

# **Proxy voting policy for Japanese portfolio companies**

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## Introduction

This proxy voting policy (the Policy) describes general positions on matters that may be subject to a shareholder vote at Japanese-domiciled companies and is aligned with governance practices believed to support long-term shareholder returns. The Policy has been adopted by the boards (or relevant governing bodies) of funds and portfolios managed by certain Vanguard-affiliated entities including U.S.-domiciled mutual funds and ETFs advised by Vanguard Capital Management, LLC (VCM), as well as the boards of Vanguard Asset Management, Ltd., Vanguard Fiduciary Trust Company, Vanguard Global Advisers, LLC, and Vanguard Investments Australia Ltd in connection with their management of certain equity index funds and portfolios (together with the U.S.-domiciled mutual funds and ETFs advised by VCM, the "Funds"). The adoption of this Policy is anchored in the belief that effective corporate governance practices support long-term investment returns.

It is important to note that proposals—whether submitted by company management or other shareholders—often require a facts-and-circumstances analysis based on an expansive set of factors. While the Policy may recommend a particular voting decision, all proposals are voted case by case as determined in the best interests of each Fund consistent with its investment objective. The Policy is applied over an extended period of time; as such, if a company's board is not responsive to voting results on certain matters, support may be withheld for those and other matters in the future.

As a baseline, the Policy looks for companies to abide by the relevant governance frameworks (e.g., listing standards, governance codes, laws, regulations, etc.) of the market(s) in which they are listed. While the Policy is informed by such frameworks, final voting decisions may differ from the application of those frameworks due to the investment stewardship team's independent research, analysis, and engagement. In addition, this Policy and its application to specific voting matters are predicated on the relevant Funds' acquisition and ownership of securities in the ordinary course of business, without the intent of influencing company strategy or changing the control of the issuer. These Funds will not nominate directors, solicit or participate in the solicitation of proxies, or submit shareholder proposals at portfolio companies. The application of this Policy to specific voting matters will also adhere to any passivity requirements to which the Funds and/or The Vanguard Group, Inc., and any of its subsidiaries (collectively, Vanguard) may be subject.

*Comply or explain.* Local standards in Japan permit companies to deviate from recommended corporate governance practices as long as they provide an explanation for the deviation. The Companies Act and the Listing Rules provide the primary legislative framework for Japanese corporate governance, with best practices outlined in Japan's Corporate Governance Code operating on a comply-or-explain basis.

Companies should explain any deviations from recommended governance practices, including providing an explanation of what they do instead of the recommended practice and why their alternative systems and/or processes are in the best interests of shareholders.

*Multijurisdictional companies.* When a company is listed on multiple exchanges or incorporated in a country different from where it is listed, the company should follow the applicable laws and listing rules of the market(s) in which it has its primary listing and apply any local corporate governance codes. If a company deviates from any market standards or local corporate governance codes, the company should explain the reasons for such deviations.

## Pillar I: Board composition and effectiveness

The Funds believe that in order to maximize the long-term return of shareholders' investments in each company, the individuals who serve as board directors to represent the interests of all shareholders should be appropriately independent, experienced, committed, capable, and diverse. Diversity of thought, background, and experiences meaningfully contribute to the ability of boards to serve as effective, engaged stewards of shareholders' interests. The evaluation of portfolio company boards will be informed by relevant market-specific governance frameworks (e.g., listing standards, governance codes, laws, regulations, etc.).

### Board and key committee independence

In Japan, corporate law allows for three types of company board structures:

1. One-tier board with three committees (audit, nominating, and remuneration);
2. One-tier board with an audit committee; or
3. Two-tier board (board of directors and a board of statutory auditors).

A company's board of directors is generally best positioned to determine which board structure is best suited to a particular company.

### Board independence

In order to appropriately represent shareholder interests in the oversight of company management, boards and key committees should be sufficiently independent.

For prime-listed companies without a controlling shareholder, at least one-third of the board should comprise independent outside directors. For prime-listed companies with a controlling shareholder, a majority of the board should comprise independent outside directors.

For all other listed companies without a controlling shareholder, there should be at least two independent outside directors on the board. For similar companies with a controlling shareholder, at least one-third of the board should comprise independent outside directors.

In cases where a company does not meet these standards, votes may be recommended against the chair of the board or other relevant board members responsible for appointing directors.

Outlined below are common factors that can affect independence:

- *Current and former employees.* Individuals who are current or former employees will generally not be considered independent.
- *Cross-directorships.* Any directors who hold cross-directorships or have significant links with other directors through involvement in other companies or bodies will generally not be considered independent. In addition, directors who work at companies considered to be cross-shareholdings of the company in question generally will not be considered independent.
- *Shareholder representatives.* Representatives of shareholders or employees of a shareholder will not generally be considered independent. In addition, any directors who have a close familial relationship and/or business connection to a shareholder will not generally be considered independent.
- *Business connections.* Any director nominee who has had a material business relationship with the company, either directly or as a partner, shareholder, director, or senior employee of a body that has such a relationship with the company, will generally not be considered independent.

- *Familial relationships and other personal relationships.* Any director who has close family ties with any of the company's advisors, directors, or senior employees will generally not be considered independent.
- *Performance-related pay.* Any director who participates in a performance-related pay scheme will not generally be considered independent.
- *Other factors.* If it is determined, through engagement or research, that director independence has been compromised, that director may not be considered independent.

### **Key committee independence**

One-tier boards (with either three committees or an audit committee) should have such committees (the audit, nomination, and/or remuneration committees) comprising a majority of independent outside directors. In the absence of such independence, votes may be recommended against inside directors and/or nonindependent outside directors.

### **Independent board leadership**

Votes will generally be recommended for management proposals to create an independent chair position or to otherwise separate the CEO and chair positions.

### **Board composition**

The Funds believe that boards should be fit for purpose by reflecting sufficient breadth of skills, experiences, and perspectives resulting in cognitive diversity that enables effective, independent oversight on behalf of all shareholders. The funds believe that the appropriate mix of skills, experiences, and characteristics is unique to each board and should reflect expertise related to the company's strategy and material risks from a variety of vantage points.

To this end, the Funds believe that companies should produce fulsome disclosure of a board's process for building, assessing, and maintaining an effective board well suited to supporting the company's strategy, long-term performance, and shareholder returns. Such fulsome disclosure may include the range of skills, background, and experiences that each board member provides and their alignment with the company's strategy (often presented as a skills matrix). Such disclosure may also cover the board's process for evaluating the composition and effectiveness of their board on a regular basis, the identification of gaps and opportunities to be addressed through board refreshment and evolution, and a robust nomination (and renomination) process to ensure the right mix of skills, experiences, and perspectives into the future.

A board's composition should comply with requirements set by relevant market-specific governance frameworks (e.g., listing standards, governance codes, laws, regulations, etc.) and be consistent with market norms in the markets in which the company is listed. To the extent that a board's composition is inconsistent with such requirements or differs from prevailing market norms, the board's rationale for such differences (and any anticipated actions) should be explained in the company's public disclosures.

Votes against the nomination/governance committee chair or other relevant board members responsible for appointing directors may be recommended if, based on research and/or engagement, a company's board composition and/or related disclosure is inconsistent with relevant market-specific governance frameworks or market norms.

## **Election of statutory auditors**

The independence of statutory auditors is evaluated using the same independence criteria stated above for directors.

Votes will generally be recommended against the election of nonindependent statutory auditors if the statutory audit board is not majority independent.

Votes will generally be recommended against statutory audit board nominees if there are concerns related to a material financial misstatement or fraud and the nominee is judged to be responsible for any mismanagement associated with it.

## **Attendance**

Votes will generally be recommended against directors who attended less than 75% of board or committee meetings (in the aggregate) in the previous year unless an extenuating circumstance is disclosed, or they have served on the board for less than one year.

Companies sometimes do not disclose the meeting attendance for insiders on the board and/or statutory audit board. Disclosure of the meeting attendance for all directors is encouraged.

## **Director liability and indemnification**

Management proposals to limit directors' liability and to expand indemnity provisions will be evaluated case by case.

Votes will generally be recommended for proposals to indemnify a director for breach of fiduciary duty of care as long as the director is found to have acted in good faith. Votes will generally be recommended against proposals to indemnify a director for activity involving willful breach of fiduciary duties or other criminal activity.

## **Directors' names and biographies**

Votes will generally be recommended against any director whose name and biographical details have not been disclosed sufficiently in advance of the annual meeting.

## **Director accountability**

Directors are generally nominated by boards and elected by shareholders to represent their interests. If there are instances in which the board has failed to adequately consider actions approved by a majority of shareholders, unilaterally taken action against shareholder interests, or, based on independent analysis, failed in its oversight role, votes against those directors deemed responsible (generally based on their functional or committee-level responsibilities) may be recommended. Such conditions will generally not apply to a director who has served less than one year on the board and/or applicable committee, but in such instances may apply to another relevant director in their place.

## Contested director elections

Contested director elections will be analyzed case by case. The analysis of proxy contests focuses on three key areas:

- *The case for change at the target company.*
  - How has the company performed relative to its peers?
  - How effectively has the current board overseen the company's strategy and execution?
  - How does the dissident's case strengthen the target company's long-term shareholder returns?
- *The quality of company governance.*
  - How effectively has the company's governance structure supported shareholder rights consistent with market norms?
  - Has the board been sufficiently accessible and responsive to shareholder input in the past?
- *The quality of the company's and dissident's board nominees.*
  - Is the incumbent board (and/or the company's nominees) sufficiently independent, capable, and effective to serve long-term shareholder interests?
  - Having made a compelling case for change, do the dissident's nominees appear better aligned with long-term shareholder interests relative to the company's nominees?

## Pillar II: Board oversight of strategy and risk

Boards are responsible for effective oversight and governance of their companies' most relevant and material risks and for governance of their companies' long-term strategy. Boards should take a thorough, integrated, and thoughtful approach to identifying, quantifying, mitigating, and disclosing risks that have the potential to affect shareholder returns over the long term. Boards should communicate their approach to risk oversight to shareholders through their normal course of business.

### Capital structures

*Dividends.* Votes will generally be recommended for proposals to allocate income unless an egregious reason why management's proposal should not be supported exists.

*Share issuance requests.* The total dilution to existing shareholders and the company's history of issuing capital will be considered.

- Votes will generally be recommended for an increase to authorized capital as long as it does not exceed 100% of the current authorized capital and the company provides an adequate rationale for the increase.
- The issuance of shares to a third party and/or for a private placement will be evaluated case by case, considering the rationale and the terms and conditions of the transaction.

*Share repurchase and reduction of capital.* Votes will generally be recommended for routine authorities to repurchase shares up to 10% of the current issued share capital as long as the terms of the repurchase appear to be in the best interests of shareholders and there is no history of abuse of such authorizations.

- Amendments to company articles that give the board discretion to initiate share repurchases without prior shareholder approval will be evaluated case by case, taking into account the rationale provided and past share repurchases and dividend payouts.
- Shareholder proposals requesting the company to engage in share repurchases, reduction of capital, or other specific capital-related transactions will be evaluated case by case if there are concerns pertaining to corporate malfeasance, unfavorable behavior, or relative company performance.

*Preferred stock.* Proposals to create, amend, or issue preferred stock will be evaluated case by case, taking into account the reason for the issuance, the ownership profile of the company, any historical abuses of share issuances, and the company's general approach to shareholder rights.

### Mergers, acquisitions, and financial transactions

Transactions are assessed based on the likelihood that they will preserve or create long-term returns for shareholders. All mergers, acquisitions, and financial transactions will be considered case by case based on a governance-centric evaluation focused on four key areas:

- *Valuation*
  - Does the consideration provided in the transaction appear consistent with other similar transactions (adjusting for size, sector, scope, etc.)?
- *Rationale*
  - Has the board sufficiently articulated how this transaction is aligned with the company's long-term shareholder returns?

- *Board oversight of the deal process*
  - Has the board provided sufficient evidence of the rigor of the evaluation process? This could include disclosures such as an independent valuation report or fairness opinion, a discussion of the board's process for evaluating alternative opportunities, management incentives, or other relevant disclosures.
  - How did the board manage any potential conflicts of interest among the parties to the transaction?
- *The surviving entity's governance profile*
  - Are shareholders' interests sufficiently protected in any surviving entities (in noncash transactions)?

### **Appointment of audit firm**

Votes will generally be recommended for the appointment of the proposed audit firm unless there are serious concerns related to changing auditors or the new auditor's independence is compromised.

### **Environmental/social proposals**

Each proposal will be evaluated on its merits and in the context that a company's board has responsibility for providing effective oversight of strategy and risk management. This oversight includes material sector- and company-specific risks and opportunities that have the potential to affect long-term shareholder returns.

While each proposal will be assessed on its merits and in the context of a company's public disclosures, vote analysis will also consider these proposals relative to market norms or widely accepted frameworks.

Support may be recommended for a shareholder proposal that:

- Addresses a shortcoming in the company's current disclosure relative to market norms or to widely accepted investor-oriented frameworks (e.g., the International Sustainability Standards Board (ISSB));
- Reflects an industry-specific, financial materiality-driven approach; and
- Is not overly prescriptive, such as by dictating company strategy or day-to-day operations, time frame, cost, or other matters.

Each of the Funds adopting this policy is a passive investor whose role is not to dictate company strategy or interfere with a company's day-to-day management. Fulsome disclosure of material risks to long-term shareholder returns by companies is beneficial to the public markets to inform the company's valuation. Clear, comparable, consistent, and accurate disclosure enables shareholders to understand the strength of a board's risk oversight. Furthermore, shareholders typically do not have sufficient information about specific business strategies to propose specific operational targets or environmental or social policies for a company, which is a responsibility that resides with management and the board. As such, support is more likely for proposals seeking disclosure of such risks where material and/or for the company's policies and practices to manage such risks over time.

## **Pillar III: Executive pay**

Remuneration policies linked to long-term relative performance are fundamental drivers of sustainable, long-term returns for a company's investors. Providing effective disclosure of remuneration policies, their alignment with company performance, and their outcomes is crucial to giving shareholders confidence in the link between executives' incentives and rewards and the long-term returns for shareholders.

Improvements in remuneration disclosure across markets, where lacking, are encouraged. Areas where a company could enhance its pay-related disclosures to help shareholders evaluate how executive pay is aligned with long-term shareholder returns may be signaled through votes on remuneration-related proposals or engagement.

### **Annual retirement and bonus plans**

Votes will generally be recommended against executive or retirement bonus-related proposals or plans where the bonus amounts are not disclosed.

Votes will generally be recommended against plans if they are excessive or include outside directors or statutory auditors because of concerns about independence and conflicts of interest.

### **Equity remuneration plans**

Votes on remuneration plans for employees will be evaluated case by case.

Companies adopting equity-based remuneration plans for employees should align the plans with long-term shareholder interests and returns. When evaluating equity remuneration plans, four main factors are considered:

- Dilution to shareholders—dilution from the proposed plan and all previous plans should generally not exceed 5% for mature companies and 10% for growth companies (as long as the company provides an adequate rationale);
- Any discount on stock options;
- The company's grant history; and
- Alignment with market practice.

### **Director and statutory auditor fees**

Votes will generally be recommended for an increase in director or statutory auditor fees as long as the increase is explained and the fees seem reasonable, are in line with peers, and take into account the amount of time required to fulfill the roles of the directors and/or statutory auditors.

Votes will generally be recommended against proposals seeking to increase director fees if there are concerns about corporate malfeasance.

## **Pillar IV: Shareholder rights**

The Funds believe that companies should adopt governance practices to ensure that boards and management serve in the best interests of the shareholders they represent. Such governance practices safeguard and support foundational rights for shareholders. Proposals on many of the following matters may be submitted by either company management or shareholders; proposals—irrespective of the proponent—that seek approval for governance structures that safeguard shareholder rights will generally be supported (and those that do not will generally be opposed) as described below.

### **Annual report and accounts**

Votes will generally be recommended for the annual report and accounts. Votes may be recommended against the annual report and accounts if:

- There are concerns about the integrity of the financial statements and/or the external auditors;
- There has been a financial misstatement; and/or
- The auditor elected not to provide an audit opinion, provided a qualified audit opinion, or highlighted an emphasis of matter that was particularly concerning.

### **Board structure and director elections**

Annual election of directors is considered a best practice. Votes will generally be recommended for proposals to declassify an existing board and against management or shareholder proposals to create a classified board.

### **Additional share classes**

The Funds believe that the alignment of voting and economic interests is a foundation of good governance. As such, companies issuing, or proposing to issue, more than one class of stock with different classes carrying different voting rights should bear in mind many investors' "one-share, one-vote" philosophy, while not hindering public capital formation in the equity markets. Furthermore, a newly public, dual-class company should consider adopting a sunset provision that would move the company toward a one-share, one-vote structure over time.

Proposals relating to the introduction of additional share classes with differential voting rights and proposals relating to the elimination of dual-class share structures with differential voting rights will be evaluated case by case.

### **Takeover defense plans (poison pills)**

The introduction or renewal of a takeover defense plan will be evaluated case by case. Votes will generally be recommended against a takeover defense plan when:

- The company has not provided adequate disclosure and rationale as to why the plan is required;
- The disclosure of the plan's terms and when it can be triggered are ambiguous;
- The special committee that evaluates transactions includes nonindependent directors or statutory auditors;
- The overall board independence is below the thresholds set out in the Board Independence section of this policy and the Japanese Corporate Governance Code;
- The trigger threshold is below 20% of outstanding shares;

- The plan's duration is greater than three years, or a plan has been in place for more than three years in totality without adequate rationale as to why the plan continues to be renewed;
- The plan somehow undermines shareholder rights;
- The company has other mechanisms or policies that could be considered takeover defense plans; and/or
- There is evidence that the plan could be abused, given past actions by the board and/or concerns about the board's oversight.

### **Amendments to articles of association**

Votes will generally be recommended for minor amendments that include any administrative or housekeeping updates and corrections. When evaluating all other amendments to the articles of association, the following will be considered:

- Any changes to corporate law and/or listing rules that may require an amendment to the articles of association;
- Whether the amendments may result in corporate governance structures and/or processes that are not best practices or are a regression from what the company already does (taking into account any explanation provided by the company for the change); and/or
- Whether the amendments are detrimental to shareholder rights generally.

### **Reincorporation**

Management proposals to reincorporate to another domicile and/or proposals for companies to change their primary listing will be evaluated case by case based on the relative costs and benefits to both the company and shareholders. Considerations include the reasons for the relocation and the differences in regulation, governance, shareholder rights, and potential benefits.

Votes will generally be recommended against shareholder proposals to reincorporate from one domicile to another.

### **Shareholder proposals**

All shareholder proposals will be evaluated case by case, taking into account the requests of the proposal, the level of prescription, the supporting rationale from the proponent and the company's response, and whether the board has already adequately addressed the issue or taken steps to address the issue outlined in the proposal.

## Shareholder meeting rules and procedures

*Quorum requirements.* Votes will generally be recommended against proposals that would decrease quorum requirements for shareholder meetings below a majority of the shares outstanding, unless there are compelling arguments to support such a decrease.

*Other such matters that may come before the meeting.* Votes will generally be recommended against proposals to approve other such matters that may come before the meeting.

*Approval of deliberations on possible legal action against directors, if presented by shareholders.* Votes will generally be recommended against such a proposal because of the lack of disclosure regarding the proposed deliberation.

*Adjournment of a meeting to solicit more votes.* In general, votes will be recommended for proposals to adjourn the meeting if the proposals in question are being supported and against such proposals if they are being opposed.

*Bundled proposals.* Bundled management proposals will be evaluated case by case.

*Change in date, time, or location of annual general meeting.* Votes will generally be recommended for management proposals to change the date, time, or location of the annual meeting if the proposed changes are reasonable.

*Hybrid/virtual meetings.* Votes will generally be recommended for proposals seeking permission to conduct "hybrid" meetings (in which shareholders can attend a meeting of the company in person or elect to participate online). Proposals to conduct "virtual-only" meetings (held entirely through online participation with no corresponding in-person meeting) may be supported. Virtual meetings should be designed by a company so as not to curtail shareholder rights—e.g., by limiting the ability for shareholders to ask questions.

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