

FINANCIAL MARKET INTEGRITY INDEX™

JAPAN

2010



## **CFA Charterholders and Professional Integrity**

*CFA Institute is the not-for-profit, professional association of 99,000 financial analysts, portfolio managers, and other investment professionals in more than 130 countries, of whom 87,000 hold the Chartered Financial Analyst® (CFA®) designation. The Standards and Financial Market Integrity Division is the research, policy, and advocacy arm of CFA Institute.*

*The CFA designation is widely recognized as the designation of professional excellence within the global investment community. CFA charterholders must pass three rigorous examinations that test their understanding of a number of financial disciplines, including ethics and professional standards, and must complete several years of qualifying financial work experience to earn the charter. To retain the designation, CFA charterholders also must annually renew their pledge to adhere to the CFA Institute Code of Ethics and Standards of Professional Conduct.*

*In 2002, when CFA Institute and the United Kingdom Society of Investment Professionals partnered, UKSIP members were adopted into CFA Institute and holders of the corresponding FSIP and ASIP designations were accepted into CFA Institute membership based on the comparable level of rigor needed to obtain these designations. Although all CFA Institute members adhere to an ethical standard, only CFA, FSIP, and ASIP designees also have displayed a level of mastery in investment principles. Therefore, this research does not include responses from all CFA Institute members but, rather, only from those who are active members with CFA, FSIP, or ASIP designations; all will be referred to collectively as “CFA charterholders” throughout this report.*

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# Introduction

# Concept of This Index

The Financial Market Integrity Index was developed by the Standards and Financial Market Integrity Division of CFA Institute (formerly known as the CFA Institute Centre for Financial Market Integrity) to gauge the perceptions investment professionals have about the state of ethics and integrity in six major financial services markets and how these perceptions evolve over time. Specifically, the index measures the level of integrity that

regulatory outreach and developing enhanced professional standards.

The Financial Market Integrity Index is distinguished from other market surveys and is proprietary in that it capitalizes on our exclusive access to seek the opinion and perspective of the CFA Institute membership (see inside cover for details). CFA charterholders are investment professionals who have earned the CFA designation

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*The Financial Market Integrity Index was developed to gauge the perceptions investment professionals have about the state of ethics and integrity in financial services markets.*

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investment practitioners experience in their respective markets—Canada, Germany, Hong Kong, Japan, the United Kingdom, or the United States—and the practitioners' beliefs in the effectiveness of regulation and investor protections to promote such integrity. This pragmatic input from working investment professionals will help raise awareness of leading issues in the capital markets and will inform the work of CFA Institute in conducting

and are required to adhere to a stringent code of ethics. The informed opinion of this particular respondent group offers valuable insight into the current state of ethical practices and standards in select global markets and will help to inform regulators and other financial industry thought leaders concerning potential areas for improving the investment profession.

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*CFA Institute provides this report to advance the cause of ethics and integrity in financial markets.*

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CFA Institute provides this report on the findings of the survey (the Report) to advance the cause of ethics and integrity in financial markets through the views and opinions of trained investment professionals so as to:

- Inform investors and regulators of the perceived ethics and integrity of practitioners and the effectiveness of regulatory systems in the market;
- Encourage investors to consider whether they are likely to be treated fairly and ethically if they invest in the market;
- Help assess whether a particular country or market has specific integrity issues that need to be addressed by regulators; and
- Inform practitioners in the market about how others perceive their actions and honesty, in general, and to stimulate remedial actions on their part where appropriate.

Each Financial Market Integrity Index Report measures the sentiments expressed by a cross section of survey respondents concerning ethical standards and investor protections of a particular market. The ratings discussed in this Report represent the opinions of a distinct group of professionals, CFA charterholders, responding to a series of questions about their experiences with practitioners, regulations, and investor protections in Japan. This Report was specifically designed to gather the perceptions of only the Japanese market. Because respondent populations differ significantly between markets, we believe it will be more valid and informative to assess each country's report independently of the others rather than to try to make cross-country comparisons.

# About the Index Methodology

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*The Financial Market Integrity Index is constructed to give equal weight to two dimensions of evaluation:*

*(1) the ethics of market participants and*

*(2) the effectiveness of market systems in ensuring market integrity.*

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The Standards and Financial Market Integrity Division of CFA Institute, in consultation with Harris Interactive, developed the Financial Market Integrity Index to specifically reflect the perspectives and opinions of investment professionals identified as being committed to the highest level of professional ethics. CFA charterholders and holders of the ASIP and FSIP designations were asked to evaluate and rate a number of financial “market participants,” including sell-side analysts, hedge fund managers, board members, and others as well as “market systems,” such as market regulation and investor protections, including corporate governance, shareholder rights, and transparency. The questions relate to how market participants and market systems contribute to financial market integrity (see **Figure 1**). Respondents

were asked to answer a number of questions that rate on a five-point scale the ethical behavior of these market participants and systems.<sup>1</sup>

More than 2,700 professionals in 80 countries who hold the CFA, FSIP, or ASIP designations participated in the research for the 2010 Financial Market Integrity Index by taking the survey either online or by scripted telephone interview between 1 February and 9 March 2010. For the first time, in 2010, the out-of-market ratings and comments for each Financial Market Integrity report were extended to CFA charterholders from around the globe and not limited to the six markets covered by these Reports. CFA Institute believes that this will allow us to gather responses from a more diverse cross-section of our membership. An analysis

### Financial Market Integrity Index Questions and Rating Scales

Please rate the overall ethical behavior exhibited by the following groups in Japan.



For each of the following, please rate the overall effectiveness of market systems for ensuring market integrity in Japan.



**Figure 1**

*The ethical behavior of market participants and the effectiveness of market systems are the two dimensions of evaluation that produce the final Financial Market Integrity rating.*

of the 2010 ratings conducted by Harris Interactive suggests that ratings given by CFA charterholders from outside the six markets are not substantially different from those given by CFA charterholders within these markets, and therefore, out-of-market ratings comparisons can be made between 2010 and the surveys of previous years.

To provide the most statistically reliable opinions, this Report will use in-market ratings when referring to an index rating or score, unless otherwise noted.<sup>2</sup> Out-of-market ratings will be used for discussion and comparisons only where noted.

The Financial Market Integrity Index is constructed to give equal weight to two dimensions of evaluation: (1) the ethics of market participants and (2) the effectiveness of a market's regulations

and investor protections (referred to herein as "market systems") in promoting and upholding market integrity. Data gathered during phone interviews were adjusted to align them with online responses so that all responses could be accurately integrated into one pool of responses. For more comprehensive information regarding the overall Financial Market Integrity Index methodology, please refer to the separate report available on the CFA Institute website at [www.cfainstitute.org/ethics](http://www.cfainstitute.org/ethics).

This is an opinion-based survey, and CFA Institute makes no representations concerning accuracy or otherwise warrants use of the Financial Market Integrity Index for any purpose by readers.

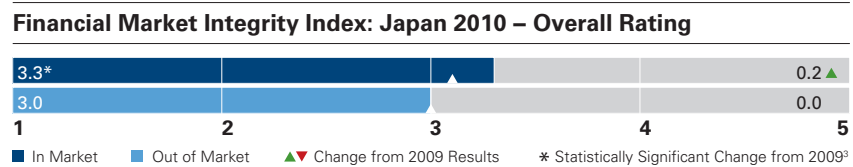
<sup>1</sup> One question dealing with severity of unethical behavior or ethical lapses was an exception and listed a score of 1 as not severe at all and 5 as extremely severe. This question did not figure in the final calculations of the Financial Market Integrity rating.

<sup>2</sup> In this Report, in-market ratings are those from respondents inside Japan and out-of-market ratings are those given by respondents outside Japan.

# Executive Summary

**Figure 2**

*In 2010, in-market respondents gave the Japanese market a significantly higher overall Financial Market Integrity rating (3.3) than they did in 2009 (3.1) and 2008 (3.1).*



The overall rating for the Japanese market increased significantly in the last year<sup>4</sup> according to those who work and live in the Japanese market (see **Figure 2**). Overall confidence in the integrity of the Japanese market has generally increased over a two-year time frame as well.<sup>5</sup> The rating for all capital market systems has increased incrementally for each of the past two years, and ratings for all market participants have generally rebounded in 2010 to levels last seen in 2008.

Although Japan’s regulatory environment largely insulated the country from the full impact of the devastating global financial crisis, Japan continues to struggle with its own unique internal issues, and ratings in several categories point to areas of investor dissatisfaction.

Japanese shareholder rights standards continue to garner the lowest rating

among Japan’s regulatory and investor protections from both those inside and outside the country. Because shareholder rights remain a primary source of concern for investors in the Japanese market, the decline in this rating indicates that respondents see more need for progress in this area.

The majority of survey respondents who answered the market-specific questions on the Japanese market clearly thought that establishing genuinely independent boards and statutory auditors is the most essential corporate governance reform needed in Japan. When asked about cross-shareholdings in Japan, most respondents inside Japan said that cross-shareholdings are acceptable if other governance measures are duly implemented or that cross-shareholdings at Japanese companies should be reduced or eliminated altogether.



## Conclusions

- Overall ratings generally indicate improvement in the integrity of the Japanese market, its financial professionals, and the effectiveness of its capital market systems during the past two years.
- When given the opportunity to provide open-ended comments, respondents most often expressed concerns with shareholder rights, Japan's regulatory system, and financial transparency—echoing the results of the 2009 survey.
- Respondents were somewhat more satisfied in 2010 with the overall ethical behavior of Japan's financial professionals than they were in 2009. Almost half of the ratings given to professional groups increased significantly from the previous year, with all scores equal to, or higher than, the ratings assigned in 2008.
- Half the ratings pertaining to capital market systems are significantly improved from the 2009 survey. However, shareholder rights ranked lowest among the group of investor protections not only in the 2010 survey but also in 2008 and 2009.
- Based on their perceptions of market ethics and integrity alone, approximately 62 percent of survey respondents in Japan said they are likely or very likely to recommend investing in Japanese markets, compared with 63 percent in 2009 and 55 percent in 2008.
- When asked to prioritize governance reforms, respondents felt most strongly about a need for independent boards and statutory auditors. Respondents also favored allowing a company's shareholders to determine the optimal board structure for publicly traded companies. Respondents were somewhat evenly divided on whether cross-shareholdings are acceptable within the context of appropriate governance measures or whether cross-shareholdings should be sharply curtailed.

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## Respondents

most often  
**expressed concerns with shareholder rights, Japan's regulatory system, and financial transparency.**

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<sup>3</sup> For these purposes, a 95 percent confidence level means that if we were to replicate this study 100 times, we can be confident that 95 out of 100 times the differences between the two groups would be different from zero. There is still a chance that in 5 of those 100 replicated studies, there is no significant difference between those two groups. Five percent represents the level of uncertainty that a surveyor is willing to accept when conducting a study with a limited number of respondents.

<sup>4</sup> A market's overall rating is composed of the 10 factors that make up the financial professionals rating and the 7 factors that make up the market systems rating. The final, overall rating for this market was created by taking the average rating or score from two sets of questions. The first question set contained 10 equally weighted components from a set of questions pertaining to investment professionals (i.e., market participants). The second question set contained seven equally weighted components of questions pertaining to the effectiveness of capital market systems in ensuring market integrity. These two sets of questions were averaged as a set, and then each set carried equal weighting in the final determination of the Financial Market Integrity Index rating for this market.

<sup>5</sup> See the appendix for ratings from 2008 to 2010.

# Key Findings

# Ethical Behavior of Individuals

The first group of Financial Market Integrity Index questions gauged attitudes concerning the ethical behavior exhibited by various financial professionals—also referred to as “market participants”—in the market over the past year. Overall, “all financial professionals” received an above-average rating of 3.6. This rating is not simply an average of the nine ratings linked to

the ethical behavior of specific professions; it is based on a separately asked control question. (The average of the ratings of the nine professions is 3.4.)

All market participants earned slightly higher ratings in 2010 than in 2009 (see **Figure 3**). Four of these ratings increased by a significant margin.

Hedge fund managers, private equity

**Figure 3**

*Respondents were asked to rate the ethical behavior of financial professionals as a whole as well as the ethical behavior of specific financial professionals.*

## Ethical Behavior of Individual Market Participants

### All Financial Professionals



### Buy-Side Analysts



### Corporate Boards of Public Companies



### Executive Management of Public Companies



### Financial Advisers to Private Individuals



### Hedge Fund Managers



### Mutual Fund Managers



### Pension Fund Managers



### Private Equity Managers



### Sell-Side Analysts



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“  
*The biggest ethical issue for the Japanese capital markets is how to protect unsophisticated individual investors from fraud and misconduct by salespeople of banks, securities companies, and other financial institutions.*

— Chief Consultant  
INSIDE JAPAN

”

managers, and sell-side analysts received the largest ratings increases at 0.3 each. Despite the significant improvement, ratings for hedge fund managers are still below a rating of 3.0, or “somewhat ethical.”

Pension fund managers received the highest rating of 3.8 despite some recent difficulties. Japanese pension fund managers have recently been

criticized for not exercising their voting rights, a governance area targeted for reform by the Asian Corporate Governance Association (ACGA). Great improvements, however, have been made in proxy voting in recent years. Early this decade, Japan’s Pension Fund Association (PFA) began to make it mandatory for its investment managers to vote proxies. As early as 2001, the PFA, the second-largest pension

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*There are no truly independent financial advisers. This is partially because of [the] poor level of investor education at schools. The government should implement obligatory courses to [teach] how to invest appropriately per each person’s risk allowance.*

— Director  
INSIDE JAPAN

”

# Ethical Behavior of Individuals

(continued)

fund in Japan, had released proxy-voting guidelines to the association's external managers about how they should vote proxies. These external managers are also expected to report their actual voting records to the PFA.

When charterholders were asked to comment on ethical issues of concern, respondents most often cited a lack of independent, objective advice given by financial advisers and the practice of

selling unsuitable investment products to investors who lack the knowledge to evaluate them.

Survey respondents also commented frequently on the behavior of corporate boards and public company executives. Comments primarily focused on the need for greater accountability to shareholders and increased transparency.

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*Public company boards [are] not shareholder focused.*

— Investment Adviser  
OUTSIDE JAPAN

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“  
*Company management executives should be more accountable to shareholders regarding the strategy and value added.*

— Executive Officer  
INSIDE JAPAN

”

A number of respondents praised Japanese financial professionals for high ethical standards, perhaps not surprising given the above-average rating respondents assigned to Japanese market participants overall.

Survey participants were also asked a market-specific question about what

type of board structure they prefer for publicly listed companies in Japan. Nearly a third of the respondents both inside and outside Japan favor allowing each company’s shareholders to determine its board structure (see the Market-Specific Questions section for a more detailed review of this issue).

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*Most of the investment professionals [closely follow] the regulations.*

— Senior Vice President  
INSIDE JAPAN

”

# Effectiveness of Regulatory and Investor Protections

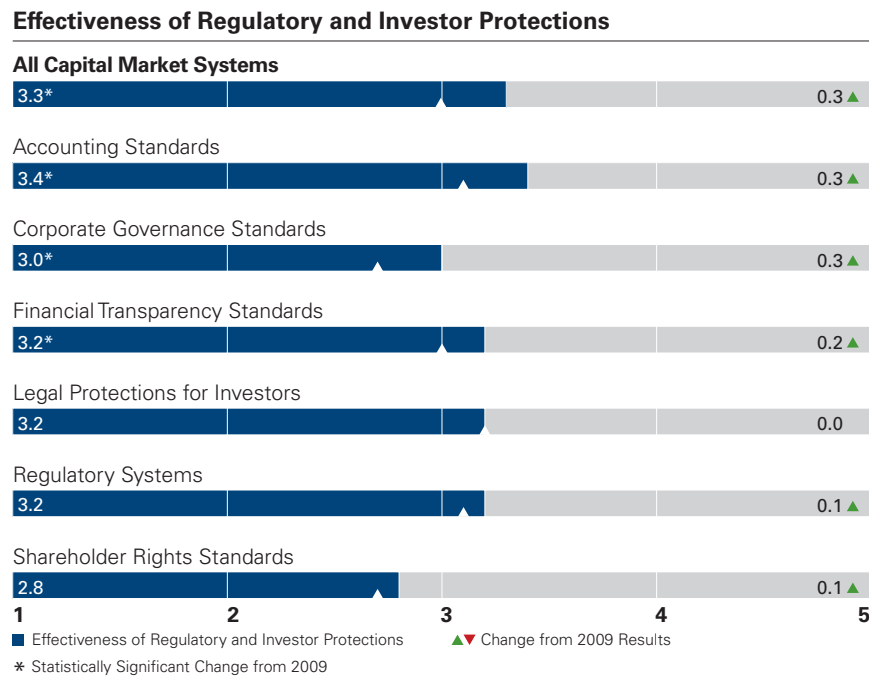
The second group of Financial Market Integrity Index questions asked respondents to rate the effectiveness of regulatory and investor protections in the market (referred to as “market systems”) over the past year. In the control question seeking ratings of all capital market systems, this group of investor protections received a rating of 3.3, slightly higher than the average rating of 3.1 earned by the group. In the 2009 survey, this control question earned a rating of 3.0 and the average of all the market systems ratings was also 3.0 (see **Figure 4**). The rating given to this control question has increased

each year since 2008 (the rating was 2.9 in 2008).

In this year’s survey, respondents saw significant improvement in half of the market systems over the last year, with accounting standards, corporate governance standards, and financial transparency all showing significant ratings gains.

Corporate governance and accounting standards experienced the largest change in rating, with each improving 0.3. Still, corporate governance is one of the two groups of investor

**Figure 4**  
 Respondents were asked to rate the overall effectiveness of capital market systems as a whole as well as the effectiveness of specific systems and standards.



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## *Japanese companies pay lip service to shareholder rights.*

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— Consultant  
OUTSIDE JAPAN

protections to earn a rating of 3.0 (“somewhat effective”) or lower. Shareholder rights is also a primary area of concern, as evidenced by its much lower rating compared with the other capital market systems.

Survey respondents who voiced opinions on the primary issues facing the Japanese market most often commented on shareholder rights, regulatory systems, and transparency issues. These were also the top concerns in the 2009 Financial Market Integrity Index survey.

Shareholder rights continue to be a major concern of respondents in Japan. Japanese shareholders have historically been disadvantaged in a number of ways, including having their holdings diluted by the issuance of new shares without shareholder approval and being forced to finance takeover defenses through the issuance of new shares to undisclosed third parties.

Shareholders in Japan also face challenges to their voting rights. A Japanese company has 90 days following its fiscal year-end (31 March for most companies) to hold an annual general meeting (AGM). Traditionally, corporations have clustered these annual meetings together within the last few weeks of the 90-day period and have given little notice to shareholders. Japanese companies are allowed to send out AGM agendas and proxy forms just 14 days prior to AGMs, making it difficult for shareholders to make well-informed decisions on all the companies they own or to attend more than a handful of annual meetings.

The “unit stock system” is also a deterrent to shareholder participation because it fosters a relatively high minimum trading cost. Under this system, most companies designate 1,000 shares as a “unit,” and any entity holding less than one unit, or 1,000 shares, is not entitled to a vote.

# Effectiveness of Regulatory and Investor Protections

(continued)

The comments received on regulation in Japan covered an array of concerns, from regulation of corporate entities and fund managers to regulations that affect retail shareholders.

Transparency issues are a continuing concern for the Japanese market. Respondents expressed concern with the degree of transparency in financial information available to a company's shareholders, often in reference to

value of the shares traded on the Tokyo Stock Exchange. These cross-shareholdings are largely undisclosed to outside investors. Despite foreign and domestic investor dissatisfaction, the practice is becoming ever more entrenched in the Japanese market.

Respondents were asked two additional market-specific questions about capital market systems to further illuminate some of the rationale

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*The trouble is that current regulations favor issuers to a very large extent.*

— CEO and President  
INSIDE JAPAN

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corporate cross-holdings, as well as with the proper disclosure of risk relating to products in the capital marketplace.

Corporate cross-shareholdings, primarily of strategically unrelated businesses, are widespread in Japan. Through cross-shareholdings, Japanese companies and financial institutions are estimated to own approximately half of the market

behind the individual scores awarded various market system components. These questions do not figure in the final calculation of ratings. The first market-specific question asked which type of corporate governance reform respondents believe is most needed for publicly listed companies in Japan; 32 percent of respondents chose a lack of independence among corporate boards and statutory auditors as their number-one area of dissatisfaction,



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*[I'm concerned about] disclosure and explanation of risks associated with financial products.*

— Director  
INSIDE JAPAN

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followed by improving the structure of corporate boards (24 percent).

The second question asked respondents to describe their opinion regarding cross-shareholdings among Japan's publicly listed companies and financial institutions. More than 40 percent of respondents believe cross-shareholdings should be significantly reduced or eliminated; however, a similar number think the practice is acceptable with appropriate governance oversight (see the Market-Specific Questions section for a more detailed review of this issue).

Respondents also were asked two subquestions about capital market systems that did not figure in the final calculation of ratings.

The first subquestion addressed the effectiveness of capital market regulation policies themselves. Specifically, we sought respondents' perceptions on whether the regulations and investor protections in the Japanese market represent industry standard or best practice and, if implemented correctly, would those market systems offer a solid framework for investor rights. Respondents rated these regulations and policies an average rating of 2.8 (this rating was 3.0 in 2009).

The second subquestion focused on the effectiveness of implementation or enforcement of such regulations and policies. This score remained the same as a year ago, at 2.9.

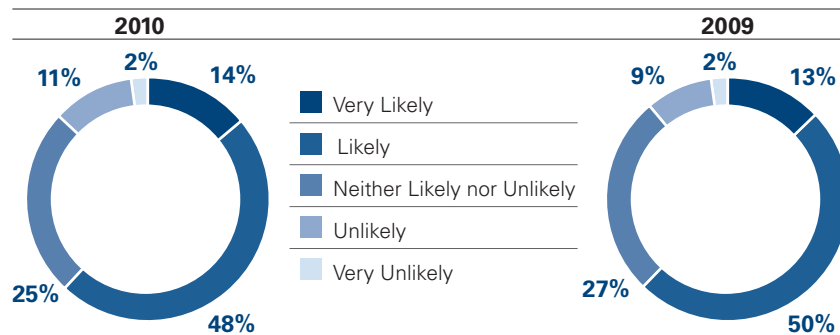
# Willingness to Invest in Japan

In this section of the survey, respondents were asked the likelihood that they would recommend investing in the Japanese market based solely on their perception of the ethical behavior of market participants and the effectiveness of capital market systems.

The prior year's survey was conducted in early 2009, at the peak of the global financial crisis. Japan's equity market, however, had limited exposure to the subprime crisis and did not experience the steep drop in confidence that other

or very likely to recommend investing in Japan based solely on the ethical behavior of market participants and the effectiveness of capital market systems. In 2009, this number was 63 percent; in 2008, it was 55 percent. These numbers differ sharply from those recorded by respondents outside Japan. In this year's survey, only 33 percent of out-of-market participants were likely or very likely to recommend investing in Japan, down slightly from 36 percent in the 2009 survey and well below the 2008 level of 42 percent. It is

**Figure 5**  
Likelihood of in-market respondents to recommend investing in Japan based solely on the ethical behavior of market participants and the effectiveness of capital market systems.



## Based Solely on Ethical Behavior and Capital Market Systems, Would You Recommend Investing in Japan?

NOTE: Percentages may not total 100 percent because of rounding.

markets experienced. It is not surprising, then, that respondents' willingness to recommend investing in the Japanese equity market has changed little from the 2009 survey (see **Figure 5**).

In 2010, 62 percent of respondents surveyed in Japan said they were likely

or very likely to recommend investing in Japan based solely on the ethical behavior of market participants and the effectiveness of capital market systems. In 2009, this number was 63 percent; in 2008, it was 55 percent. These numbers differ sharply from those recorded by respondents outside Japan. In this year's survey, only 33 percent of out-of-market participants were likely or very likely to recommend investing in Japan, down slightly from 36 percent in the 2009 survey and well below the 2008 level of 42 percent. It is

apparent that those outside Japan may be increasingly hesitant to invest in the Japanese equity market. This divergence in sentiment between in-market respondents and their out-of-market peers is likely the result of an investment environment that is

often perceived as hostile to outside investors as well as several persistent issues that have tarnished the investing environment in Japan, such as shareholder rights and corporate governance standards that seriously lag global standards.

Although in late 2009 the Tokyo Stock Exchange proposed new rules promoting higher governance standards, they were characterized as weak and largely ineffectual by the Asian Corporate Governance Association. The ACGA has challenged Japan to take “a bolder approach” in promoting independent directors for corporate boards and transparency in proxy voting by pension fund managers. Although many of the global equity markets are benefitting from a rebound in confidence following the global financial crisis, it is evident that Japan continues to struggle with its own internal challenges.

## Other Key Survey Considerations

# In-Market vs. Out-of-Market Perceptions

For purposes of this Financial Market Integrity Index, charterholders from other markets around the world were given the opportunity to rate and comment on both their own and the Japanese market. (Survey respondents were given the option to skip questions pertaining to any market about which they did not think they were knowledgeable.)

In 2010, respondents inside Japan generally gave higher ratings to both the integrity of Japanese market participants (see **Figure 6**) and the effectiveness of Japanese capital market systems (see **Figure 7**) than did those from outside Japan.

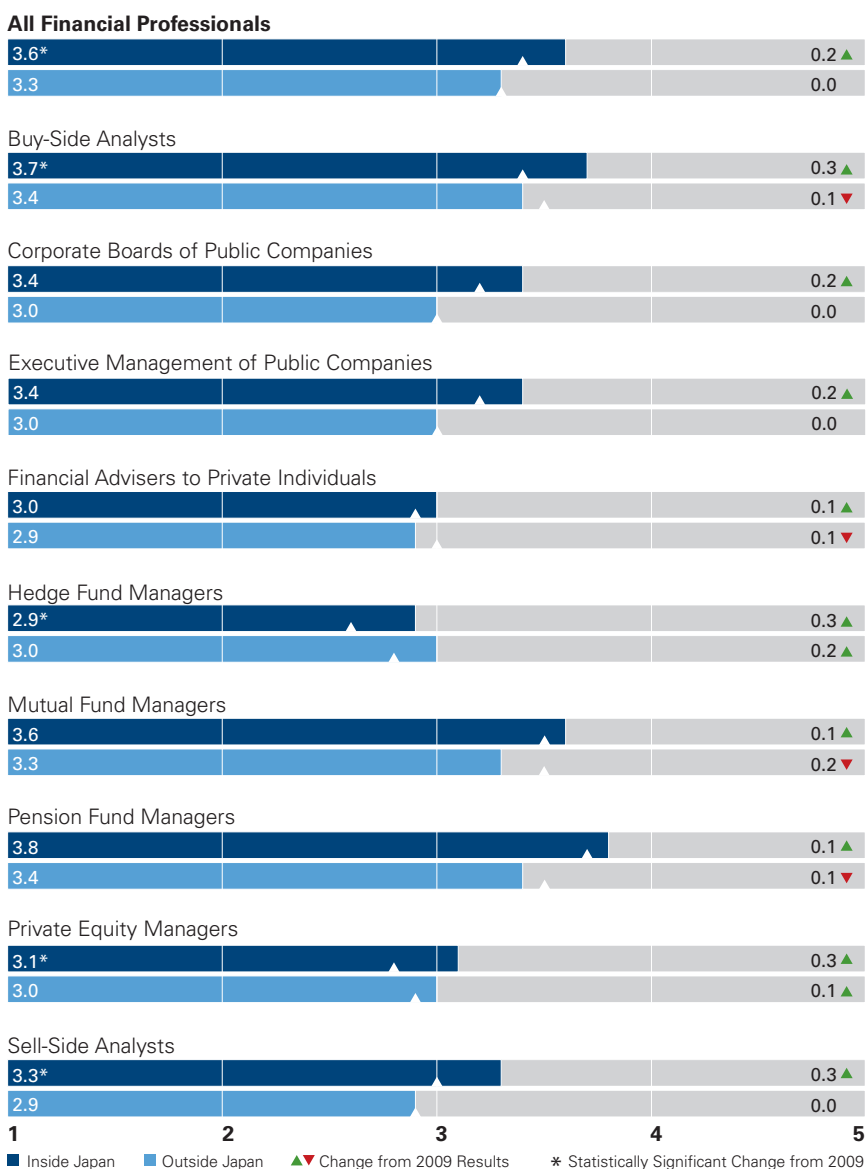
The differences in the ratings concerning the ethical behavior of market participants are significant in some instances. The greatest disparity occurs in the categories of corporate

boards, corporate executives, and pension fund managers. In each case, in-market respondents assigned these categories of professionals a rating 0.4 points higher than the comparable rating assigned by out-of-market respondents. The differences in ratings for boards and executives may have their roots in corporate governance matters, which those outside Japan still rate rather low. The discrepancy in the ratings for pension fund managers may highlight some dissatisfaction non-Japanese shareholders have with pension fund managers' practice of not voting proxies or not publicizing their votes (though a rating of 3.4 for this group by those outside Japan may still be considered rather favorable).

Most regulatory and investor protections are rated average or above average by those inside Japan. By contrast, only two of the these six ratings

### Ethical Behavior of Individual Market Participants

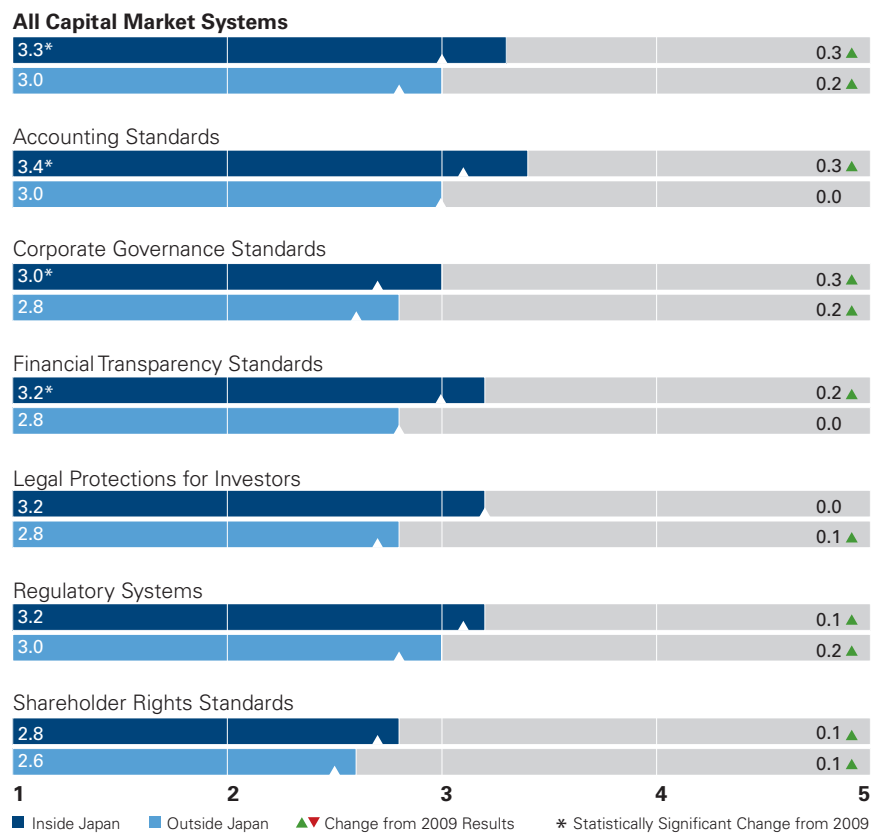
Figure 6



# In-Market vs. Out-of-Market Perceptions

(continued)

Figure 7 Effectiveness of Regulatory and Investor Protections



are given an “average” rating by those outside Japan, with corporate governance standards, financial transparency standards, and legal protections each earning a rating of 2.8. Shareholder rights earned the lowest rating of all from those outside Japan, at 2.6.

Accounting standards, financial transparency, and legal protections for investors are viewed more favorably inside Japan than outside, with each rated 0.4 higher by those in Japan.

All the scores are equal to or higher than those given in the 2008 survey; in that survey, corporate governance, transparency, and shareholder rights were given very low marks. The upward trend in ratings perhaps indicates that those outside Japan are aware of efforts to implement reforms but are sending a signal that more needs to be done.

# Market-Specific Questions

In the 2010 Financial Market Integrity Index survey, we offered survey respondents the opportunity to answer a market-specific question addressing an issue of particular importance to participants in a given market. Not all surveys included a market-specific question, but in- and out-of-market respondents to the Financial Market Integrity Index survey for Japan were asked their opinions on corporate governance reform, the acceptability of cross-shareholdings, and the optimal corporate board structure.

The first market-specific question asked survey respondents to prioritize which governance reform was most needed at publicly listed companies in Japan (see **Figure 8**).

Charterholders inside Japan appear to be acutely aware of the need for independent company boards and auditors; nearly a third of those responding listed this as the most-pressing reform needed for publicly listed companies. Just over a third



of out-of-market respondents chose this as the most-needed governance reform as well. Nearly a quarter of those responding in Japan seek an improvement in the structure of corporate boards before other governance reforms, whereas a similar percentage of respondents outside Japan (18 percent) consider this the most-needed reform. Dispersing the cluster

of annual shareholder meetings is ranked the third most important reform by those inside Japan, with 22 percent of those inside Japan listing this as the top priority. Few outside Japan focused on this issue as a top governance priority. In fact, the most popular answer from those outside Japan was “not sure,” at 40 percent.

**Which of the following corporate governance reforms do you feel is MOST needed for publicly listed companies in Japan?**

|  | In Market | Out of Market |
|--|-----------|---------------|
| Ensuring True Independence of Boards and Statutory Auditors                      | 32%       | 34%           |
| Improving the Corporate Board Structure  | 24        | 18            |
| Reducing the Concentration or Clustering of Annual Meetings around the Same Date | 22        | 5             |
| Increasing Required Time between Mailing of Proxy and Voting at Annual Meetings  | 6         | 1             |
| Abolishing the Unit Stock System   | 5         | 1             |
| Other  | 3         | 2             |
| None: I Do Not Think Any Corporate Governance Reforms Are Needed                 | 1         | 1             |
| Not Sure   | 6         | 40            |

Figure 8

NOTE: Percentages may not total 100 percent because of rounding.

# Market-Specific Questions

(continued)

## Which of the following BEST describes your opinion regarding cross-shareholdings among Japanese publicly listed companies and financial institutions?

**Figure 9**

|  | In Market | Out of Market |
|--|-----------|---------------|
| Cross-Shareholdings Are Acceptable So Long as Other Governance Measures Are Duly Implemented | 46%       | 27%           |
| Cross-Shareholdings Should Be Significantly Reduced or Eliminated                            | 43        | 42            |
| Cross-Shareholdings Are Acceptable Because This Is a Locally Accepted Custom                 | 6         | 2             |
| Not Sure   | 4         | 29            |

NOTE: Percentages may not total 100 percent because of rounding.

The second market-specific question asked respondents their opinion concerning the cross-shareholding of shares among Japanese public companies (see **Figure 9**).

Many of those responding to the question regarding cross-shareholdings in Japan believe that this practice should be significantly reduced or eliminated.

The percentages were similar for respondents both inside and outside Japan (43 percent and 42 percent, respectively). Of those charterholders responding inside Japan, however, a slightly higher percentage (46 percent)

believes cross-shareholdings are acceptable as long as other governance measures are implemented alongside them. Only 27 percent of respondents outside Japan agree with this choice, and 29 percent of survey respondents outside Japan are undecided as to whether cross-shareholdings are acceptable.

The final market-specific question for Japan asked survey respondents which board structure they most preferred for publicly listed companies in Japan (see **Figure 10**).

Nearly one-third of both in-market and out-of-market respondents prefer that each company's shareholders determine an appropriate board structure. The largest difference in preferences is demonstrated by those who feel that each company should choose for itself, with management determining the structure of the board. Twenty-seven percent of those inside Japan feel that management should choose

the company's board structure, with only 4 percent of those outside Japan agreeing with this sentiment. About 16 percent of those inside Japan prefer a single board with committees, while 23 percent of those outside Japan feel that this is the most appropriate model. Fifteen percent of those inside and outside Japan prefer a two-tiered board structure accompanied by a board of statutory auditors.

**Which board structure do you MOST prefer for publicly listed companies in Japan?**

|   | In Market | Out of Market |
|---|-----------|---------------|
| Each Company Should Choose for Itself, with the Company's Shareowners Determining the Appropriate Board Structure | 30%       | 30%           |
| Each Company Should Choose for Itself, with the Company's Management Determining the Appropriate Board Structure  | 27        | 4             |
| Single Board Structure with Committees  | 16        | 23            |
| Two-Tiered Board Structure with a Board of Statutory Auditors   | 15        | 15            |
| Not Sure  | 10        | 27            |

**Figure 10**

NOTE: Percentages may not total 100 percent because of rounding.

# Comments of Survey Respondents

More than 100 respondents offered comments about the current state of financial market integrity in Japan. Respondents were given opportunities in connection with several of the survey questions to provide written comments about their thoughts and concerns. In particular, additional comments were solicited in the survey section concerning individual market participants and, again, after questions concerning market systems. At the completion of the survey, respondents also were asked for additional issues of concern and for any other comments.

More than 150 substantive comments were received; those responding with “no answer” or “nothing to add” were excluded.

The various responses were examined and then categorized based on the concerns addressed in each comment (e.g., regulation, shareholder rights, transparency). The key areas of comment and the topics raised most often are highlighted in **Figure 11**. In instances in which an individual raised more than one concern, each separate concern was identified and counted.

**Figure 11**

*Survey respondents commented most about regulation, shareholder rights, and transparency.*

| Issues Raised Most Frequently       |  |
|-------------------------------------|--|
| Regulation/Regulatory Systems       | <b>14</b> comments (11 inside Japan/3 outside Japan) |
| Shareholder Rights                  | <b>14</b> comments (11 inside Japan/3 outside Japan) |
| Transparency                        | <b>13</b> comments (10 inside Japan/3 outside Japan) |
| Corporate Governance                | <b>12</b> comments (10 inside Japan/2 outside Japan) |
| Education                           | <b>12</b> comments (12 inside Japan/0 outside Japan) |
| Insider Trading/Insider Information | <b>11</b> comments (10 inside Japan/1 outside Japan) |

## Regulation

Japan's regulatory environment was among survey respondents' primary concerns in both the 2009 and 2010 surveys. This topic also generated the most detailed and most diverse comments by charterholders, among them concerns that Japan suffers from over-regulation and that standards of regulation differ among the financial professions.

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“  
*Regulations [are] sometimes too rigid. [Regulators] give institutional managers lots of paperwork to do and prevent overseas investors from coming into our market.*

— Portfolio Manager  
INSIDE JAPAN

”

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“  
*The problem is not with the enforcement of the standards as much as the standards themselves. In addition, it should be noted that individual investors are protected by a very bureaucratic process mandated by the authorities. Over-regulation is more of a problem than under-enforcement.*

— CEO and President  
INSIDE JAPAN

”

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# Comments of Survey Respondents

(continued)

## Shareholder Rights

The issue of shareholder rights continues to be a major concern for investors in the Japanese market and generated just as many comments as regulatory issues did both this year and last. The majority of comments regarding shareholder rights are in unison that the rights of shareholders are not valued by Japanese companies or regulators.

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“  
*Shareholder rights protection is a big issue.*

— Chief Fund Manager  
INSIDE JAPAN

”

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“  
*[I am concerned about] lack of transparency on complex financial products.*

— Partner, Overseas Client Services  
INSIDE JAPAN

”

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## Transparency

As in the 2009 Financial Market Integrity Index survey, transparency issues again rank third among concerns most frequently raised by respondents. Among those commenting, most express a greater need for transparency in financial statements and disclosures. A need for proper disclosure of risks relating to investment vehicles was also called for by several respondents.

## Corporate Governance

Most respondents commenting on corporate governance did not elaborate on this topic. Survey respondents were given the opportunity to evaluate the most pressing corporate governance reform needs in a separate market-related question, and more than half listed the need for more independent corporate boards and auditors as a top reform priority.

Those who showed concern about the ethical behavior of financial advisers most often cited potential conflicts of interest, adviser incentive structures, and the suitability of investment advice given by these advisers as their top concerns.

---

“  
*Corporate governance and capital markets policies are still dominated by the interests of issuers and sometimes large market participants. There is little internal motivation to change the situation, so I suspect any improvement will be motivated by institutions such as the Asian Corporate Governance Association (ACGA) and CFA Institute.*

— CEO and President  
INSIDE JAPAN

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”

# Comments of Survey Respondents

(continued)

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“  
*Individual investors' investment decisions tend to be driven by short-termism that is often caused by brokers' aggressive sales activity. This could lead to unethical investment behavior. We should pay much closer attention to developing well-thought-out investment education programs.*

— Deputy Chief Manager  
INSIDE JAPAN

## Education

The 12 comments relating to education were fairly evenly divided between calls for improving investor education and calls for improving education for financial advisers and professionals. Many thought it is incumbent on the Japanese government to mandate an education program that raises the level of financial awareness among individual investors and teaches them to invest responsibly.

---

“  
*Financial professionals have little knowledge [of the] investment industry; the government should improve education.*

— Fund Manager  
INSIDE JAPAN



## Insider Trading

A number of respondents who commented on this issue simply listed “insider trading” as an issue of concern. Others commented that retail investors are disadvantaged by asymmetric information accruing to financial professionals who work for large institutions.

“  
*The concern on the corporate executive side is with corporate governance, which includes shareholders’ rights issues such as the . . . leakage of insider information to select individuals.*

— CEO and President  
INSIDE JAPAN

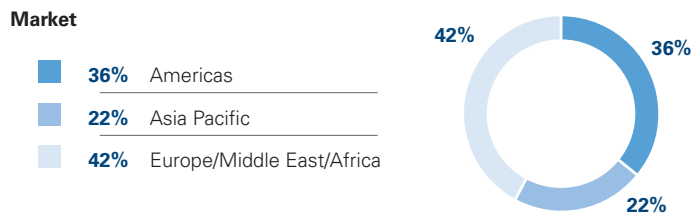
“  
*Individual investors need to keep in mind that some individuals—most of whom are affiliated with large institutions—have an information advantage. The markets also tend to accommodate the rumor mill, which is often accompanied by nonfundamental share price volatility.*

— CEO and President  
INSIDE JAPAN

# Demographics

The following figures indicate some of the key demographic information about the respondent base (please see the complete methodology report at [www.cfainstitute.org/ethics](http://www.cfainstitute.org/ethics) for further details).

## Overview of Out-of-Market Respondents



## Respondent Profiles for Japanese Market

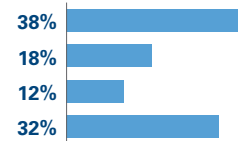
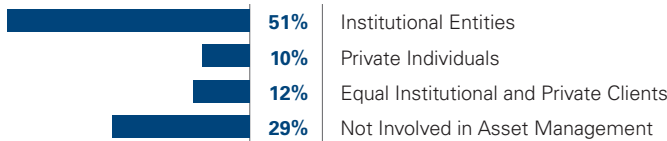
In Market (201 respondents)

Out of Market (182 respondents)

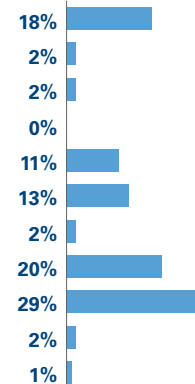
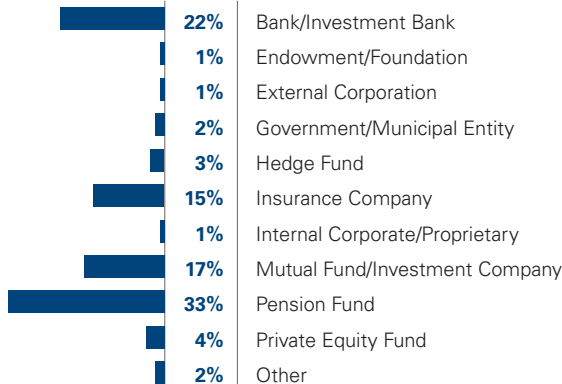
### Buy/Sell Side



### Client Asset Base



### Institutional Asset Client Type



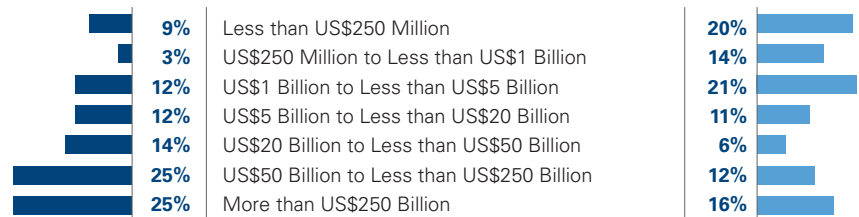
*These results represent only those respondents identified as being in the "Institutional Entities" Client Asset Base category.*

## Respondent Profiles for Japanese Market (continued)

In Market (201 respondents)

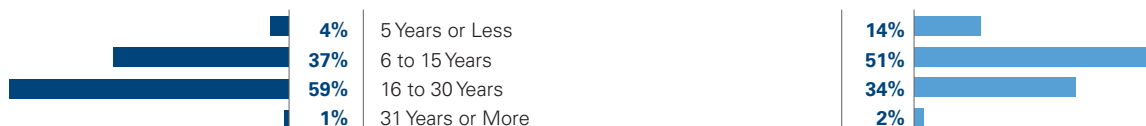
Out of Market (182 respondents)

### Assets Under Management

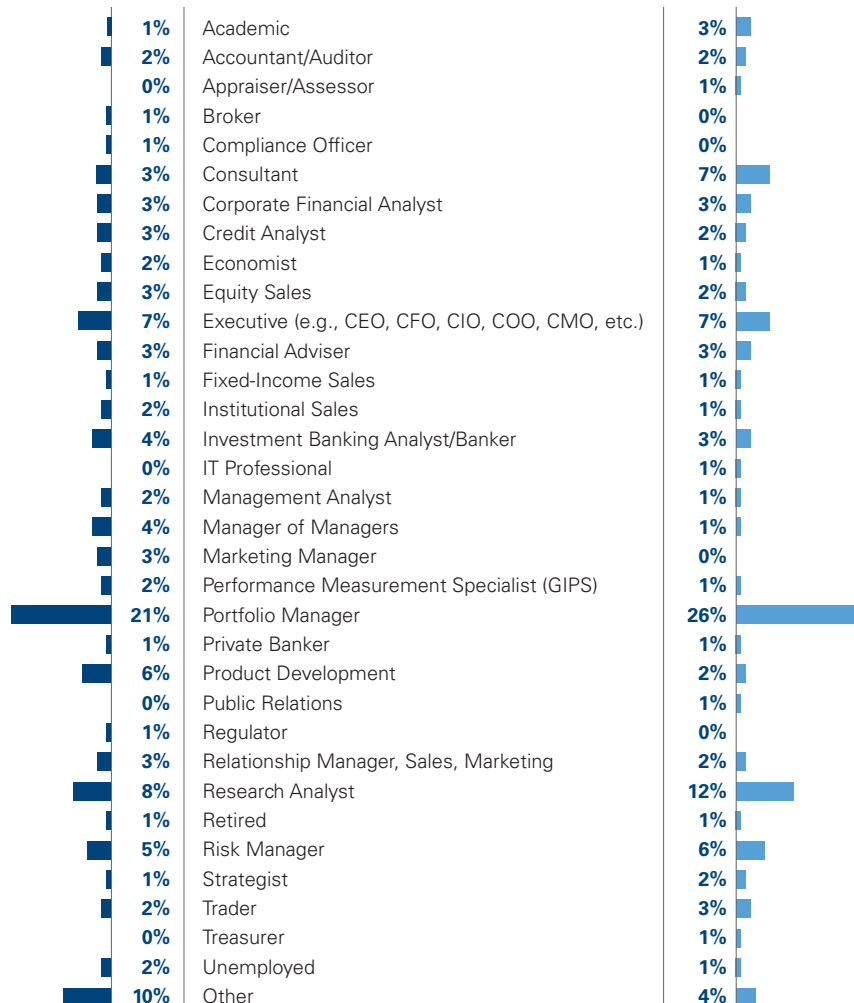


These results represent only those respondents identified as being in the "Institutional Entities" Client Asset Base category.

### Years in the Investment Industry



### Primary Job Function



NOTE: Percentages may not total 100 percent because of rounding.

# Appendix

## Results from 2008 to 2010

|   | In Market     |            |            | Out of Market |            |            |
|---|---------------|------------|------------|---------------|------------|------------|
|   | 2010          | 2009       | 2008       | 2010          | 2009       | 2008       |
|   | A             | B          | C          | D             | E          | F          |
| <b>Overall Rating</b>                     | <b>3.3 BC</b> | <b>3.1</b> | <b>3.1</b> | <b>3.0</b>    | <b>3.0</b> | <b>2.8</b> |
| All Financial Professionals               | 3.6 B         | 3.4        | 3.5        | 3.3           | 3.3        | 3.3        |
| Buy-Side Analysts                         | 3.7 B         | 3.5        | 3.6        | 3.4           | 3.5        | 3.3        |
| Corporate Boards of Public Companies      | 3.4           | 3.2        | 3.3        | 3.0           | 3.0        | 2.9        |
| Executive Management of Public Companies  | 3.4           | 3.2        | 3.2        | 3.0           | 3.0        | 2.9        |
| Financial Advisers to Private Individuals | 3.0           | 2.9        | 2.9        | 2.9           | 3.0        | 2.5        |
| Hedge Fund Managers                       | 2.9 B         | 2.6        | 2.9 B      | 3.0           | 2.8        | 2.5        |
| Mutual Fund Managers                      | 3.6           | 3.5        | 3.6        | 3.3           | 3.5        | 3.4        |
| Pension Fund Managers                     | 3.8           | 3.7        | 3.8        | 3.4           | 3.5        | 3.4        |
| Private Equity Managers                   | 3.1 B         | 2.8        | 2.9        | 3.0           | 2.9        | 2.9        |
| Sell-Side Analysts                        | 3.3 B         | 3.0        | 3.3 B      | 2.9           | 2.9        | 2.6        |
| All Capital Market Systems                | 3.3 BC        | 3.0        | 2.9        | 3.0           | 2.8        | 2.7        |
| Accounting Standards                      | 3.4 BC        | 3.1        | 3.1        | 3.0           | 3.0        | 2.8        |
| Corporate Governance Standards            | 3.0 BC        | 2.7        | 2.7        | 2.8 F         | 2.6 F      | 2.1        |
| Financial Transparency Standards          | 3.2 BC        | 3.0        | 3.0        | 2.8 F         | 2.8        | 2.4        |
| Legal Protections for Investors           | 3.2 C         | 3.2 C      | 2.8        | 2.8           | 2.7        | 2.6        |
| Regulatory Systems                        | 3.2 C         | 3.1 C      | 2.7        | 3.0           | 2.8        | 2.7        |
| Shareholder Rights Standards              | 2.8 C         | 2.7 C      | 2.5        | 2.6           | 2.5        | 2.2        |

NOTE: Column letters are used to denote significant year-to-year differences at the 95 percent confidence level. For example, a letter "B" next to a rating in column "A" means that the rating in column A is statistically significantly higher than the rating in column B at a 95 percent confidence level.

**Based Solely on Ethical Behavior and Capital Market Systems, Would You Recommend Investing in Japan?**

|                             | In Market |      |       | Out of Market |      |      |
|-----------------------------|-----------|------|-------|---------------|------|------|
|                             | 2010      | 2009 | 2008  | 2010          | 2009 | 2008 |
| Number of Respondents       | 201       | 194  | 167   | 182           | 61   | 49   |
|                             | A         | B    | C     | D             | E    | F    |
| Very Unlikely               | 2%        | 2%   | 1%    | 4%            | 2%   | 0%   |
| Unlikely                    | 11%       | 9%   | 9%    | 10%           | 10%  | 11%  |
| Neither Likely nor Unlikely | 25%       | 27%  | 36% A | 53%           | 52%  | 48%  |
| Likely                      | 48%       | 50%  | 46%   | 25%           | 26%  | 33%  |
| Very Likely                 | 14%       | 13%  | 9%    | 8%            | 10%  | 9%   |

NOTE: Percentages may not total 100 percent because of rounding.

NOTE: Column letters are used to denote significant year-to-year differences at the 95 percent confidence level. For example, a letter “B” next to a rating in column “A” means that the rating in column A is statistically significantly higher than the rating in column B at a 95 percent confidence level.

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