



After the Crisis: Corporate Governance in Japan

Friday, August 7, 2009

Transcribed Conference Proceedings



JAPAN SOCIETY
OF NORTHERN CALIFORNIA

After the Crisis: Corporate Governance in Japan

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After the Crisis: Corporate Governance in Japan

Executive Summary

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Executive Summary

First, several speakers explored various corporate governance practices for Japan as alternatives to the current norm. Some focused on the role of independent directors as a critical component of best corporate governance practice. However, there were differing opinions regarding the distinctive Japanese model of independent directors. Some suggested that Japanese managers may feel that independent directors might impede decision-making. A few held the traditional view that Japanese companies should try to hold on to the strengths of their current management system even as they adjust to new demands and new market situations. Results of the dialog indicated that one cannot expect a quick convergence on a different model of corporate governance in Japan.

Others encouraged a broader sense of engagement: for example, the importance of developing methods to encourage shareholders to express their needs and desires to management. One speaker suggested possible mechanisms of engagement—specific ways that institutional investors might improve their communication with management.

Regarding corporate governance best practices, several participants mentioned a current area of concern in the United States—executive compensation—suggesting that perhaps compensation issues in Japan might be a reverse situation than in the United States. A few noted that as opposed to American executives in general, Japanese executives in some instances may be underpaid, or their company's incentive system may not be structured to reward risk-takers.

The second theme of the day suggested that changes to Japan's corporate governance systems are already underway. Many voiced cautious optimism here, although such enhancements may not occur as quickly as some would like. Several participants observed that the Japanese government seems to be in favor of these developments.

Many shared the observation that the global financial crisis is not viewed in Tokyo as a vindication that Japanese capitalism is best and the US system of capitalism is inherently corrupt. Japan's overall weakening market—which has declined further during the financial crisis—seemed to fuel this view.

Third, speakers offered suggestions to encourage further change in Japan. To understand how Japan is evolving, panelists examined the level of change at the regulatory (governmental) level as well as the corporate level. Some speakers approached the notion of change cautiously, while others urged more proactive efforts toward change. Some debated the most beneficial approach to change: structural changes within the corporate governance system as a whole, or simply advocating prompt, positive results within the corporate sector.

A Note About this Document

The transcription and translation of the following proceedings are based upon original audio recordings as heard on the particular transcribing equipment used, the quality of the recording provided, the speaking speed, and the content of the conversation as understood by the transcriptionist. The substance of the discussions has not been edited or altered.

The resulting document has been professionally reviewed for punctuation, basic grammar, and general accuracy regarding proper nouns and acronyms. While it is believed to be accurate, it is not warranted to be so.



After the Crisis: Corporate Governance in Japan

Opening Remarks

*Panel I: New Regulatory Developments
in Japanese Corporate Governance*

August 7, 2009

Opening Remarks

Dana Lewis: Thank you everybody for coming. I am Dana Lewis, President of the Japan Society of Northern California, and we're delighted to have so many people here. Now, we're going to have more people arriving through the morning, but I think we should get started. We have a pretty tight schedule for today, and I would like us to begin. Others will be joining us as the morning progresses. This is the third conference on corporate governance in Japan sponsored by the Japan Society of Northern California. We had previous events in 2003 and 2006. On our list of participants, we have people who have been at both of these events: founders of the events, participant speakers, and we also have a lot of new people joining us for the first time.

I hope you all have a chance to meet and talk during the breaks, lunch and at the post-conference reception starting at about five o'clock, which will be upstairs, hopefully, with wonderful views if the San Francisco fog does not come rolling in.

We have the privilege of being joined today by Consul General Yasumasa Nagamine, who is en route to meetings up in Sacramento but has made time in his schedule to come and mark the opening of this conference. I think many of you have met the Consul General. He has been here two years, an incredibly dynamic representative of Japan here in the Bay area, and we're honored to Consul General Nagamine with us today, please.

Yasumasa Nagamine: Thank you, Dana. Good morning, ladies and gentlemen. My name is Yasumasa Nagamine. I am the Consul General of Japan in San Francisco. Whenever I see the abbreviation, like a CG, always I think it refers to Consul General. So, this is a conference about the Consul General? [laughter] I'm a bit nervous, but this time CG stands for Corporate Governance. First of all, thank you very much, Japan Society, for inviting me and my colleague, Mr. Higuchi sitting over there, for this conference. This time the Consul Office is not sponsoring the organization, but to be closely working together with all the organizations, including Japan Society for the promotion of Japan-US relationship. Therefore, I'm delighted and honored to speak at the beginning of this conference.

I am particularly grateful for this conference. I know this is the third of this round of corporate governance of Japan held by the Northern California Japan Society. Of course, corporate governance has been always a subject matter among the Japanese corporate and the Japanese government and also the investors from all over the world.

The core concept is to make the business environment in Japan facilitating the investment from all sources, including the sources from the United States, of course. And the government of Japan has been strongly promoting in the past years the "Invest Japan" campaign, and so I'm sure the conference aim will be somewhat resonated with our effort for inviting investment to Japan from overseas sources.

Also, I'm very delighted that the Japan Society is widening the scope of activities, not only cultural or education or the other areas, but including the core issue of Japan-US business relationship. So, I congratulate the Japan Society to continue to include this very important subject matter. I think that John, sitting over there, a former chairman, initiated

this kind of initiative and that the position has been carried through all these years. I am very delighted to see witness that this area of business is a very center piece of the society's activities.

And also, this conference will provide you with a good opportunity among the Japanese and American business people to get together, and so it has a multiplied effect of this conference than the greater hours we spend together. We need a very strong corporate governance system in Japan, and we need a good review, peer review, by the corporate and the business partners and government partners, too. So, I think this conference will provide such a good opportunity to exchange views about the situation in Japan from the Japanese point of view and the American point of view, too.

I may not be able to participate fully this morning and afternoon, but I want to see that some of the important issues can be included in this conference. First is the leadership, the question of leadership by corporate. I think under the present economic situation what is really necessary is, of course, a good corporate governance system, but at the same time you need a good leadership by corporate.

Also, I'd like to see some aspect of social responsibility of corporate in Japan, especially when at the time of economic crisis, the corporate may concentrate their efforts for the corporate management. But the corporate responsibility for the social issues is also very important, so I would like to see some discussion to be included in this conference. So, with this word I look forward to a very lively discussion during the day, and then I would very much like to associate the debate today from the CG, Consul General, point of view [laughter]. So, thank you very much.

[applause]

Dana Lewis: Thank you very much, Consul General, especially for making time when you're en route to a round of meetings. One of the main supporting organizations of this conference series since its beginning has been the Federal Reserve Bank of San Francisco. We're always grateful for their help and assistance. Today, we have Chris Sigur, Senior Project Analyst and Outreach Coordinator for FRBS with us today, but I also want to point out that he was my predecessor as the president of the Japan Society. He was our President for eight years, and he was here in 2003 at the start of the conference. It is a double pleasure to have Chris come and say a few words on behalf of the Federal Reserve.

Chris Sigur: Thank you, Dana, and good morning and welcome to you all. On behalf of the Federal Reserve Bank of San Francisco and our Country Analysis Unit, I'd like to welcome you all here today and tell you how pleased we are once again for the third time to be part of this series of discussions that the Japan Society hosts on corporate governance in Japan. The Reserve Bank has been honored to be part of the Japan Society's series over the last several years, and we've worked very, very closely with the Society on a number of other programs and events that focus on the financial, economic and banking relationships between the United States and Asia. A regular series that we work with the Society on is our Asia Financial Forum. It's a luncheon series that takes place periodically throughout the year, and most recently the Japan Society was part of



our effort to look at the Asian banking in challenging times at the symposium we held in June. So, the Japan Society is clearly one of our favorite partners, and we're pleased to be here today.

Today's topic of corporate governance is a great concern to our bank and to our Country Analysis Unit. The Country Analysis Unit is part of banking supervision and regulation, and we've been tasked by the Federal Reserve Board to provide ongoing analysis of Asia, specifically the performance of Asian banks and especially those banks that have branches or other representation in the United States.

As part of that analysis we obviously look at many different factors, including how well the parent company is prepared to manage risks and the ups and downs of the marketplace. And clearly, corporate governance is one of the issues that can give us a picture on that.

In conclusion, I think there are really three reasons why we're here today. First, we love the Japan Society. Thank you for giving us that opportunity. We like the programs. We enjoy co-sponsoring the programs with you that give us information and give us a broader perspective on the kinds of things that are happening in Asia.

And then, finally, it's specific events like this where we actually, I think, can really learn something that will benefit the analysis that we do at the bank and promote our activities and so forth.

With that, I just want to thank you again for giving us the opportunity to be here as part of this program, and I'm looking forward to a great conference.

[applause]

Dana Lewis: Now, I'd like to call up our current chairman, David Lyon, Chairman of the Board of the Japan Society and Founder of the Public Policy Institute of California, and back in the days of US-Japan trade conflicts the Japan Center at Rand Corporation, to say a few words. Thank you.

David Lyon: Good morning, everybody. I have the pleasure this morning of acknowledging the number of people who are at institutions that have supported these enterprises. Before I do, I don't know how many of you read the New York Times Op-Ed page this morning, but there was an article there and featured a story about the future growth of the Japanese economy, and it stressed the importance of the internal credit markets as a way for the country to grow in the future, and not trade and export of Japanese products. It's very provocative and an indication of the kind of challenge that the Japanese economy and government and corporations face in the future. So, I wanted to congratulate them for getting that article published on the day of the conference, highlighting what a challenge is facing the Japanese economy and the fact that the New York Times actually pays attention to what's actually going on in San Francisco.

Let me also say that this is exciting. I think the fact that the Consul General recognized John Thomas is really important. John worked hard to get this series started. Chris backed



him; he was president, and this is great to have it as a periodic event and I'm hopeful this will be in the future.

So, let me get right to the credits. We want to start at the top at Union Bank and Union Bank's CEO, Masaaki Tanaka, one of the board members here; he's our lead underwriter and luncheon speaker for today's conference and supporting that event and all together with the Bank of Tokyo.

Secondly, Mizuho Securities USA and Director, Hiroshi Matsui, head of their San Francisco office, we appreciate your support. They are sponsoring tonight's post-conference reception.

We'd also like to thank the law offices of David Makman, San Francisco and the Japan Foundation Center for Global Partnership. They're also sponsors in helping us underwrite this event.

Our co-organizers, the Federal Reserve Bank and Chris, mentioned the Pacific Pension Institute. Marsha Vande Berg is their CEO. Also, the California Asia Business Council. I think there is somebody here from that council. Would they raise their hand? Way back there. I think that's Jeremy. Is that right, Jeremy? Thank you for coming and thanks to that organization for their support.

Our conference airline sponsor has been All Nippon Airways, and last but hardly least, I want to extend on behalf of the Board and all of us here who are benefiting from this incredible work that our staff has done to make this conference possible, and especially Susan Parini. Let's have a hand for Susan. She's really done an outstanding job.

[applause]

David Lyon: She's been working on this for a long time, and it's good to see it finally reach fruition. So, again, thank you all for coming. It's my pleasure as Chairman to see this kind of event happen, and it also gives you some indication of the amount of work that goes into just the fundraising that makes this kind of thing possible. Our appreciation to everyone for providing this. Dana, over to you unless... Let's get this on. [applause]

Dana Lewis: So, thank you. Sarah, you and your panelists can come up. Our first panel is on new regulatory developments in the Japanese corporate governance. It will be moderated by Sarah McLellan. As Vice President of Morgan Stanley, she just flew in for today and has to fly out again before the end of the day, but we're happy to have her. The other speakers can come up.

New Regulatory Developments in Japanese Corporate Governance

Sarah McLellan: Good morning, everybody. My name is Sarah McLellan. Thank you, Dana, for that introduction. On behalf of the Japan Society I welcome you to our first panel discussion on the regulatory aspect of this issue. I see many familiar faces in the crowd, and I'm not alone in saying that it's wonderful to be back here for the third conference. About a year ago we were sitting in David Makman's office, and we were discussing all of these reports that were coming out. There was a report from the Asian Corporate Governance Association, an ACGA white paper. There was the corporate value study group's report, and then we were talking about the survey for the Tokyo Stock Exchange that was geared towards particularly foreign investors.

It struck us that it's about that time for a need to have another one of these things, and certainly it's been enough time, about two or three years. Having it in these two- or three-year increments gives us the opportunity to look back and say, "Were we overly optimistic or overly pessimistic, or what were the different factors? And what are some of the new pieces of the puzzle that we face today that will, in turn, form our expectations going forward?"

Some of them come from both the financial and the foreign side of things, kind of a double whammy. It's the regulatory piece that is often the biggest question mark, the biggest variable. So, I was talking to one of our panelists—one of our panelists up here to my right—last week, and I was saying how memorable his presentation was for me at the last conference. And I think he thought I was kidding and I was trying to win over some favor with him, but because for those of us that are observing the regulatory piece, it's very insightful to hear from these experts today on what is happening in Japan and what we can expect of the regulators and also the government.

So, joining me on stage today, to the far right, is Nick Benes. He is returning to the Japan Society conference. He is President of JTP Corporation, which is an independent consulting firm specializing in M&A and other financial-type transactions. Nick brings both the legal and the business background to our panel discussion.

He also chairs the FDI Committee at the ACCJ, the American Chamber of Commerce Japan, which has published some viewpoints recently about some of the issues we are going to discuss in depth today. Nick also will enlighten us with his comparative understanding of Japan versus the West and where are the differences, where, maybe, some areas are lacking or surprisingly exposed. So, more on that later.

To his left is Stephen Codrington. Stephen is the CEO of Codrington Corporate Governance Japan, CCGJ, which is a corporate governance advisory company. He engages with management teams on behalf of their clients, and in that process he also interacts with pension funds. We'll get into pension funds, regulatories, bureaucrats and so forth.

So, we have those two perspectives, and in addition we have Professor Kenichi Osugi from Chuo Law School. He is the Professor of Corporate Law & Securities Regulation. He also, in addition to his academic research and background, brings his first-hand

experience with METI, the Ministry of Economy, Trade and Industry, where he has served as a member of corporate value and corporate government study groups.

As many of you know, the corporate governance study group recently published opinion reports and he is going to provide us some more details on that and how we can expect, what are the implications going to be for that report.

So, before we get started, as the first panel I just want to let you know the formats. Each panelist will spend about 10- to 15 minutes going over their individual presentations, giving us an overview of the subject. Then, we're going to open it up to all of you.

I encourage you to just jot down some notes. We're going to make this a real lively discussion and make it helpful and informative to all of you. So, without further ado, Stephen, come on out.

Stephen Codrington: Thank you very much, Sarah. So, good morning to everybody. A quote on the first slide here, a quotation from Derek Hicks which came to me from [inaudible] corporate governance some years ago because it makes a very important point that corporate governance is more than just the structural issues. The responsibilities of the board to shareholders are paramount points of corporate governance. Therefore, the engagement between shareholders and the board is absolutely crucial, and what CCGJ [Codrington Corporate Governance Japan] is involved in is that engagement between the top management and the share holder.

Now, regulatory reform can certainly help in this process and I think the recent activities we've seen from regulators have been very constructive in promoting further dialogue. Other panelists are certainly far better qualified than I am to talk about content of some of the discussions that have taken place. The nature of the dialogue, the inevitable compromises perhaps that been reached with Keidanren. However, I think that it is enormously positive having METI taking us on and providing some direction in leadership.

It is, of course, crucial for the long-term goal of encouraging FDI to have a number of obstacles to that removed. Corporate government says it's clearly one of the central aspects of that. There has been a lot said on the topic of independent directors and a lot of debate in Japan on the topic. I think that there are a number of crucial issues that have to be considered along with the simple appointment of an independent director.

Clearly conduct is essential. The OECD principles do detail responsibilities of directors and bear in case in that Combined Code, several pages in the very back of it, giving a very good outline of what is expected of independent directors, what's expected actually of chief executives to determine and address committees as well.

One of the major nestlings from the last financial tip up we are just emerging from is that independent directors or extended directors cannot simply be the grace and the good.

They have got to have independence, they must have objectivity, but essentially they have got have the commitment to get the job done properly. That commitment also

involves all training; the OECD particularly highlighted the need to have risk-management skills. I think diversity, of course, is also going to be an important feature as well. It seems a shame to me the Japanese poolers aren't tipping into the global pooling talent for boards, which I think would enhance the job of the board.

Independent directors also need to have independent means of access: access to shareholders and access to information. Board agendas are set by the executive, so if the independent directors are going to be able to do their job properly, they do need to have some other sources of information. There has, naturally, been quite a significant resistance to the concept, and why should we change the model that has worked well for us. I think the METI Corporate Value Study Group picks its words very carefully about the existing frameworks.

Now, why I think independent directors are crucial for the longer-term corporate governments. They are not panacea to solving corporate governments in Japan. There are certain other management functions that are of equal importance, and I particularly highlight the need to have properly functioning chief financial officers, which are, I'm afraid, a rarity at the moment. Now, if you examine the board's responsibilities towards shareholders and how that can be successfully done and accomplished, engaging with the shareholders is one of the crucial aspects of that. Without engagement, it's never going to work.

I'd like to give you, very briefly, a couple of miniature sort of case studies to examine the effect of engagement, and how this actually works. There's one company I shall name as, I think, one of the good guys now, is Fuji Film. Some four or five years ago, if you asked most investors about Fuji Film, they wouldn't necessarily have a particularly complimentary view of management's engagement with the shareholders, management's understanding of what shareholders wanted, and it would be described as having a difficult relationship with the company.

We've been engaging with the top management of Fuji Film now for a number of years, and we've seen an enormous transformation take place. I suppose definitely helped—picking up on some of the comments earlier—helped by the sense of crisis in their business, and that sort of, of course, being magnified in recent years as well, the recognition that things have got to change. And one of the things they've adopted, in a very wholesome way, is the concept of engagement with the shareholders. The consequences are that the board discusses financial targets at every board meeting, something that never happened before. They're looking at divisional profitability measures, such as return on assets and asset deficiency. They, clearly now, are much more focused on the value of the company, and that's essentially what shareholders are after. They're after management looking to improve the long-term value of the company.

Now, in contrast, there is what I should describe as a sunken machinery company that hasn't been particularly interested in a dialogue with the shareholders. The consequences are the value is being destroyed on a pretty enormous scale, and that's in spite of the company having a bit of high operating profit margins. The ACGA picked up on this a couple of years ago in the White Paper, and basically put this company up as a poster

child for poor corporate governments and poor capital policy. This underlines to me that there is requirement, really a need, to have at least some willingness to start an engagement process going, to talk to shareholders, and get an understanding of what they're really after. And when that happens, and management builds confidence in the topic, then change is going to happen.

These changes are going to be helped by better disclosure. There are a couple of rudimentary changes that are coming through which are going to reinforce this. The FSA is very keen to put forward a motion that institutional investors in Japan have to disclose the way they vote. Their sights are very firmly on the life insurance industry fulfilling their fiduciary duty to the policyholders. They want to see the appropriate exercise of voting rights. Now, there has already, mind you, been quite a dramatic change in the way that votes have been cast. The stereotype of the Japanese investors supporting management all the time is very outdated.

Some four or five years ago, the Pension Fund Association would be voting something like 40% of their vote against management proposals. That would compare to probably about 5% being cast by institutional investors against management. Today, the last AGM season we had in June, the PFA is probably in the median position now. One of the larger corporate pension fund managers in Japan was voting something like 50% against management proposals on their active funds and through to, say, about 20% rejection of votes being cast by one of the major mutual fund companies.

This is already having an impact on corporate behavior. The turnout of voting by foreign investors still remains, I think, briefly low. It's sitting at about 62%. OK, that's up from 33% a few years ago, but what are those other 38% of investors doing? Why are they not voting to express their opinions on the management?

The second aspect of disclosure the FSA is looking at is, I think likely to be an extremely important development. That is the requirement that companies disclose the results of proxy voting on each agenda item. This year 22 companies jumped the gun and disclosed the voting and they bundled the votes of the directors together but there is evidence that this is actually bringing companies to the table to engage with shareholders to find out what it is that they are expected to do.

Daiichi Sankyo would be a case in point there. If you look at the results of the voting, the votes for the re-election of the directors were carried by between 75% and 97%. So a significant 25% of the voters voted against at least one director. The consequence of this was that the president of the company, Mr. Shoda, did the rounds of the major institutional investors to talk to them about the company's policy, what they want to do, and to hear the shareholders' opinions.

The whole point of engagement is precisely this, so that we get management and shareholders having the same view. That either involves management persuading the shareholders of their point of view or shareholders persuading the management. It is a dialogue; it is not a process of simply an interview. So it is probably one of the single most important changes that we've seen in this current series of regulatory change.

Longer term, there are other changes that are coming through which are going to have a significant impact on investment in Japan as well as the corporate structures in Japan. The Shimada report again focused really on the prospects for FDI has quite rightly picked up on M&A as an important issue. Now M&A and Fuji's investment bankers are around here, but M&A is a very thorny issue for shareholders.

Large-scale M&A around the world, no matter where it takes place, very rarely, if ever, accrues value to the shareholders of the acquiring company. And yet management are always very keen to talk about it. I think here is a very clear role for independent directors to exert some sort of check on management's advisors' enthusiasm for a transaction.

Takeover bids always raise a certain amount of concern about foreign takeovers, especially state-sponsored takeovers. But the takeover rules apply just as much to domestic takeovers as they do to cross-border. Mr. Niihara's interests in the UK takeover panel system is, I think, very encouraging, because it would help to eliminate some of the abuses that take place today.

For example, some months ago, one major conglomerate was looking to increase its ownership of various subsidiaries from a 30% stake up to 50%. Under revised takeover rules, that would not be possible without bidding for the whole company and thus ensuring that minority investors are not going to be disadvantaged.

We spent a fair bit of time talking to companies about M&A, about the price paid for prime positions, about the whole concept of looking to get a return on the investment that they're making. So we examined the discount rates they applied to the future cash flows to establish what is value for that business. We're very concerned that cash-rich companies talk a lot about M&A and running the risk of diluting what is a profitable business that they already have by taking on additional businesses with far lower returns.

The practice that we've had in the past of parent-child listings or parent-subsidiary listings is being addressed in the TSE's guidelines on how parent companies should behave with subsidiaries. It's resulting in a number of those subsidiaries either being sold off entirely—in a few cases—or being re-absorbed back into the parent company. So that is again, I think, a very positive development.

The real possibility of a takeover, of course, helps to keep the feet of management close to the fire. It helps keep them focused on the concept of maximizing shareholder value. That itself is a concept that is worthy of some discussion. It often gets confused with maximizing the share price, which it is not about. Maximizing shareholder value, I think, is perfectly aligned with the long-term goals and interests of all stakeholders.

For M&A we've had a whole series of poison pill measures put into place. I suspect a lot of these are going to unwind in the years to come. Mr. Niihara is certainly keen to see them eliminated. The risks, though, of establishing an M&A market—a market of corporate control—is that we'll see a resurgence of cross-shareholdings emerging for protective reasons. I think that is something investors will certainly want to be very vigilant on.

The FSA draw attention to the bank's shareholding purchase corporation as a means for absorbing the shares the banks own in their customer companies. I'll just give you a quotation from the FSA's paper on the topic. "From the perspective of reducing cross-shareholdings and strengthening the governance function performed by shareholders, it is hoped that this measure will be used actively." So there's a lot of pressure on banks to unwind and I think, again, there's another very useful step in encouraging better governance. In particular, I want to pick up on those comments from the FSA in terms of improving the governance function of shareholders.

Cross-shareholdings do dilute the returns. I'm in no doubt of that myself. We've written a couple of reports for our clients that look at both the on-balance sheet and the off-balance sheet holding of equities through either cross-shareholdings, investment securities, or, on the other hand, the pension assets from their pension funds. It exposes the extent of exposure to equity market volatility that companies are holding without them necessarily recognizing those risks. And that creates volatility in shareholder's equity, which in itself tends to undermine the concept of present book value as a bedrock of evaluation.

I mentioned earlier that value creation is about future cash flows, and so holding these cross shareholdings, holding equity holdings, certainly weighs down balance sheets. I think one thing worse than active holdings on balance sheets at companies are bond holdings, which have no prospect of increasing in value and generate no cash flows. That is simply a dead weight in terms of value creation.

Fortunately, the recent crisis, the recent substantial losses that have taken place, have resulted in a wave of criticism of cross-shareholdings, from the stock exchange, the FSA, and importantly from the media. I think companies in Japan do tend to respond a lot to what the media has to say.

The consequence of this is that cross-shareholdings, investment securities, are being re-examined. If we look at the losses from the latest round of annual results, we can see a significant unwinding taking place in shareholding, which I think is a very encouraging feature, particularly if the proceeds of those can be used to buy back shares.

Investors constantly raise with us one of their great concerns, being diluted by new equity issuance. Indeed, the whole process where public offerings are conducted under third-party offerings, where the share prices tend to get hallowed in the days running up to the announcement, let alone running up to the pricing period. And we've seen bank financings, Toshiba's financings, we've got many more in the pipeline. The use of third-party allocations, that system, does dilute shareholders, and could also manipulate the ownership of the company. There are several other abuses to do with market practices, which have nothing to do with the companies.

The rights issue process does protect shareholders, and it can provide a rapid timetable for the companies to raise their funds. I think what has to happen is the TSE does need to tighten up some of its own guidelines about what is an acceptable level of dilution before some sort of rights issue process needs to be used. And certainly I think the regulatory fining process also needs to be speeded up, so that a rights issue can be conducted in a rapid way, as it is elsewhere in the world.

But underlining this method of issuing new equity, we have to get down to the bottom of the discipline of examining the cost of capital. And ultimately, corporate governance is about reducing the cost of capital. So companies need to have, I think, a better grasp of what is an efficient capital structure, rather than a knee-jerk reaction of looking to take on new equity whenever further funds are needed. And the point to reflect on is "Do we actually need new capital for our balance sheet? Do we need new equity capital for our balance sheet?" We always stress with the companies that we meet, the word that investors want to invest in those companies that have got strong balance sheets. They're not looking for geared companies. We never talk to companies about gearing up their balance sheets, but instead we're actually looking to trim the balance sheets and improve the returns.

I thought I would just touch on treasury stock, because Japanese companies have been very good at buying back shares in recent years. In contrast to some perhaps in this part of the world, they've been buying back shares at the bottom of the market rather than the top. However, they have tended to be holding on to treasury stock, and part of the cause for that is that when they're originally encouraged to buy back shares, they've been told to keep treasury stock. Now, the whole point of buying back shares is to improve the value of the company, to improve the intrinsic value per share, and therefore treasury stock ought to be canceled, unless it's going to be used, for example, to meet conversion of commercial bond or to meet vesting options. And in both cases, it's probably going to be a relatively small amount of treasury that's needed for that. We have several companies now sitting on the equivalent of 20% of their issued share capital in the form of treasury, and there are a lot of potential abuses arising from that as discussed in the third party allocation side.

I'm aware that reissuing treasury is marginally cheaper than brand new share issue. However, having that treasury sitting on the balance sheet, companies do consider that as being quasi-cash. And they're inclined to think "Well, we can always reissue that when we need it, or we'll use it for M&A. We're already sitting on a very strong balance sheet." I would strongly urge companies to adopt best practices by eliminating treasury, and actually making sure that that value creation is followed through.

I think the regulators have done an outstanding job so far, and I've been very impressed by their focus on some of the issues that will make a difference to improving corporate governance. The FSA is now pleading with shareholders to have a robust dialogue with management. And I would certainly fully endorse that. Constructive dialogue does not involve making demands, and it involves instead establishing a collaborative relationship.

It appears they set the ball rolling, I think, with some very good early initiatives. And the baton is now being picked up by the FSA and by METI, or by government, really. It's now time for shareholders to take it on. Domestic investors and foreign investors do have common goals, and many from both sides speak very frankly to management. But I think there's still a lot more dialogue that is needed. CGs [as heard] today are doing that and are seeing positive results from doing so. We're seeing divisional targets, return targets, being put into place. We're seeing a focus on cash flow, we're seeing share buy backs, dividend improvements, particularly those that link it to free cash flow. So as a consequence of this

sort of activity, combine that with the efforts on cost-cutting that are taking place at the moment, and better financial discipline, we're going to see a jump in the returns in Japan. And I think regulators can certainly take a lot of the credit for being on the right side of this.

The longer term objectives of civil servants are also going to make Japanese capital markets a more attractive place to be investing in. I think all of this creates a very interesting long-term opportunity for investment in Japan.

Sarah McLellan: Thank you Stephen. [applause]

Kenichi Osugi: Thank you Sarah. I got to San Francisco yesterday, and I was surprised to see it was not hot at all. I came from the hot and humidity city of Tokyo. Today's topic is corporate governance. It is a hot issue in Japan and I hope it will be hot as well here, too. And I'd like to touch briefly on five issues. Namely, a new system of *kansayaku*, criticism on Japanese corporate governance from overseas investors, the responsibilities of Japanese ministries and industries, the report published by the Ministry of Economy, Trade, and Industry, and finally, my comments on the issues. So let's start. Companies Act in Japan stipulate an increase in *kansayaku*. And it's often translated as statutory auditor or corporate auditor, but today I use Japanese word. You see on the slide several numbers with brackets. Actually they are links on the references, and if you want to have those references, email me. The law in Japan is the following: In each company, three or more *kansayaku* shall be elected by the shareholders meeting. Each *kansayaku* engages in compliance matters. *Kansayaku* shall attend board meetings, tell their opinion if they think it necessary. However, they have no voting rights at the meeting.

The system was reinforced in the 2001 revision of the act. Until the reform, a company was required to have only one outside *kansayaku*. The reform made it so that a half or more of the *kansayaku* of the company shall satisfy outside status. On the other hand, the 2002 reform introduced a new committee system, which has three committees, with respect to the audit, compensation, and nomination matters. Each committee has to have at least three members from directors, and more than half of the members of each committee must be outside directors. That means the minimum number of outside directors for the companies that adopt the committee system is two.

So we have two forms of corporate governance, *kansayaku* and committee system. Each listed company is supposed to choose between these two. The reality is only 72 listed companies have chosen the committee system, and it accounts for only two percent of the entire listed companies. The other 98 percent adopt *kansayaku*. All *kansayaku* belong to the board of *kansayaku*. There are arguments on the similarities and differences between the board of *kansayaku* and the audit committee. This is the background.

Then a shock came from abroad. In May, 2008, as you know, Asian Corporate Governance Association published white paper on corporate governance in Japan. ACGA is a Hong Kong-based organization headed by the secretary general Mr. Jamie Allen. The white paper was drafted by him and Mr. Michael Connors from Hermes Fund Management and Anna Krutikov from F&C Asset Management. It was endorsed by 10 investment funds and asset management companies, including CalPERs.

The white paper recommended Japanese companies to index at least three independent directors to protect the existing shareholders against the decisions of their investment, and so on.

Then what happened? Various organizations in Japan issued their own report from March to June this year. About half of the arguments made were a response to the ACGA's criticism. But notice, the other half was relating to other corporate governance issues which were raised not by ACGA, but by the press and public in Japan.

I don't have enough time to pick up all the arguments between ACGA and those organizations. I'd like to introduce only the first issue on independent directors, and only the opinion announced by the METI.

What is the Corporate Governance Study Group? It was organized in December, 2008, and with METI as the sponsor. One of the 20 members was a law professor. Among its 20 members, there were three executive officers from famous large companies in Japan. I suppose each of those persons was the second or third highest rank in the management team of their companies, respectively.

In addition to 20 members, we had two observers coming from the Financial Services Agency of Ministry of Justice, respectively. In our sessions we invited Mr. Allen of ACGA, Mr. Thomas Whitson of the American Chamber of Commerce in Japan, and Mr. Atsushi Saito, the CEO of Tokyo Stock Exchange Group, to listen to their valuable opinions.

Part One of the report says it is important to have a system that has the potential to foster international standing. Look at the screen. The underscored names of parts of sentences in italic form are derived directly from the report. Accents are added for emphasis.

And Part Two of the report analyzes what role independent directors, or *kansayaku*, should play in the management of the company. Here it argues that a trade-off can be found between ensuring effectiveness for corporate governance and security of independence.

And the report went on to say, "...Consequently, the corporate governance study group has concluded that "Number One: The framework must necessarily assume that at a minimum, there will be an independent director, *kansayaku*, who is not at risk of having conflicts of interest with minority shareholders, and who is supposed to protect minority shareholders."

"Number Two: As to actions to be taken by individual listed companies, each listed company will be required to improve disclosure of its views in the framework so that consensus regarding the most appropriate corporate governance structure for each company can be fostered through dialogue with shareholders, taking into account the dual requirements to secure independence while ensuring the effectiveness of corporate governance."

Are you sure the leaders differ in the interpretation of those lines. The paragraph one used the old "assume." This assumption will probably be codified as a self-regulation or non-binding target.

If a company listed on TSE adopts *kansayaku* system, and does appoint two outside *kansayaku*, it is required by paragraph one to have one or more independent directors or *kansayaku* while the remaining outside *kansayaku* could be outside but not independent, such as a person who came from the parent company. This is my way of reading these lines, and I put it on slide page 12.

Back to the report. It went on to say, "Consequently, the study group concluded to require listed companies to choose either of options one or two below.

"One, to have an outside director as a minimum, and to disclose facts concerning the corporate governance system, such as the role and function of the outside director.

"Or two, if option one is not chosen, to disclose facts concerning the corporate governance system using the company's own original method, such as separation of the chairperson and the CEO, reduction of numbers of directors to make a quick decision and setting up nonbinding advisory committees in the company, et cetera."

According to these sentences a listed company is not legally obliged to have an outside director. However, in each case it must publish its opinions on best practice on corporate governance.

The final part of the report proposed that the measure to improve the corporate governance should be dealt with not by the revision of the statutes, but by self-regulation of the Securities Exchange.

Finally, I have two comments on the issue. First of all, I believe there are two reasons why we are relying not on statutes but on self-regulation. I'll skip these two reasons on the slide to save time.

In any case, what is important is the content of the rules made by the TSE later this year or next year possibly. We can't tell the impact of the reform simply by reading the report so far.

My second comment is probably controversial. I suppose to some extent the rate of human networking and the very creation mechanism in Japanese companies are different from those of Western companies. Let me use two examples and one hypothesis in order to persuade you of the idea. The first example is the relationship between medieval merchants featured in a survey by Professor Avner Greif at Stanford University. According to his survey, because the society that Genoese traders belonged to had high mobility, promises among these merchants had become enforced by legal institutions. They have employees. Cooperation among merchants did not develop alone.

Here we see a simple principal-agent relationship. On the other hand, more greedy traders made transactions repeatedly among fixed merchants based on mutual confidence, and

one of them who cheated another was expelled from the guild. Modern society has its power. Here I use those typical and type, because foreign talking is not what will be taking place in the real world, rather it is a simplified prototype.

In typical large companies the relationship between a boss and her subordinate is pretty close to the centuries-old principal-agent model, whereas in the typical Japanese large companies the relationship is often more complex because collaborating among workers are promoted. Moreover, collaborating is expected not only among rank-and-file workers, but also between the boss and subordinates.

In other words, person A and B are both principals and agents of each other. It is often pointed out that creation of managing Japanese companies often comes from information and wisdom on the spot. This reminds me of the words of Friedrich Hayek's which put emphasis on the knowledge of the very level man on the spot. Of course he didn't speak about Japanese companies. Keeping this in mind, his work simply points to a strength of Japanese companies.

The third step of my influence graph is the most provocative. Therefore I call it hypothesis. Here I wrote, that in these companies, the relationship between shareholders and the managers is modeled on a simple principal-agent relation, again. In this part the independent director is expected to discipline the agent. On the other hand, in Japanese companies, the shareholders and the managers are both principals and agents of each other.

To be sure, the focus is moving in recent years, even in Japan. But as long as the creation of value comes from the knowledge on the spot to a large extent, corporate managers do not tend to believe that an independent director who does not experience this spot would be helpful. Thus, I predict Japanese companies will not simply Americanize or Westernize in the near future. On the one hand, they try to keep their strength, and at the same time they search for the way to overcome their shortcomings and adapt to the changing environment. This trial-and-error process will probably lead to a hybrid of US-type and J-type companies. On its way, it is important to have serious dialogue between investors and corporate managers, and let us hope, cases of success.

I have notes about this which you don't have. I thought this PowerPoint slide would be handed out, which wasn't. Anyway, this concludes my comment. Thank you for having me.

[applause]

Sarah McLellan: All right. One more speaker. Are you guys all set?

Nick Benes: Thank you Sarah, and thank you Stephen. Both of you for making this easier than it would be otherwise because you've covered a lot of the key themes already. I guess I should be a lawyer for a minute here and jump to the most important part of the whole presentation, which is the disclaimer. Which is to say, I am the chair of the FDI Committee at the ACCJ, the American Chamber of Commerce in Japan, and actually we have been responsible for many of the viewpoints that Steve referred to as on the

disclosure side, particularly, resulting in coming to fruition, in terms of the FSA, in particular, recently announcing that it would probably proceed with those recommendations.

But I do not represent ACCJ in this meeting, I represent me, and what I am is an investment banker who has been independent for about 15 years. But I've also sat on four different Japanese boards. One of them listed, one of them just de-listed—the post-scandal Lidor Holdings, which I was hired to help clean up—and two of them not listed, and all of those in an independent outside director capacity. So I have some reason to say what I say, I would think.

The other side of this is on that the M&A side of my business in Japan, one sees the seamy, unseen side of corporate governance when it doesn't work, and when assets that should be sold, either to the foreigners at a high price, or to anyone else at a high price, at a price which would optimize the use of capital for its deployment in core businesses in Japan, is constantly stymied, slowed down, and never happens because of failures in corporate governance. Not only to improve business but also to just see the right thing happen, I've been very interested in corporate governance for about 15 years now. So I have to rush, because we've all been busy with others of these statements so far. I'll go as fast as I can.

I think there's no turning back. Key regulators, as we've just heard, have all acknowledged essentially the same thing, that Japan's stock markets face a major credibility problem with regard to corporate governance, particularly among foreign investors who have all just left the market in their view. And they're quite concerned about this.

Number two, the traditional reliance on statutory auditors as the source of "independence in our system" often results in inadequate governance. This has been admitted; it's been acknowledged. The traditional assumption in the system was that statutory auditors were our independence. In fact, the Japanese government, under Keidanren managed to convince the SEC of this when they snuck the *kansayaku* system in as the way for Japanese companies with ADRs to comply with Sarbanes-Oxley, supposedly independent.

Why are they independent? Is it defined in the law? No, the word independent is defined nowhere in the law. They are assumed to be independent. Wouldn't we all like that, to be assumed to be something. Well, they are assumed to be independent because they have no vote. They have no vote on the what? On the board, legally. But the board, in Japan, as you know, is all internal. It is assumed to be synonymous with management. In fact, people use the word management 70 percent of the time to describe the board because it is all internal. So because they are not "managers" with an executive capacity, they are assumed to be independent. And it would not matter if they were your mistress, your brother, your uncle, your little kid, it wouldn't matter. They would be assumed to be independent, under the system. This assumption, which lacks any legal logic or reality or whatever, has been exploded. The reports have all essentially acknowledged that this assumption makes no sense.

Last week at the Ministry of Economy, Trade and Industry Corporate Values Study Group, a close friend acknowledged the fact that in the case of M&A, independence of judgment is necessary. And it doesn't matter that shareholders said it's OK to have this poison pill, and pay off someone at too high a price, you still as a director, internal or otherwise, have a duty to make an independent judgment.

So now, everyone has sort of turned over to the TSE and said, "It's all over to you TSE, we've done our job. I'm METI and not in charge of the corporate law." MOJ isn't, MOJ is too scared to do anything. FSA has said "Well, we could change the securities law, theoretically, but, the Keidanren et cetera opposes this, so we'll come up with an exhortatory statement." That they've done quite nicely, to their credit, but they are not changing the law. They have decided to not impose a law for public companies only, which they could easily do, under the jurisdiction of the FSA. And everyone has turned to TSE and said "TSE, you do it, we're going to try and strong-arm you to come up with rules which reflect our principles."

What are the principles? We've said therefore more independence is necessary. We've said, therefore most likely, the independence will come from independent outside directors, not independent outside auditors. Now they've said both, but the stress is on the directors' part of it. They have said boards with independent directors should probably be the model. Interestingly when the FSA produced its materials, I was a primary translator of the METI materials, but not the FSA materials.

But when they produced their FSA materials, the FSA has an overview that they issued to everybody in English at the same time. The overview actually says that the model should be boards composed of one third or more independent, outside directors. Fascinating, because that's not in the report, that's in the overview sheet they handed out to all the foreign press club correspondent people. So you can see the level of concern that the regulators have that foreigners not get the wrong picture that Japan is internally never going to fix itself. They're trying to fix it.

And so this last bullet point here, the red one here anyway, this is just the key conclusion. Companies should be required to have at least one independent, external director, company director, and if they do not, explain why they have a better system, why their framework, and what it is, is actually better for governance. And at the same time, in order to do this, they should increase dialogue with their investors. And if TSE has been requested, "over to you TSE," to change its listing to both, do something like that.

So, TSE is between a rock and a hard place, the hard place being kansayaku and the rock being the government. Just to step back from that, can we all hear the new word here? I think we can resoundingly go cheer it. It's independence. This word is not defined anywhere in Japanese law. Nowhere in Japanese corporate law is it defined.

The word outside, although it's used glibly as if it did, is often used to try and suggest independence, but it means nothing. It means only that one is not inside. Surprised? It's verbally then. Grammatically, that's what it means. That's all it means legally, too. And so, if your uncle, your brother, your mistress, et cetera, your wife, and secondly superficially

some sort of beefed up disclosure kind of looks and acts like compliance explained of this nature just described, is probably not too hard for the TSE to come up with.

They already request, require companies to list on the TSE website a report whereby they disclose their own governance framework, perhaps, and the facts that led into it somewhat. And so, they can just add to that, explain whether you have independent outside et cetera, and if not, why and what's your system?

And so, everybody would come up with this two paragraph or one little thing put together by their outside counsel who normally knows absolutely nothing about management or practicing corporate governance and puts together some sort of statement that sounds good and legal and people wash through it and it's too dry so they go on to the next thing.

In that case, we have it in a very perfunctory manner, and it would be easy to do, but here's my question. Is it going to be possible for the TSE to do even that without defining the word, independence. I don't think so. I would like to ask Professor Osugi later if he thinks so. I don't think it's easy to say: tell us if you have independent outside directors or statute auditors; if not, explain why not and what's your framework without defining what independence means.

I think to do that would make the TSE an absolutely laughing stock, and the whole purpose of this exercise is to improve the credibility gap in the market for the purpose of the government, and the TSE tries to understand it very well. It would be completely undermined and set back five years. So, the word, independence, is about to be defined, and this is a seminal sea change in Japan.

Shifting gears, here is the self-interest part of my presentation. It's in the interest of Japanese management to embrace independent outside directors and the concept board that actually acts like a board, actually performs monitoring discussion, debate, constructive policy and formation. Why? They are much more exposed than they realize, far more exposed.

Access to the processes is a new word here. The business roundtable complains about it. It's a very limited narrow variation when the TSE proposes it, but actually it's been a reality in Japan for decades. You only need one percent of the stock or 300 voting units to submit a proposal which can include, [inaudible] law prohibits it, but which can include the appointment, until recently, of any director you like or replace the entire board.

Secondly, depending on the company as was explained earlier, there's now a significant probability or possibility that the wrong director candidate or internal director candidates that are simply not any independent one may not be elected. The last movement of the policy for not supporting the board's fight with it or not or, at least, the top person on the board, there are not more than two independent outside directors.

You have the recent changes that you referred to earlier that the JCCJ had written and proposed for the disclosure of voting results at AGMs and also disclosure of voting records. We said per item, per item voting record by each of those investors. But all these factors will sort of come together to make it sort of embarrassing as an institution to not

vote prudently more often than not. Or embarrassing to not have some candidates which arguably are independent outside directors on your board, unless you want to look particularly like a laggard in the corporate government sense.

Next, we don't go around saying sale and pay here like it's something new and revolutionary. That's safe. That's a nonbinding resolution by shareholders. The board doesn't have to follow the nonbinding resolution in the U.S. version of sale and pay if it doesn't want to. For decades, the Japanese corporate code has had binding permission by shareholders of an aggregate cap on all director compensation of Japanese-listed companies, or Japanese companies in general.

This is directive capping of director compensation. So, the point here being is that most Japanese companies don't have severance arrangements. They now have, many of them, one-year board terms. When you have a one-year board term, article 339 of corporate code, doesn't protect you for the remainder of your term. Normally, we give you "You're fired", the remainder of your term, in terms of the compensation you would have received had you remained. Well, if you're canned after 10 months into a 12 month term, ok, you get two more months of compensation. That doesn't amount to a lot of golden parachute severance, particularly when Japanese compensation for their directors is so low. So, we corporate managers, if we are looking at ourselves that way, are very exposed.

Now, let's add the last point here. It is easy, and it has been made recently easier, for a group of individual investors who happen, to Toyo, whatever it is, [inaudible] or so-and-so, Osaka Engineering, at any company they wish, to group together and make a joint shareholder proposal to totally change the board, to fire the board, to appoint independent outside directors to do it, to do what they'd like, because they have access to proxy. And if they don't individually have 300 voting units or one percent of the stock, which is the trip level, they group together 300 with the minor, tiny investment of one vote each and get together and submit a joint proposal. This is really exposed management in the preparative corporate code context. We have a far more shareholder-rights intensive corporate code regime.

So, what does the future hold? We have to move fast here. A smart company is going to see the writing on the wall, you're going to have to get a split between the Fuji Films, the Shiseidos, the good corporate governance folks and the laggards. They will start, the former, the good folks will start appointing more independent outside directors, and this will create the chance, the real chance for the first time, of forming true strategic boards that decide policy and actually monitor at the same time, and are not only proposing internal posts or their cronies.

But at our present, as Osugi-san mentioned, he's quite right, very few executives can see how such a board can possibly help them. I mean, how can somebody who doesn't understand valve-pump mechanisms and how to sell them in the Kansai region, how can he help me? He's useless because our board is a management organ. If you view your board as a management organ, yes, per se, it is absolutely by definition of the fact that somebody from the outside can't help you very much.

So, this version of the board, this concept of the board, has to be socially changed. Organizationally, managerially changed, and a lot of people are starting to realize that, but no one knows how to really design it and run it. We need leadership to do it, and I think there is a huge need there for education and training, of what a board can be, should be, and what the best practice can be, should be. A homogenization is achieved through three or four days of intensive instruction and debate between both internal director appointees and external director applicants.

This is the only way to create something like that in the next four or five years, and this is the real challenge that the system faces now. It would be nice if we had certain legal changes that require independent outside directors, but there's been enough discussion and enough exploitation. And the government policy is clear enough now that even if we don't get that, or even if we did, the major challenge and the value add that's necessary to enact will be not bad, but what I just spoke about. The need for training, homogenization, consensus formation, of what a real board can be that Steve can engage you in.

Right now Steve engages with, not a board, but management appointees, management representatives. Not a board where representatives of a board that is overseeing, and monitoring, dealing, responsible to him so much as explaining by excuse, hook or by crook, what management is doing in a way that will impress in making this a company.

This transition to a real board that Steve can engage with, will take some time. It will take a lot of effort on all parts. It will require an organization that identifies candidates, that trains both internal and external. That fosters a consensus as to the best practice.

It talks about the laws and the regulations and the ways in which he can get information in a company when it is denied to you. It helps people understand more their liabilities and how to protect themselves from liabilities when they are general candidates, et cetera, et cetera.

And that sort of institution or organization that exists, will contribute the most to better corporate governments in Japan next. And so this is my own personally taken-on mantle or goal.

In the next year I would like to set up such a foundation to do that sort of consensus formation and training and identification of candidates, function, in together with a group of people who are now combining with me, who are all Japanese professors, or experts or entrepreneurs or folks who have experience in the outside director job in Japan which are precious few.

And with that, I'll end my comments and hope we start some fun debate here. Thank you.

Sarah McLellan: Thank you Nick. All right, we are going to open it up to questions in just a few minutes. I just had two quick questions I wanted to ask the panelists. Seems that you are suggesting the TSE is the one that everyone is looking at to make changes to the rules. From a legal perspective, from a framework perspective, will this be sufficient for Japanese corporate governance? That's question number one. Assuming that TSE does something, will that be sufficient?

Number two, how is the US financial crisis, I don't know if this is to your question, has the US financial crisis stalled action at the regulatory or the government committee level? So do you see that as being a major negative or minor negative or somewhere in between?

Kenichi Osugi: I was thinking about the second question. My personal view is that on the global financial crisis, didn't have a large impact on the arguments in Japan on corporate governance. The financial crisis revealed that Japanese companies relied too much on exports and so they should change their components in management and business. So it had many lessons to Japanese companies, but to speak about corporate governance, at least so far, financial crisis didn't influence our arguments. As I told you, the white paper by ACGA and of that sorts had a major impact on Japanese debate. How about the TSE framework?

Sarah McLellan: Yeah. How about TSE?

Nick Benes: Who will the TSE...

Sarah McLellan: How 'bout that?

Nick Benes: What will the TSE...well that's the new question. What will the TSE do and will it be sufficient? I think the TSE, as I said earlier, will at the very least have to be forced to define independence. And I think that is 80% of the progress that's necessary to move to the next step. I doubt very much that it is almost, that it is extremely unlikely the TSE will impose a rule requiring independent outside directors or statutory auditors and even if they did it would be OAR. And so if it's OAR statutory auditors, it's a virtually useless rule since they have no vote.

And so that would actually be retrograde motion if they did install such a rule. And the most important benefit comes from simply the definition. Once you define something in Japan, and people have to disclose it, you then have a criteria by which they are judged.

And so those people who want to be judged highly as leaders, the Shiseidos of the world, will look at that because it's now going to be disclosed and start installing more independent outside records for the definition. That will have a huge impact.

Stephen Codrington: I'm trying to think it's very much a work in progress. Prior to the Keidanren effectively blind-siding the METI committee, coming out with their own paper, and stalling the whole debate, the FSA were very much talking about bringing through some sort of a ministerial order to enforce the issue. And I get the sense that the FSA are very determined to get changes made in regulations. They will do so through using ministerial orders to force basically changes that will appear in the stock exchanges' listing requirements.

And I agree with Nick that the defining of independence is very important. The various study groups that reported seemed or appeared to me, I may be interpreting this incorrectly, that seemed to me to be watering down the concept of independence by talking about a trade-off that can be made.

Whereas the OECD's principles put out very clearly what they mean by independence. Initially those tend to be a series of negative characteristics of what is not independent. But since the financial crisis, they have suggested that there are a number of attributes, positive attributes that could be put in there.

For example, this concept of commitment and getting the job done properly, that actually helped to stiffen the definition of what independence is.

Kenichi Osugi: The definition of independence is not that difficult itself. So politically speaking, the TSE will define the independency in its listing agreement. It is a question of how you read the METI report and other reports from FSA. So, I introduced the interesting word "assume" in the report. So speaking about independent, our director made it actually clear that we do not require, we do not organize listed companies to have at least one, but the report said we assume that every listed company has at least one independent person who may be a director, who may be kansayaku.

And if this word, "assume", means the listing agreement has to codify this part. I mean, Tokyo stock exchange will have a hard situation, I mean, Keidanren and business world may resist the clear definition of the idea.

The definition itself is, again, very easy. We can follow the definition from the New York Stock Exchange version. So I'm not sure about how they read the reports.

Oh, excuse me, earlier I said that the global financial crisis didn't have impact on Japanese argument. But it was not correct. To think of the points, the points Steve just have made. So, I'm talking about the, excuse me, trade-offs between independency and effectiveness. I don't like the word "effectiveness" which was used in the METI report. Steve mentioned the better word should be, what?

Stephen Codrington: Commitment.

Kenichi Osugi: Commitment, exactly. Actually, many Japanese, especially company managers, believe that the cause of financial crisis in the United States was their lack of commitment, not their lack of transparency. So, I read a report issued by research from here which argued that the problem lied in the lack of transparency, talking about Lehman Brothers and that sort of collapse of financial institutions. But, Japanese have seen the issue from a different point of view. Commitment may be a better word to describe and analyze this situation. That's my answer.

Nick Benes: But I could not agree more with the importance of commitment Steve talks about. And I think it's related, just to add one more thing here. It's related to the challenge that's next faced. At present, Japanese board directors, internal directors, do not have commitment themselves to the job of director. They have commitment to the job of a promotional ladder and their rung on it in an internal organization of which they are a manager. They have commitment and loyalty to a management structure, one of the parts of which happens to be called the board but doesn't function really as a board. And that's very different from having commitment to the duties of care and loyalty and detachment

and independence and judgment on behalf of the minority holders that directors are supposed to have commitment to, and I think this issue is really the most crucial issue.

Stephen Codrington: So, Kenichi, about whether the American financial crisis stalled government action. I think, actually, it's completely the opposite. I asked various civil servants why METI had been entrusted in pursuing better governments, in particular since their perception to the outside world is that they've been the voice of Keidanren in the past, and the answer coming back was it's all about FDI. Japan has been a loser from FDI. It's seen FDI basically bypassing Japan into the rest of Asia, and it's long been, of course, a government aim to increase FDI, though we do seem to be getting an acceleration in measures being put forward to actually solve some of the issues that prevent FDI from coming into Japan. Those are, for example, the fact that getting returns of investment in Japan have been below the level of returns you can get elsewhere. Getting a fully functioning M&A market, and improving governments. And I think these are issues that are addressed in the Shimada report, along with, for example, changes in the tax regime as well, to lower corporate taxes to bring them in line with competing Asian countries. So, I think actually, there's been an acceleration of government interest. Whether that we then get a hiatus with potential change in government coming through this month remains to be seen.

Sarah McLellan: Sure. That is an excellent point. I mean, in the corporate world as well, like you mentioned with Fuji Film, it's often that crisis in operations that can drive change at the other level. Let's open this up to some questions.

Virgil Adams: OK, my name is Virgil Adams. I'm a manager of [inaudible] over here in San Francisco. You've talked quite a bit about the mechanics of this worker governments and how companies are going about doing this. I don't really understand the base motivations for this. I mean, what's the carrot, what's the stick in this case? I mean, the carrot of enhanced corporate value ... I just ... I don't really see that as a real riding motivation in Japanese companies. These companies, it's an ambiguous concept. Most ... if you were to tie it to anything related to share prices, most of these directors in corporate management don't own a lot of their shares, anyway. And they've never really shown a great, I guess, desire to focus on raising their share price with that in view as the question of corporate value. And the stick, I don't really understand what the stick would be. Is that a de-listing graph from TSE? Is that binds? Have we ever seen this actually take place? In the United States, you know, the threat ... the stick would be if you're not run well, you're going to be taken over by someone who will run you well or who will split up your company. And that doesn't happen very often in Japan, especially the more financially strong companies. Or you can be sued, which is very rare in Japan. So, I was wondering if you could address the base motivations for this supposed focus on corporate governments, or heightened corporate governments.

Sarah McLellan: Does that mean you'd like to address this, then? [laughter]

Sarah McLellan: Surely you had a question. Talking about what the proper carrot and stick ... what the real motivation, is enhanced shareholder value going to do it? The lack of a corporate action, this is kind of the chicken and the egg situation, where ... where

lacking a corporate action, the threat of takeover is important, but the same time, how do we get that without the proper rules? Nick would you like to start off?

Nick Benes: Sure.

Sarah McLellan: OK.

Nick Benes: I think the financial crisis has actually affected this very positively in the sense that there has been what's perceived as and actually is a large departure of foreign capital, for whatever reason, hedge fund or otherwise, from the Japanese stock market. And partly as a result of that and other factors domestically, the stock market is now at the same level it was ... that I said in a securities report in 1992 it would get to, then everyone laughed at me. And that was 18 years ago, or something. So, that's a pretty desolate state of affairs to be in. And secondly, in the back ... the larger issue there is you had a fiscal deficit crisis here. And the public welfare fund, or private corporate pension fund, need to get returns or this private company or public government basis will become even worse. So, Japanese corporate industry has to improve productivity. Japan has had a very sluggish productivity growth line trend for the last 15 years or so. It came up a bit in the last few years, but among developed countries it's a real lagger, as productivity growth goes. And so economically, stock market, fiscal deficit, they know they need to revitalize the market here.

They also need to revitalize it for their youth, who is at a much higher level of taxation, and it's going to go out in the ceiling somewhere, to pay for all those aging society folks, whose welfare pensions are double what they're going to get.

And so you have a lot of problems in here where the bureaucracy and the government are well aware that getting foreign capital back into the market and revitalizing the economy and industry are very necessary, as is increasing the productivity of Japanese management. Which gets back to METI. METI has traditionally, as Steve said, been Keidanren's best buddy in most cases, but at this point, when productivity has to be increased, they start to scramble around and try to find other ways to do it. I think those issues are all very relevant here.

Sarah McLellan: I'm so glad someone brought up my favorite topic, pensions. And the issues with pensions are with demographics [inaudible], it's a slow-moving issue. And so it's more the near-term crisis, in terms of what's going on globally with FDI, and also at the government level that may drive some of these real changes. Stephen, would you like to talk?

Stephen Codrington: Well, Virgil, I think the stick is really the fact that the shareholders are increasingly using their votes against management. I think that publicity of those is going to help bring them to the table and react a lot faster. The speed of change is something that people have often criticized, and this might help to improve it. There is also, I think, very much a united pressure now from domestic and foreign shareholders. It is not simply seen as being a foreign beef. I know of even life insurance companies that are going around seeing companies in Japan to say that they have got to be increasing their returns. I think the pensions issue is also very much behind a lot of the pressure

being put on by the likes of Pension Fund Association, by [inaudible] and others. But the situation can't carry on as we are seeing it.

Last year pension assets at most corporate pension funds declined by anything between 20 and 22 percent, which is going to result in a huge hit on P&L over the course of the next two or three years as those differences are amortized. So it's bringing home to management that they can't just ignore these issues, that it is not just some esoteric theory of finance. It is coming home to roost that they have got to improve their returns in equity. I think that there are very positive signs that that is taking place.

Very few people in management hold shares in their companies. I would certainly love to see that increased. In a few cases where we have seen management adopt remuneration schemes that provide options, I personally prefer to see restricted shares rather than options in place, but they have got limited options schemes there. There was that sort of stereotype that I had that it doesn't make any difference to senior Japanese management having financial reward for it. It is all about the prestige of the top job.

That was blown completely out of the window when one of these companies that had recently adopted a parent option scheme started talking about the value of the company, that the shares were undervalued. What can we do to improve the value of the firm? So I think that may actually be a better catalyst for getting change.

Sarah McLellan: Osugi-sensei, do you see any other factors or...?

Kenichi Osugi: I do agree. Theoretically, the motivation to increase shareholders value and enterprise value comes from monetary and non-monetary benefits, and traditionally Japanese managers felt the non-monetary reward must be better incentives for them. They actually don't ask a high amount of salary reward, but, as you mentioned, so commitment or, say, love for the company could be easily turned into an excuse. As you mentioned, American motivation is not enough in Japan, I admit that. So, as Steve and Nick told you, shareholders will be a driving force in Japan to put pressure on managers, I really believe so.

Sarah McLellan: Yes, please.

Man 1: Bill Crist, Governance for Owners. After a lot of years of CalPers, I also let note be [inaudible] financial impact. But I'm really interested in this whole business of independents outside and defining the need to do that. It's nothing new, this happened to have been the case around the world for a very long time. But let's assume that this could be done, stock exchange and whoever could provide some kind of really useful definition of outside independent and so on. A really huge problem, and I was very interested to hear Steve say that, once this is done, we've got to find these people, and all up to actually putting people on the board who can really be committed to the outside independent, is talk. Then you've got to go get them. You're going to eventually see that getting them into, as I think attorney's use, into international sources or into cross-border sources. It might be one way. I spoke with a professor earlier, and it's very difficult within Japan to do this, and has always been. So I would like to have you all say, what's the reality of them finding these independent people who can revitalize and so on.

Sarah McLellan: OK, so we're assuming the independence issue is somewhat resolved, we have a definition of it, now how do we get the talent to these boards. [laughter]

Kenichi Osugi: Let me see. Let me put it this way. I suppose that many Japanese companies may disclose their own opinion about corporate governance, such as, "We couldn't find good candidates for outside directors." That may be true; that may be an excuse. I don't like a Japanese company to use this phrase. I rather would like them to express their own ideas. What kind of person or what talents must be a good source of independence? Each company should disclose their own opinion about what kind of people they are searching for. And after that question say, "We tried but couldn't find a good enough candidate so far."

Actually, as you mentioned, because Japan is a country in which the ability of people relatively low, I really believe searching for a good candidate is not easy for Japanese companies. But it could easily turn into the excuse, as you noticed.

So Japanese companies should have, as I say, TSE should require that the companies disclose their policies, how they think about the corporate governance and best composite of members of boards of directors and that might help us.

So how eager company managers search for candidates, that depends on the disclosure. That is part of my answer.

Sarah McLellan: Now, Nick, you're on the boards—both boards—right now. How are you approached, or what do you think the...

Nick Benes: Have been on. I'm on one now.

Sarah McLellan: OK.

Nick Benes: But, I think the best answer to your excellent question is, if you think about the U.S. as one example, or the U.K., it's taken us decades to get even as far as where we are, which is now much criticized for all sorts of shortcomings. As far as finding the best outside independent directors and ensuring that they actually behave according to the function that's expected, and we have created ad hoc, as it were, over three or four decades, a lot of practices and assumed that, you know, common assumptions, common ways of behavior and thinking, that enable that process to occur efficiently more than it did decades ago.

They don't have that in Japan. When you ask your normal Japanese company if you could really get in to the brain of the senior managers who may be thinking about asking independent outside directors to come on, they don't know really what that concept is. And half the time, I think it's something sort of being forced upon them.

The independent outside director candidates who come in alongside me in a situation that's often troubled companies that I've been involved in, even if they're fine, upstanding, well-known respected lawyers, have almost no clue as to what it really will require in

terms of independent judgment and courage and analysis in getting at the information to perform the function that it's hoped they will perform.

And so, we have a really major challenge in terms of creating that consensus or that common knowledge base. And it will only happen, I think, in Japan, if there's a neutral body that large organizations such as the Keidanren included, and METI and the Cabinet Office buy into as being an acceptable, then I have to support it exclusively. But an acceptable organization's function that creates the courses in a three- or four-day period where people will be inculcated with a lot of different notions that simply don't exist right now.

Not imported from the U.S. or the U.K. The good parts only, and add a lot of lore from experience by outside directors in Japan and entrepreneurs in Japan who have good experience. So the bar is raised in terms of training and what's expected of you. So when you join the board, whether you're inside or outside, you know what's expected of you and it's something different from that next rung in the ladder. I think that's what's necessary, and without that we'll have a lot of nominal inside and outside directors, but we won't make a lot of progress in corporate government.

Stephen Codrington: I've asked a lot of companies, "What will you do about getting independent directors?" Of course, the common theme is, "Well, we're actually fine without, thank you very much, but if the law was to change, then, of course, we'd comply." I do get a very strong sense that would just be a tick put in that box, and the board picture at the end of the year would look pretty similar to the way it does now. I think to say that there aren't any candidates there, I think, is wrong, and I think headhunters who haven't got a huge amount to do at the moment would work very well in sourcing suitable candidates out of academia, the financial world, legal world, as well as the corporate world.

You're talking really about, if you're looking at three directors per listed company, a short 600,000 or so people would be needed for just the first section companies. So it's quite a challenge, but I back up what Nick says, "You're simply not going to change things overnight." It's a question of evolution as people get to understand the role that's being demanded of them.

Nick Benes: Can I add something here that's really important? When someone's asked to be an independent outside director in Japan, he's usually asked by the president or a managing director or both, and it's some sort of friendship relationship, some would say crony, but it's a friend of a friend sort of thing. In Japan, the social nexus or context is such that the person who introduces you to an opportunity or situation is very important to you. You instinctively are led by the culture and customs to think you must be loyal to that person. In a public forum, you must not embarrass him; that would be rude. Or you should not go against his opinion until you really, really have to.

The other aspect of this is there's a tendency for people looking for independent, outside directors to think, "Well, we want to find somebody who looks as good as possible." He's got a shining reputation. He's well-known. And so they do what Sony did, and they select someone who's a television personality who knows nothing about...

[laughter]

Nick Benes: ...corporate governance, management, law, or fifteen other things related to finance. This sort of thing happens, and the reality, however, in Japan is the higher and the more shiniingly brilliant the reputation of the person you select is, the less likely he is to say what's needed to be said at that crucial time on the board when somebody's got to stand up and say, "The Emperor's naked," etc., etc. He may. At the very top of the scale, you get the outliers where Okuda-san from Toyota doesn't care who thinks what of him anymore because his reputation is so good. He probably would. But those are outliers. Ninety-nine percent of the people who fit this role are not inculcated with that thinking. So we need a forum where people go mix for several days offsite and learn that there's a different set of values and criteria and behavior habits that are now expected of you if you really want to be an independent, outside director. We are not going to support, or this organization will not support, or other shareholders will not support you as a candidate unless you really look like you have that commitment that Steve was talking about because of those values. If you're just taking this because your friend asked you to, you're not independent, first of all, nor do you share those values. Sorry.

Sarah McLellan: Thank you, we're getting the tug over here. [laughter] I think lunch is awaiting us in the next room, but let's take a moment and thank the panelists for their great comments. [clapping]



After the Crisis: Corporate Governance in Japan

***Luncheon Keynote Address:
Corporate Governance After the Global Financial Crisis***

August 7, 2009

Luncheon Keynote Address: Corporate Governance after the Global Financial Crisis

[Introductory comments were not recorded.]

Priya Mathur: ...until she has accepted her present position as director of corporate governance at our sister pension fund CalSTRS, the California State teacher's retirement system. Now, I hate to admit it now, but I wasn't exactly thrilled to hear that Anne Sheehan was joining our board.

[laughter]

I had become quite close to her predecessor Maeley Tom and was truly very sad to see her go at the time. Maeley has spent many years working in the state legislature and she had taught me a lot about getting things done in Sacramento.

It also didn't help that Anne's boss, the Governor of the State of California, had earlier supported efforts to reduce retirement benefits for California public workers.

[laughs]

Priya Mathur: So needless to say, I was a little bit suspicious with Anne at the start. But really quickly Anne put my concerns to rest, not by making promises or uttering soothing words but by being a truly terrific trustee. Anne proved herself to be one of the hardest-working board members.

She asked thoughtful incisive questions and drew intelligent and intuitive conclusions. Always fair, respectful and sharp as a tack, Anne pushed our staff and our board to do our very best.

Anne joined the CalSTRS board as the designated representative of the state personnel board on which she still sits and actually chairs, I believe, and served as a member of our investments performance and compensation and health benefits committee as well as our policy subcommittee of our investment committee.

Anne has devoted her career to serving the people of California, and in fact, she said to me when she left and decided to join up with CalSTRS, she transitioned from having ten, fifteen, twenty jobs at once to having just one job.

[laughs]

So even though it is an incredibly challenging job to be the head of corporate government at CalSTRS, I think she is finding it a little bit more restful than her time before.

Prior to joining CalSTRS, Anne served as the executive director of the governor's Public Employees Post-Employment Benefits Commission, which recommended a package of pension fraud and abuse reforms that have now become law.

And she also served as chief deputy to the State Department of Finance under our current governor Arnold Schwarzenegger, and has nearly two decades of management and leadership experience on public policy issues.

And she served six years on the behalf of former governor, Pete Wilson, at the California State and Consumer Services Agency as deputy secretary, under-secretary and actually secretary. She shares her personal time with the Children's Receiving Home of Sacramento where she serves on the board of directors.

Now I'd be remiss, if I didn't mention that Anne is also the devoted mother of two teenagers. Her daughter recently finished her first year at the California Polytechnic State University in San Luis Obispo, and when she is not traveling all over the world advocating corporate governance, Anne can be found pool-side where her son is a champion water polo player.

So please join me in welcoming my most respected colleague and a woman I'm honored to call friend, Anne Sheehan.

[applause]

Anne Sheehan: Thank you. Thank you for that introduction. It truly is a pleasure to be here. It's wonderful to see Priya my former colleague on CalPERS. It really is nice to be here. I am thrilled to be participating with Japan Society as well as well the effort of the Pacific Institute in this effort.

I want you all to eat and don't worry... I ate. Nice to see you. So as I will go ahead and speak, please go ahead and eat. You're not insulting me and I'll join you after I finish up here.

Before I get into my remarks about what we are doing in Japan and what is our interest is in Japanese Corporate Governance, let me tell you a little bit about what we at CalSTRS are doing in the world of corporate governance.

What my job is, what my shop does and the activities that we are pursuing. First off, a little bit about CalSTRS. CalSTRS is the second largest public pension fund in the country, second to CalPERS, our neighbor across the river. Right now, today, we are about a 125 billion in assets. At one point we were a 165 billion in assets...

[laughter]

... but this past year has proven to a bit of a challenge for all of us, as I don't have to tell the people in this room. We were established over 90 years ago, really for the retirement benefits for the teachers in the state of California. We have over 800 thousand members and beneficiaries that we serve and we do solely the retirement benefits for the teachers.

The health care benefits are done at the local level. We are really the retirement system for the teachers of the State of California. Like many of the other public funds, we invest across all of the asset classes. All of them: public equity, fixed income, private equity, real estate, and we have also just created a new absolute return class.

In terms of our allocations, it does mirror many of the public funds; Global Equity is about 50 percent; Fixed Income is about 20; Real Estate and Private equity is about 20 percent and then we have another five percent class in absolute return and we are just moving into that.

It's a sort of decision that has come about as a result of the last nine months. Given us the opportunity to, I don't want to say chase them or oust, but see what we can do to enhance our returns.

My unit, the corporate governance unit, is a division within the investment office. The other directors in the investment office cover the other asset classes, and then corporate governorship is really a directorship that cuts across all the asset classes.

We are primarily focused on public equities, but we do participate with our colleagues in private equities and what's going on in corporate activity, real estate as well as the fixed income unit.

And in terms of our corporate governance program, we have activist fund managers, which I will talk you a little bit about. We have managed about three billion dollars for us on the behalf of the corporate governments unit. We do portfolio public engagements with, as you can imagine, we are invested all across the public equities market.

So we have holdings in all of the big companies both here in this country as well as overseas. So we do engagement with some of those Portfolio companies that we may have some concerns with.

We developed a work plan list of companies large in our portfolio that we have concerns with and that we try and work with them to maybe make some changes either on the government side or even on the operational side that we think that will enhance the value of our investment in those companies.

My office votes all the proxies for the companies we have in our portfolios, the activist in the United States as well as some overseas. This past year we voted about 43 hundred proxies.

Also my shop is active in the legal regulatory in the legislative support side. We support our securities litigation unit of our legal office due to proofs of claims. We also track any activities going on either in Sacramento or Washington, DC on the legislative front or the regulatory front.

Right now, as I am sure others in the room, we are closely watching and putting together our letter on proxy access, trying to seek the ability to gain access to the proxy as a large share holder, and will be filing our comments with the FCC in the next ten days.

A little bit about our activist manager program as I mentioned. We have about three billion dollars committed to this equity investments style. There're funds here in the United States, in Europe and actually we are looking for a Japanese manager right now.

I've spent the past two weeks meeting with a number of managers who have come to Sacramento to talk about the possibility of us partnering with them to do work in Japan.

So this speech is, and this event is, very timely for me, because, as I say, I've worked so much in the last couple of weeks in terms of what's going on in Japan: How corporate governments is viewed, how activist management is viewed. So it's been very helpful for me in preparing for this speech here today.

Anyway in terms of our manager program, they hugely hold eight to twelve companies in their portfolios and they take a fairly large stake in the company. Somewhere between five to ten percent in their companies with the intention of trying to make some changes to really turn around an underperforming company.

They look for these underperforming companies who have strong fundamentals who feel that with some changes they can really make a difference. They look for strong cash flows, a good brand of the company, low leverage.

The managers also help provide a catalyst for improvement. They may want to invest in underperforming assets, use better uses of the capital in the company, possibly institute some share buybacks; many of the tools that any of the activist managers use, so that is our primary in terms of our participation and work for the investment part.

I talked a little bit about the portfolio company engagement; we are a long-term asset owner in these companies. My boss, Chris Ailman, who many of you know, says "As long as there are teachers in the State of California we are going to be invested across the public markets."

So for the companies that we are holders in, whenever they come to meet me, I say, "We are going to be with you a long time." Whether it be Exxon, a large company, or a small technology company that is just blossoming down in Silicon Valley. We are going to be holders in those companies, so our long-term interest and the interests of those companies are definitely aligned and we want to make sure we see things the same way and communicate our issues to those companies.

In addition into just engaging with the companies directly, our staff will reach out to companies, and we have done it on a number of issues this year. Executive compensation: Holsters this year published executive compensation guidelines, and then what I did was send it to our 300 largest holdings and said "We would like you to review this, we would like you to see what your feedback is."

Over the past month or so we had conference calls with those companies giving us feedback on the guidelines and for us, my staff hearing from them, how they view compensation.

As most of you know—and it was mentioned this morning—we are anticipating that share pay will become a reality in this country and that large share companies will have the ability to have advisory vote. Well, my view on this, and I know we've had discussions with Abe and others in this room: we don't want share pay just to be a "check

the box." As long-term shareholders, we really want to sort of get underneath the hood, understand how these companies are putting their compensation packages together, make suggestions to them where we feel they may have some shortcomings or learn from them where we feel they have really done a good job in setting good performance targets, good long-term goals for their executives.

So that is another issue that we really engage with our companies as executive compensation. With the debate having gone on in Washington and all across the country this year on compensation, it really has been a target and a focus for many of us. In terms of our focus list, it really is. We send out the portfolio companies or the companies within our portfolio through a screen to see, the underperforming ones, which ones we have a large stake in that possibly we can spend some time engaging with them on some shortcomings that we may think they have, and understanding what some of their problems are so that we can help them increase their value so we win and they win.

We do develop a focus list similar to CalPERS and spend quite a bit of time working with those companies. Proxy voting, I talked a little bit about, we vote all of our domestic proxies in-house.

One of the other things that CalPERS did announce this year—it really started in the medium to light proxy season—is, we are going to pre-announce our proxy voting, so going into the next proxy season, it's our hope to get our proxy votes up online and make it public as to how we are voting before the general meetings.

Now, our commitment is to try and do a week to ten days out, but catch me next May and see if we have made that goal yet, but that truly is our goal and the goal of our board to try to get that information to others, so people to know whereof us as large shareholders are on some of these major issues—as well as to help influence others possibly in seeing some things in the same way we do.

We do vote some of our active proxies overseas: Canada, Australia and a few of the European ones. Our Japanese proxies are voted by our fund managers, who follow our guidelines. The CalSTRS Proxy Vote Guidelines and our corporate governance guidelines are posted online for everyone to see. Every time we update them we share them with our managers.

And then finally I talked a little bit about the legal regulatory legislative support that my office does. We are tracking the legislation in Washington, tracking the regulatory issues coming out of there, whether it's the Securities Exchange Commission, the New York Stock Exchange; we are very active with them; PCAOB, any other world changes or regulatory changes that may affect our operations or the companies that we deal with, and I said legislation both at the state level and at the federal level.

The other thing that my office is responsible for is our Geopolitical Risk Program. In California, we have legislation relating to our investments in companies that do business in either Iran or Sudan, so my shop is the one that engages in those companies that have activities there—works with them to see what they're doing. Are they continuing work? What their humanitarian efforts are. We need to report to the legislature on a regular basis

as to how we are responding and are we divesting in those companies. Are we keeping them? What is the communication with them?

Now let me talk a little bit about our activities in Japan. Currently, in terms of just investments in Japan, we have close to 400 billion dollars invested in Japan in the equities market and we have about 25 billion in the fixed income.

Needless to say we have a vested interest as to what goes on in Japan and tracking the success of the capital markets over there and hopefully proving as a large shareholder to be a positive influence and an active owner in the companies over there.

In terms of corporate governance activities that we are doing, as we say, we are looking for a manager right now; someone that can do some work for us over there and really give us some exposure to the activist manager over there and see if we can make any movement on some of the corporate government activities that we have talked about this morning.

We are active with the Asian Corporate Governance Association and I'll talk a little about the paper that they published. I know the speakers on the panel this morning had talked about it and we as well as CalPERS and some of the larger Pan Funds; we are really sponsors of that paper.

We also host visitors from Japan; the FSA was in just recently. As I mentioned, we've talked about some fund managers; the pension fund managers have come to visit us, so we really try and stay up and active on this.

My staff have been very active in the Asian Corporate Governance Association and was involved in two of the trips over there and Chris Yuleman is very active in the Pacific Pension Institute Board and has done a number of trips over there.

In terms of the white paper from the ACGA, I think most of you know it was issued a little over a year ago and really was intended to initiate a discussion on corporate governance, and I guess as we had discussed this morning from some of the subsequent papers that come out.

I would say it succeeded in sort of fostering that dialogue about corporate governance in Japan. As I say, we were a sponsor of that and we really saw it as a good way to get the issues out there and foster that dialogue.

One of the things about corporate governance, as people say "Well you know you got to look at the fundamentals of the company and it's not just the structure," but we see them as intricately tied together.

Now, I don't think corporate governance has a plan for all the answers in the market place either in America, Japan, or anywhere, but we do see it as a very critical part of rebuilding the confidence of shareholders, especially after this most recent financial meltdown; and we see that there are some benefits, positive benefits coming out of corporate governance activities.

In terms of the... let me just touch on a couple of the issues that the ACGA paper hit on that we are very supportive of and that is the whole concept and was discussed this morning, of shareholders as the owners. And not just the stakeholders but the whole system is beginning to change in Japan.

The view of shareholders; how are participation in the companies; what are the rights of shareholders; should they be better recognized; how should they be recognized; how do shareholders engage with the management of the companies to make their points known, what is the best way.

It doesn't help us to have an adversarial discussion or an adversarial relationship because, as I said before, we're in this for the long run. We're going to have a long-term relationship, so what is the best way to open that dialogue to begin that discussion?

Another point that was hit in the white paper that we are spending obviously goes to the core is, as we look at these companies, the efficient use of their capital. What are they doing with the capital in terms of savings on the books, capital that they're just keeping? Are they doing share buyback programs, paying dividends?

What are some of the actions that we feel as shareholders are really good for the long term value of shareholders? And is the management of the company looking at that as the primary issue, or are they just protecting themselves and protecting the management?

In some ways, that doesn't necessarily help us, but we need to understand what their rationale is in the decisions that they make.

So, the use of capital has been real key in this. I've talked to managers, talked to them, OK. As they've gone into these companies, what has been their experience? What have they seen as a good way to solicit the information, how that decision making process is done, and get some insight into the Japanese culture.

We talked a lot about the board independence and independent directors. For those who had asked in terms of a definition, I know we have a definition at CalSTRS in our guidelines, I know CalPERS has a definition, and I suspect many others in this room. So there are numerous definitions that are out there that are accepted in terms of what is an independent director.

I think one of the points that was hit on—and I know Mr. Tanaka and I were speaking at the luncheon table about the independent directors—it's not just the independence of the directors that is so important, but also the skill set that they bring to that position.

As we are looking at proxy access in this country, one of the issues that many of us have talked about is, if we get a proxy access, how we are going to find these directors that we're going to nominate to these boards or that we will. And as I talked to my colleagues I said, "We need to figure out what are the skill sets that are required for a good board director." And then we back up into that, "OK, who are those people that may need those skill sets?"

But it really is the skills and the capabilities of the individuals that is the most critical component of them being independent directors on the boards. It's getting the skill sets first, and then figuring out where they could be nominated as an independent director.

Another issue that was hit in the ACGA paper that was touched on this morning is preemption rights, and should shareholders be protected in terms of some of the actions that are taken to preempt their rights. We are a bit concerned about that, as we are about the fifth issue in terms of poison pills and takeover defenses.

In terms of our voting guidelines, if there is a rationale for a poison pill, talk to us about it. What is it, what is the concern that is being addressed?

Have some triggers or some mechanisms in there so that if it is for a specific instance, we understand what it's for, what the rationale is and, most importantly, allow the shareholders to weigh in on that issues. Give us the opportunity to give corporate management our views on these sorts of things.

If simply a takeover defense is just to sort of circle the wagons for a company that is not doing well, maybe we should think about some other alternatives or change in management or possibly an independent director to bring in some new ideas. But not just to institute poison pills as a way to sort of protect the status quo.

If the companies are going to be successful and we as shareholders can participate in that, we think it will lead to better value in the long run, both for the management and the corporation itself as well as for those of us who are shareholders.

Finally, the whole issue of shareholder meetings, votings, making public the results. As I said before, we are big at CalSTRS in terms of posting on how we vote on proxies, what our opinions are in terms of these various issues. We think it's very important for the companies to post the results very quickly, for us to know what happened, how people voted, what the results were.

Transparency is an extremely important priority and value to us at CalSTRS, and that is something as we talk to anyone. Give us the information, disclose it early, and let's have a dialogue about whatever an issue is.

Now, I know there have been a number of other papers that have been spurred from the ACGA paper. As I said at the top of the speech, we think that the papers have really begun to foster that dialogue that needs to take place in Japan and around some of the changes in corporate governance.

I think what's happened over the past nine to twelve months has just facilitated and expedited the need for that dialogue.

I know we talked about some of the others, the METI paper, the FSA as well as some of the corporates that have come out with some of theirs. While we don't agree with all of the findings of some of theirs, and some of them there again are sort of protectionist,

what we do like is that they are, at least, able to put out some views and help us to start that debate and discussion about corporate governance.

The FSA study report in terms of... and I know the panel talked a little bit about that in terms of board structure, board independence; the monitoring of management, the giving the shareholders the right to do some more in terms of looking at that. We were very supportive of that. I guess the issue is, I know, where do we go next and what are some of the takeaways from that?

One, we are very heartened by the debate and discussion that's going on in Japan and with the managers over there and with the corporations over there.

We are heartened that the Tokyo Stock Exchange may begin to look at the idea of one independent director and trying to figure out what the definition is, but just the fact that that discussion is going on and that movement is taking place, we see it as very positive.

We appreciate the fact that many of the reports have talked about publicizing and communicating better with shareholders, and for management to really spend some time talking to the shareholders and opening up that dialogue.

In terms of when we think some of these changes will take place, it will be slow. We, as the Americans and as a large American pension fund, can share with those others our ideas and why we think these things work, but it's also incumbent on us to understand what the culture is, what progress they've made.

As I mentioned at the lunch table, there are many rights that shareholders have in Japan: proxy access as well as others that we don't have here in the United States. So, there are models that are being done over there that we are looking to get in this country, so it really is a give and take in terms of the two.

I don't think Americans should go over and presume that we have the best corporate governance. I think this past six or nine months has proven that there's room for improvement in our system, but what I think can be done is that sharing of ideas and learning from each other in terms of making us better as shareholders, whether it's the teachers of the State of California or a pension fund in Japan that also is a shareholder in those.

So, in terms of the next steps, we are very hopeful to be signing with a manager very quickly. As I say, we are already in the markets over there. We have a vested interest in what goes on, and it's our goal to really step up to the next level of participation and become much more active participants in Japan as a large shareholder in an American pension fund.

With that, let me end, and I want to thank you again for the opportunity to be here, for sharing with you what our goals are and what we're looking at at CalSTRS and, hopefully, to network and dialogue with a few of you before I have to get out of here. Thank you.

[applause]

Man: Could you take a few questions?

Anne Sheehan: Easy ones. Not from this guy. [laughter] Yes sir?

Man 2: Can you speak a little about carrying corporate governance to the state of California for a moment?

Anne Sheehan: Oh that could be a long discussion.

Man 2: There are many people who would say that our activist shareholders are citizens and the initiative process has really made governance virtually impossible in this state. Now if you took a look and said what do you think the limits of activism ought to be on the part of the shareholders? First if you align on the directors, to do the right things in the interests of the shareholders and either getting rid of the directors or getting out of the company.

Anne Sheehan: Well, good question. As I say, I'm not sure I would use the governance of the state of California as the model.

Man 2: I hope not.

Anne Sheehan: Exactly. Although I do think the one thing that is good in terms of the model for the governance of the state of California and the initiative process is the rights of voters, where the parallel to us would be shareholders, to have that say in the process. So that would be a parallel. Now, whether you like the initiative process or not and what it has brought us, we could debate that forever.

In terms of the limits on activist shareholders, where to draw the line and what role the directors have, our goal, and one of the reasons that we are very supportive of proxy access, because you look at the many of the issues that we talk about in corporate governance. You know, majority vote for directors, declassified boards, whatever some of the litany of issues that we are supportive of, it really is access to the proxy to be able to nominate directors, and to change directors, like we do with hold votes, for people who are not doing the job that we as the shareholders have elected them to do.

And I don't want to run the day-to-day operations of any company. That's not my job. My job is really as a shareholder to see is the board carrying out their responsibilities that we have vested them with, and are they doing it in a way that protects all shareholders?

Not just their shares, or the insiders in the company, but all shareholders, and especially the rights of the minority shareholders. So the limits are when the director fails to do his or her job as a director, is when it's time to get rid of that person, and send them a message.

Now, let me say, what I have done, and one of our values at CalSTRS is, if we have a problem and we vote against or we withhold a director, that company will have heard from us before. They know what our concerns are. I understand where people are fearful of the proxy access, and you know, you'll put directors up and we've never heard from you.

I can guarantee, and now I can speak for myself and I know CalPERS is the same way, if we decide to nominate a director for a board, that company has heard from us on what our specific concerns are, whether it's compensation, whatever the shortcoming is.

So the limits are if we get involved in the day-to-day operations of the company, and that's the responsibility of the board and the chair to do that, and it's not the responsibility of the shareholders to be in there telling them what they should be doing but rather, elect them, empower them, and tell them that we can get rid of them if we don't think they're doing a good job.

Man 2: Do you, or do you not, or if you do not, why do you not support a binding version of say on pay, and same question with access to the proxy? Do you support a much less limited version of access to the proxy, such as they have in Japan?

Anne Sheehan: I would say no on the second one, the reason being that I think if we can have full access as a long term shareholder, it balances. I hate the term, "levels the playing field," because it always means somebody is trying to get their side.

But I think it then balances the rights of each side as well as hopefully balances the responsibilities of each side of what it is they need to do if they really want to use that power, which would be my hope it would be used sparingly, and to engage in this in other ways. Now, the first question was?

Man 2: Say on pay.

Anne Sheehan: Well, I don't think there's a one size fits all on compensation.

And for us to go in and tell a biotech company they have to have a pay structure this way, and a manufacturing company to do that, I also think in terms of the knowledge that would be necessary to really go in and understand each of those pay packages, if my staff goes through the CDNAs, and I'm sure PERS and AID [as heard], I mean, it's pages of this stuff.

And so, I think the idea is, it gives the directors an understanding of "You've got the right structure, you have to do the specifics of it." There again, if it's binding, it's telling them, "You should only pay a certain level, you should only do this." Through our guidelines, we hopefully communicate with them what it is we're looking for.

But I don't want to substitute my judgment. As an outsider, I give them the idea of what I want, versus sitting on the inside and having to make that decision.

Man 2: But can't you do that through engagement? Could you not do it more through engagement that's binding in the first place?

Anne Sheehan: Well, where I sit in my job, I do it whether it's binding or not through engagement and through the guidelines that we do. So I see it maybe a different way. Others may see it as you should have it binding. I see it as a responsibility to the shareholders to let them know. So whether it's binding or not, I take that responsibility the same way to the shareholder.

Woman: There was a discussion this morning about the practice in Japan of using an independent auditor or auditors as a system, and it seems to be that is the preference to a company of Japan. The concept has not been explored [off-mike comment]. Do you have any thoughts about using an auditor to [off-mike question]

Anne Sheehan: I haven't spent as much time in terms of that. I mean I know it's a difference in terms of that. What we have over here is the independent audit committee and the independent auditor.

What's really come out of Sarbanes-Oxley, what we've lived with the past few years, but I haven't spent the time really focusing on the audit issue for them. We've spent more time on some of the board issues and some of the other key ones.

Man 3: If there aren't any other questions, let's have a little bit of lunch.

[applause]

Anne Sheehan: Thank you.



After the Crisis: Corporate Governance in Japan

*Panel II:
Perspectives on Japanese Corporate Governance*

August 7, 2009

Perspectives on Japanese Corporate Governance

Dana Lewis: Lets us just begin. So we are very happy to have Nami Matsuko of Nomura Securities moderating this panel. She was talking when we had some conversation yesterday that it will be interesting for her to be moderating the panel from the investor perspective, since she has been on the study groups looking more on the regulatory side.

She has participated in previous Japan Society Corporate Governance Forums. We are really happy to have her. And Nami Matsuko will speak for us. Thank you so much.

Nami Matsuko: Thank you Dana. Let me welcome you all back to the after-session. And I hope that, because it's in the afternoon, I would like you to relax and enjoy the conversation and discussion that these distinguished panelists will have this afternoon.

But I just want to make sure that you don't just fall asleep, because it is very rude to do so in front of the panelists and speakers under the Japanese standard.

My name is Nami Matsuko from Nomura Securities in Japan. I am also a member of the METI Corporate Value Study Group last year. And also in the morning session there was a lot of talk on the new ruling under the TSE regulations, and I actually worked at it myself. But my immediate boss is a member of the corporate governance committee under the TSE. So if you have any requests or any ideas for the new rulings under the TSE, please come to see me so that I can try to incorporate your ideas to the ruling-making process at TSE.

I am a little bit different from the three panelists is that I am from the corporation side. I work for the investment banking business development department. What I do is basically to advise companies and financial institutions in Japan for their M&A activities or finance activities and any kind of corporate actions activities, including corporate governance and stock executive compensations and employees stock ownership, and sometimes takeover defense measures itself. And what I am trying to do is trying to rid the gap between the investors and corporations.

Let me briefly introduce here today's panelists. And first I would like to introduce Scott here. He is the CEO of Ichigo Asset Management and also the Director and Chairman of their listed companies in Japan. And I am sure that he is very known by many Japanese because of his involvement with this proxy fight—the direct and employed proxy fight in Japan. And that many Japanese managers and directors are afraid of him; I know. So I would like Scott to show he is not the person to be afraid of.

And the next person here is Oguchi from Governance for Owners. I would like to point out today that he has been with the Nissay and Nippon Life Insurance companies, which has tons of cross-shareholding shares on their balance sheet.

And of course Nissay Insurance Company is not a listed company or anything, but I am sure they have the potential to improve Japanese corporate governance because of the shares that they hold.

And then the last person is Abe from Barclays Global Investors and global head of corporate governance and proxy voting [inaudible] BGI is a proxy voting of worldwide. Before that he was at Glass Lewis. And I just talked to him at lunch and then just found out that Jun Frank, who is going to be moderating the next panel, is one of the persons that he recruited and that Jun was the best recruit. Do you see him here?

So anyway, let me finish my talk and then I would like to have everybody to speak for about 10 minutes, and then, afterwards, I would like to have some questions through them and then I would like to open the floor for the discussion. Thank you....

Scott Callon: Can the folks in the back hear me? I have this little problem. I am terrified, and my voice gets a little small. I'm not sure why everybody is afraid of me for that. Just to give you some context for where I'm coming from, I'm coming from originally San Jose, California. So, it's a pleasure to be here, but I've lived in Japan now for 20 years. It's where my life, my wife and my children are all are. We've made our home there, and it's an incredible pleasure to have been able to raise our children there. I say that because I have significant emotional commitments to a country that has done so much for my family. Actually, my parents originally brought us there, so multiple generations.

In 2006 I left Morgan Stanley and started a small multiple assets manager called Ichigo Asset Management. For those of you who speak Japanese, you'll know that *ichigo* means strawberry, which is sort of good news and bad news. In our case actually, it doesn't mean strawberry. The *ichigo* we use in our name is the writing of a 16th century master tea ceremony, and the full phrase is "*Ichigo, Ichie*," and it means one lifetime, one encounter. It's a writing from a master to his students of the tea ceremony where he points out that in any situation, that moment is truly unique, just like this moment here.

When you are doing the tea ceremony for guests, you should remember that when the moment comes up. So, we were kind of three guys with a dog and a dream and our ideals of how to contribute to Japan. And we started this small [inaudible].

For better or for worse, our very first investment was a wonderful small Japanese steel company called Tokyo Kohtetsu where literally within days of investing the management announced that they were selling the company at no premium to a member of the Nippon Steel Group.

And we thought the company was far more valuable than no premium, than the last traded stock price. We particularly felt that because at the time of the announcement, the company simultaneously announced, "We're selling the company at the last traded stock price, no premium to the shareholders."

And then they had a following announcement, "Earnings are up 34% over forecast." Of course, that announcement meant that it wasn't in the stock, so we felt very strongly that they probably should have revealed that information prior to the announced merger.

And I think there was a little bit of idealism and a little bit of stubbornness, but we decided to discuss with management, whether or not this was a strong merger, and

begged them, we literally begged them, to do something that was a better outcome for the shareholders. And no Japanese shareholders in history have ever successfully fought a management-led merger, and so I think that probably was the context: we were told "no" by the seller, "no" by the buyer, "no" by the very, very large shareholder whose biggest customer in the world was Nippon Steel, and therefore they would only sell the company on the cheap to them. And this is where I think the idealism and the stubbornness came in. We knew we weren't going to win, but we felt we should challenge this action by appealing to the other shareholders.

But this was you know, effectively an element of shareholder democracy, that we had rights as shareholders to pass judgment on the transaction, not just accept what management deemed to be a good transaction. And the weird and wild thing is, *we won*. So, nearly three-quarters of the individuals who held the stock voted with Ichigo and we blocked the merger. We're still holder of this company. It is still a fabulous, fabulous steel company, and we're very, very proud to be shareholders. And I guess probably the context from what Matsuko said that people are afraid. I'm not quite sure what there is to be afraid of.

We care deeply about the companies we invest in. So we have a little bit of some perspective, or I have some perspective, on behalf of my partners at Ichigo, what it's like to be involved in a proxy and what it's like to interact with Japanese managements as an investor.

But the other thing I would add—I am very happy to take questions on this or have a discussion—is that in the last year we have taken control of some companies. So I am actually the chairman, an elected board member of a listed Japanese Company called Asset Managers.

I think my shareholders would be upset if I didn't mention that the stock code is 2337. It's very cheap and you should all invest in it. [laughter] So I have some context: I actually run the shareholder meetings for this public company, and that's has been a very interesting experience.

We also are the sponsor, meaning the controlling shareholder, as Ichigo, of the whole Japanese REIT listed on the Tokyo Stock Exchange called Japan Office. I think the [inaudible] would feel that I remiss if I don't point out that it is 8983 and also very cheap and worth investing in. So to some extent I stand on both sides—as a manager of a Japanese company and as an investor.

Let me just declare one of my core beliefs—one of our core beliefs at Ichigo. It has some context for looking at corporate governance in Japan. We believe culture is not dead. People talk about a global village, as if we have all come together and are the same. And our view is, if there is a physical global village, then the neighborhoods are very, very different.

There is a very, very special country called Japan, and it's different from another special country I love called America. It's different from Korea and from France. It has its own

values and its own traditions and its own language. And I think one of the challenges of interacting effectively with Japanese management is that if you tried a strategy of: "Hi, we are from New York... we are here from New York. Here are our empty suitcases, give us your goal," it just doesn't work very well. And I think it's fundamentally, enormously important to recognize its uniqueness and to work within a culture as opposed, perhaps, to battle against it.

I should say on a daily basis I spend most of my time in Japanese which can sometimes be a struggle for me. That's fundamentally right also. We don't ask upper management to come to us, we run to them in all senses of the word.

This diversity of culture is a strength rather than a weakness. Looking at Japanese corporate governance, I don't think we should really object to it on grounds that it's different. That's fine. It's perfectly acceptable to have a [inaudible] system; it's another system.

Speaking as someone who is a long-term resident of Japan (I have the Japanese form of a green card), that the more fundamental issue is it's not working. That's not an issue nearly as important a problem to, for example, Americans, [as it is] for the Japanese to live in Japan.

We cannot fund the future of the country without higher returns. We face a shrinking labor pool. It's static, if you look at the classic elements of production: land, labor, and capital. We have static land; we have shrinking labor. Capital is relatively flexible.

Japan has some of the highest human capital in the world, but its financial capital is clearly not being deployed in ways that serve the country. So, in a sense, my argument would be that the capital market is letting the country down. That means management is going to have to deliver returns for letting the country down.

My last comment on that would be that it's not management's fault. I think it's a very clear case, so I'm going to make a sweeping assertion that we can discuss. Japanese managers have been asked to do something slightly different. They've been asked to take care of employees on a long-term basis. They've been asked to have some of the greatest attention to customers and clients in the world. They deliver very well on those two. Then the shareholders is the third element, but in last place.

I speak quite a bit in Japanese, so I look at Japanese audiences and say, "We want to change man's behavior, then we need to change what's in our hearts. We need to change how we interact with Japanese management." It's really, really hard to run companies well. These are typically men who are enormously successful, committed, and ethical. You do not find Japanese managers paying themselves outrageous sums of money. In many ways they represent the best of Japan. But if we want them to do more, we're going to have to ask them, and we're going to have to praise them for their success.

So I generally say, half-jokingly, we should give them *kunsho*. We should give them imperial prizes, like poets and doctors do when they contribute. Because raising returns for the country's fund futures is so incredibly important.

I'll stop there, because I could go on for hours. But I thank you for the opportunity and I'm looking forward to interacting with the other panelists and all of you today. Thank you.

[applause]

Nami Matsuko: Thank you very much.

Toshiaki Oguchi: I'm Toshi Oguchi from Governance for Owners in Japan. Thank you Matsuko-san and thank you for giving me this opportunity to join the panel discussion hosted by the Japan Society of Northern California. And Matsuko-san.

Perhaps an explanation of the Governance for Owners itself. I joined Governance for Owners in 2002, in Governance for Owners group is chaired by Bill Crist over there.

In that time Governance for Owners Japan was established as the pre-owned subsidiary of Governance for Owners Group. Lastly, the company; the total money asset management got 40,000 stakes of our company. Now Governance for Owners Japan has come the total venture of Governance for Owners and total money asset which is about our largest pension fund, pension asset management company to Japan.

And also I just want to introduce myself a little bit. I am a member of the METI Study Group which professor Osugi delivered to you in the morning session. I will tell you, he sat next to me at the group meeting because we have the same initial of "O" [laughter].

I know the discussion is the main point, but I have to share my question on the Institute of Investors in Japan with all of you. OK, maybe many of you are familiar with this chart. It shows you the shareholders of Japanese companies.

Actually, I just added "A". "A" means foreigners and foreigners' percentage or market value owned by foreigners, it shows "A". "B" is Trust Bank including the account for the Japanese institutional investors.

To show you that "A" plus "B", or roughly 40,000, is owned by institutional investors account fiduciaries regardless of the nationality, Asian. So now I want to raise this simple question to understand how accountable, how responsible Institutional Investors are in Japan.

First question: Is it the same thing as what Steve mentioned in the morning session. My first question is if the shareholder duties are fully discharged.

This is data for 2008 and maybe Steve mentioned about the numbers of 2009; but you can discover how each shareholder group exercised a voting right. So foreigner [inaudible] investors are known to the broker in Japan.

However, the exercise ratio of voting right is rather low compared with the Japanese banks and the life shares companies. Regarding life shares insurance companies, the ratio does not look so high.

However, according to the guy who made this chart; he told me that it is likely that they exercised at the agent; to come to the agent directly maybe to support the company and the shareholder. So it may not be surprising that the Japanese management does not correctly understand the holder's message—especially when that company of close shareholding and political investors who are Japanese including life insurance companies, as long as the holders support the management. The Japanese investors should exercise their rights more wisely. I understand that there are many obstacles for investors in Japan, especially to non-Japanese investors.

So, the FSA Study Group—the official name is very long, the Financial System Council's Study Group on the Internationalization of Japanese Financial and Capital Markets. It's very long, so I call it SGI. They published their report on the 17th of June and pointed out, as you see, those [inaudible] on the new technical problems to be addressed. In addition to improving the voting environment, SGI required listed companies to disclose details on voting rights, which people mentioned this morning.

I believe that this requirement encourages non-Japanese investors to take more interest in Japanese voting, and also Japanese companies to be more accountable to shareholders. That's my hope and my belief.

The second question is, are shareholders' interests reasonably cared for. Needless to say, and someone earlier pointed out, many issues have been raised with regard to the so-called cross-shareholdings. Unfortunately the ratio rose for the third consecutive year, according to Nomura Securities.

This is just about cross-shareholding. In addition to this one, more than five percent is headed by life insurance companies, so I'll say it, in a sense political investors. I think it is too naïve to expect those shareholders to care minding these shareholders' interests, as long as they have other strong business interests.

Therefore, I think, it makes sense for some companies to deduce those so-called inside shareholders, in the sense disclosure and the internal accounting quoting for the accountability to the shareholders. This is now for the topics in Japan and also the demand to mitigate the possibility should contribute to market efficiency.

Another important notice is that the Japanese management is really that positive in Japan cannot be exercised when necessary. So that is recognized as a reason for the closed shareholder holdings to divide, therefore making a concerted effort to establish a Japanese takeover panel in the near future.

Someone mentioned about Mr. Niihara, Mr. Niihara is a Director of METI study group. Unfortunately, he changed his position to another one, but I met him last month. He brought his successor and he said METI is very keen to continue the discussion. They are

sending a delegate to study more on takeover panels, not only UK but also Germany or some other country, which Japan may have some similarity.

I hope it would relieve to no need of closed shareholding as part of takeover differences. So I would like to say that increase of the closed shareholding have some sort of reason. Without adding such reasons, companies have incentive to keep them because shareholding forever, you say.

So the question is, is the principal-agent problem between the institutional investors and these other interests in Japan. Now, I would like to ask about a response from special bond, maybe there are many big here to agree with you are agent. Japanese manager come to Malaysia. As you see do not accept outside director an outside director to contribute to shareholders interest, as you see. So they did not expect so much from them. If agreed, that's fine. If not, I think something needs to be done.

So more limited with these Japanese regulator requires institutional investors to be accountable to their principles and the beneficiaries. In that sense I think that US and the UK bank code are worth consideration.

However, I make this question to Matkosa, and he said maybe it very tough to desert. If so, it is too optimistic to expect the association to improve. The reason why he said is that in order to making the loan in Japan, in general, 60% or 70% should agree with the concept. Otherwise, we are very tough to make the things. So that means this mandatory accountability has not reached at that point. I understand.

If so, it seems to me the more effective totality limited is that no Japanese principal is accountable initially, but their agent Japanese I sent one in Malaysia to take more honest action or matters or corporate others by using character mistake. Character means giving more money to the hands of the stakeholder. Very simple.

So another important question is that institution needs to send the right message to Japanese companies. The thing is still mentioned in the morning that more than 20 companies—around 30—disclosed details voting dissent, and disclosure always tells me something.

So you can see—this is on the website—only disclose the ratio of amount output for seven individuals, ranging from 16.4 to 19.9. The only Japanese ratio is, as you see, more than 30%, and there are two outside directors around seven.

According owner is very known as shareholder for the company... to the shareholder proceed otherwise as recommended to shareholders to vote against the ration for outside director and argued against the website. Maybe you can see those on the website.

On the other hand, I want a company. This is a good company because they disclose what the ratio, what the result... I just want to talk about the fact about the company disclosing the ratio above input for the 12 individuals candidates ranged from 92 to 97.

Non-Japanese shareholders percentage is also more than 30%, and there are no outside directors around. I really understand for their recommendation. But what do those two examples suggest? Is it wise for the company to promote no outside directors to avoid the list to be voted against? Is this really what institutional investors want? This may be worth consideration of discussion.

Suggests to me that Japan is an exception. But I wonder if the Japan exception is really legitimate, maybe in a sense, in some point, legitimate, but in others, I don't think so. As we know, this [means] bond institutional shareholders have a responsibility to make considered use of their vote, and need to fulfill their fiduciary responsibilities at their own risk.

The last and the most fundamental question is, do institutional investors succeed in building a win-win relationship with Japanese companies? As I showed you, non-Japanese investors holding us own a quarter. Recently, up to nearly 30% of Japanese equity is held by non-Japanese investors. However, except for some exceptions, I found it difficult to say that the Japanese management and non-Japanese investors have had a constructive relationship.

But there's more. Non-Japanese investors have not succeeded in building up cooperative relationships with Japanese institutional investors. So we started a new challenge called Japan Engagement Consortium this year with Tokio Marine Asset. The intention is to bring together responsible Japanese and institutional investors. On first, you have the consortium objectives with Japanese companies to improve share returns. Initial members were Tokio Marine Asset and Railpen UK. USS, the Universities Superannuation Scheme, the second-largest pension fund in the UK presently, become the third member of the JEC. You can see those names on our website.

The full-time team of governance specialists, investment specialists seconded [inaudible] by Tokio Marine Asset, is supplemented by an advisory board of leading Japanese industrialists and the public figures. Two years of Japanese engagement. [inaudible]

So, in a sense, Japan is very difficult, so we need support, a very public figure to support and otherwise hold discussion with the company to have the company believe ourselves. We need some sort of advantage to talk with us. I hope our challenge will contribute to a win-win relationship between Japanese companies and long-term shareholders. Thank you for your attention.

[applause]

Abe Friedman: Hello everyone, I'm Abe Friedman. I am the global head of corporate governance and proxy voting for Barclays Global Investors. In that capacity, we have a team of 13 people around the globe at BGI that carry out our responsibilities as a large shareholder, one of the largest in the world, of most major companies around the globe.

Our responsibility as a team involves voting our assets that we hold on behalf of our clients. It also involves engaging with portfolio companies and generally attempting to

use our role as an owner to further the long-term economic interests of shareholders and obviously of our shareholdings.

I want to make a few comments. At the outset I think I just want to make a comment that sort of picks up on a point that Scott made and also a point that Anne made at lunch today, which is that corporate governance is not about one particular or any, even, group of particular action. So the board independence or shareholder access, the proxy, which we are looking in the US right now or approval of auditors, whatever it might be, these things themselves are not corporate governance.

Corporate governance is about designing a structure, a governance structure that is maximally likely within reasonable bounds to further and promote and, in some cases, protect the economic interests of shareholders. And in that there is a balance, because if you think about governance in the public sector, excuse me, there are lots of things that we—for example, in democracies—that we accept, tolerate, frankly, encourage, that we would not want to encourage or accept in a corporate context.

And similarly in the corporate, and by the way, on the public side, obviously we see democracies take very many different shapes around the globe and different forms, and governments operate slightly differently while still being essentially democracies.

On the corporate side the same thing is true. There are various governance structures that exist around the globe. And there are various ways in which governance has evolved within particular markets based on cultural, based on norms, based on historical expectations of investors within a particular market and based on shared collaboration and exchange of ideas that has happened globally as we have become more of a global village, if you will.

And when I think about corporate governance in Japan, I think there are a couple of things that come immediately to mind. First of all, a system that is robust in its design, in the sense of providing rights to shareholders that some markets, the US included, don't necessarily afford their shareholders.

I also think about challenges because that's a big part of my job, is to think about ways in which we can encourage the best practice or we can encourage companies to adopt practices that are more shareholder-friendly, so I think about challenges within a market. In thinking about those things, I think there are trade-offs between various systems.

So, by way of introduction, I thought maybe I would spend a couple minutes on two of the key proposals that I think are being talked about on the corporate governance front in Japan at the moment, and share some thoughts on those. And maybe talk about one thing that I don't think is being talked about particularly in Japan, but I think is a concern to investors and something I would be interested, very frankly, from a learning perspective, to hear from you or from my colleagues on the panel, perspectives on this topic. And then set aside some of the other issues which I am happy to engage on as well. I mean, I have a lot to say about whether we should stagger AGM dates, or whether English translation of materials could be better, or other foreign language translation materials, or more

ubiquitous distribution of materials and timeliness...There's lots of other issues that are out there, vote disclosure and so forth.

But the two things that I will start with, that are being talked about today, are issues around companies issuing stock without shareholder approval and questions on board independence, because I think those are two very big issues that are being talked about in Japan today.

So, on the first issue, I think that there are some reasonable safeguards that have been developed in Japan law to protect shareholders from abuse by managements of equity in a way that would dilute shareholders unreasonably or fundamentally alter the ownership structure of the company.

But I do think there is opportunity here, and I think it's interesting that this community, the corporate governance community, and the government in Japan has taken up this issue because I think there is an opportunity here to potentially make some improvements to that structure. And essentially just to get to the bottom line, from my perspective, having some threshold above which a company could not go in terms of dilution of shareholders without seeking shareholder approval would make some sense to avoid situations where the right or power issuance has been abused or it's had a negative impact on shareholders.

But I think the threshold there... In the US the New York Stock Exchange has about a 20% threshold. That seems to be an effective threshold, I think, in the US, although we're not counting our other situations where we have issues with shares, even as we're voting on these things. It's a challenge because often when a company is faced with the need to issue shares and certainly if they're doing it at a discount, it's not usually because things are going very well at the company.

In some ways, I'm not sure that people would be happier with the outcome whether they're voting on it or not, because often you vote in a way that you don't feel thrilled with it but you don't have a lot of choices.

I do think having some safeguard there is important, and I think 20% works well in the US. I would share that. I don't know if it makes sense for Japan, but I do think that certainly considering that is important.

On the question of board independence, I think it's a little bit more complicated in Japan, and I would point out along the lines of this business of different standards and different approaches there is no one standard on director independence. Frankly, even different markets feel very strongly about the idea that boards should have a substantial component of their membership that is independent have very different approaches. All you have to do is look at the UK and then look at the US, two models that are in many ways similar, but when it comes to director independence, there are substantial differences.

I spent this proxy season in the UK for the first time, and I learned a lot. It was very interesting. I have studied UK's corporate governance and thought about it, but I never

spent as much time as I did this season there. I had never engaged with as many UK companies as I did this season.

The standards for the independence are different in the UK from the US. What one considers an independent director, or I should say more precisely, a non-executive director in the UK does not necessarily meet the same standards of the exchanges in the US run independence for. Frankly, shareholders often are higher thresholds for independence. The percentage expectation around independence of the UK boards is very different than it is in the US.

There is an interesting debate, and for me a debate that I sort of always had as I thought about this issue. I have looked at it in practice and have had to vote our shares on this issue about the trade-off between a board that is very steeped in the operations of the business, that understands fundamentally what is happening at the company, how it works, how its various divisions operate, what the business is about, and what the client demands are from a board that is maybe less steeped in those issues; but in theory, and hopefully in practice, more supervisory and more functioning as an oversight check but without some of the tools that an executive comes with.

There are trade-offs in this director independence business and there are different ways of doing it. I think from our perspective, I would say a few things.

First, we favor the idea of having some independence on boards. We think that at a minimum, management teams of public companies need to have some oversight. Now the way Japan corporate governance is structured, that oversight is largely supposed to come from the investors themselves through the voting process. But, as Scott said, it doesn't always work as well as it should. So, having some independence on a board I think is probably a very good thing. The challenge, I think, in Japan is that I'm not sure the system is entirely set up to support that.

So there are other expectations for Japanese companies, there are expectations around the employees, there are expectations around client services, some of the other things you've heard. And those expectations, and frankly, even the laws and the structure of the society and the way in which the courts have ruled on issues, tend to prioritize in some instances those things over, or not require that management teams, from a procedural process perspective, put shareholders above any of those things, the way they would in the US.

Because of that, the idea of independence in the board is one that I think is still evolving in Japan. So I guess what my point is, I think from our perspective, the best thing that could happen with respect to independents in Japan, is to see that happen organically, and to see companies begin to find benefit from outside, independent thought—to have company managements internalize the idea of the benefits can accrue to the business from having that oversight. The responsibility that is due to investors that can be furthered by having independent directors.

I think, if you were thinking about whether you wanted to have a mandatory regime or a comply-or-explain regime, I would suggest that, perhaps in Japan, starting at the comply-or-explain kind of approach might work better.

There are a few areas where we have a fairly strongly held view that having director independence—or having some independence is essential. So, when a company has implemented a poison pill or is taking decisions around poison pills, we think there has to be some independent check, and we would support the idea that companies in those situations have independent directors.

Where a company has taken away the right of approval of dividends from the shareholders and delegated that to the board, we think that's an area where independence is required on behalf of shareholders.

Where there is a controlling shareholder, or a group of controlling shareholders, we think that's a situation in which having independents on the board to ensure that the minority shareholders are protected, or the public shareholders, if you will, are protected, is very critical.

So, those are some areas where we think it really is important and we would encourage that, but I don't think that we are out beating the drum that every company should automatically be required to have director independence.

So, I said that I was going to talk about something that wasn't out there, but why don't I save that for the discussion, and you can follow up when you're ready so we can keep the..?

Nami Matsuko: Right. Actually, I was really impressed with what you guys talked about and I thought your comments from the investors' side were very understanding towards the Japanese corporations. I was so happy to listen to it so I kind of lost track of the time. I'm sorry about this.

[laughter]

Nami Matsuko: So, I have a question that I would like to ask them, but I'd like to open this floor now for a question and an answer. I'd like to ask the person who asks questions to be specific about things and try to be concise. Thank you. Is there anybody coming forward? OK, please.

Man 1: I'd like to ask Abe what it is that he's [inaudible] and we haven't talked about.

[laughter]

Abe Friedman: OK, thank you. So, the one thing that I think, and Scott briefly alluded to this notion, but I don't know if we have the same take, so I'd be interested to hear some discussion, but...

In the US, we hear a lot of discussion these days about executive compensation, and it is the topic *du jour*, it is in the paper every day, and there are, certainly and with good reason, there have been some extraordinary abuses with respect to executive compensations in the US that need addressing.

But, by and large, the vast majority of companies, I would argue, in the US are actually doing a fine job. There are some companies that have done a terrible job, and the coverage has taken over. In Japan, you have exactly the opposite situation, and Masa Tanaka in his comments at lunch also, I think, made a joke about executive compensation and it's not untrue.

I think in Japan, I would argue that executives are not sufficiently compensated. And what you have in Japan is a structure where executives—there's not really a market for executive talent. Executives work their way up through the ranks of a company over many, many, many years. And they get to a point where they maybe join the board or become a senior executive of the business. And if they lose that job there's no place to go.

I'm speaking generally. Obviously, there are some alternatives out there. But there is not a broad-based market for executive talent, where they can leave and become the CEO of a company and go off and do other things. And they're not particularly incentivized through their compensation to take risks.

And so I would argue that maybe there's something in the system there that's not being talked about necessarily in the proposals that are out there, but that is potentially serious: that there is no market for executive talent and that executives aren't sufficiently compensated.

As a result they are—having reached this pinnacle of their career and not having any opportunity particularly to move on and do it again at another company after they have this try—they're not incentivized to take the risks that will build businesses and drive value for the long term. Instead they're incentivized to play it safe, build value but very carefully and without taking extraordinary risk, such that it's not clear that the risk/reward ratio has balanced out.

I just throw that out there. I think it's an interesting idea. I throw it out there as a cautionary tale to all of us in the US who are focused on corporate governance in the US. The thing about executive compensation, there was a question about salary pay at lunch. There is an alternative on compensation and it's not necessarily the one that everyone would want.

So I just throw that out there. That was my third that I think I would be interested to see discussed and interested to see addressed. I'm not sure it's being discussed as widely as we would think.

Toshiaki Oguchi: Regarding the regulation, I think Japan has a problem in the definition in a different sense. Typically Japanese do not have the incentive to take a risk.

Mainly in a sense, if they work longer, they get more. There used to be they had a so-called retirement bonus. The number or the amount does not be disclosed. So that one reason fits. They do not have any incentive to look at the shareholders, because there is no same interest between the shareholders and companies, unless they have some incentive.

So therefore for the companies, I strongly encourage the companies to some sort of remuneration linked to stockholders or who are. Otherwise I understand there is no incentive for management to listen to the shareholders. And maybe Saito-san from Shiseido will talk to you later on the remuneration, because I was very surprised the interest by the disclosure on remuneration. Maybe he should talk more about it later. But he disclosed the total remuneration package composed of the fixed salary and bonus salary, maybe the ratio is four-to-six or three-to-seven; depends on the length.

But they disclosed regarding the remuneration variable portion, composed of three variables: short-term, one year; three years; and more than three years. To disclose how the management are incentivized to do something. So that information we need.

What I want to say is, we don't have a problem regarding the higher remuneration program in Japan. But there is a problem in remuneration in a different way.

Nami Matsuko: Thank you very much. Anybody, would you like to ask questions? No? You sure?

Man 3: Bingo! What you talked less about now, as it relates to your point. I believe that every manager needs to be in medals of honor as managers.

So we're not talking about overpaid managers who underachieve in most cases, even though there are exceptions to every rule, and act subtle and be smart. In general, many managers are ethical, but to be black when it comes to the board. We have active CEOs in a certain [inaudible] report directly to the managers. The report being their act of energy. And that's how the problem begins.

So when you talk about standing committee [inaudible] either they work. Legally there's no such thing for a contractor to set up companies because a legally structured mission statement is different than the US board. You can't set up a committee for [inaudible] and delegate it [inaudible].

You can work inside of a group for important changes. The people of a committee that has no legal authority to advise the board, and the advisory board and the board has to make the only legal decision that needs to be made in important matters.

So we have a practical problem when it comes to even the independent boards feel it necessary to oversight and performance-based compensation [inaudible], which is not recognized.

Nami Matsuko: Would you like to comment on... the comment?

[laughter]

Toshiaki Oguchi: Committee.

Nami Matsuko: Committees.

Toshiaki Oguchi: OK. I just want to add one comment regarding the committee in Japan. So other information. In the company, the statutory auditor system often set up so-called committee, but often it's an advisory committee, not the part of the board. So for the three committee system, so far with the contract system that is a legal organization. Also they often have a sort of advisory committee on remuneration and an advisory committee on the appointment or something like that.

Otherwise I have the same concern of the function of the legal load of those committee. However, however, I think that those are much better than nothing. So, if company believes they need to delegate some sort of authority to the committee system, company has a choice to move into the three-committee system legally.

For example, Toshiba, I had a discussion that I had with Toshiba. Toshiba used to have some sort of structure with the system and decided moving to the three committee system, because they believe that is clearer, in the legal sense.

But now it is dependent on in companies—this is, I personally believe three committee system is clearer from a legal perspective. However, I don't want to deny other approach.

Man: I'll reply.

Nami Matsuko: OK.

Man: [off-mike comment] The three-committee system, though, [inaudible], there's no committee that can be legally formed under the three-committee system that has all the COE [as heard], it doesn't exist.

Toshiaki Oguchi: No.

Man: [inaudible] So any committee you set up we could add a committee, [off-mike comment] a legally non-valid committee to those groups, and any others.

Nami Matsuko: OK. Thank you. Your turn now.

Scott Callon: Is this OK?

Nami Matsuko: OK, sure.

Scott Callon: I hope this is not regarded as a cheap shot, particularly at a corporate governance conference. [laughter] Let's be very honest. I have a very strong preference for the PFA, for example, what the PFA chose to do, which is to say, "Your ROE is too low." Because I think we can thrash around, and there's no question, and this is why it's a

cheap shot, I understand there's no question that we can make structural improvements to governance in Japan.

But my experience has been that we introduce independent directors and they don't serve the function that we wanted independent directors to do. In other words, the structural change hasn't been as effective in driving the outcomes that we want, and the outcomes we want are higher returns for shareholders.

And so, that's what I admired about the PFA cutting to the chase and saying, "You've got 4% ROE. You've had a 4% ROE for 25 years. That's unacceptable. Fix it, and if you can't fix it, then we're going to start voting against you." Because that gets to the heart of solving, I think, the problem of Japanese corporate governments, which is ultimately and forgive me to put it this way.

Corporate governance is a tool, it's a risk management process, but it ultimately is trying to protect outcomes, which are protecting the life savings of savers, and as I say, I would strongly prefer an approach that focuses on getting there as quickly as possible.

Because what we have, as a final comment, people, you have in Japan, is we have typically very low ROEs. And yet, operating margin and returns are fine, and the problem it proves to be, it turns out, is the world's largest heap. Japanese companies tend to be sitting on massive amounts of cash, and so better distribution policy tends to be the way that you're going to achieve kind of outcomes more easily, and when the PFA put pressure on the Japanese companies, you saw dividends go up and stock pre-purchase increase, and that's been very, very positive to shareholders.

Nami Matsuko: Thank you very much. Do you have a [off-mike comment]

Toshiaki Oguchi: I just wanted to... the new commission, so I agree, regarding especially the future of a strong and confident index like [inaudible] and the present view. In our position, if the company, regarding important position, with many things to talk about and all.

But now, what I want to focus on watching is if the company has a position, too. They need more independent vote. Ideally, more than half should be independent. Otherwise, few can protect minor... to shareholder to use position, too.

New commission area, we have no legal committee regarding the [inaudible] and the present view. And the ultimate decision should be done by the board at the moment. Therefore, if present view is established on the introduced, I believe the vote should be more independent to other companies.

Nami Matsuko: Thank you very much. Now we do have some comments on these comments by the district leader. Anybody else from the floor? If not, let me ask one question from me.

I just wanted to ask you one question that the—how do you think it is true or not that foreign shareholders are really losing confidence in Japanese market, because as you can see from today's Nikkei, that foreign investors are pretty much coming back to the Japanese market.

And if that is true, what are these foreign investors looking in the Japanese stock? Are they looking at—expecting more improved corporate governance or, corporate [inaudible] in the first place? If you could, quick comment. Thank you.

Abe Friedman: Well, I would just follow on what Scott was saying, which is I think investors—what investors care about is their long-term economic interests and what, you know, retirement investors and savers are looking for is a return on the investment they make over the long term, and if companies can offer that return that's where they'll go.

And corporate governance is about trying to, you know, structurally design a system that will encourage managements to focus on those things. So you say that you get the corporate governance structure right, hopefully some of these things flow from that.

But my point, that I was trying to make earlier that I'll just reiterate, is I don't think there is one structure that works.

And I don't think we should think of independent directors as a panacea or any other particular structure, any more than all of these rights that shareholders have been granted in Japan have helped them, you know, manage these corporations better than they've been managed in the US where we don't have those rights.

So, I think, you know, I'm an advocate—obviously, I think corporate governance is important. It's what I do every day, it's my job, but I'm an advocate for not a particular single approach, but rather an approach that makes sense in a particular market, and looking at markets and trying to identify why things aren't working, and where economic value isn't being consistently delivered, and then trying to, you know, improve the system to do that.

Nami Matsuko: Thank you. Thank you very much.

Toshiaki Oguchi: I just wanted to comment from the opposite side of presentation. Ashiro... Tokyo Exchange said that the FSA Study Group in April felt that Tokyo and equity market have changed in to “productful uproar” [as heard] for at least last 10 years, mentioning that the podium voting by non-Japanese investors account for up to 65,000.

He said the Tokyo market should be thoughtful by an opposing vista, fair, not only Japanese investors, but also non-Japanese investors appreciated Japan and should be developed for long-term investing.

Your case, in answer to your question, is that, if long-term investors are really conducted Japanese market or just arbitrators are coming back by taking some sort of chance of the election, I don't know, but that's my question.

Nami Matsuko: Thank you, thank you very much.

[applause]

Dana Lewis: Thank you, Nami, and thank you to all our panelists. We really appreciate it. I know there will probably be more questions if you'd like to talk one on one.



After the Crisis: Corporate Governance in Japan

Case Study in Corporate Governance

August 7, 2009

Case Study in Corporate Governance

Jun Frank: Hello everyone, I'm Jun Frank from Glass Lewis investing company, and my boss used to be Abe Friedman. I believe he is about to leave. But I have been with the company since about 2004—sorry, 2005—the first year we started doing Japanese equity. We advise institutional investors on how to corporate meetings. Shiseido is one of the companies that we research and buy shareholders meetings and stake in other companies. On our case study in corporate governance, we have Yukihiro Saito-san of Shiseido. He is a general manager and head of investigations at Shiseido. As you know, Shiseido is a Japanese cosmetics maker, toiletries, and beauty products. In our opinion and in many people's opinion, Shiseido has been one of the pioneers in Japanese-based practice for corporate governance.

I am excited to hear from Saito-san directly on what sort of support Shiseido has done to address governance at Shiseido. The Shiseido talk will address many of the concerns that relate to earlier panels such as independence of support. Shiseido has three independent directors, two that are not just outsiders, but under our classification satisfies the standard of independence. Shiseido also has a very robust performance team paid program, which is very rare in Japan.

So Shiseido has been a leading figure in addressing corporate governance issues, and I believe Saito-san has been quite instrumental in pushing Shiseido to adopt these practices.

The first time I actually heard from Saito-san was back in 2006. We wrote a negative recommendation on the poison pill that Shiseido was proposing at the time. Then I got an email from Saito-san, attacking the underlying logic of our recommendation.

In the end we were forced to change our recommendation to support the poison pill. But I think voting against it was a good decision, but now Shiseido has taken down the poison pill in 2008, and I believe that was a great step for Shiseido.

So without much further ado, I would like to have Saito-san come and talk about his corporate governance practice at Shiseido.

Yukihiro Saito: Thank you very much, Mr. Frank. Thank you. My name is Yukihiro Saito, and I am the general manager of the Investor Relations department at Shiseido. I would like to express my sincere gratitude for your constant guidance and encouragement for Shiseido to business activities. I am also truly grateful for being the given the opportunity to talk to you at today's meeting about Shiseido's corporate governance. Please refer to the presentation handout.

As slide two reads; "As you can see, Shiseido has set out its basic policy on corporate governance. Shiseido's basic policy on corporate governance emphasizes the importance of maintaining support from stakeholders, which partially affects Japanese approach of treating all stakeholders' inquiries."

While the White Paper on corporate governance in Japan, published by the Asian Corporate Governance Association, ACGA, in May 2008, refers to Japan's management approach to treating the interest of all stakeholders' inquiries as stakeholder criticism, it's outdated. Shiseido's understanding is that maintaining support from all stakeholders cannot be achievable without its effort on maximizing the long-term shareholder value. In other words, including corporate value for shareholders as owners of the company is an essential factor for satisfying all stakeholders.

Based on this basic policy, Shiseido is working to reinforce the supervisory function of the Board of Directors, the executive function of corporate executive officers and the auditing function of auditors, while at the same time enhancing transparency and fairness and sustainability.

Slide three, please.

This slide shows the structure of the Shiseido's Guidance System. Shiseido has a high verdict, a two-tier board structure. There are a Board of Directors and a board of Corporate Auditory. Currently, we have chosen to stay with conventional Japan's board structure combined with the features of the US Star company with committees by adopting the Corporate Executive Officers system guided by various committees.

The ACGA white paper regards this hybrid board structure as a positive trend in Japan and help for development while studying their company with committee system and a hybrid board structure. It will only go well if their external directors are independent, confident, sufficiently empowered, and bring diverse view points, experience and skills to sit with the board. I will agree with that statement.

I would now like to briefly explain the committees Shiseido has established. Shiseido established the two committees to plan the advisory law to the board of directors: The Remuneration Advisory Committee and Nomination Advisory Committee. Shiseido also established the Senior era Committee and the Co-alliance Committee.

As committees, jurisdiction of the Board of Directors does promote company-wide things. Most committees are headed by a vice president and composed of members elected from company-wide. As I make proposals and report on plans and results of activities to the Board of Directors.

Slide four please. And now let me talk about corporate governance reforms at Shiseido.

Since adopting a corporate executive officer system in the year ended March 2002, to increase the transparency of fairness and speed up management, Shiseido has implemented corporate governance transitions based on the following four strategies: clarify the application of responsibility, strengthen decision-making functions, enhance management transparency and soundness, and reinforce supervisory and auditing functions.

OK, slide five. Where do we start with initial things to clarify the application of responsibility? Shiseido considers it essential to establish corporate governance practices

to get cooperation and trust from stakeholders worldwide. And to build a strong senior management team to outperform the competition.

In 2001, Shiseido adopted a corporate executive officers system to spearhead efficient corporate management. Separated roles and functions of directors who are responsible for the making and supervisory auditing functions of management and corporate executive officers who are responsible for business execution.

Most directors and corporate executive officers are proposed by the nomination advisory committee. And directors are elected by resolution at the general meeting of shareholders. Corporate executive officers are elected resolution at the Board of Directors meeting.

The term of office of directors and corporate executive officers is one year.

Slide five continues.

As part of efforts to build a strong senior management team based on the understanding that a consistently strong performance by all corporate officers is crucial for Shiseido's sustained development, Shiseido set an upper term for corporate officers of four years per position in principle and six years maximum in special cases, formulated rules governing demotions for corporate officers, and set an upper age limit for holding office that is mandatory retirement age in position.

We also reduced the number of corporate executive officers from 32 four years ago, to 19, carefully selecting a small and able group of executive officers, and also lowered the average age by recruiting younger members.

Slide six. Moving on to our efforts to strengthen decision making functions. In 2001, we established the Corporate Executive Officer Committee. We are certain corporate executive officers meet three times a month in principle to examine the execution of important business from diverse perspectives.

We also established the policy meeting of corporate officers where all corporate executive officers meet to discuss long-term strategy and so on. In 1993, Shiseido had 29 directors on its board. By the fiscal year 2009, number of directors has been reduced to 10, including two external directors in the bid to stimulate discussion at Board of Directors meetings, and to accelerate decision making.

Shiseido amended its Articles of Incorporation at the General Meeting of Shareholders in 2002 to set the upper limit of the number of directors as no more than 12, clearly demonstrating its commitment to effective and efficient board practice.

Slide seven.

Next, I would like to discuss our efforts to enhance management and transparency and soundness. We established the Remuneration Advisory Committee in 2001 and the Nomination Advisory committee in 2005 as advisory committees to the Board of Directors, both committees shared by an external director to maintain objectivity.

I will talk about two committees in more detail later.

Please, slide eight.

I will move on to our efforts to reinforce supervisory and auditing functions. In 2005, we increased the number of external corporate auditors from two to three, so more than half of the Board of Auditors and independent corporate auditors who have no interest, past or present, in the company.

Shiseido's corporate auditors monitor the legality and adequacy of director's performance by attending Board of Directors meetings, regularly listening to proposals and reports on business. And at the matter's end, when necessary discussing matters with directors, and reporting audit results from the internal auditing department, and so on.

In 2006 Shiseido appointed two external directors on the basis that at least 20% of the total number of directors should be external directors. Having independent, external directors with different perspectives has strengthened the supervisory capabilities of directors and stimulated discussion at Board of Directors meetings.

Slide nine, please. I would now like to talk about the composition and diversity of the Board of Directors. Currently Shiseido's Board of Directors is composed of ten members including two external directors. In addition, we have three external corporate auditors and five members are corporate auditors. The Board of Directors meets at least once a month to discuss all significant matters.

The external directors have built careers outside of sales. For example, one is a former director of the Bureau of the Ministry of Health, Labor, and Welfare. Another is a former executive officer of PNG. This promotes diversity among directors.

Wide perspective and insight based on diverse background and areas of expertise will promote objectivity and strengthen the Board's supervisory and advisory function. The SCGA white paper also states that it is necessary for external directors to bring diverse insights, experience and skill straight to the board, so the promotion of diversity in its Board of Directors is consistent with this—though not yet on the level comparable to the United States and Europe.

And, slide ten.

And with this I would like to discuss external directors. Shiseido has two independent external directors, to obtain objective views from the outside.

To further strengthen the Board of Directors' supervisory pension and rigor to business execution, and to increase the flexibility and the diversity of the board of directors, Shiseido appointed two external directors in 2006: Mr. Shoichiro Iwata, president and CEO of ASKUL Corporation, a rapidly growing provider of office supply mail order services; and Mr. Tatsuo Uemura, a professor of Waseda Institute, for Corporation Law and Society.

Shiseido believes that maintaining independence is the most important criteria when pre-selecting external directors, and recognizes its current two external directors as certainly independent.

We have given utmost consideration to independence, and have also given careful consideration to transparency, disclosing in our notice of convocation of the general meeting of shareholders that Shiseido has no significant business, not only with Professor Uemura, but also with President Iwata of ASKUL Corporation, which does good business with Shiseido Group; and also disclosing the scale of such business on our website.

I would now like to explain about the Remuneration Committee and the Nomination Advisory Committee. The Remuneration Advisory Committee is an advisory committee to the Board of Directors, charged with setting directors' remunerations.

In anticipation of further globalization, Shiseido changed its remuneration package in 2005, and again in 2008, strengthening the links between the remuneration share price and performance. The Remuneration Advisory Committee proposed a list of candidates for directors and corporate officers.

Besides this, the committee developed a system aimed at building strong senior management team, including setting up term limits for corporate executive officers, and formalizing the rules governing the motions of corporate officers, to maintain transparency and impartiality.

Next, slide 12.

Remuneration System. Mr. Oguchi already explained.

The Remuneration Committee can be credited for designing Shiseido's remuneration package for directors and corporate officers. The unfunded retirement benefit plan for directors and corporate officers, with its fixed remuneration payout, was abolished in the year ended March 2005 to increase the transparency and objectivity of its remuneration package for directors and corporate auditors.

Shiseido adopted a new remuneration package in year ended March 2006. This remuneration package was designed by the Remuneration Committee, with independent objective input from an outside agency, and consisted of a basic fixed portion and a performance-linked portion that fluctuates depending on achieving management targets and share price. The performance-linked portion was equivalent to about 50 percent of remuneration. Effective the year ended March 2009, the fixed portion was revised downward and the performance-linked portion was revised upward to around 60 percent of remuneration.

This performance-linked remuneration consists of a bonus based on annual consolidated results as a short-term incentive, medium-term remuneration based on the achievement of the primary targets of the three-year plan, and stock options as long-term incentive primarily aimed at fostering shared awareness of profits with shareholders.

Performance-linked remuneration is designed to give directors and corporate officers a medium- to long-term perspective, not just a single-year focus, and to motivate management to become more aware of Shiseido's performance and share price.

Due to the nature of their functions, external directors and corporate auditors receive basic fixed remuneration only to eliminate linkage with performance. Please see the detail of each type of performance-based remuneration later.

Now turn to slide 16. I would like to discuss initiatives relating to the exercise of voting rights. Please, slide 16.

We started out talking earlier with the initiative to enhance communication with foreign institutional shareholders by identifying our actual foreign shareholders, translating proxy notice of this into English in response to voters' wants, and increasing the number of voting shareholders.

We also have frequently responded to the exercise of voting rights through diverse means, including the exercise of voting rights by electronic methods, the exercise of voting rights by mobile phone, and the participation in the TSE's voting platform.

Slide 17. In 2008, Shiseido began disclosing the voting results, to increase the transparency of resolutions of the general meeting of shareholders. Here you can see the voting results of Shiseido's general meeting of shareholders this year, which we disclosed on our website the same day after the closing of the general meeting.

The results of this vote is based on the percentage of the votes cast in favor of the resolution prior to the general meeting of shareholders. As in Japan, votes cast prior to the meeting determine whether or not it will be an agenda item.

Votes cast, usually by shareholders present on the day, do not count. The reason for that all of the domestic and foreign institutional votes are almost always tabulated before the meeting and reflected in the published result.

Slide 18. Finally, I would like to talk briefly about the investor relations department, of which I am the general manager.

Shiseido integrated the shareholder relations function in charge of shareholders' meetings and investor relations function under the control of one department in 2006, and has since then disclosed a consistent flow of information including financial results, business reports, and the agenda of shareholder meetings.

While this is nothing out of the ordinary in the United States, in Japan, given the historical background, that's slightly different because of the emphasis on the legal aspects of the shareholders' meeting. And the implications of the dealing with corporate lack of tiers known as the *sokala*, which in the past were quite powerful.

Therefore, in Japan, the legal department or the general affairs department is usually in charge of the shareholders' meeting, based on the belief that IR activities are not just

about dealing with buy or sell activities of investors—and that they hold the key to helping the shareholders make the right decision at the general meeting. Shiseido views the general meeting of shareholders as the business of the IR department. Both at the time of adoption of the anti-takeover measures in 2006, and at the time of the resolution on the discontinuation in 2008, IR department assumed a key role.

I believe that the implementation of IR as a pipeline between investors and the company only strengthens corporate governance. That completes my presentation. Thank you very much for your attention. Thank you.

[applause]

Jun Frank: Before we open for Q&A from the floor, I would like to ask a couple of questions myself to Saito-san. And then I will ask some questions from the floor. But when you ask questions, please state your question slowly because I may have to translate your questions and I may translate Saito-san's answers in turn. So, Saito-san, your company has adopted quite a progressive stand on Japanese corporate governance, but there is a very strong position in Japan, as we discussed earlier in the panels, about putting independent directors on the board. What has Shiseido's experience been in introducing these external board members? What I would like to know is, what is the actual benefits your company derived from these independent members? And what are possible negative consequences you may have suffered?

Yukihiro Saito: [speaks Japanese]

Jun Frank: [Jun Frank translates Mr. Saito's remarks in this section.] One impact that outside directors had is that discussion has become much more active. But also that means that discussion tends to take a longer time now.

Yukihiro Saito: [speaks Japanese]

As a benefit it is beneficial to bring in different perspectives and different opinions. But at the same time, in terms of speedy decision-making it is a bit of a trade-off there.

Yukihiro Saito: [speaks Japanese]

Jun Frank: One of the things Shiseido has done to address the issue of sacrificing speed is that it changed fundamentally how these board meetings are held. For example, Shiseido distributes materials beforehand to the board members so that the board, at the time of the meeting, would know the materials very well and they can focus on the discussion and not just essentially educate directors as to what the material is. Another question I have is what were the biggest challenges in implanting these changes, governance changes. I'm sure some of the board members or executives may have had strong opposition to these changes. What were some of the biggest challenges you experienced?

Yukihiro Saito: [speaks Japanese]

Jun Frank: Many of the changes that Shiseido implemented are very new and unprecedented in Japan, so there are a lot of discussions, and some issues took a long time. But one of the most challenging, according to Saito-san, is the issue of compensation and changes in compensation structure and introducing new compensation. It is something very new in Japan, so they had to spend a lot of time discussing it, and it took a very long time to come to a conclusion. So, now I would like to open questions to the floor. Anyone have a question?

Woman: Thank you. My name is [inaudible]. I'd like to have one comment from Saito-san regarding the compensation issues, but also I have one favor to ask for Jun-san about compensation issue. And one comment I'd like to have from Saito-san is that, what do you think about giving the subsidized incentives to employees there, because in Japan it is very difficult, for example, to monitor the same thing you do; in new companies too it's a big challenge. And one of the reasons could be that Japanese management are feeling kind of guilty of giving a lot of compensation in the face of the employees.

But I thought that giving the employees more incentives, sharing the relationship, that it would be a good idea, like Japanese version of employee stock, like employee stock ownership plans, and I'd like to have some comment on that. And also, I have one favor to ask for Jun-san. I do understand your policy on executive compensation of Japanese punishment, especially on the ones which discount functions, which are usually used by the Japanese companies as a kind of substitute for the restricted stuff in Japan. And we do that because of some restriction in the company law.

So I do understand your stance. But at the same time, because direct compensation it is very important to include Japanese corporate governance. So if you could lower a bit the standard you are encouraging for the time being.

Yukihiro Saito: [speaks Japanese]

Jun Frank: Shiseido's theory is that encouraging employees' corporate ownership is a very important thing, and that many companies in Japan establish a sort of employee ownership—not a fund, but sort of a group—essentially an employee shared ownership program. And Shiseido does this as well. The company will provide incentives or subsidies to buy into company shares. And now about half of all employees in Shiseido have some ownership stake through this plan.

Yukihiro Saito: [speaks Japanese]

Jun Frank: So with regards to employee shared ownership program, he just this next year from Nomura, he got in just this year. But Shiseido's view is that it's important to encourage ownership in the company, not necessarily from the perspective of the welfare of the employees, but also to encourage employees to have some sort of stake in a company's management: to encourage them to have a management vision or incentives. Yes?

Virgil Adams: My name is Virgil Adams with Matthews. I have two questions. Shiseido's been kind of a pioneer in this corporate governance area quite early. Have you seen other Japanese companies or agencies contact you and ask you for advice or help in navigating this? Or are you still kind of alone on the woods in this? The second question, this is not really related to corporate governance. You're been very successful at standing outside Japan, and there are not very many cases of healthy Japanese companies that have really global—they have global businesses, but not really global leaders, executives, board members, and so on.

I'm wondering, do you see in the near future that Shiseido could have, for example, a Chinese executive manager in Japan, or a European on the board? You see that happening in companies that have really fallen down, like Sony or Nissan, but not so much by healthy companies.

You're a global business, but you're not really global when you look at management composition. Do you expect that to change in the future?

Jun Frank: [speaks Japanese]

Yukihiro Saito: [speaks Japanese]

Jun Frank: In Japan, through IR service or IR organizations, there's a lot of connections there, a lot of people know each other, in a sense. With regards to abolishing poison pills, many companies did come to Shiseido to ask about the process, why and how Shiseido decided on a poison pill. And similarly when Shiseido disclosed the result of the board and shareholder meetings, many companies did ask for advice from Shiseido about the whole process as well.

Dana Lewis: Do you think we could finish with Virgil's question?

Jun Frank: OK. [speaks Japanese]

Yukihiro Saito: [speaks Japanese]

Jun Frank: So, Shiseido does have one foreign executive on the Board. I can't pronounce his name, but he's from PNG. He's a director and also an executive of the Shiseido Group. He's in charge of all international business. [speaks Japanese]

Yukihiro Saito: [speaks Japanese]

Jun Frank: So he cannot say how many or what portion, but he believes that in the future there will be more broader management implemented in Shiseido, and there will be more foreigners or people with different backgrounds coming into management, executive or board level. Thank you for your time.

Dana Lewis: Thank you very much, Mr. Saito. Thank you, Jun for interpreting as well as moderating. Thank you.



After the Crisis: Corporate Governance in Japan

*Colloquy:
Where Do We Go From Here?
Lessons from the US and Japan*

August 7, 2009

Where Do We Go From Here? Lessons from the US and Japan

Dana Lewis: Now we're going to go into what I think is sort of becoming a tradition in our corporate governance conferences, a wrap-up session led by Dr. Steven Vogel of UC Berkeley. This time he's going to work with his colleague, Dr. Zenichi Shishido of Hitotsubashi University.

They're going to lead us in a look back over the various lessons that have come up during the course of the day. We hope this will be a very interactive interaction with all of you and the audience. So please welcome Steve and Zen up to the front, and we'll move on to the wrap-up session. Thank you.

Steven Vogel: Good afternoon. I'm Steve Vogel at UC-Berkeley. This is my colleague Zen Shishido. We are both very delighted to be here. We're going to proceed as follows. I'm going to attempt a kind of a quick wrap-up. I won't be able to summarize what we've discussed, but I'll try to highlight a few key themes. Then Zen is going to offer some comments, some selective comments on some of the things that have come out today. He'll then give me the mike for a few comments, and then together we will launch the conversation back at you. So I'm hoping you're going to react to at least something that Zen and I say, and that we can kind of conclude with a broader discussion of some of these issues, that is not simply about us, but about all of you participating as well.

In my very selective reading, I see three big themes or three big questions that have come out of today's conversation. The first is what are the best corporate governance practices that Japan should be adopting? And here, Nick Benes got us started off by talking about a lot of things, but I think he particularly focused on independent directors as a very critical piece of best corporate governance practice.

Steven Codrington followed up, also talking about independent directors, but also I think about a broader sense of engagement. How do you get shareholders—what are the channels by which you get shareholders to be able to express their needs, desires, wants to management.

But then we got an interesting, slightly different perspective, I think, from Osugi-san, particularly on the issue of independent directors. That Japanese managers think that sometimes independent directors impede decision-making style. And we got a little bit of a flavor of that just in our conversation now about Shiseido. He suggested that Japanese companies should try to hold on to their strengths of their traditional management system even as they adjust to new demands and new market situations. So I think since the moderator's job is to stir up trouble, I would like to suggest that there's a slight tension in the perspective between the first two speakers and the third speaker, one that I think would be interesting to return to.

And in his preparatory remarks at lunch, Tanaka-san also, I think, pointed to the distinctive features of the Japanese model. I'll let him speak for himself about whether he was saying these features are—I don't think he was saying these were either wonderful or terrible, but he was, I think, highlighting that they're distinctive. And I guess at least the

implication would be that we shouldn't expect a quick or automatic convergence on a different model of corporate governance.

I think Oguchi-san fleshed out some of the earlier ideas about what engagement really means, by specifying what the mechanisms of engagement might be. In other words, how institutional investors might, in concrete terms, improve their communication with management.

And then Abe Friedman filled out our picture of best practices with a few fairly specific suggestions. One had to do with strengthening the protections of shareholders against the dilution of shares. And he also talked about what is a big and very hot issue today in the United States, executive compensation: suggesting in a sense that maybe the problems in Japan might be a flip of those in the United States. In other words, that some Japanese executives might be underpaid or that the incentive system may not be structured to reward them for taking risk.

Second big question is, is Japan changing? Is it moving in this direction of better corporate governance practices? And here I think we got a sense of kind of cautious optimism: that on our panel on regulation, I think the answer was yes—maybe not as fast as some would like.

And I think there's an interesting twist to this story, that both Nick Benes and Steve Codrington were suggesting that by and large the Japanese government is on the side of change. Yes, I actually think I meant what I just said. And it's actually the business community that is the restraint here, right? That the regulators are on the right side of this issue.

There was also another interesting comment, which was shared by several people, which is that US financial crisis is not seen in Tokyo as a total vindication that Japanese capitalism was best after all, that the US is the home of corrupt, savage capitalism, that it's not going to put a stop to this process of change.

And actually what's driving change in Japan is much different, it's the weakening of the Japanese market overall, which obviously has only gotten worse with the financial crisis. And also the need to encourage foreign direct investment into Japan, which of course is a new issue, or has only recently been seen as a problem.

We also got some cautious optimism from our luncheon speaker, Anne Sheehan, who suggested that the trends are good. And of course we got a case study of real change from Saito-san about Shiseido.

So this brings us to the third question, which is, how does one encourage further change in Japan? And here I think obviously relates back to the first question, what is change? But I think the first two panels were structured in a way to help us conceptualize this, which is that one level of change is at the regulatory level, what's the government doing. And the second is at the corporate level, and to really understand how the Japanese is evolving you have to at least look at both of these.

But here again I would like to suggest that there were some subtle differences in the answers of our speakers. I think there's a difference in terms of those who would take a much more cautious, kind of quiet approach, and those who would take a more demanding or aggressive stand to try and get the Japanese to change.

But leaving that aside, let me raise two interesting debates that percolated up. One is kind of the organic or less than mandatory approach to regulatory change. In other words, allowing, facilitating, versus just outright requiring it. And there we had a difference between Abe Friedman and Nick Benes on independent directors, for example.

And then there was another interesting difference, which was, do you push for structural changes, right? This corporate governance system as a whole, or do you push for results, right? Is it all about returns, and that's what really it's all about. The latter viewpoint was, I think, articulated very nicely by Scott Callon, but a lot of the other, earlier speakers had been pushing in a different direction, which was towards structural changes.

So those are some of the issues. I would love to get your thoughts on those, and if somebody can resolve a few of those debates for us, terrific. On that note, I'd like to pass the mike to Zen, who's got his own comments about today's conversation.

Zen Shishido: Thank you, Steve. First, let me say today I'm very glad to know there are so many sophisticated American people—not only American—but people are still so seriously interested in Japanese corporate governance. I have been a student of Japanese corporate governance for over a quarter century and since when no Japanese, including the lawyers, knew the concept of the corporate governance and the concept of the institutional investors.

I'll tell you that the variance, the Japanese corporate governance, changing the Japanese corporate governance, is so interesting, I've never been tired. As my comments, let me give you some historical perspective of Japanese corporate governance. I think that kind of a precedent of the argument in this room is Japanese-type corporate governance is quite deeply-rooted. Cultural overlies things. But actually not.

In my paper of 2001, I divided the hundred years or more of Japanese corporate governance into five eras. Since the 1872 National Bank Act established—actually until the Sino-Japanese War of 1937, I'd say, the first era is a quite classic shareholder ownership era. You may know that as the *zaibatsu* era. During that period, the Japanese corporate system is quite capitalistic, market-oriented, and shareholders' power is so strong.

And then the second era would be that during the war, since 1937 until say, just after the war, 1948 or 1949. We call that the System of Forties, *Yonjuu-nen Taisei*. During that war time, by the strong governmental regulations, the shareholder power is gotten rid of and moved to the employees or the management, or human capital providers.

And interestingly, even after the war, the post-war era, after the war until, say 1965 or so, the employee-oriented management is established. I would call it the second era, employee managing company and regulations. That's during the war.

And the third era is, I would call that, the growth-oriented governors and a dispersed stock ownership. Since 1949 until 1964, the allies, the United Nations, I'm sorry, American governments forced the Japanese shareholdings to disperse, as you know. During that era, again that the Japanese shareholders powers regained, and very strong. But after the Yamaichi crisis in 1965, that makes the strengthening or increasing cross-shareholding.

Japanese human capital providers, managers and employees, recognize it is so problematic to be so strongly impressed by the shareholders. Then they found out a very sophisticated way of cross-shareholding each other and creating the web of the cross-shareholding, and stabilized their shareholding.

Then this era, the fourth era, I would call the heyday of company community, and many advances. Probably the company community is a key concept to understand the Japanese corporate governance. The company community consists of top management, employees, and board members. Most board members are insiders, promoted from the freshmen in the company, just after graduating their college. And they share the same identity of Mitsui man or Mitsubishi man or whichever.

It is very important to look at the power balance between the company community and shareholders. More strictly speaking, not just the shareholders, I would say genuine shareholders. I believe that most people in this room today are representing that genuine shareholder, like a fund or institutional investors. I mean, genuine shareholders are genuinely focusing on the return of investment. But many Japanese shareholders are not genuine shareholders, but I would call trading shareholders or *mochiai* shareholders. They have different interests besides the return of investment.

The continuing of the long-term trading relationship is the most important interest for them. So there is a conflict of interest between genuine shareholders and trading shareholders.

And my observation is—before I get into the contemporary things, let me finish my historical story. The fifth era is from the start of the bubble in 1993, I would say until 2005. I would call that the post-economic growth governance imperfection and transition of corporate governance.

Before the bubble, the Japanese corporate company community system is established so well, and the company community enjoyed the almost perfect autonomy. During that era they did a good job; shareholders don't need to complain about it. But after the bubble, for the first time in history, the Japanese company community enjoyed the free cash flow.

And Japanese corporate governance had never known the system or mechanism of how to monitor the company community on how to use that free cash flow. And actually they

totally waste that free cash flow, as many of you remember. They made a terrible investment in the Rockefeller Center or Pebble Beach, or whichever. So then the corporate governance is a very serious topic in the Japanese corporate system after the bubble and bubble burst.

My observation, since 1985 the genuine shareholder bargaining power is increasing, strengthening, until 2005. Why 2005? 2005 is the year of the Nippon Broadcasting Case. Now famous, Livedoor, a very interesting venture company, tried to acquire the traditional Japanese broadcasting company.

That almost succeeded. Actually at that time I was so glad to see that, the cultural market opening. That's quite exciting for me. But soon after that, you can observe the Bull-Dog Sauce Case in 2007. Just after the Nippon Broadcasting case, Japanese company community deconstructed. It looked like loosely, but because of such a shock of the hostile takeovers, they again are reconstructing their unity and being supported by trading shareholders.

So the symbolic event is Bull-Dog Sauce Case. The Bull-Dog Sauce shareholders, more than 80% of the shareholders supported the management-proposed poison pill against Steel Partners. And even though all the shareholders lost their money by such an attempt, even though they do that, they supported their company community.

And then the financial crisis in 2008 changed the climate a bit. Not a bit, it changed the climate a lot. So I have a little bit different opinion from Professor Osugi on that point.

I think that shock, only that some strong shock is important, makes the difference in the corporate governance, their long history. The financial crisis in 2008 looks like a really good shock. So they change the climate and that turned out to be the tailwind for anti-market or anti-deregulation people in Japan.

That gives the Japanese traditional management a good excuse for keeping free cash flow in their companies. And also I can observe the strong sentiment against shareholder supremacy. That's come to be not necessarily overwhelmed, but it's come to be over the surface of the waters.

So I am a bit pessimistic in this situation. Although Mr. Benes said there is no turning back any more. But I'm quite skeptical about that.

[laughter]

Zen Shishido: Although I am in the more—I'm a very Americanized Japanese and I like shareholderism. But from that point of view, I'm quite pessimistic on that point. And let me conclude my first remarks on that with a little bit about the outside director or the independent director. That is one of the major topics that Steve picked up. Again, I picked up the comments by Mr. Benes. He said outside it means nothing. Even the CEO's mistress could be outside director or *kansayaku*. That is true, but I would give you a bit of my observations. In the history of Japanese corporate governance and corporate law, the

definition or introducing the outside auditor concept is quite important—kind of revolutionary to the Japanese company community.

So in the first time in 1993 when Japanese corporate law introduced the outside auditor as compulsory—one outside auditor is compulsory to each big corporation—what had happened? 99% of the listed companies put the ex-employee after five years have passed into the outside auditor position—because at that time, regulation says that outsider is the people who have employed at that company not five years before.

So then the 2001 reformations, the Japanese corporate laws changed. They say outside auditor means the people never, ever served as the employees or directors. So that means Japanese corporate law seriously intervened in the company community concept for the first time in the history.

So, yeah, it is true, even the mistress could be the outside auditor. But for the Japanese company community, it's not insider, not a member of the company community, is very important. So the outside and inside, the Japanese community—not only the Japanese corporation—is constructed hundreds of layers of outsider and insider things.

So, I would say don't be too rushed. Of course, I agree that we need to reshape the definition of independency of the *kansayaku* or director. But historically, this is a very important first step to put the outsider into the Japanese company community.

So it is just my tip for the American institutional investor, how to push the Japanese company. And there is an interesting debate over how useful is the independent director or *kansayaku* in Japanese companies. Actually, it is kind of common sense for the Japanese management or company community people, the independent director is not useful. They always say, oh, they know nothing about the company. They know nothing about our industry.

But that is kind of their misunderstanding of the board of directors system, because Japanese board is managing board, not the monitoring board. So they always are seeking for the specialist of the industry. But American investors always are just talking about the monitoring board, who could be the good monitor, independent monitor.

So that is a gap of the understanding of the board system between the American investors and the Japanese managers.

Yeah, so, that is my comment.

Steven Vogel: Terrific, thanks very much. Before opening things up to the floor I would just like to add my comments. I've got three comments. Hopefully, I'll be brief.

Starting first, I would like to counter Zen as the very American Japanese by trying to be the very Japanese American...

Zen Shishido: [laughs]

Steven Vogel: ...and suggest that the institutions of Japanese capitalism may have some value yet. I am not prepared to go so far as to give a lecture on the virtues of Japanese management. I don't think I could even stomach that. But I am going to suggest an argument that goes as follows. Let us assume, as a given, that the Japanese market institutions have some value. I'm not arguing that they are superior to the institutions of American capitalists. All we have to assume is that they have some value, that they are not totally destructive of corporate value.

Then, let's also take as a given that they are interconnected. In other words, that there's a relationship between Japan's labor relations system and its financial system and its management system and supply networks, right? That these pieces are interconnected. If we take those two presumptions, I would argue that that logically leads us to the conclusion that any assessment of change should be viewed holistically.

What I mean by that, let's say generically we can make a nice, tidy theoretical argument that independent directors are superior to insider directors or that a certain structure is better than another structure. I'm suggesting that that assessment should be contingent upon how it interacts with other pieces of the puzzle, right? That, in other words, that you have to think, not just in isolation, but how's this going effect the other pieces of the management system? Or the nature of the labor relation system? And are the costs going to outweigh the benefits or vice versa? So, in a sense, I'm just restating Osugi-san's point in my own language, which is to suggest that I don't think that we can look at these individual changes and isolations without thinking about how they interact with other pieces of Japan's economic system.

Second point is that on this debate about what are best corporate governor practices, I would like to suggest that this seems to be a moving target, right? In other words, if we take for example, stock options. This is something that there's a very tidy, logical argument about how stock options should, in theory, align the interests of the manager with the interests of the shareholders.

Now, without going into a long discourse about intellectual history, I think we can all agree that the consensus has shifted somewhat over the past few years about whether that's actually how they operate in practice. So my suggestion is that this might be true of other things as well, and that we should assess, again, these changes, not based on pure logic, but on actual evidence of practice, and not in the realm of theory, but in the realm of actual behavior.

In other words, I'm suggesting that we should look at, and this I confess as a professor, maybe we should look at some research, right? Because the research actually is quite divided, and to his credit, Stephen Codrington brought up a good point about M&A, that in theory, a market for corporate control should keep managers on their toes, therefore they should perform a little bit better.

If you had a more vibrant market for corporate control, then shareholder value should increase, but based on the available research, we know this doesn't happen to be true, at

least for the companies that are doing the buying as opposed to those that are being bought.

Likewise, in terms of the studies I've looked at, there is very little evidence that independent directors actually enhance the performance of firms. Certainly, they can enhance a firm, I'm just talking about over a broad aggregate at the national level. The evidence that I've seen from studies is inconclusive.

So I'm just, I guess, raising the question that maybe we have to look at the specifics and also perhaps come to more contingent generalizations about, well, what are the conditions under which independent directors really enhance the performance in the corporate world. The evidence that they do it across the board automatically seems to be relatively weak.

The third point—and I'm hoping I'll get lots of reactions—I would simply suggest that maybe this is not the best moment in the history of time to be extolling the virtues of American practices.

There was a suggestion that the financial crisis has not affected the Japanese debate over corporate governance to date, and I would actually agree with that. But I'm not sure that that's going to hold in the future. In other words, that in the short run I think that to kind of portray the situation simplistically, the bureaucrats do run Japan. And that in my own study of Japanese reform, I pointed to corporate governance as one area where we've had relatively rapid reform precisely because it's a stealth reform. In other words, that the would-be opponents, particularly labor unions, were asleep at the wheel. And so things got through that wouldn't if they had been more politicized.

All I'm suggesting is that situation may not hold forever. And as a political scientist I would be remiss if I didn't remind you that in a couple of weeks we have an election in Japan, and that we are likely to see change in government.

Now what this new government will do is a question that I can't answer. But I do think that it's going to be a real change in Japanese politics that will, over the long term, mean a real change in policy. Not sure what it's going to mean for corporate governance reforms, but I think at the least we can suggest that it's going to be a government that's more responsive to labor unions than the current government.

I would suggest in looking forward that this very technical issue is going to become an even more political one. Do you want to comment? Lots of people?

OK, on that note, we open the floor to all of you.

John Thomas: I'm John Thomas, and a board member of the Japan Society. I had the pleasure of being able to view now the third of our conferences on corporate governance. There's so many useful thoughts that were raised throughout the day by the professors. One question I had that emanates from the point that Scott made, which I think is really central, that the real focus should be on return on equity. So effective investment stewardship of capital is really what's critical.

Scott mentioned PFA's [Pension Fund Association] voting practices being important. My experience in Japan is there never was a strong view or definition of fiduciary responsibility. PFA, I think, took that forward, but at least to my understanding—and this is the point I wanted to throw out for some of you who are more knowledgeable than I am—to what extent are institutional shareholders being thoughtful in their voting of shares? Is it only PFA and one or two others? Are there other major pension funds and capital pools which are taking a strong fiduciary view in the way they're voting their shares?

Steven Vogel: Anybody want to take up that question?

Audience Member: I know of one company, Pico Asset Management has given very specific...

Zen Shishido: I'm sorry, I cannot hear you...

Audience Member: Pico Asset Management, which is actually now run by two foreigners. The former head of Charles Schwab in Japan as the CEO, and the former head of Dell in Japan is the president. They have given Japanese companies specific R&D departments and told them that Pico is going to invest in those companies against the European. And I can imagine if Pico is doing that, it won't be long before others jump in and are doing it, if they aren't already doing it.

Audience Member: A large number of Japan investors are, like Pico Asset Management, Tokio Asset Management, a number of companies—I do not know the extent. [inaudible]

Steven Vogel: OK.

Audience Member: Actually I chaired a discussion on governance from both the domestic [inaudible] because we need to help each other. As in your scenario, I've seen many asset companies like you mentioned, who are akin to, because their client tells them. [inaudible] I understand, because of course though it is legal for people to come from here, they are expected to put up with misery while they spend time here. So to give a little incentive for them to be responsive to the initiative that is close to the mission. That's my understanding of corporate governance.

Steven Vogel: Thank you. I think at this point in the day we all probably have met many of each other but it would be helpful if you could still just quickly identify yourselves before making your comment now.

Bill Crist: I'm Bill Crist, Governance for Owners. I've been involved in this for 25 years, since 1987. I would like to associate myself with Professor Vogel's notion that a holistic approach is necessary. Not unlike other countries totally, but the relationship between labor relations, financial management, production management and so on is very, very tight. I also think, however, that at least all of the people I've worked with over the years trying to support corporate governance in Japan and other places, no one who has a fiduciary sense of responsibility goes to change the structure of any business's governance as an end. I mean that's kind of insulting, really.

It's no great thing to have independent board members if that doesn't contribute something to the bottom line. We're looking after the ability to fund pension rights way down the road. So that's just one of the things that they should do.

You have to analyze the company carefully and always, I just have never talked to a company without saying, "No, we're interested in your performance." If it's bad it better be good, you don't have to give an ultimatum.

So I think we all have to know that, the kind of board members that are needed are independent thinkers. Don't worry about defining independent and outside because you can't do it very well. We need independent thinkers. We need people with the guts, with courage, and with knowledge. They don't have to have knowledge of the production line, they have to have knowledge of how to cause the business to be more profitable.

And what they have to do has to be transparent. Because in the United States—and by the way, I don't know any of my friends in the United States who are advocating for the American form of governance structure. [laughs] If they are, they should be fired.

[laughter]

Bill Crist: If you take the Enron case, if you look at Enron's board at the time of the collapse of Enron, on paper that was pure. It was just absolutely what you want. The problem was nobody was watching the store. They didn't know exactly what was going on off the balance sheet and behind. And whatever Ken told them was OK. That's just not the way to run a business. I think we have to stick with the business of trying to cause other business in which we have interest as shareholders to look at profitability once in a while, and not just at saving the world. And that's what I really think is our responsibility as fiduciaries.

Takahide Akiyama: I agree with Bill's comment. My name is Takahide Akiyama, with CB Richard Ellis. I have recently moved back to the San Francisco area from Japan. I used to work in the '90s in this area. This whole subject is a very wide-ranging subject to talk about. It's very hard to summarize what we've been talking. It's been a very interesting day, and I'd like to thank every presenter and the participants for this interesting discussion on this subject.

The corporate governance, I agree with someone's definition, this is the structure or the tool designed to protect and promote the shareholders' interests. And the shareholders' interests in the long term cannot be made maximized unless we pay attention to the whole set of stakeholders, not just the shareholders: employees, clients, suppliers, society. The whole set of participants in society. And really, as we said, just providing the framework doesn't work. It just comes down to the people who do it. That's the whole key thing. I believe that outside directors work, if those people are engaged and committed to provide contributions to the betterment of the company and all society. It will work.

We have discussions about how we find those people, in Japan or wherever. That's the key. It really comes down to the people, how do we bring up those people. And it comes

down to education also. This is something we should pay more attention. It's one thing to try to provide better structure, but if there isn't any content in the structure, it doesn't work. That's my belief.

And also talking about shareholders' interests. Shareholders vary from small individuals, people, institutions, companies. We've been talking about institutional investors, but we must not forget small individuals. Individuals need to be educated to be able to know what this means, what shareholding means to them.

FSA in Japan has been trying to educate the individual shareholders through different mechanisms, but it is not working. It takes a long time. When the whole investment by individuals in this country, through individual funds study—it was 10 years ago in the early '80s or something like that. In Japan it's just beginning.

Not to be dismissive, Japan tends to follow what happens in the US. Anything that starts in the US, good or bad, goes to New York, comes to Japan, depending on things in the last 20 years. So my point is, it comes down to the people and education. That's something, if you have any comments, that I need to hear. Thank you.

[laughter]

Steven Vogel: I would just like thank Bill Crist and you. You've helped me to understand this issue better. Yeah.

Nicholas Benes: The point was made just now—precisely the main point that I tried to make in my presentation—is you need training. It's so important, and often we don't talk about it. One interesting historical thing that is wrong is why we have outside statutory workers. In 1993, the ACTA [as heard] published a viewpoint opposing independent outside directors, and the National Association of Outside Directors, a Japanese organization, supported the concept. In reaction to that, the wagons were circled, and the Statutory Workers Association felt very threatened. And the powers that be determined that the bait-and-switch style, instead of having to debate outside directors, much less independent outside directors, an outside requirement for outside statutory auditors, since they don't vote. So it was precisely the kind of shock or pressure from the outside that the issue occurred.

That was the reason in 1993 the law was changed to require the number of outside statutory auditors. So I would make the proposal that—what I had said in my presentation—that there's no going back. While it may sound a little bit proactive, there's a qualifier.

The qualifier is there's no going back if tomorrow's investors continue the line of engagement and pressure that require a higher depth of training and information that leads to the foundation of a Japanese manager that matches with governance as a concept. Because that concept is just growing, and that concept is not going away.

Legal changes are second to that, to that sense of information and set of common practices being formed, and the next challenge will be to face that sort of pressure. And the knowledge and engagement you can get from that, going forward.

Steven Vogel: Thank you, Nick.

Zen Shishido: Let me make my final remarks. I agree with Akiyama-san that education and training is very important. And let me add, thinking about the incentive of the people is very important. That's on Steve's point about—the third point, I think—the mandatory regulation or not. Actually I don't like the mandatory regulations. Rather, from the shareholder's side, if you would like the management or the company community is doing something for your interests, it's asking the legislature to make the mandatory law is not a good idea, I think. Rather thinking about what would be the good incentive for management to adopt your recommended idea.

So I like the way that Mr. Friedman says, let the management know what is the benefit of having an independent director for management. Even in the United States, the independent directors are overwhelmed. Not because that is a real good way of capitalism, but there has been some incentive mechanism built up, particularly by the case law.

If you have enough number of independent directors, you will be much safer when you are sued and the poison pill is more stable. Actually, so far, there is nothing good incentives for Japanese management to have more independent directors.

So that is the one key thing, and another of my comments is—some good news—it is not necessary that the older Japanese companies are still staying traditional. Traditional J-type. Actually, Japanese-listed companies are pretty much diverse.

We also have not a small number of very Americanized-type, A-type companies. They are not careful about cross-shareholding and poison pills. An interesting study shows the company who introduced the poison pill, they are at the same time building up the *mochiai*.

So, that's our typical entrenchment symptoms, and there are such type of the company on the side and on the other side, there are more liberalized American-type shareholder reactive companies. So, yeah, it is too simple for you to say Japanese companies. We should more carefully observe the whole Japanese corporations situations. Thank you.

Steven Vogel: Thank you. On that note, thank you very much. [applause]

Dana Lewis: Thank you very much, Steve and Zen, for this nice wrap-up. And thank you everyone out in the audience who contributed. I think hearing these very knowledgeable comments being made out in the audience, there will be a lot to talk about at the reception, which will be starting, basically as quickly as we can move out from this room up to the 25th floor. But before we go, I just want to ask for a round of applause again for all the speakers who've spoken today since the morning.

[applause]

Dana Lewis: Thank you very much. Also to remind you what I mentioned earlier, the evaluation form in the back of the book. Please do fill that out. Leave it at the registration desk as you head for the elevators. That will help us improve our presentation for the next event. And then let me quickly thank again our many sponsors and co-organizers for today's event. I'd like to thank Union Bank. I'd like to thank Mizuho Securities USA, who is hosting the reception upstairs that we'll be going to shortly. I'd like to thank the Law Offices of David A. Makman. I'd like to thank JETRO San Francisco. I'd like to thank the Japan Foundation Center for Global Partnership. All of who have helped underwrite today's event.

And also our co-organizers: Pacific Pension Institute, Federal Reserve Bank of San Francisco, California-Asia Business Council, and All Nippon Airways. And I thank all of you coming in the middle of summer vacation for this event today. Thank you so much.



After the Crisis: Corporate Governance in Japan

Appendix

August 7, 2009

Conference Agenda

Friday, August 7, 2009 (Location: Hotel Nikko, San Francisco)

- 10:00 am Welcome & Registration
- 10:30 am Opening Remarks:
The Honorable Yasumasa Nagamine, Consul General of Japan in San Francisco
Christopher Sigur, Senior Project Analyst/Outreach Coordinator, Federal Reserve Bank of San Francisco
David Lyon, Chairman, Japan Society of Northern California
- 10:45 am Panel Discussion:
New Regulatory Developments in Japanese Corporate Governance
Nicholas E. Benes, Chair, Foreign Direct Investment Committee, American Chamber of Commerce in Japan
Stephen Codrington, CEO, Codrington Corporate Governance Japan
Dr. Kenichi Osugi, Chuo University Law School; Member, METI Corporate Value Study Group
Moderator: **Sarah McLellan**, Vice President, Morgan Stanley
- 12:30 pm Luncheon Host Remarks: **Masaaki Tanaka**, President & CEO, Union Bank, Luncheon Host
- 12:45 pm Luncheon Keynote Address:
Corporate Governance after the Global Financial Crisis
Anne Sheehan, Director of Corporate Governance, California State Teachers' Retirement System
Introduction: **Priya Mathur**, Trustee, Pacific Pension Institute; Trustee, California Public Employee Retirement System
- 1:45 pm Panel Discussion:
Perspectives on Japanese Corporate Governance
Scott Callon, CEO, Ichigo Asset Management
Abe Friedman, Director of Corporate Governance & Proxy Voting, Barclays Global Investors
Toshiaki Oguchi, Representative Director, Governance for Owners Japan KK; Member, METI Corporate Governance Study Group
Moderator: **Nami Matsuko**, Executive Director, Investment Banking Business Development, Nomura Securities Co., Ltd.; Member, METI Corporate Value Study Group
- 3:00 pm Break
- 3:15 pm *Case Study in Corporate Governance*
Yukihiro Saito, General Manager, Investor Relations Department, Shiseido Co., Ltd.
Moderator: **Jun Frank**, Director of Asian Proxy Research, Glass, Lewis & Co. LLC
- 4:00 pm Colloquy:
Where Do We Go From Here? Lessons from the U.S. and Japan
Dr. Zenichi Shishido, Graduate School of International Corporate Strategy, Hitotsubashi University
Dr. Steven Vogel, Professor of Political Science, University of California, Berkeley
- 5:00 pm Networking Reception Host Remarks: **Hiroshi Matsui**, Executive Director, Mizuho Securities USA Inc., Reception Host

Participant Biographies



Nicholas E. Benes

Nicholas Benes is founder and President of JTP Corporation, an independent consulting firm advising on M&A and financial transactions in Japan. He also is Chair of the Foreign Direct Investment Committee, American Chamber of Commerce in Japan. Previously, he was Senior Managing Director at The Kamakura Corporation and served at JP Morgan as a Vice President. Mr. Benes holds a BA in Political Science from Stanford University and received his MBA and law degree (JD) from UCLA. From 2000 to 2007 he was a member of the Expert Committee of the Japan Investment Council, which advised the Japanese Cabinet on foreign direct investment policies. He is fluent in English and Japanese.



Scott Callon

Scott Callon is Chief Executive Officer of Ichigo Asset Management, Ltd., an independent investment manager specializing in Japanese equities. He is Chairman and Representative Statutory Executive Officer of Asset Managers Holdings Co. Ltd. (2337), a Japanese real estate asset manager listed on the Osaka Securities Exchange, and a board member of Japan Office Advisors, Inc., the asset manager for Japan Office Investment Corporation (8983), a J-REIT listed on the Tokyo Stock Exchange. Previously, Mr. Callon held various positions at Morgan Stanley Japan, the Japan Securities Dealers Association, and PCA Asset Management of the UK Prudential Group. He has lived in Japan for 20 years and is fluent in Japanese.



Stephen Codrington

Stephen Codrington is Chief Executive Officer of Codrington Corporate Governance Japan (CCGJ). CCGJ was formed in 2002 to promote long-term value through constructive dialogue with the top management of Japanese corporations. CCGJ views corporate governance as the responsibility of the Board to Shareholders primarily for returns and increasing corporate value. The firm's focus on capital policy is on behalf of its clients, the shareholders, and brings CCGJ into regular contact with academics, pension sponsors, regulators, politicians and bureaucrats. Mr. Codrington graduated from Oxford University and worked in the Japanese Equities department at Robert/Jardine Fleming, and later at SG Warburg/UBS in London and Tokyo.



Jun J. Frank

Jun J. Frank is Director of Asian Proxy Research at Glass, Lewis & Co. LLC. Prior to joining Glass Lewis, Jun Frank participated as an analyst on a project co-sponsored by the Aomori Prefectural Board of Education of Japan and the University of California at Berkeley. Mr. Frank was previously a cultural resource specialist at Pacific Legacy Inc., where he assisted in preliminary studies for environmental restoration and commercial development projects. In 2008, Frank was named a "Rising Star of Corporate Governance" by the Millstein Center for Corporate Governance and Performance at the Yale School of Management. He is fluent in both Japanese and English.

**Abe Friedman**

Abe Friedman is Barclays Global Investors' Global Head of Corporate Governance and Proxy Voting and leads BGI's proxy voting efforts worldwide. Prior to joining BGI, Mr. Friedman served as chief policy officer and general counsel for Glass, Lewis & Co. LLC where he developed and led Glass Lewis' proxy research business. Mr. Friedman also was a deputy city attorney for the City and County of San Francisco where he served as counsel to the San Francisco Ethics Commission and advised city officials on political ethics laws. He holds a JD and Masters in Public Policy and a BA in Political Science from UC Berkeley.

**David Makman**

David Makman specializes in patent and intellectual property litigation. He has experience in high stakes patent infringement litigations involving electronics, semiconductor manufacturing, software, and other technologies. He also has intellectual property consulting experience with copyright, trademark, and Internet law. Since 2007, he has expanded his practice and is handling commercial litigation and corporate governance issues. Prior to becoming an attorney, Mr. Makman worked for several years for Matrix Kabushiki Kaisha in Tokyo marketing U.S. software products to Japanese companies. In Japan, Mr. Makman represented companies marketing AI, CAD CASE and object oriented software. Mr. Makman is bilingual in English and Japanese.

**Priya Sara Mathur**

Priya Sara Mathur has served as Trustee with California Public Employees' Retirement System (CalPERS) Board of Administration since January 2003. Ms. Mathur was the first woman elected to the CalPERS Board in 40 years and its youngest member ever. She is also the first Indian-American to hold statewide office. Ms. Mathur serves as Chair of the Health Benefits Committee and as Vice Chair of both the Investment Committee the Performance and Compensation Committee. She chairs the Program Committee of the Pacific Pension Institute, an educational organization which assists pension funds and other investment institutions worldwide with carrying out their fiduciary responsibilities.

**Hiroshi Matsui**

Hiroshi Matsui is currently serving as Director for Mizuho Securities USA Inc. in San Francisco. Mr. Matsui has been with Mizuho Securities since 2002 as a Japanese equity sales person, and has worked with the firm in New York, Los Angeles and Tokyo. Prior to joining Mizuho, Mr. Matsui worked at ING Barings, WestLB, Kokusai Securities, and other financial industry companies. He graduated from Waseda University School of Commerce and also holds an MBA from the Anderson School of Management at the University of California, Los Angeles.

**Nami Matsuko**

Nami Matsuko is Executive Director of the IB Business Development Department at Nomura Securities Co., Ltd. Ms. Matsuko provides corporate advisory services to Japanese and foreign corporations. She also devotes her time to the Corporate Value Study Group and M&A Study Group organized by the Ministry of Economy, Trade and Industry (METI) and Cabinet Office, respectively. Ms. Matsuko has appeared at international seminars including the "Corporate Governance in the New Japan—Revisited" conference (Japan Society, San Francisco, 2006), and the International Bar Association conference (Singapore, 2007). Ms. Matsuko holds a BA in International Law from Sophia University in Tokyo and LL.Ms from Georgetown Law Center and New York University School of Law.

**Sarah I. McLellan**

Sarah McLellan joined Morgan Stanley in 2004. Currently, Sarah works with the investment bankers in Tokyo on fundamental value, accounting, and financial valuation analysis for the firm's Japanese corporate and private equity clients. Ms. McLellan studied Japanese at Tufts University and earned a degree in International Relations (Japan) and Quantitative Economics. Ms. McLellan returned to Japan as a Fulbright Fellow and researched the country's pension crisis at Osaka University. She holds an MBA from the Wharton School and MA in International Affairs (Japan) from the Lauder Institute at the University of Pennsylvania, and won the 2004 Thesis Prize for her MA thesis on Corporate Pension Reform in Japan.

**Toshiaki Oguchi**

Toshiaki Oguchi is Executive Director of Governance for Owners and a member of the Ministry of Economy, Trade and Industry, Japan (METI) Corporate Governance Study Group. He has more than 20 years of business experience in Japan, the US and the UK and has extensive skills in both corporate governance matters and institutional relations. He has held positions in corporate planning and product development for Nippon Life and Nissay Asset Management Corporation. From 2002 to 2003, he was seconded to Hermes Pensions Management in the UK to take the role of Manager, Corporate Governance, Asia-Pacific, where he was exposed to international corporate governance approaches.

**Kenichi Osugi**

Kenichi Osugi is a Professor of Corporate Law and Securities Regulation at Chuo Law School. He also is a member of the Ministry of Economy, Trade and Industry, Japan (METI) Corporate Value Study Group. Dr. Osugi's research interests include corporate law, securities regulation and financial economics. He has spoken at several international corporate governance conferences on a range of topics including Japanese corporate governance principles, the structure of law of corporate finance and protecting minority shareholders during shifts in corporate control. Dr. Osugi obtained his LLB from Tokyo University and has served as visiting fellow at Columbia Law School.

**Yukihiro Saito**

Yukihiro Saito is General Manager and head of the Investor Relations Department at Shiseido Co., Ltd. Shiseido Co., Ltd.'s principal activities are the manufacture and sale of cosmetics, toiletries, beauty products, health foods and pharmaceuticals. As the head of Investor Relations, Mr. Saito has been in charge of shareholder meetings for 19 years. His efforts have reformed the corporate governance of Shiseido by implementing new processes such as adapting and discontinuing anti-takeover measures while considering the shareholders' point of view. Regular communication with investors, explaining business results and the policies of the company's leaders have all helped to build trust between Shiseido and the firm's shareholders.

**Anne Sheehan**

Anne Sheehan is the Director of Corporate Governance for the California State Teachers' Retirement System (CalSTRS). She is responsible for the development and implementation of major corporate governance initiatives approved by the Board of Directors of the second largest pension fund in the United States. Prior to joining CalSTRS, Ms. Sheehan worked with Governor Arnold Schwarzenegger as the Chief Deputy Director for Policy of the California Department of Finance. In this capacity, she represented the Governor on more than 80 state boards, commissions, and public authorities. Ms. Sheehan has had nearly three decades of management and leadership experience in major policy positions at both the state and federal levels.

**Zenichi Shishido**

Zenichi Shishido is a Professor of Law at Hitotsubashi University Graduate School of International Corporate Strategy and Faculty Fellow of Research Institute of Economic, Trade and Industry (RIETI). He has served as visiting professor at UC Berkeley, Columbia, and Harvard law schools. His major publications include 動機付けの仕組みとしての企業：インセンティブ・システムの法制度論 (*The Firm as an Incentive Mechanism: The Role of Legal Institutions*) (Yuhikaku, 2006); "The Turnaround of 1997: Changes in Japanese Corporate Law and Governance" in Masahiko Aoki et al., eds., *Corporate Governance in Japan: Institutional Change and Organizational Diversity* (Oxford University Press, 2007); and "Reform in Japanese Corporate Law and Corporate Governance," 49 Am. J. Comp. L. 653 (2001).

**Masaaki Tanaka**

Masaaki Tanaka was appointed President and Chief Executive Officer of UnionBanCal Corporation and Union Bank in May 2007. Previously, he served as Executive Officer and General Manager, Corporate Planning Division of The Bank of Tokyo-Mitsubishi-UFJ, Ltd. in Tokyo from January 2006 to May 2007. He joined The Mitsubishi Bank in 1977. He has over ten years of banking experience in the United States. Mr. Tanaka serves as First Vice President on the Board of Directors of the Japanese Chamber of Commerce of Northern California, the Advisory Council of the Asia Foundation, and is a trustee of the Asian Art Museum and a Director of the Japan Society of Northern California.

**Steven K. Vogel**

Steven K. Vogel, Professor of Political Science at the University of California, Berkeley, specializes in the political economy of advanced industrialized nations, especially Japan. He is the author of *Japan Remodeled: How Government and Industry Are Reforming Japanese Capitalism* (Cornell, 2006) and co-editor of *The Political Economy Reader: Markets as Institutions* (Routledge, 2007). Dr. Vogel has written extensively on comparative political economy and Japanese politics, industrial policy, trade and defense policy. He worked as a reporter for *The Japan Times* in Tokyo and as a freelance journalist in France, and holds a BA from Princeton University and a PhD in Political Science from the University of California, Berkeley.

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