

2011 Policy Proposal by the Committee on Financial and Capital Markets (Summary)

May 18, 2012

1. The Issues and Purpose of the Policy Proposal

In order for the Japanese economy to grow in a more sustainable manner, it is essential to develop a growth model in which funds will be effectively invested in growth areas both at home and abroad and where investors will reap the fruits of their investments. However, in the Japanese financial and capital markets, the following issues need to be addressed in making the development of such a growth model possible:

- The majority of household financial assets are not used effectively to contribute to industrial revitalization as they are squirrelled away in bank deposits and invested in government bonds.
- A slump in equity prices is prolonged on the back of the low levels of return on equity (ROE) achieved by Japanese companies, among others.
- Judging from such facts that the number of corporations introducing independent external directors still remains lower, corporate governance in Japan is not sufficient compared to international standards.

In light of these issues, the purpose of this policy proposal is to recommend the development of systems and a set of behavioral requirements for participants in financial and capital markets, among others, to ensure the circulation of household financial assets as investment funds.

2. Policy Proposal

Our policy proposal is outlined as follows for each of the participants who plays a central role in ensuring the circulation of investment funds, i.e. household, financial and capital markets, and companies:

(1) Increase the supply of investment funds from households

- In place of the Japanese version of Individual Savings Accounts (ISA), which is due to be introduced from 2014, we propose to introduce the Keizai Doyukai (Japan Association of Corporate Executives) version of ISA (contribution type personal savings/investment accounts with preferential tax treatment) as an asset building system.
- Under the Keizai Doyukai version of ISA, a dedicated personal account, where funds are managed and invested in deposits, bonds, equities and investment trusts, among others, is created at a financial institution. Funds are contributed from after-tax income and not subject to any taxes upon investment profit or withdrawal.

(2) Strengthen the international competitiveness of financial and capital markets in Japan

- Amid severe competition among international financial and capital markets, it is necessary to further enhance the attractiveness of financial and capital markets in Japan. In establishing an Integrated Exchange, the convenience of the exchange needs to be further improved to enable all transactions related to equity, financial, and commodity derivatives, including the management of margin money and settlement in an integrated manner.
- Concerning the application of International Financial Reporting Standards (IFRS), Japan should be more actively involved in discussions on the development of an IFRS, including further progress on convergence, to ensure that its opinions can be fully reflected in the IFRS development process.

(3) Strengthen the Disciplines of Capital Markets

- Japanese companies should aim to enhance long-term corporate value. It is required for Japanese companies to manage business focusing on higher rates of return and capital efficiency as well as implement corporate governance reform (In the future, the Board of Directors should comprise at least two or more independent external directors and the independence of external directors should be further strengthened as part of the listing rules of a stock exchange).
- Institutional investors are required to act more proactively. We expect that the Pension Fund Association, a leader of private pension funds, will publish

again the Corporate Governance Principles, which it developed and published in 2007, on its website, among other things.

- Capital markets are closely linked to the lives of the people through public pension plans. In light of the objectives of the Government Pension Investment Fund (GPIF), which manages and invests national pension reserve funds, GPIF is expected to change the organizational structure and operations. More specifically, it is necessary to adopt a system where decision-making and business execution functions are separated and decision-making is implemented based on a collegial body consisting of two or more board members, among other things.

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