law requires companies to set a physical venue for a meeting, on February 26, 2020, the Ministry of Economy, Trade and Industry ("METI") released guidance that a hybrid meeting structure was permissible. Further, on April 2, METI, together with the Ministry of Justice, released guidance that companies may restrict the number of shareholders in attendance at a physical meeting, and may in fact host a meeting without any shareholders being physically present.

Companies in Japan are legally required to disclose their notice of meeting a minimum of 14 days before the meeting date. In recent years there has been an increase in companies which have chosen to disclose their notice of meeting earlier than this legally required deadline, which provides shareholders with additional time to consider their voting options. However, given the dynamic situation resulting from COVID 19, it is possible that this year will see an increase in the number of companies disclosing only 14 days in advance.

GENDER DIVERSITY

Glass Lewis recognizes the importance of ensuring that the board is composed of directors who have a diversity of skills, thought and experience, as such diversity benefits companies by providing a broad range of perspectives and insights.

In Japan, since June 2018 the Corporate Governance Code has encouraged listed companies to include women on their boards to address the issue of the Japanese business world being dominated by men. In addition, it encourages members with an international background to be included. It appears that gender role expectations ingrained throughout Japanese society have impeded the progress of gender diversity in corporate Japan. While regulators and investors push for board gender diversity, we also note that companies have been struggling to find qualified female board candidates. While we believe that there should already be sufficiently qualified female candidates in Japan, we strongly encourage Japanese companies to implement sufficient gender diversity policies and programs aimed at expanding the pool of future female candidates for executive positions, which in turn will expand the pool of future female outside officer candidates with business experience among Japanese companies.

Glass Lewis will continue to closely review the composition of the board. For companies listed on the First and Second section of the Tokyo Stock Exchange, we will recommend against members of a board that does not have any incumbent or proposed female members. In such instances, we will generally recommend voting against the chair of the company (or the most senior executive in the absence of a company chair) under the two-tier board or one-tier with one committee structures, or against the nominating committee chair under a one-tier with three committees structure. In the case of a two-tier board structure, we will examine the board of directors and board of statutory auditors as a whole, and in the cases of one-tier with three committee structures, we will consider whether the company has any female executive officers as well as female directors.

However, when making these voting recommendations, we will carefully review a company's disclosure on its diversity considerations and may refrain from recommending shareholders vote against directors for this issue alone when the company has provided a sufficient rationale for not having any female board members or has disclosed a plan to address the board's lack of diversity.

STRATEGIC SHAREHOLDING

Strategic shareholding – when companies hold shares of business partners, creditors and listed companies for the purpose of maintaining business relationships – separates economic interest from voting rights and shields management from the corrective pressure of the capital market. In most cases, companies in which the company holds strategic shares also in turn hold shares of the company, a phenomenon commonly labeled as "cross-shareholding."

The practice of strategic shareholding not only exposes shareholders to undisclosed risks, but also enables management to utilize shareholders' capital for their own self-preservation. Under Japanese accounting rules, if the market value of securities in which a company has invested falls below 50% of the purchase price, the company is required to record the loss on its balance sheet. Often the returns on these investments are disproportionate to the risks, as evidenced by a number of companies which have recorded or are expected to record losses related to their recent securities investments due to market volatility. Thus, management effectively creates fiscally nonsensical, relationship-building partnerships using shareholder capital. Although the board might personally benefit, shareholders do not derive any value.

In response to criticisms of strategic shareholding, the Japan Corporate Governance Code now suggests

companies disclose their general policy on strategic shareholdings and conduct annual reviews regarding the rationale and objectives. Furthermore, in January 2019, the Financial Service Agencies amended the Cabinet Office Order on Disclosure of Corporate Affairs ("Amended Cabinet Office Order"), to require companies to disclose their 60 largest equity holdings ,as well as the reason for such holdings, and the state of any cross-shareholding relationships in the securities report. The Amended Cabinet Office Order is effective from the end of the March 2019 fiscal year.

In 2020, we will not make voting recommendations solely on the basis of excessive strategic shareholding; rather, it will be one of many considerations we make when evaluating a company's oversight structures. However, we are cognizant of the aforementioned concerns regarding both general security investment practices and cross-shareholding relationships in Japan. As such, beginning from 2021, Glass Lewis will generally recommend voting against the chair of the company (or the most senior executive in the absence of a company chair) when the size of strategic shares held by the company exceeds 10% of net assets, as disclosed in the securities report the previous fiscal year.

When making these voting recommendations, we will carefully review a company's disclosure of its strategic shareholding policies and practices and may refrain from recommending shareholders vote against directors for this issue alone when the company has disclosed a clear plan to reduce the size of its strategic shareholdings or has a track record of reducing such shares.

COVID-19

Glass Lewis expects all governance issues and most proposal types to be impacted by the pandemic and we will exercise our existing discretion and pragmatism to prioritize timing, certainty, disclosure and voting on any affected proposals. We consider it likely that this will continue to be the case through 2021 and we believe it is important to provide the market with certainty and transparency on our established approach. These areas are of particular relevance for Japan's upcoming proxy season:

INCOMPLETE AUDITED FINANCIAL STATEMENTS AND HYBRID AGM

For the upcoming Japanese proxy season, we expect that a notable number of companies may choose to hold hybrid annual general meetings as described above. In such cases, the companies may have limited information such as director attendance, compensation and independent auditor report in their proxy materials, which are disclosed in the business report for the most recent fiscal year. Under such circumstances, we generally do not support proposals such as election of directors and statutory auditors and appointment of auditors due to lack of limited information. However, given the effect of COVID-19 on companies' auditing process, we may refrain from recommending against any nominees or proposals solely based on lack of disclosure of these materials at this time. However, we will monitor and hold to account such nominees at future meetings if this material is not released in a timely manner after the meeting.

ALLOCATION OF PROFIT

With limited exceptions, Glass Lewis will generally support the dividend policy proposed by a company. However, in light of the global market volatility and uncertainty caused by the COVID-19 pandemic, we believe a cautious approach to dividend distributions by certain companies, especially insurance and financial institutions, would be prudent. Given the circumstances, we generally support decisions by boards to take a cautious approach to capital management for the time being, including deferral of dividend payments, reduction of payout ratios, or suspension of dividend distributions, provided the company provides a compelling rationale for any material change in policy. Companies who provide such a compelling rationale, should ensure that rationale is consistent with other decisions they make on governance issues such as remuneration.

ADOPTION OR RENEWAL OF TAKEOVER DEFENSE PLAN DURING PANDEMIC

Glass Lewis generally opposes the adoption or renewal of takeover defense plans, as these provisions carry the potential to reduce management accountability by substantially limiting opportunities for corporate takeovers.

However, we are supportive of takeover defense plans that meet certain conditions, particularly those that are limited in scope to accomplish a particular objective. As described in greater detail in our Japan policy guidelines and Poison Pills and Coronavirus: Understanding Glass Lewis' Contextual Policy Approach, we are supportive of takeover defense plans that meet certain conditions to accomplish a particular objective. This objective may include the closing of an important merger, managing a clear and present hostile takeover threat, or other contextual factors like a severe drop in stock price due to a widespread industry or market downturn.

We consider companies that are impacted by coronavirus and the related economic crisis as reasonable context for adopting a takeover defense plan under the following conditions:

- The duration of the plan is limited to one year or less; and
- The company discloses a sound rationale for adoption of the plan as a result of coronavirus.

If the plan does not meet these conditions, Glass Lewis will recommend opposing the renewal or adoption of takeover defense plan proposals.

If the company fails to put the renewal or adoption of takeover defense plan up for shareholder approval, Glass Lewis will recommend opposing the re-election of chair of the Company (or the most senior executive in the absence of a company chair).

CONCLUSION

As the COVID-19 crisis continues to unfold, and the sweeping fiscal impacts become more apparent, Glass Lewis will continue to apply our contextual approach with the appropriate discretion and pragmatism in making our recommendations.

To learn more about Glass Lewis' approach to the coronavirus and the impacts on governance and our voting recommendations please visit our coronavirus resources page.

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