

Japan corporate governance and responsible investment policy



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Introduction

This document sets out Legal & General (L&G) expectations of investee companies in the Japanese market in terms of responsible investment best practice. This is region specific and therefore separate to our [Global Policy document](#), which provides a full explanation of L&G's approach and expectations in respect of key topics that we believe are essential for an efficient governance framework.

L&G recognises that the move towards strong corporate governance in Japan begins with compliance with Japanese legislative and regulatory frameworks. This responsible investment policy goes beyond minimum compliance and reflects L&G's approach with respect to key topics we believe are essential for an efficient governance framework and for building a sustainable business model. When developing our policies, we not only look at local market regulatory and best practice expectations, but also at broader global guidelines and principles, such as those provided by the United Nations Global Compact (UNGC), OECD guidelines and ILO conventions and recommendations.

While there is no “one-size-fits-all” solution to building a sustainable business model, we look for companies we invest our client's money to demonstrate that sustainability is effectively integrated into their long-term strategy and daily operations. Companies should aim to minimise the negative impact their businesses have on the environment, while innovating to find better solutions. Their strategies should include ways to make a positive impact on society and, embrace the value of their workforce and supply chains, and deliver positive long-term returns to shareholders.

We publicly disclose our voting decisions, including the rationale for votes against management. This data is now accessible one day after the shareholder meeting, and it is available [here](#).

Company board

The board of directors is responsible for the management and long-term success of the company. It should always act as a steward of stakeholders' interests.

The board has the crucial task of setting the strategy of the business, while ensuring the necessary resources are available to enable its implementation and making sure that appropriate risk management and internal controls are in place. It establishes the philosophy for the company, ensuring that stakeholders' views are considered and embedded in its culture. The board is expected to take into account environmental, social and governance considerations and to report on company performance in these areas. It is also responsible for ensuring the integrity of the company's accounting and reporting, and the effectiveness of its internal control systems. Lastly, the board is ultimately accountable to investors and other stakeholders and should make sure its decisions are effectively communicated to them.

Board leadership

We believe that having the right composition at the top of a company is an essential element of its success. We expect each director on the board to fully exercise their duties and promote the long-term success of the company.

We expect the board's decisions and actions to demonstrate leadership in managing the company's responsibilities to its stakeholders and to limit any negative impact of its operations on the environment.

As such, L&G will usually hold the board chair accountable for failing to meet our minimum expectations under key policies to safeguard the value of our client's assets by protecting our planet and safeguard society. For more information on key environmental and social focus areas, please see below and on our [website](#).

Board chair and chief executive officer (CEO)

The responsibilities of the board chair include leading the board, setting the agenda for board meetings and ensuring directors receive accurate and timely meeting information. Under their direction, there should be a good flow of information between the board and its committees. The chair is also responsible for leading the appointment process for the CEO¹.

The chair should be able to challenge the inside directors and encourage the outside directors to actively participate in board discussions. It is the chair's role to regularly assess whether board members have the adequate expertise for their roles, if they are making a sufficient time commitment and whether there is an appropriate level of diversity. We expect the board chair to be clearly named and identified in all relevant company disclosures, including in the English version of the annual report, in meeting documentation and on the website.

By contrast, the CEO has responsibility for executing the strategy agreed by the board and leading the business.

Given the importance of the chair's role, we expect the appointment of an independent director as board chair, who is separate from the inside-company chairperson. How we determine the independence of the board chair is detailed in the section below, *Structure and Operation - independence*

We would not expect a retiring CEO to take on the role of board chair. These two roles involve separate responsibilities and a different approach to board relationships and the company's strategy. We recognise the challenge for those who have had executive responsibilities to adequately distance themselves as a non-executive chair. Where a company would find the presence of the former CEO on the board beneficial in times of transition, our preference is that the CEO is used as a consultant rather than as a formal board member, and we would stipulate that this should be for a maximum period of one year.

An important distinction for Japanese companies to note is that the board chair (Gicho) is different from the company chairperson (Kaicho). In Japan, it is common for a Kaicho², who is typically a former CEO, to be at the helm of the company. Nonetheless, from the perspective of an independent board chair, we focus on the Gicho rather than the Kaicho for companies in Japan.

The case of the combined chair and CEO

Although many Japan-listed companies do not separate the roles of the board chair and CEO, this section provides guidance on our views.

We believe that the roles of the chair and CEO are substantially different and require distinctly different skills and experience. This division of responsibilities also ensures that a single individual does not have unfettered powers of decision-making at the head of the company, thereby securing a proper balance of

¹ Kaicho is not a legal term in the Companies Act and transparency around the responsibilities of the role is usually insufficient.

authority and responsibility on the board. Therefore, we will vote in favour of resolutions that separate the chair and CEO roles.

While L&G typically does not support the election or re-election of any individual who holds both a board chair and CEO role, this voting policy does not currently apply to Japanese companies. Nonetheless, we expect Japanese companies to appoint an independent director as board chair, and to provide disclosures in English regarding the individual chairing the board. We also expect Japanese companies to provide a clear explanation if they choose not to separate the roles of board chair and CEO.

For more details, please refer to our board guide on the nomination of the board chair, available [here](#).

Senior or lead independent director

The position of senior or lead independent director may not yet be well established in Japan. We believe, however, that this is an essential role on the board. This person should lead the succession process for the chair and appraise the chair's performance. Additionally, they should meet investors regularly to stay well-informed of any concerns as a key contact for investors, especially when the normal channels of the chair, CEO or chief financial officer have failed to address concerns or are not the appropriate avenues.

We expect the senior or lead independent director to be an unquestionably independent outside director. How we determine the independence of the director holding the role of senior or lead independent director is detailed in the section below, Structure and Operation - independence

While the presence of a senior independent director should not be limited to cases where there is a combined board chair and CEO, this is of extra importance when the company combines the two roles. Where companies have historically combined the positions of CEO and chair and have chosen to keep this structure, we expect a strong, senior independent director or deputy chair to be appointed and for a meaningful explanation and justification to be provided in annual disclosures.

Please see our website for a thought piece on the role of the senior independent director, available [here](#).

Outside directors

L&G expects these directors to use their skills and experience to constructively contribute to board discussions and help develop proposals on strategy. They are expected to oversee management performance and provide constructive challenge at board meetings.

We encourage boards to appoint one director who may not have previous board experience, but has a unique skill aligned with the company's strategy. We believe this can lend support to board discussions and grow the future pool of independent outside director talent.

Given the responsibility the roles involve, these directors must make sure they have sufficient time to perform their duties. This should be a factor considered when taking on outside board roles. Please refer to our section on board mandates below.

Outside directors should continually update their skills and knowledge and agree on their specific training and developmental needs, which should also include all aspects of the environmental, social and reputational risks faced by the business.

Structure and Operation:

Board Structure

Japan's Companies Act offers listed companies three options for board structures. Our voting policy may vary depending on the structure of the board.

Statutory auditor (Kansayaku) model (two-tier model)

This structure consists of a board of directors and a board of “statutory auditors” (Kansayaku, also referred to as the “Kansayaku board” or “audit and supervisory board”). The law stipulates that at least half of the Kansayaku board must be composed of outside Kansayaku. The role of Kansayaku is to monitor the company's financial reporting and auditing practices as well as the directors' conduct. The legal position of Kansayaku is that of a fiduciary, and their duties include: attendance at all board meetings, determination of audit policy, deciding methods for monitoring and investigating the company, auditing accounts, and reporting breaches of directors' duties. Although Kansayaku have an important role and the obligation to attend board meetings and express their opinions as necessary,, they do not have voting rights.

Three-committee model (one-tier model)

This US-type structure consists of three committees, responsible for audit, nomination and remuneration. The majority on each committee must consist of outside directors. Under this model, the main role of the board is to monitor the performance of executive officers appointed by the board.

For auditing purposes, this structure is considered preferable, because the audit committee is an integral part of the board. As board directors, committee members have the right to vote and the ability to exert direct influence on board decisions. As a result, they are considered to have greater capacity to positively influence the robustness of a company's internal controls.

Audit and supervisory committee structure (hybrid model)

Hybrid board structures with an audit and supervisory committee (Kansatouiinkai, also referred to as the “supervisory committee”) emerged as an amendment to the Companies Act in 2015. A majority of the audit and supervisory committee members are required to be outside directors.

While the role of the audit and supervisory committee is similar to that of the Kansayaku board under the two-tier model, this committee has the right to give its opinion on the nomination, removal and remuneration of directors who are not committee members.

Board committees:

Audit, nomination and remuneration committees

Board committees ensure that specific directors are responsible for key board functions. Globally, we ask for the nomination committee to comprise a majority of independent non-executive directors, while emphasising that the remuneration and audit committees should consist exclusively of independent non-executive directors. It is essential that these committees are able to freely discuss and act on sensitive areas without an inside director in attendance. Non-independent directors may attend

some or part of the meetings on occasion by invitation, but should not be a member of the audit and remuneration committees.

Japan-listed companies with the three-committee model are required to put in place three separate board committees responsible for the core board functions of audit, nomination and remuneration. For those companies, we will vote against the president or company chairperson if the candidate sits on the remuneration or audit committee.²

By contrast, companies with the Kansayaku model or audit and supervisory committee model have the discretion to establish voluntary advisory committees on nomination and remuneration. For such companies with board structures not legally obligated to form such committees, we maintain our expectations regarding independence and expect the board to uphold the committees' recommendations.

Additional board committees

Companies may consider it appropriate to set up additional board committees to assist the board in its discussions. These committees are useful where the board could benefit from an increased focus on an issue that is directly linked to its long-term success, or where the company operates in a high-risk sector.

A sustainability committee could be beneficial by providing sufficient time and expertise to focus on those key issues that are directly linked to long-term success and those environmental and social areas which may represent a material risks to the business model.

In other cases, boards may consider the need for direct access to independent and external advice and expertise from third parties or stakeholders. We are supportive of companies setting up advisory committees. This is a flexible option to obtain specific and relevant information to assist the board and management in their decision-making without having to impact the size and composition of the board.

To enable investors to assess the effectiveness of board committees, we expect disclosure of the role and composition of all board committees and a report on their activities to be provided to investors in the annual disclosure documents.

Board size

We consider that board effectiveness is optimised when it comprises no more than 15 members and its composition should depend on the size and complexity of the company. By their nature, small boards that are suitably diverse are better equipped to facilitate active, constructive debate and agile decision-making processes. With the exception of companies with the U.S.-type three-committee board structure, we will vote against the most senior non-independent member of the board standing for re- election when the board exceeds 15 directors.³

² This currently applies only to companies with a three-committee structure due to availability of public information.

³ This applies to companies with a two-tier board with statutory auditors (Kansayaku) or the hybrid audit and supervisory committee structure

Board effectiveness

Culture

Companies should maintain the highest standards of conduct towards all stakeholders. The board should promote behaviours and values that demonstrate integrity and respect. The board should assess at least on an annual basis, if the company's values and behaviours are understood, and respected throughout the organisation.

Boards should disclose information that helps investors understand their company's culture. Investors need assurance that the CEO and the senior management team are really driving the cultural message and setting the tone from the top.

We expect companies to disclose information including:

- How they measure culture and how that relates to the business strategy;
- How their mission statement and values are communicated and reinforced; and
- Any key performance indicators that are linked to culture.

Where there are situations, such as impropriety or general misconduct, L&G expects the board to conduct a thorough evaluation to determine the suitability of the connected directors as continuing members of the board. We will also conduct our own analysis to determine the appropriateness of a given director's continuation at the company and may vote against the re-election of directors who we believe have not demonstrated good business conduct.

Board diversity

We expect all companies in which we invest globally to have at least one woman on their board.⁴ In Japan, we started voting against the appointment of the most senior member of the board (usually the company chair or president) or the nomination committee chair of TOPIX 100 companies with all-male boards in 2020. We currently vote against the most senior member of the board or the chair of the nomination committee unless at least 15% of the board at TOPIX 500 companies are women. All other companies, including but not limited to Prime-listed companies, should have at least one woman on the board. We will continue to expand our policy to a greater number of Japanese companies and also look to require a higher threshold of board diversity over time.

We also expect companies to promote diversity below board level, namely at the executive and management levels, as well as throughout their entire workforce.

For more information, please refer to our [diversity policy](#).

⁴ We do not count Kansayaku as board members

Re-election of directors

In Japan, directors serve in their positions until the conclusion of the AGM for the last business year that falls within two years from the time of their election. Nevertheless, we support proposals that reduce the director's term to one year, as permitted by the Companies Act, and encourage others to follow.

The provision of biographical information on directors is essential to enable shareholders to make an informed decision about the appropriateness of nominee directors. In addition to the biographical details of each director, we also encourage the disclosure of the attributes and skills the director brings to the board and how these fit with the long-term strategic direction of the business. In addition, investors benefit from companies providing information regarding the expected time commitment to the company, a record of attendance and an explanation if a director has missed a scheduled board or committee meeting.

Re-election of Kansayaku

The Companies Act stipulates that at least half of the Kansayaku should be outsiders, but with no obligation for them to be independent. It is vital that true independence from the company is maintained in the Kansayaku board. Therefore, we vote against outside Kansayaku nominee members who are not independent (regardless of the overall independence of the Kansayaku board). We also vote against inside Kansayaku nominee members unless the Kansayaku board after the meeting is at least 50% independent.

Independence

Independence is essential to ensure the board exercises sufficient oversight and consistently acts in the best interests of the company and its stakeholders.

We expect unaffiliated outsiders to bring an independent perspective to boardroom discussions and make observations and suggestions that are pertinent to the company, but which inside directors may not have thought of, or may be reluctant to address. A relevant and suitably diverse mix of skills and perspectives is critical to the quality of the board and the strategic direction of the company.

It is important that directors are independent of one another, and that any interlocking board relationships are disclosed and explained.

To remain competitive and attractive to foreign investors, Japanese companies should focus on establishing a board that meets the international best practice trends. Notwithstanding, we recognise that reaching the optimum level of independence will be a continuous, iterative process, and companies need time to test the dynamics of new board composition.

To balance these considerations, we call for a minimum of one-third of directors to be independent and ask companies to outline the steps to be taken to increase independence in the future. Regardless of the board structure, we will vote against the chair or most senior member of the board if, after the shareholder meeting, the board is not at least one-third independent. We additionally expect companies to comply with the 2021 Corporate Governance Code in instances where the code requires a higher level of board independence. For instance, we will vote against the chair or most senior member of the board at companies with a controlling shareholder unless a majority of the board comprises independent outside directors. In the coming years, we will be looking to raise the board independence threshold to a majority, starting with the top-tier companies.

An outside director under Japanese law is generally someone who:

- Is not an employee of the company or group;
- Has not been an employee of the company or group within the last five years;
- Is an outsider who represents less than 10% of the company's voting common stock;

- Does not have close family ties with any of the company's advisers, directors, or employees.

In addition to the conditions above, we will consider candidates who fall under any of the following categories as non-independent:

- Individuals who work or worked at major shareholders of the company;
- Individuals who work or worked at the main providers of financial services to the company;
- Individuals who work or worked at the lead underwriter(s) of the company;
- Individuals who work or worked at business partners of the company and the transaction value is material from the recipient's perspective or is not disclosed;
- Individuals who worked at the company's audit firm;
- Individuals who offer or offered professional services such as legal advice, financial advice, tax advice or consulting services to the company;
- Individuals who have a relative(s) working at the company as executives or employees in important positions;
- Individuals who worked at the company; or
- Individuals who work or worked at companies whose shares are held by the company as "cross-shareholdings" (this includes not only mutual shareholdings, but also unilateral holdings held for reasons other than pure investment purposes); or
- Individuals who have served on the board for more than 12 years.

Advisory positions (Komon/Sodanyaku)

Advisory positions unique to Japanese companies, known as "Komon" or "Sodanyaku," are usually held by the former company president or another senior executive.

They are not held accountable to shareholders as they do not serve on the board. Still, they can apply pressure on the board and are often referred to as "ghosts in the boardroom" or "corporate backseat drivers". In cases where the former CEO remains as a senior adviser, they may exercise unreasonable influential power over incumbent management members, which could be detrimental to the board's functioning and dynamic.

With no basis in law, these roles vary from company to company. Furthermore, companies are not required to disclose details of these positions but are given the option to do so in the Corporate Governance Report required by the TSE. We expect companies to provide adequate disclosure on the presence of an advisory position, their role and responsibilities of the position, the duration of the appointment, and what the individual is paid. We also recommend that any company that does not have a "Komon" or "Sodanyaku" should make that known to investors. We expect these disclosures to be made in the corporate governance report and in English before the annual general meeting (AGM).

Succession planning

Succession planning is a vital function of an effective board. It ensures continuity, provides individuals with the right skills to sit on the board and can help to avoid the dangers of "group think".

We expect companies to put in place a formal and transparent procedure for the appointment of new directors. The annual board evaluation exercise should assist in this task. We expect the nomination committee, together with the board, to consider setting short, medium and long-term plans to ensure there is an orderly replacement of board members and senior executives. The plans should map out potential successors in the short term for unexpected departures, in the medium term to replace directors who reach their tenure limits, and in the longer term to take account of future skills and diversity requirements.

We encourage companies to publish as much of this information as possible in their annual disclosures. In addition, we would expect to see a skills matrix linked to the strategy of the company, and an explanation of how the skills of newly appointed directors are complementary in relation to the matrix, along with the minimum time commitment expected of each director.

Board tenure

The regular refreshment of the board helps to ensure that its members remain independent from management and third parties, that different perspectives feed into board discussions, and that skillsets remain relevant. A regularly refreshed board is more likely to question established practices, avoid groupthink, and exercise more efficient oversight over management to stay ahead of market changes.

We expect all companies globally to put in place an individual director term limit of a maximum of 12 years.

Board mandates

We believe it is important for inside directors to seek external board appointments as this will help broaden their skills and knowledge, enabling them to provide more input to board discussions. However, when taking up external appointments, they should be mindful of the time commitment required to exercise their duties on multiple boards.

As the number of companies a director serves on increases, so does the risk that they may become less effective. This risk increases further depending on the role and time commitment needed due to the size and complexity of the company itself. A director has a duty of care to ensure they have sufficient time to contribute effectively to each directorship.

We would encourage inside directors not to undertake more than one external directorship of an unrelated listed public company.

Although it is not yet a voting issue, in Japan we encourage outside directors to limit their number of board positions to a total of five public company board roles. We consider an independent board chair role to count as two board roles due to the extra complexity, oversight and time commitment that it involves.

To help investors assess how directors with other board mandates are performing their duties, we would like the company to disclose the level of time commitment expected from outside directors.

Board meetings and attendance

Regular board meetings are vital for the board to effectively perform its duties.

We believe the board chair should hold separate meetings with independent directors to discuss the performance of the executives. In addition, the independent directors should have at least one meeting during the year without the chair present.

Director attendance at board meetings is a vital part of the role to ensure contributions to board decisions and fiduciary duties to investors are fulfilled. We therefore expect companies to allow investors to assess directors' attendance at board and committee meetings by publishing attendance records in their annual disclosures. We expect directors to have attended no fewer than 75% of the board and committee meetings held. Where a director does not attend a board or committee meeting, the company is expected to report to investors the reasons for non-attendance. Where a director's attendance is below 75%, and the board has not provided an explanation for the absence, L&G may vote against the director's re-election.

Board effectiveness review – internal and external

The evaluation of directors is a key way of improving board effectiveness and ultimately its performance.

Japan's Corporate Governance Code states that boards should conduct an annual board-effectiveness evaluation and disclose a summary of the results. We expect an internal board evaluation to take place annually. This should be led by the most senior independent director on the board, or if managed externally, by an independent third party. We expect an external evaluation of the board to take place at least every three years. It should be performed by an independent third party to avoid conflicts of interest. External reviewers can also bring different perspectives on the functioning of the board, as well as experience of how other boards operate.

In the interests of transparency, we expect the process and general outcomes of such evaluations to be published in the company's annual disclosures, as well as any progress made on the outcomes of previous board evaluations. Any potential conflict of interest with external reviewers should also be disclosed. We would expect the external board reviewer to be refreshed after they have conducted two consecutive reviews.

For more details on our position on the topic, please refer to our short thought-piece on the topic, available on our website [here](#).

Board responsiveness

Voting at company meetings is part of a shareholder's escalation strategy to signal concerns with aspects of governance. Where 20% or more of votes have been cast against a board-recommended resolution, we expect the board to engage with shareholders to determine their reason for voting against. The next annual report should provide information on the steps taken to address shareholder concerns. We may vote against a relevant director's re-election if a company has not demonstrably undertaken such discussions.

Outside director induction

The chair of the nomination committee is responsible for ensuring that incoming outside directors receive a comprehensive induction to the company on joining the board, and that training is available on an ongoing basis. This will allow new directors to contribute to board meetings as soon as possible. We support the view that companies should hold regular briefings or presentations to the board from divisional executives to ensure that directors are kept informed on all aspects of the business.

Directors should be encouraged to continually update their skills and knowledge, and should agree on their specific training and developmental needs, which should include all relevant aspects of environmental, social and reputational risks faced by the business. One way to remain up to date is to regularly meet with investors, along with other relevant board members, to gain knowledge and to hear various perspectives.

L&G regularly publish thought leadership pieces and blogs on relevant topics related to corporate governance, stewardship and responsible investment, which can be accessed through our [website](#) and the [L&G.blog](#).

Stakeholder engagement

Well-run companies generally take account of the interests of their stakeholders on material issues. Therefore, we encourage all companies to have regular dialogue with key stakeholders to ensure a good understanding of material concerns. We expect companies to report in their annual disclosures how engagement with key stakeholders has fed into board discussions.

Employee dialogue

We acknowledge that different countries, through regulation or best practice codes, may have different approaches to how boards should consider the views of their employees.

Where hard or soft law does not provide any guidance, we encourage companies to set up an appropriate structure. Companies may prefer to appoint employee representatives to the board or use forums or advisory panels.

We do not consider any single model superior to another and encourage companies to select the method that is most effective for their business model and current circumstances.

For more details on our position on the topic, please refer to our thought piece on this issue available [here](#).

Investor dialogue

We believe that a two-way engagement with investors constitutes a vital risk-mitigation tool for the board. This is an opportunity for directors to explain company decisions and to make sure they are well understood by the market, as well as to take market soundings, which can aid future board decisions.

L&G's stewardship priorities focus on material issues that are not only important to our clients, but also pose a risk to the long-term value of their assets, e.g., climate change, human rights, health, etc. Therefore, these engagements will take priority over general ESG engagements.

That said, where the board has additional information that was not included in the annual disclosures and has reason to believe that shareholders do not have all of the facts in order to cast their votes in a fully-informed manner, L&G encourages companies to proactively request engagement with their investors at the earliest opportunity.

Audit, risk and internal control

The board is responsible for determining and disclosing the company's approach to risk, its risk appetite, and monitoring the outcome and controls in place for effective risk management.

It is also responsible to its investors for presenting a true and fair view of the company's financial position and for setting out future capital management plans and near-term financial prospects.

The board is responsible for ensuring the independence and robustness of the internal and external audit functions and for assessing their effectiveness. Conclusions of this review along with bespoke narrative on the assessment and noted areas, along with actions taken to address any concerns are expected in annual disclosures.

Compliance with regulations

The audit committee should ensure that all laws and applicable regulations are complied with and to avoid exposing the company to the undue risk of fines, censorship, and reputational damage⁵. We will hold the audit committee chair responsible for failing to detect breaches in accounting practices.

External audit

Auditors are an essential feature of an effective and transparent system of external supervision. To minimise potential conflicts of interest, the auditor's primary line of reporting should be to the audit committee, where one exists, and not to senior management. The auditors are ultimately employed to serve the shareholders, not the managers. Shareholders should be given an opportunity to vote on their appointment or re-appointment at each AGM.

High-quality audits are valued by investors and should be considered an asset rather than a cost to the business. It is important that the audit fee is reflective of the work involved, and that the auditor is selected based on quality rather than because it offers lower fees.

An external audit provides independent assurance of the financial statements of a company to its investors. The role of the auditor is to provide reasonable assurance that the financial statements give a true and fair view of the financial health of the company and that they have been prepared in accordance with appropriate accounting standards. Any significant audit matters raised by the auditors should be fully explained by the board, including how these have been addressed.

The external auditors are also responsible for producing the auditors' report, which is a formal opinion and evaluation of the financial statements.

The board is responsible for appointing the company's external auditor. The company is expected to clearly disclose the audit firm used, the partner who led the audit, the tenure of that firm, and why the board considers the auditor to be independent and how any potential conflicts are being avoided.

In Japan, audit firm rotations are not mandated by regulations. Furthermore, the appointment of an external audit firm is typically only put to a shareholder vote when companies intend to appoint a new audit firm. This is because an audit firm is deemed to have been re-elected at the AGM, unless otherwise resolved by the meeting.

⁵ In terms of regulations, L&G is in favour of streamlined disclosure requirements for the pre-AGM business report and financial statements (subject to the "first" audit based on the Companies Act) and the yukashoken hokokusho (subject to the "second" audit based on the Financial Services Agency's Financial Instruments and Exchange Act).

We believe the role of the external auditor should be put to tender on a regular basis to enhance the independence and quality of the external audit. Rotations should take place at least every 10 years, with the total tenure of the audit firm not exceeding 20 years. Within this timeframe we expect the lead audit partner to be subject to refreshment every five years. We expect the process of the tender to be disclosed, and the rationale for the appointment to be explained.

The fees for the external audit should be published in the annual disclosures. Where the external auditor provides non-audit services, these should be fully explained in the appropriate annual disclosures. We expect non-audit services provided to be incidental to the audit, with the primary purpose of improving the quality of the financial accounts. We do not expect excessive non-audit work to be conducted by the company's external auditor, as this will bring into question the independence of their judgement. Non-audit-related services are not expected to exceed 50% of the value of the audit services in any given year.

We believe auditor liability is an important and proportionate approach to supporting a high-quality audit. We are not supportive of fixed auditor liability or restrictions on that liability.

The audit committee, Kansayaku/Kansayaku board, or audit and supervisory committee (depending on the board structure) is responsible for explaining how it has assessed the quality of the external audit and recommendations arising from the external audit, and this should be reported to investors when considered material by the board and/or the audit partner.

Internal audit

Companies should have an effective and sufficiently resourced internal audit system in place, which is designed to take account of new and emerging risks that will affect their business objectives and identify the level of risk taken. The process and procedures in place to manage such risks should be embedded in the risk-based control system for the company and should be summarised in the annual disclosures to investors.

The audit committee, Kansayaku/Kansayaku board, or audit and supervisory committee should have responsibility and oversight of the internal audit function.

Whistleblowing

We expect companies to establish a whistleblowing policy that is integrated into their code of conduct. The policy should be publicly disclosed and open to all employees including those across the supply chain. Every effort should be made to ensure that all employees and supply chain workers are aware of these procedures, and how to access them.

The whistleblowing reporting channels should be easily identified and independent from management, with a direct line to the board or audit committee, Kansayaku/Kansayaku board, or audit and supervisory committee to allow for appropriate oversight and independent escalation where necessary. Companies should ensure their policy safeguards the identity of any whistleblower and that they are protected from internal harassment. Companies should also report how the risks associated with bribery and other illegal behaviour are being monitored and addressed.

Digitisation:

Artificial Intelligence

In our view, AI should drive long-term innovation, productivity and value creation but in order to see these benefits over the long-term, it is equally as important that such gains have appropriate governance and transparency to manage any down-side risks.

AI entails risks around data privacy and security; regulatory compliance; operational and critical infrastructure; workforce transitions; intellectual property; reputations; and trust in the information environment. There are also a host of ethical concerns as to its application.

L&G expects companies to meet baseline expectations around AI's governance, risk management and transparency. For companies more exposed to the development of AI systems, we will expect higher standards and additional resources to be applied to meet these expectations.

We expect the board to have clear accountability for AI strategy and risk oversight. The board should maintain knowledge of emerging AI risks and opportunities, and provide transparency of the governance and risk processes in place on this issue.

Specifically, companies may wish to consider utilising product safety assessment risks including on human rights, building trust by utilising third party groups, establish baseline understandings of AI ethical expectations and processes for employee and user feedback, or remediation if required.

Cyber security

The vulnerability of a company's IT systems can lead to material financial and reputational impacts. Therefore, we expect a risk-based approach to be taken to address the issue of cyber security and data protection. It should be integrated into the control functions of the business and overseen from a strategic perspective by the board. It is the board's role to understand the infrastructure needed in the business to protect valuable information assets, key intellectual property and customers' confidential data. Therefore, accountability should not be delegated. Cyber security should be a regular board agenda item. Any material data breach incident should be disclosed to customers and the market in a timely manner in line with regulatory expectations.

For more information, please refer to our guide on the topic, available [here](#).

Climate risks

We expect companies with climate change as a material financial risk to appropriately reflect these risks in the scenarios, assumptions and estimates used to prepare their financial accounts. Companies should ensure, through transparent disclosure, that there is consistency between their narrative on climate change and their accounting determinations. In addition to our ongoing targeted engagements relating to climate accounting topics, we will develop our work further in this area. This may lead to applying voting sanctions on companies that fall short of minimum expectations.

Remuneration

We regard appropriate remuneration levels as fundamental to recruiting, incentivising and retaining directors of the quality required to manage a company successfully. We seek disclosure and justification of the chosen remuneration structures and levels.

In general, Japanese companies are less prone to excessive remuneration structures than companies in other markets.

Cash retirement bonuses constitute a significant portion of executive remuneration, and the majority of these are not reflective of performance. We believe that Japanese companies should adjust their executive remuneration structures to align with company performance and shareholder value creation. Accordingly, remuneration disclosure should focus on the structure of incentive arrangements.

Key pay principles

We apply a set of simple pay principles when looking at remuneration structures:

- The structure of remuneration and the payments awarded should be fair, balanced and understandable. This means: fair in terms of what the company has achieved; balanced in terms of the amount paid to the executive, employees and investors; and understandable for the recipient, the board and investors.
- Awards should incentivise management to focus on long-term performance and be aligned with and support the achievements of the business strategy and objectives.
- Executives should have meaningful direct equity holdings while employed and thereafter; buying shares is one of the best ways of aligning the interests of management and investors.
- Boards should retain the ultimate flexibility to apply discretion and ‘sense check’ final payments to ensure that they are aligned with the underlying long-term performance of the business.
- Companies should be transparent on why rewards have been transferred to the executive, setting out targets, their relevance to meeting long-term goals, which targets were met and justifying all adjustments made to accounting measures for remuneration purposes.

Fixed remuneration

We expect a base salary for executives to be commensurate with the size and complexity of the company. Although salary levels at peer companies may be considered, these should not function as an immovable benchmark.

Salary increases should not be automatic each year. Any increase in salary levels should not exceed what is offered to the general workforce, and its impact on total remuneration should be assessed before approval.

Incentive arrangements

Annual bonuses for directors and Kansayaku

Companies may choose to award an annual bonus to inside directors. We believe that any annual bonus should be geared to delivering the strategy of the business.

Investors expect companies to set out as a minimum the level of bonus that can be earned for target and maximum performance.

A majority of the annual bonus should be linked to the delivery of financial performance. It is helpful if companies explain why targets were selected. In addition, achieving a threshold level of financial performance should be a pre-requisite for the payment of any bonus that is based on personal or strategic objectives.

Where multiple performance conditions are set, investors welcome the disclosure of the weightings applied to each performance condition. Where a target is commercially sensitive to the business at the time when the award is made, disclosure a year later is acceptable. If this is not possible, an explanation of why the target continues to be commercially sensitive is expected.

Ideally, strategic, qualitative and personal targets should be separated, with each having its own weighting. The use of financial metrics that are reported in annual disclosures to determine performance is considered best practice. If these reported numbers are adjusted in any way, for example by excluding exceptional items, more disclosure is needed to explain why it is considered appropriate to make the adjustment.

Companies exposed to high levels of environmental, social, or reputational risk should consider including targets that focus management on mitigating these risks. Any relevant environmental or social metrics selected should be meaningful, measurable, aligned to the company's strategy and subject to third-party verification.

Measures such as health and safety should be used as a reducing rather than a compensating feature because ensuring the health and safety of employees should be embedded in the philosophy and values of the company and a normal expectation of running a successful business.

Companies that want to demonstrate best practice would put in place contractual and statutory provisions that allow for a reduction or forfeiture of the annual bonus component in exceptional circumstances (malus and clawback).

We do not expect outside directors, audit committee directors and statutory auditors to receive annual bonuses. Receiving a bonus can erode independence, and negatively influence the veracity with which management is scrutinised.

We will oppose the approval of annual bonuses for directors/Kansayaku if:

- Recipients are outside directors, audit committee directors and statutory auditors
- There is clear evidence of mismanagement on the part of the recipient; and/or
- The company's performance has been poor.

Retirement bonuses for directors and Kansayaku

We expect the company to ensure that there are no rewards for failure. This requirement may be satisfied by introducing a remuneration committee to determine executive pay and to take into account poor performance or any exceptional events, e.g., loss of life, when deciding whether a director should be paid a bonus for the period worked.

With the exception of dismissal for cause and/or poor performance where awards should be lapsed, any outstanding awards of leavers should be time pro-rated and allowed to run their course subject to the same vesting conditions as those applied at grant.

Retirement bonuses are standard practice in Japan and make up a sizable portion of lifetime remuneration for directors and Kansayaku and this is not necessarily judged on performance. The details of bonus proposals, such as the amounts paid and the status of recipients, are seldom disclosed. This prevents shareholders from assessing the merits of bonus proposals, and potentially undermines investor confidence in the company's capital management practices.

We will oppose the approval of retirement bonuses or special payments if:

- Recipients are outside directors.
- Neither the individual payments nor the aggregate amount of the payments is disclosed, or it is disclosed, but it is not considered appropriate; and/or
- There is evidence of mismanagement on the part of the recipient.

Furthermore, we consider that outside directors should not receive special payments in connection with the abolition of a retirement bonus system. The receipt of special payments can erode independence, and act as a disincentive for outside directors or Kansayaku to speak out against management.

Long-term incentive plans (LTIP)

In general, stock option or long-term equity incentive plans should be promoted as a tool to better align the interests of directors with those of shareholders. Ideally, LTIPs should be introduced within the value of the total compensation that is currently on offer. We do not expect outside directors, or statutory auditors, to receive share-based incentives that require some level of performance to deliver value.

We believe that a company should motivate and reward inside directors by granting long-term equity incentives that will align their interests with those of long-term investors. Incentives should be structured to motivate management to build a sustainable business that will generate positive returns for investors over the longer term.

In the interest of simplicity, we advocate the adoption of one long-term plan. We discourage the adoption of any additional incentive plans that would complicate the remuneration structure.

The LTIP should not have too many performance conditions but should include at least one measure that is linked to shareholder returns. Other measures should be linked to the strategy of the business such as KPIs that are selected by the board. Performance conditions should be measured over three years.

If share options are used, these should not be capable of exercise for a period of three years from the time of the award. Outstanding share options should not be re-priced.

Investors expect companies to disclose the performance metrics and as many of the performance targets under those metrics' as possible.

We will oppose deeply discounted option plans if:

- The total dilution from the proposed plan(s) and previous option plans exceeds 5% for mature companies, or 10% for growth companies;
- Recipients include individuals who are not in a position to influence the company's stock price, including employees of business partners or unspecified "collaborators;"
- The maximum number of options that can be issued per year is not disclosed; and/or
- No specific performance hurdles are specified.

Use of ESG metrics

ESG metrics should be meaningful, measurable, aligned to the company's strategy and subject to third-party verification.

Companies in sectors that can have a significant effect on climate change should link part of their pay to delivering their climate mitigation goals. The performance targets should be linked to SBTi (Science Based Targets initiative) approved/or equivalent transition plans aimed to achieve net zero by 2050 or sooner. Targets should also be set to create new opportunities that not only improve revenue, but also have a positive impact on the climate.

By 2025, companies will have only five years to reach their 2030 climate change transition goals. By this time, we expect a majority of companies will have a clear idea of what must be done to hit these crucial targets. Therefore, for companies in L&G's Climate Impact Pledge, we will not support their remuneration report if there are no climate reduction targets linked to the CEO's incentive pay programme. These targets should be in line with their stated transition goals to ideally reach net zero or carbon neutrality. Climate Impact Pledge companies span 20 climate-critical sectors: autos, apparel, aviation, aluminium, banks, cement, chemicals, food, forestry, glass, insurance, logistics, mining, oil and gas, REITs, shipping, steel, technology, telecoms, and multi-utilities. Companies outside of these sectors are also encouraged to link long-term executive compensation to climate targets.

We believe linking climate mitigation targets to executive pay can act as a motivational driver to deliver on climate reduction goals.

The use of diversity targets would be relevant for sectors that struggle to recruit women.

L&G discourages the use of employee engagement targets, as we believe well-governed companies should have an inclusive culture in place that facilitate this on an annual basis. Financial incentives should not be necessary to drive such a programme. In our view, a better metric for companies, especially for those that have a high level of staff turnover, would be to set targets around employee retention to gauge whether their internal strategies to improve retention are working.

For oil and gas companies, remuneration should prioritise financial value over fossil fuel production volumes. The use of measures that directly encourage volume growth (such as reserve replacement ratios or production targets) risks incentivising overinvestment at a time when growth in demand seems increasingly uncertain and should therefore be avoided. L&G prefers financial measures (relating to total shareholder return and balance sheet strength) or other strategic metrics. The use of volume growth targets may result in a negative vote.

Holding periods

We encourage the use of a two-year post-vesting holding period because we find this helps in aligning the remuneration structure with long-term performance. These holding periods should continue to apply even after a director has ceased employment with the company.

Dividends

Accrued dividends on share awards should only be paid on those shares that ultimately vest. L&G will vote against any share-based incentive plan's operation if it permits the payment of dividends on unvested awards.

Malus and clawback

Employment contracts and incentive plan terms should be designed to enable the application of malus and clawback, which should apply to all elements of variable remuneration.

To provide clarity for all stakeholders, remuneration committees should set out the circumstances under which malus and clawback will be applied. These circumstances should not be too narrowly defined.

Equity dilution

We believe that strict guidelines should be adhered to in relation to the issuance of shares for incentive schemes to limit the potential dilution to shareholders. As a general rule, we expect no more than 10% of a company's equity to be used for all share schemes over a 10-year period. The annual run rate or burn rate should also be reasonable at about 1%.

Treasury shares should be included within these limits. Such restrictions should apply to all newly issued shares. We encourage companies to provide transparent explanations regarding the issuance of shares.

Shareholding guidelines

We expect companies to encourage their directors and senior executives to build up and retain a meaningful interest in the shares of the company they manage. This is an essential part of aligning directors' interests with those of investors. The level of shareholding should be linked to the size of the company and the level of reward that the director receives under the long-term incentive. Ideally, these shares should continue to be ring-fenced by the company in a trust.

Shares held within an unvested incentive award, including those held in retention periods, should not be included in the calculation of shareholding guidelines.

Discretion

Companies can build trust with investors if they can demonstrate restraint, consistency, and alignment with the shareholder experience. In exceptional circumstances, discretion applied to any earned award by executives is one way to demonstrate this alignment. We define discretion as anything that alters the monetary outcome of total remuneration.

We expect the company to state:

- The main reasons that might give rise to the application of discretion
- Whether their discretion policy applies to revising pay upwards as well as downwards
- The elements of pay to which discretion may be applied
- The effect that the application of discretion has had on the director's final pay outcome

Directors and Kansayakus' compensation ceiling

Japanese companies are less prone to excessive or misaligned remuneration structures than companies in other markets.

This notwithstanding, the management of Japanese remuneration still requires structural realignment. Performance-based remuneration occupies a relatively small portion of total pay. We will generally support proposals calling for an increase in the director compensation ceiling if this increase is intended to introduce or increase the performance-based pay component for inside directors. If proposals seek an increase in non-performance-based director pay, or it is unclear whether pay is performance based, we will examine these on a case-by-case basis. We will vote against proposals seeking to increase director compensation in cases where there are concerns of mismanagement.

We recognise that companies that disclose their remuneration structures may be penalised in this policy. In order for the policy not to act as a disincentive to disclosure, we will consider voting against company directors for inadequate disclosure.

Investor rights

The provision of shareholder and bondholder rights is a basic entitlement for investors. We expect companies to acknowledge and respect the rights of investors by adhering to the highest market standards. This includes providing high-quality disclosures and the equal treatment of shareholders. Below, we have outlined guidance on the topical issues that concern us as an investor:

Voting rights and share-class structures

L&G supports the ‘one share one vote’ philosophy and favours share structures where all shares have equal voting rights, and those rights are equal to the economic value held. We do not support the issue of shares with enhanced or impaired voting rights.

Transparency

We encourage companies to allow investors to be able to appropriately identify and assess their performance on material ESG issues.

We expect companies to adopt an open approach to the public disclosure of information, within the limits of what they can disclose. We would also encourage disclosures, in particular the main elements of the annual securities report (yukashoken hokokusho), to be made in English and disclosed well before the AGM to allow access to important information by a greater number of investors. This is particularly important so that voting decisions can be made, based on the latest information on governance issues such as cross shareholdings.

Improved transparency encourages informed voting, engagement and the integration of environmental, social and governance issues into investment decisions.

Furthermore, we would like to see companies disclose their attempts to engage with investors (including minority shareholders) and who at the company undertook that discussion. Our expectations are listed in the sustainability section below.

AGM timing

The Japanese market continues to have a highly condensed AGM season, in which the majority of AGMs occur in a single week near the end of June.

We would encourage Japanese companies to change the record date and hold their AGMs later in the year. By separating the record date from the end of the business year, companies will no longer need to hold the AGM within three months of the close of the business year. We believe this will alleviate unnecessary time pressure on companies and audit firms, and in turn make it possible for the AGM season to be less concentrated. This will also give companies time to translate key documents into English. Companies that move the record date closer to the AGM will also find themselves more in line with global practice.

Virtual/electronic general meetings

We believe that a company's general shareholder meeting is fundamentally important to the exercise of shareholder rights and integral to a good corporate governance system. Furthermore, we view physical shareholder meetings as providing an important mechanism by which a board is held publicly accountable to institutional and retail investors.

Shareholder meetings provide an invaluable opportunity to raise concerns with a board in a public forum, and investors can use this mechanism as part of their stewardship activities. For example, they could be utilised as an escalation tool that enables shareholders to make statements and ask questions to the whole board.

We are cognisant that companies are keen to make sure that their shareholder communications keep pace with developing technology and conducting shareholder meetings electronically is an area of focus. We also agree that using technology, such as webcasts, to complement the physical shareholder meeting could be beneficial and increase investor participation.

However, we believe such technology should be used in parallel with the in-person meeting and should not lead to companies adopting a virtual-only approach. The shareholder meeting is the only time that the whole board is present and publicly accountable to its shareholders. The attendance of the board at that meeting is a demonstration of its commitment to hear and understand the views of shareholders.

Virtual-only shareholder meetings remove this accountability due to the remoteness of participants. The public nature of AGMs and full attendance of the board is also important to allow us to bring matters to the board's attention. Removing this tool impairs our ability to hold boards to account on behalf of our clients. Companies that adopt a "virtual-only" approach may also risk giving the impression that they are attempting to filter questions or limit the participation of shareholders and that they do not want to be subject to the varied questions of their investors.

Any amendments to a company's constitution in relation to electronic meetings should confirm that a physical meeting will continue to be held unless it is prohibited by law.

Article amendments

It is common to see requests for amendments relating to various issues, including capital increases, changes to capital structures, board size and composition, as well as takeover and defence-related plans bundled together as a single voting resolution.

We expect these changes to be clearly outlined and disclosed in the notice of meeting. We do not support changes to a company's constitution that are introduced to curtail or reduce shareholder rights. We would expect substantially different changes to a company's constitution to be proposed under separate resolutions and not to be bundled into a single amendment to the constitution. Where such a bundled resolution includes one or more changes that are not deemed supportable, this will lead to a vote against the entire proposal under the resolution.

Capital management

Balancing the long-term investment needs of the company with shorter-term returns to investors is a critical role of the board.

The board has a key responsibility to ensure the company has sufficient capital; oversee its management to ensure efficient capital allocation; and, when additional capital is required, facilitate its raising in an appropriate way.

We therefore support the right of shareholders to have a separate vote on the tools and authorities provided to the board to manage its capital structures. Such rights protect shareholder interests while balancing the need for board flexibility, e.g. making sure that share issuances are not overly dilutive and capital is being raised in the long-term interests of investors.

We support the TSE's request, made in March 2023, for all listed companies on the Prime and Standard Markets to take "action to implement management that is conscious of cost of capital and stock price."

The TSE explains that "this starts with gaining a proper understanding of their cost of capital and profitability based on the balance sheet and continues with analysing and assessing the current situation around these and the market valuation at board meetings, preparing and disclosing plans for improvement, and then using dialogue with investors to update them on the progress of these efforts." We expect actions to be directed towards these areas, rather than solely focused on share buybacks and dividend increases.

Issuance of shares

The current practice allows Japanese boards to have the discretion to issue shares within the authorised capital (a maximum of four times the current issued capital) on the condition that the issuance price does not constitute an advantage. If a price is considered advantageous, shareholder approval will be required. With this in mind, we believe that issuances should be limited to what is necessary to maintain business operations and should not expose minority shareholders to excessive dilution of their holdings.

We regard pre-emption rights as fundamental to protecting shareholders' investments in a company, and to fostering investor confidence. However, it is common for Japanese companies to undertake significant private placements without offering pre-emption rights to existing shareholders. Companies should consider alternative means of raising capital that do not expose minority shareholders to excessive dilution of their shares.

We may consider voting against the re-election of directors if there are serious concerns with capital management.

Share repurchases

Share repurchases can be a flexible way to return cash to shareholders. We expect the board to be transparent about how this share-buyback authority will be used in relation to other potential options (such as dividends, internal investment or externally for mergers and acquisitions).

However, the benefits of using this approach are dependent on factors such as the price at which shares are bought back, the company's individual financial circumstances and the wider market conditions at the time.

Japanese companies, when stipulated in their articles of incorporation, have the option of waiving the requirement for prior shareholder approval for share repurchases. We would expect a detailed rationale for any buyback authority that is greater than 10% of the issued share capital.

Cross shareholdings

While cross shareholdings - where listed companies hold the shares of other listed companies - are in gradual decline; in Japan, the practice is still prevalent. Cross shareholdings may serve a strategic objective, but they can also cause problems including poor corporate governance or the inefficient use of capital.

We expect companies to fully comply with the Corporate Governance Code's provisions on cross shareholdings, which call for companies to disclose their policies with respect to cross shareholdings,

including their policy regarding the reduction of such holdings. The Code further requests companies to annually assess whether or not to hold each individual cross shareholding and to disclose the results of this assessment.

Therefore, management should be prepared to engage in an open dialogue with shareholders to demonstrate the value created through cross shareholdings, and to share plans for such holdings to be reduced.

We also examine cross shareholdings when we determine if an outside director is independent. In 2022, we started voting against the board chair if the company allocates 20% or more of their net assets to cross shareholdings with no clear rationale for this decision. We will continue to review this threshold and look to tighten our policy over time.

Mergers and acquisitions (M&A)

We will support a proposal that will create shareholder value, provided the financial terms, quality of management and synergies represent an improvement on the status quo.

To make an informed assessment, we expect management to be transparent on the terms of the transaction and its financial and cultural integration implications on the long-term business strategy. We expect all companies to explain how the transaction is expected to yield significant long-term benefits for the company and its stakeholders, including investors.

We encourage the independent outside directors, together with the board chair (if they are independent), to hold separate meetings with their investors without executive management present, to explain the risks and opportunities of the transaction. In a contested takeover, we will aim to meet with both parties before making a final decision.

In addition, we believe that a strong governance framework is essential during any M&A activity. Companies should therefore make sure the independent outside directors are informed at an early stage and can obtain independent advice at the cost of the company, with advisers remunerated on a fixed-fee basis. A robust process should be in place to ensure there are no conflicts of interest. The skillset of the board must also be reviewed, including past M&A experience, to ensure the board is appropriately equipped to successfully lead the transaction and manage its impact on the company. The board may consider putting in place a separate ad hoc committee of independent outside directors to consider the merits of the transaction, and to engage with their investors.

Takeover defence plans – poison pills

“Poison pill” is the term given to an artificial device implemented by a company to deter takeover bids. Well-designed poison pills may strengthen the board’s negotiating position and allow it to obtain more favourable terms from an acquirer.

It is vital that this process is controlled by the independent members of the board, who are more concerned with shareholder value than with protecting the company’s position. We do not expect a poison pill to entrench management or protect the company from market pressures, which is not in investors’ best interests.

We will also examine if there is sufficient independent board oversight in the use of such a mechanism. This means that we only support poison pill proposals when the board comprises a majority of independent directors.

Additionally, a poison pill should not be capable of activation until a threshold of 20% of the outstanding issued share capital is triggered. The duration of any poison pill (defined as the sum of the number of years the company has had a pill in place and the number of years the proposed pill will be effective)

should not exceed three years; thereafter, shareholder approval should be sought. The bid evaluation committee should be composed of a majority of independent outside directors, or independent statutory auditors and who meet our guidelines on attendance.

We also expect the company to post its proxy circular on the stock exchange website at least four weeks prior to the meeting, to give shareholders sufficient time to study the details of the proposal and where necessary, engage with management about them.

For more details, please refer to our board guide on the topic available [here](#).

Related-party transactions

Related party transactions (e.g., between a controlling shareholder or director and an issuer) are an important issue for minority shareholders as there is a risk that a related party may take advantage of their position. Adequate safeguards must be put in place to protect the interests of the company and shareholders who are not part of the related party, including minority shareholders.

All transactions must be authorised by the board of directors. The audit committee should ensure that such transactions are conducted based on an independent assessment and valuation.

For material related-party transactions, we expect companies to provide additional information to shareholders in their annual disclosures. This should include information on whether board approval was unanimous or received majority support. In addition, shareholders should be given the opportunity to approve material related-party transactions, including any transactions undertaken with directors.

Shareholder proposals

We consider all shareholder proposals tabled at a company's AGM in the wider context of the corporate governance practices at the company, our thematic policies, and the long-term benefits for investors.

We may support certain shareholder proposals on key topics where we want to draw attention to the importance of the topic for investors. The board can gain insight into what topics are considered material by shareholders by the level of shareholder support.

We expect majority-supported shareholder proposals to be adopted, no matter whether these proposals are binding or merely advisory in nature. Where there has been significant support (20% or more), we expect companies to consider the benefits of the proposal and to discuss this with their shareholders and to include any outcomes in their annual disclosures.

Political donations and lobbying activity

We will not support direct donations by companies to political parties or individual political candidates. We believe that companies should fully disclose all political contributions, direct lobbying activity, political involvement and indirect lobbying via trade associations. There should be full transparency regarding memberships of, and monies paid to, trade associations and lobbying groups, including:

- A breakdown of payments to political parties, candidates and associations, trade associations, and think tanks, and of direct and indirect lobbying activity on policy and legislative proposals etc;
- A clear explanation of how each of the above associations, contributions and actions would benefit the causes the company supports and how they are linked to its strategy;
- A public statement from the company outlining where it disagrees with the associations of which it is a member on a particular issue, and the reasons why it believes it is beneficial to remain a member; and
- Disclosure of where responsibility sits within the company for the oversight of such relationships.

Sustainability

As a major global investor, we have a fundamental interest in ensuring that shareholder and bondholder value is not eroded by a company's failure to manage the risks associated with its natural and social environment. We believe that if companies take advantage of the need to move towards a more sustainable economy investors can benefit through protection from future risks and the potential of better long-term financial outcomes.

Sustainability governance, process and operations

With this in mind, we expect our investee companies to meet minimum standards on how they identify, assess, manage and disclose sustainability-related risks and opportunities across their business operations. Our key expectations are laid out below:

Risk identification and management

Material environmental and social (E&S) risks will vary between sectors and from company to company, depending on a range of factors. Stakeholders will also have different views on the issues that are material for them. Despite this complexity, it is important that all companies across different sectors undertake an analysis of E&S issues that could be material to their business over varying timeframes.

A dynamic risk-mapping exercise should identify the degree to which a company is exposed to each risk element. It should also be used to identify business opportunities, such as new products and services, and potential efficiency gains as a result of changing policy, technology and business environments.

Robust E&S risk-management processes should be integrated into company Enterprise Risk Management (ERM) systems, and implemented across all business operations that either can be considered to be exposed to environmental and social-related risks, and/or that may produce negative externalities. Where possible, such systems and processes should be externally verified.

Where risks have been identified for the business, comprehensive policy statements should be disclosed to all stakeholders to demonstrate the company's commitment to managing these risks.

Governance and accountability

Although responsibility for managing a company's E&S impact and related risks is shared across all business functions, accountability sits at board level. The fulfilment of sustainability targets and commitments is the responsibility of the CEO and the board.

Sustainability strategies

Building a sustainable business model that enhances performance and creates resilience should be at the core of business strategies. E&S issues should not be viewed as peripheral components of business operations or simply ethical and compliance obligations. Where material risks and opportunities have been identified, there should be a clear link to a company's overall strategic priorities. Plans to mitigate risks and realise opportunities should be disclosed clearly.

Reporting and disclosure

Target-setting

Companies should set targets to focus their efforts on realising their strategic E&S objectives, mitigating and managing material E&S risks and impacts, as well as maximising broader positive stakeholder impacts. While it is important for the targets to be achievable, companies may benefit from setting challenging goals in order to maximise their overall impact. We expect companies to report suitable metrics that allow progress against these targets to be tracked effectively.

Public disclosure and transparency expectations

Transparency and disclosure are key tools that enable investors to undertake a robust analysis of investment risks and opportunities, and allocate capital accordingly. We expect companies to demonstrate their commitment to the disclosure of sustainability information and data in key company reporting; this includes the annual report and accounts, with supplementary information in sustainability reports and on their corporate websites.

We are very supportive of the International Sustainability Standards Board's (ISSB's) first two standards, published in June 2023. The standards present a global baseline for sustainability disclosures acting to amalgamate previously disparate disclosure requirements. L&G expects companies to align their sustainability disclosures with the ISSB's published standards and any new ones, building on much of the work already in place from previous disclosures through standards such as GRI, SASB, etc. Disclosing in a clear and consistent manner is important in facilitating the analysis of trends in this area.

We encourage our investee companies to be proactive and undertake, where possible, the verification of their sustainability data externally by a reputable independent assurance provider, based on recognised standards. This can be evidenced by making the assurance statement public. The verification exercise should provide comfort and credibility to stakeholders, including investors, around the sustainability data disclosed.

We encourage companies to make disclosures to key third-party sustainability agencies.

Financial impact quantification

The quantification of sustainability risks and potential impacts can help investors make more informed capital allocation decisions, according to their risk, return and impact objectives. Quantification practices

can also support companies to better understand their risk exposure and achieve a net benefit by managing sustainability impacts effectively.

We encourage companies to demonstrate a commitment to best sustainability practices and, where appropriate, quantify the financial impacts to internalise the associated costs and benefits.

Industry collaboration

Companies may benefit greatly from sharing knowledge and experience with their peers by joining and contributing to industry-wide associations. We encourage collaboration between companies, where appropriate, to progress the broader sustainability agenda and broach cross-sectoral and inter-sectoral sustainability challenges. Where relevant, we expect companies to engage with regulatory bodies to promote best practices and policies to achieve sustainability targets.

Lobbying transparency

Whether companies perform individual engagement with regulators or policy makers, or collaborative engagement as part of an industry association, we expect them to be transparent and to comprehensively disclose their public policy engagement activities, including trade association memberships (see section above on political donations).

Sustainability themes:

L&G focuses on material issues that can impact a company's long-term sustainability, both financially and reputationally.

Below, we highlight our expectations in relation to some of our key themes: More information and articles on our position on broader themes can be found [here](#).

Future World Protection List

The Future World Protection List (FWPL) is comprised of companies that fail to meet L&G's minimum standards of globally accepted business practices. Securities issued by such companies on the list are excluded from L&G services and products that specify the application of the FWPL. More information can be [found here](#).

Climate change

Climate change can be a defining factor in companies' long-term prospects. We expect companies to disclose how they may be impacted by climate-related risks and opportunities, and how these factors are considered within their strategy.

With the Financial Stability Board's (FSB's) announcement that the Taskforce on Climate Related Disclosure (TCFD) will now be integrated into the ISSB, we expect to see companies developing their climate disclosures in line with IFRS S2 requirements, with a focus on improving approaches to scenario analysis and the quantification of financial impacts that result from climate risks.

In addition to IFRS S2 disclosure, we expect companies to report using the CDP climate questionnaire, which is aligned with the TCFD and IFRS S2 frameworks and crucially provides investors with climate data on a large universe of companies in a comparable format. For sectors where it is material, we strongly encourage companies to also report via the CDP Water and Forest questionnaires.

Science Based Targets (SBTs) are decarbonisation targets aligned with the objective of the Paris Agreement. We therefore encourage all companies we invest in to commit to and work towards approved SBTs aligned with the Science Based Target initiative's recent net-zero standard. Additionally, we expect companies to articulate how their business models reflect a Paris-aligned transition.

As part of our Climate Impact Pledge, we expect companies to have greenhouse gas (GHG) reduction targets in place, and to disclose board oversight of climate change and other sector-specific policies. More information on our expectations of different sectors and the metrics we use to assess companies, can be found [here](#).

In relation to climate change, we would expect companies to publicly disclose any concerns they may have with current or evolving legislation and to publicly report on any lobbying activity that is undertaken because of such concerns. We recognise that achieving the Paris Agreement requires policy action in a wide range of areas. Therefore, we expect companies to engage with policymakers and regulators to encourage the introduction of policies to enable a net-zero transition for their respective sectors.

Companies that fail to meet our minimum standards on climate disclosure may be removed from select funds, including our Future World funds, subject to tracking error constraints. For all other funds where we cannot divest, we will vote against the board chair or other directors to ensure we are using one voice across our holdings.

Please see more on L&G's policy on climate change [here](#) and our Climate Impact Pledge [here](#).

Nature

Biodiversity

We believe that biodiversity loss presents a major global systemic risk.

We expect companies to assess their impact and dependency on biodiversity with a view to managing risk, as well as mitigating and, over time, reversing negative impacts. We encourage companies to commit to having an overall positive impact on biodiversity and to consider the direct as well as indirect activities of their supply chains. We will be seeking greater disclosure from investee companies in line with the Taskforce on Nature-related Financial Disclosures (TNFD) framework.

As a signatory to the Finance for Biodiversity Pledge, we have committed to collaborating and knowledge sharing, engaging with companies, assessing their impacts, setting targets and reporting publicly. Our land related policies can be found on [our website](#).

Deforestation

L&G recognises the importance of ending commodity-driven deforestation to tackle climate change, reduce biodiversity loss, and support food security. We are a signatory to the COP26 Commitment on Eliminating Agricultural Commodity Driven Deforestation from Investment Portfolios.

In 2022, L&G launched our deforestation policy. In line with our COP26 commitment, the policy commits L&G to assessing commodity-driven deforestation risk in investment portfolios. This has been done, and where identified, we have contacted companies in high-risk sectors with little or no deforestation policies of their own. Since 2023, we have voted against the re-election of board chair or other board directors of these companies. We also encouraging companies and data providers to improve the quality and availability of data on deforestation risk. You can read more on our deforestation policy [here](#).

Although our policy was first published in 2022, we have been engaging with key companies in high impact sectors on the topic of deforestation since 2017 as part of its Climate Impact Pledge under which, the lack of a comprehensive deforestation policy constitutes one of our 'red lines'.

Circular economy

We believe that the current globalised economic model can be described as 'linear.' Many production processes follow the same route, which is the extraction of raw materials, manufacture and use and disposal ('take- make-waste'). This system does not put a value on materials that are at the 'end-of-life' stage, or the environmental and social implications.

We believe this traditional linear system can be reformed, accelerating the 'Just Transition' to net zero and nature-positive economies, with ecosystems restored. The economic model that can reform our system at scale is the introduction of the 'circular economy.' This is a key component of L&G's approach to nature. It is based on three principles, driven by design: eliminate waste and pollution, circulate products and materials (at their highest value), and regenerate nature.

L&G will focus its engagement efforts on supporting a transition from a 'linear' economic model to a 'circular economy' model. L&G's expectation of companies will be expanded; it currently includes:

- Strengthened disclosures on the approach to a circular economy and the reduction of waste and pollution;
- A circular economy commitment, strategy, business model and policy across the value chain;
- Disclosure of the proportion of raw, re-used, recycled and compostable materials;
- Explanation of how the strategy is embedded, including any targets and progress made;
- Board-level oversight;
- Activities undertaken to protect and regenerate nature and ecosystems; and
- Any lobbying activities.

Water

Globally, we need a 'Just Transition' to economies that are net zero and nature-positive, and in which ecosystems are restored. Water is a key element of this, as it is the very essence of life on this planet. It permeates our lives and has an impact on all of us, reaching across all sectors, businesses and economies. Water can have a diversified impact along a company's value chain, directly impacting operating risks and financial performance.

In its current form, the water system presents a long-term systemic market risk that will impact L&G, the markets that we invest in and our investment returns, and ultimately our clients.

L&G will focus engagement activities on key areas of the water system, i.e. water scarcity and security, and water quality. L&G's expectation of companies will be expanded and include: strengthening disclosures on their approach to the impact on water quantity and quality; whether a commitment, strategy and policy is in place across the value chain; explanation of how the strategy is embedded, targets and progress; board level oversight; protection and regeneration of nature and ecosystems; and lobbying activities. More information can be found [here](#).

Health

Antimicrobial resistance (AMR)

The importance of tackling AMR should not be underestimated. It can have a material financial impact on investments. The World Bank has estimated that AMR could result in a 3.8% loss in global GDP, an impact comparable to that of the 2008 global financial crisis.

We ask pharmaceutical companies involved in antimicrobial manufacturing to manage their effluent waste to reduce the risks of AMR, and we ask animal pharmaceutical companies to transparently disclose their AMR stewardship efforts. We also ask companies in sectors such as the food industry to apply the World Health Organization's guidelines on antibiotic use in food-producing animals, including in their supply chain. Further, we expect all water utility companies to be aware of the possible risks of AMR from contaminated water.

For more information on our concerns, please read our [health policy](#) and blogs on [the scale of the AMR problem](#), [why the issue matters to investors](#), and [how we are engaging with water utility companies on AMR](#).

Nutrition

Poor nutrition can have a negative health impact on individuals, workforces and broader societies. This can create a financial burden on economies from increased healthcare costs, both private and public, and on companies from absenteeism. For consumers to make informed decisions about the food they consume and to promote healthier diets, we encourage companies to be transparent on their nutrition strategies; demonstrate progress on these strategies; commit to disclose the share of the company's portfolio and sales associated with healthy food and drink products (using government-endorsed nutrient-profiling models such as the Health Star Rating or NutriScore); and set targets to increase the proportion of these sales.

For more information on our concerns please read our [health policy](#).

People

Employees are one of the greatest assets a company has. We believe that the value they bring to the long-term sustainability of the company should not be underestimated. Therefore, our approach to this topic covers issues such as human capital management, employee welfare, human rights, modern slavery, income inequality, diversity and inclusion. We consider these topics to be financially material.

Human capital management

As an investor, it is important for us to understand the culture of the companies in which we invest our clients' money and how that culture affects the people working within its operations. We expect companies to disclose information that will provide a holistic view of their culture. We would ask companies to provide metrics such as: workforce turnover and how that compares with the sector average, skills and development training, compensation, benefits, workforce demographics including diversity and health and safety.

The value a company places on employees can be measured by its efforts to receive and act upon employee feedback. Therefore, companies should also support workers' rights by allowing participation in freedom of association and collective bargaining.

Employee welfare

Companies should ensure that their workforce receives adequate training to gain the appropriate skills to carry out their jobs safely and effectively. Workers should be protected from harassment, discrimination, and all forms of forced or compulsory labour. Their working environment should be safe and annual training on health and safety within the workplace should be compulsory. All workers should receive benefits such as paid sick leave, maternity leave and paternity leave. We expect companies to provide access to services to help workers with any medical issues such as mental health, private health cover etc.

For more information on this topic, please refer to our human [capital management policy](#).

Diversity and inclusion

Just as we believe a diverse mix of skills, experience and perspectives is essential for boards to function and perform optimally, we similarly expect the companies they oversee to embrace different forms of diversity, including gender, ethnicity and neurodiversity. Our expectations on diversity and inclusion extend beyond the executive level and apply throughout the company. For more information on this topic, please refer to our [diversity policy](#).

Human rights

We expect companies to respect workers' human rights as set out in the Universal Declaration of Human Rights and the main instruments through which it is codified, such as the International Labour Organization's eight core conventions. In addition, we expect companies to comply with the principles of the United Nations Global Compact, OECD guidelines for multinational enterprises and all local and national laws and regulations relating to the protection of employees.

Modern slavery

Modern slavery can take a number of forms, such as child labour, forced labour and human trafficking. Companies should ensure that they are not permitting modern slavery to take place either within their own operations or their supply chains. As such, we expect companies to adhere to all applicable laws pertaining to modern slavery that could result in financial and reputational risks, as well as potentially cause distress to those workers involved.

We believe merely putting in place a code of conduct is not sufficient for ensuring modern slavery does not exist within the supply chain. We expect companies to have a more rigorous process that includes, and is not limited to, due diligence audits, local workforce interviews and using technology to provide full traceability of all components of goods or merchandise sourced.

For more information please read our [human rights policy](#).

Income inequality

Living wage: We expect all companies to pay employees the national minimum wage as mandated by law. However, we believe that to ensure employees avoid the poverty trap, which can create hardship, stress and health problems that may have an impact on the operational performance of a company, it is important that employers pay a living wage. .

A living wage should be sufficient to afford a decent standard of living for the worker and their family. Elements of a decent standard of living include food, water, housing, education, health care, transportation, clothing and other essential needs, including provision for unexpected events.

Our expectation that workers receive a living wage also extends to all contractors who operate within a company's operational premises. Procurement practices should ensure that workers' pay is ring-fenced from negotiations on price to ensure they receive a living wage. Companies should work with suppliers to ensure wages are transferred electronically.

To better inform investors, we are calling for greater transparency on employee practices. We expect companies to say in their annual disclosures whether they are paying a minimum wage or a living wage. We also ask companies to disclose the steps being taken to ensure their suppliers are paying, or working towards paying, their workers a living wage.

Additionally, we want to understand whether companies are offering all employees the opportunity to work for a minimum of 15 hours a week and what other benefits are in place to alleviate financial hardship, such as free meals, interest-free loans etc.

Financial wellbeing training – it is not only important to ensure that all workers are receiving a living wage, but it is equally essential that they get guidance on issues such as money management and where to get financial help. We encourage all companies to provide their employees with training on this important topic.

Pensions: taking into consideration the long-term health and wealth of their employees and where possible, employers should consider increasing the non-contributory element of pension provisions.

Equity ownership: We encourage all companies to offer employees the opportunity to participate in equity ownership. We believe that this can be a performance motivator and retention tool. To ensure sufficient take-up, we encourage companies to offer free shares to all employees, or to those earning below the national median pay level. The offer of shares should be linked to continued service.

Gender pensions gap/ethnicity pay gaps –companies should make themselves aware of these inequalities that exist in their organization, and take positive steps to reduce them.

Why adherence to these principles is important for L&G

We believe that integrating environmental, social and governance considerations into investment processes can help mitigate risks and improve long-term financial outcomes. For this reason, we embed both top-down and bottom-up ESG analysis into our investment processes. In addition, positive and negative externalities generated by companies can have consequences for the economy and society at large. We believe that investors have a responsibility to a broad set of stakeholders and the market as a whole. We need and expect companies to play their part. Our sustainability principles set out our minimum expectations of companies with regard to the prioritisation, management and disclosure of sustainability issues. These principles naturally feed into our voting and investment decisions, and for certain themes we have very structured processes in place.

Important information

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