

Corporate Governance Reform in Japan

Japan Corporate Governance Forum at the ICGN 2024 Annual Conference, London

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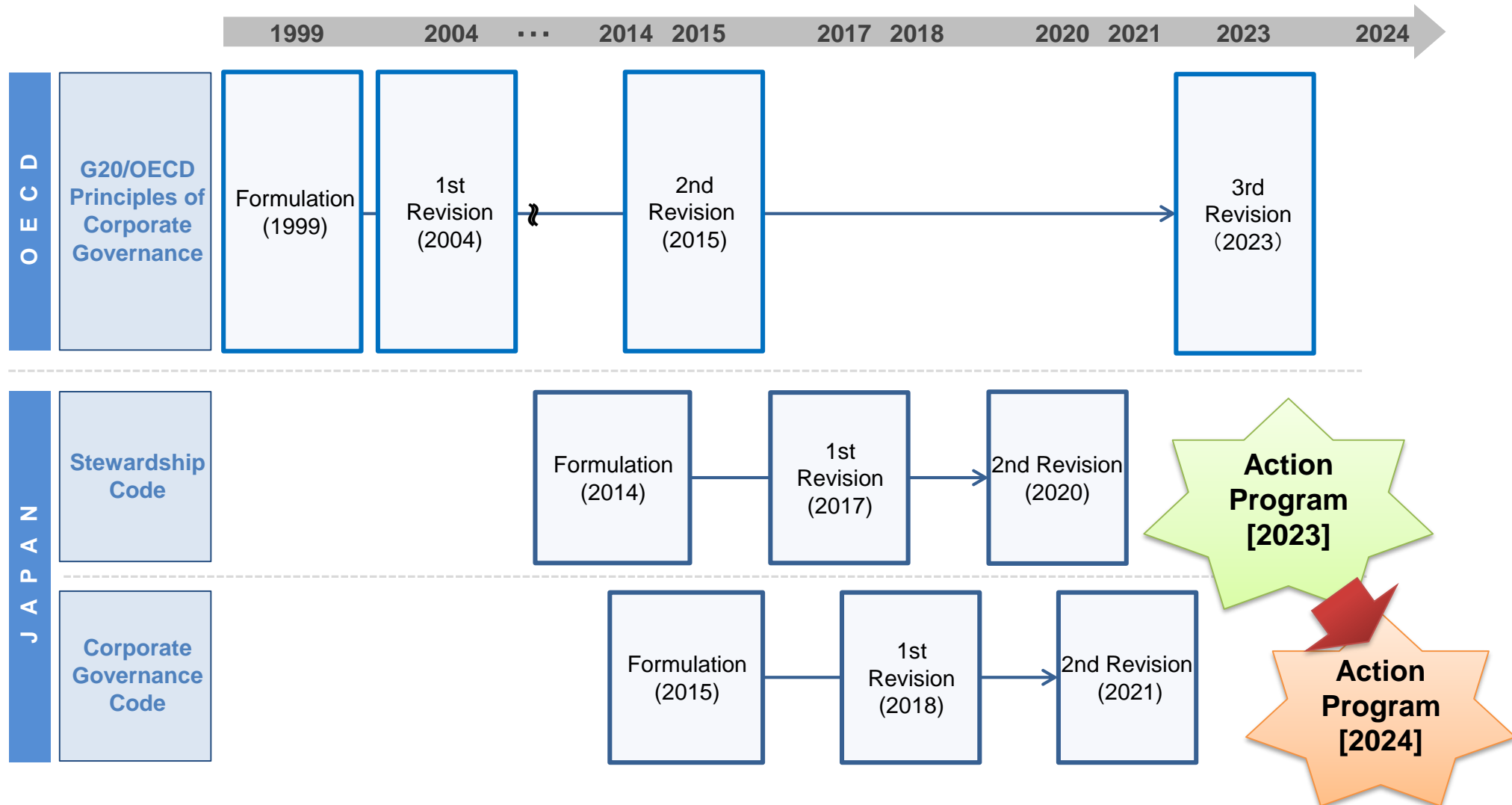


金融庁

Financial Services Agency, the Japanese Government

July 2024

Overview of Japan's Corporate Governance Code and Stewardship Code

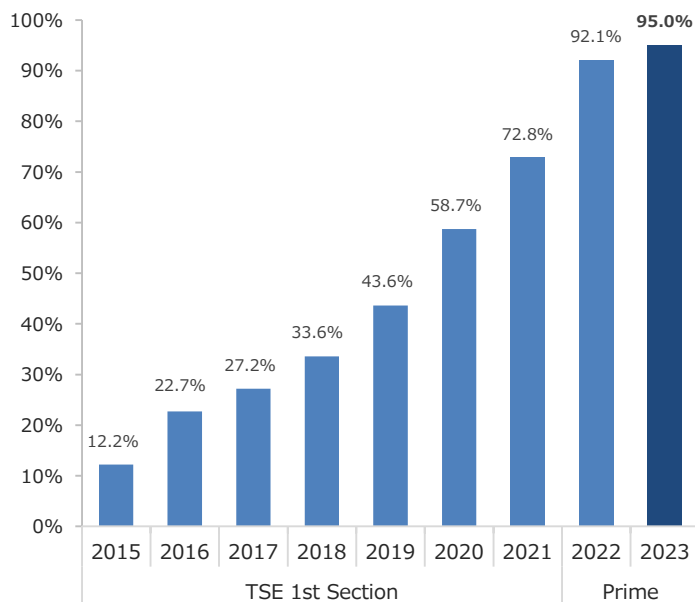


Action Program for Corporate Governance Reform 2023 & 2024

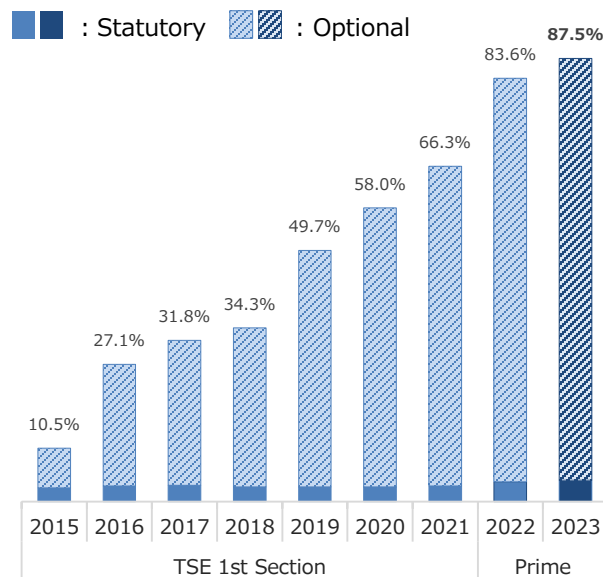
- In April 2023, the FSA published the “Action Program for Accelerating Corporate Governance Reform” (the "**Action Program**"), addressing the following key issues:
 1. Effective implementation of **stewardship activities** and resolving legal issues
 2. Improvement of the **effectiveness of the board**
 3. Encouraging the management with an awareness of **profit-making and growth**
 4. Enhancing the **quality of disclosure** and promoting **dialogues with global investors**
 5. Resolving market environment issues
 6. Encouraging the management with an awareness of **sustainability** issues
- Going back to the spirit of the Codes, which is to ensure **sustainable corporate growth** and **increased corporate value** over the mid- to long- term, a set of initiatives should be undertaken for transforming **corporate governance reform “from formality to substance”** based on self-motivated changes in the mindsets of companies and investors through examining and sharing specific measures.
- In June 2024, the FSA updated and published the “Action Program for Corporate Governance Reform 2024: **Principles into Practice.**”

Progress following the 2021 revision of the Corporate Governance Code

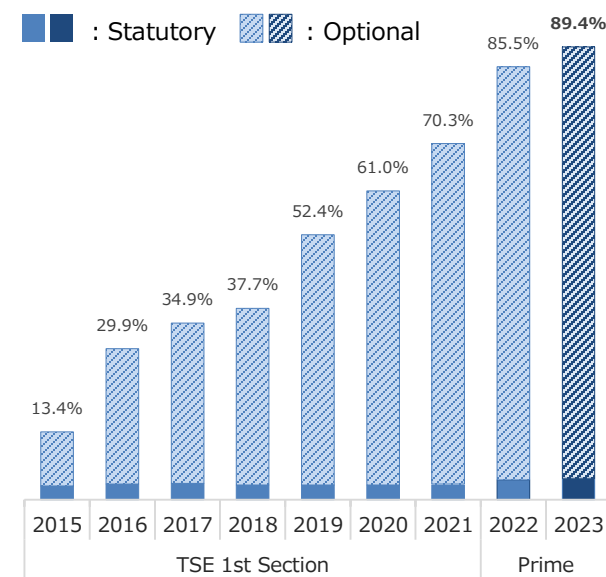
Trend in the proportion of companies where 1/3 or more of the directors are independent directors



Trend in the number of companies with a nomination committee



Trend in the number of companies with a compensation committee



- ❑ Since the formulation of the Stewardship Code in 2014, a series of corporate governance reforms have been implemented. Following the 2021 revision of the Corporate Governance Code, companies have made progress in their efforts to reform corporate governance systems.
- ❑ Examples of the progress of corporate governance systems of listed companies as of July 2023 are:
 - At more than 90% (95.0%) of companies listed on the Prime Market, at least one third of their directors are independent directors.
 - More than 80% (87.5%) of companies listed on the Prime Market have established nomination committees and more than 80% (89.4%) have established compensation committees, both including optional (non-statutory) ones.

Effective implementation of stewardship activities and resolving legal issues

[Follow-up on the Action Program]

- In December 2023, the Financial System Council made a series of recommendations, including:
 - ❑ promoting **collective/collaborative engagements**
 - ❑ revising the **large shareholding reporting rule**
 - ❑ ensuring the **transparency of beneficial shareholders**.
- In May 2024, the law to amend the Financial Instruments and Exchange Act, including clarification of the scope of “joint holders” in the large shareholding reporting rule, was enacted.



[Future initiatives]

- Consider the revision of the **Stewardship Code** with the aim of promoting collective/collaborative engagements that contribute to **constructive and purposeful dialogues** and ensure the transparency of beneficial shareholders.
- Assess the application practices of the Stewardship Code by the signatory entities (asset managers, asset owners, proxy advisors, etc.)

Improvement of the effectiveness of the board

[Follow-up on the Action Program]

- In January 2024, the Ministry of Economy, Trade and Industry (METI), jointly with the FSA and the Tokyo Stock Exchange (TSE), published a leaflet titled “**The Basics of Being an Independent Director**” as a part of their efforts to ensure and improve the quality of independent directors.
- Private entities, such as the **Japan Association of Corporate Directors** (JACD), continue to provide substantial training dedicated for independent directors, as well as work to increase awareness of good corporate governance practices through granting national awards.



[Future initiatives]

- Share specific **good examples** of efforts, such as **dialogues between independent directors and investors** and encouragement for substantive discussions by the secretariats of boards, in order to promote the implementation of efforts to improve the effectiveness of boards.

Encouraging the management with an awareness of profit-making and growth

[Follow-up on the Action Program]

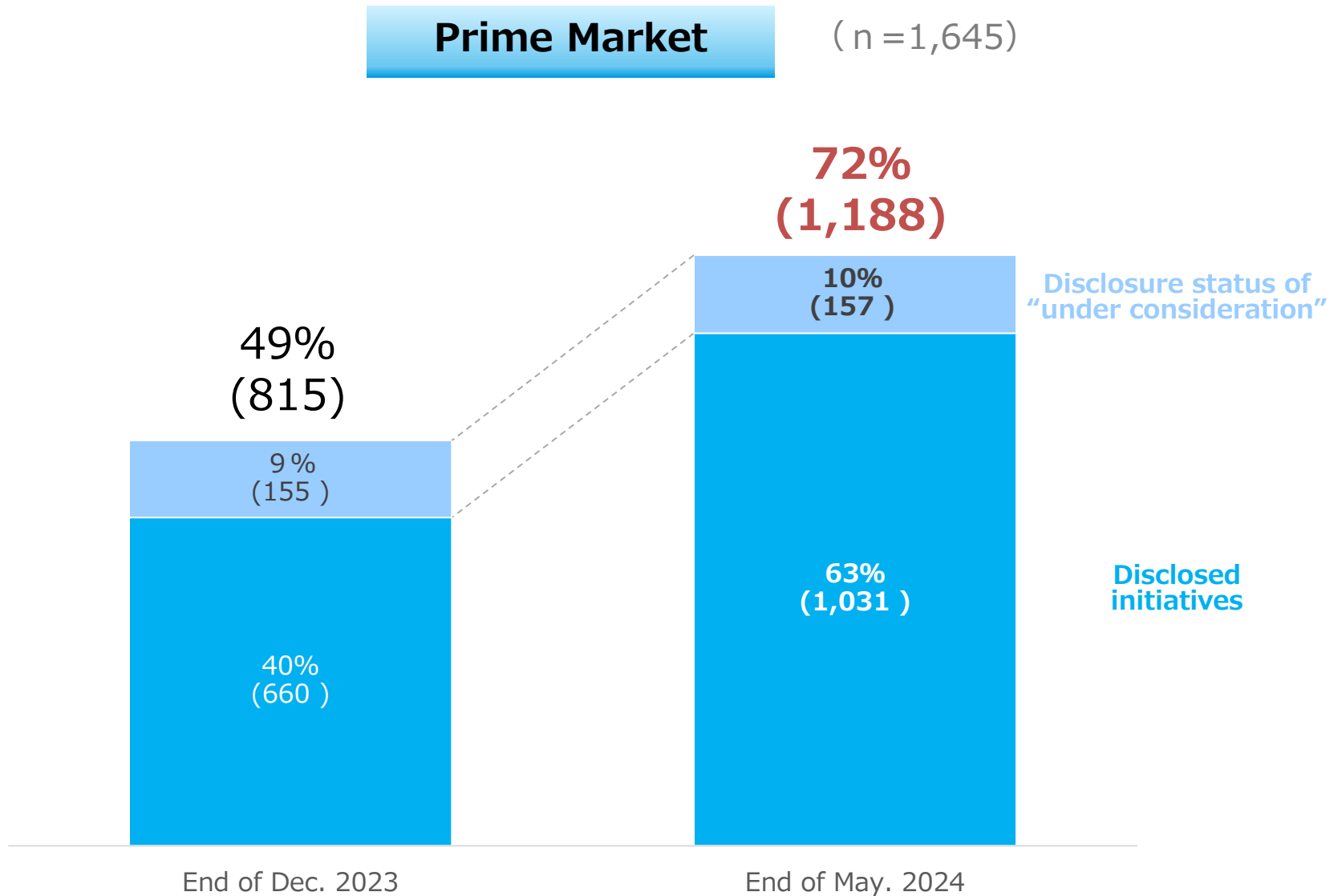
- In March 2023, the TSE made a request ("Action to Implement Management that is **Conscious of Cost of Capital and Stock Price**") and has begun publishing a list of companies that have disclosed information in accordance with the request from January 2024. As of May 31, 2024, 72% of Prime Market listed companies have disclosed information following the request.
- In February 2024, TSE published several key points and examples of initiatives based on interviews with investors. These include the need to calculate cost of capital and analyze return on capital based on investors' perspectives.



[Future initiatives]

- Follow up on the status of each company's initiatives continuously to encourage them to take **substantial and tangible measures**. In doing so, focus on whether **boards are committed to the initiatives proactively and actively**, whether specific discussions are conducted during dialogues with investors and whether analyses and evaluations are conducted with an awareness of specific outcomes from the perspective of increasing corporate value over the mid- to long- term.

Status of disclosure on “Action to Implement Management that is Conscious of Cost of Capital and Stock Price”



Note: Tokyo Stock Exchange aggregated the number of companies that used certain keywords in the company's most recently submitted Corporate Governance Report.
Source: Compiled by JFSA based on Tokyo Stock Exchange, Inc. "Status of Disclosure on 'Action to Implement Management that is Conscious of Cost of Capital and Stock Price' (As of May 31, 2024)" (June 14, 2024)

[Follow-up on the Action Program]

- In March 2023, the TSE published “Better Dialogue with Shareholders and Related Disclosure” to encourage companies listed on the Prime Market to disclose information about dialogues with shareholders.
- In addition, the TSE has been discussing mandatory English disclosures by companies listed on the Prime Market. In May 2024, the TSE revised its listing rules to make **English disclosures** of financial statements and timely disclosure information mandatory (effective on or after April 1, 2025).

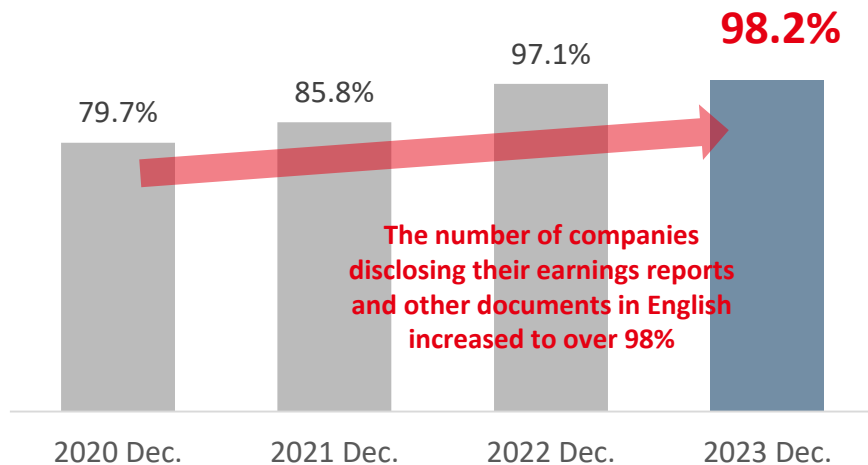


[Future initiatives]

- Examine actual situations and advance discussions on the development of an environment, including enhancing the efficiency of disclosures of duplicate information in Annual Securities Reports and Business Reports, that will lead companies to **disclose Annual Securities Reports before general shareholder meetings**, in addition to enhancing timely disclosures.
- Publish a specific list in order to “visualize” the group of companies that willingly and actively respond to the expectations of global investors.

Current status of English disclosure by Prime Market listed companies

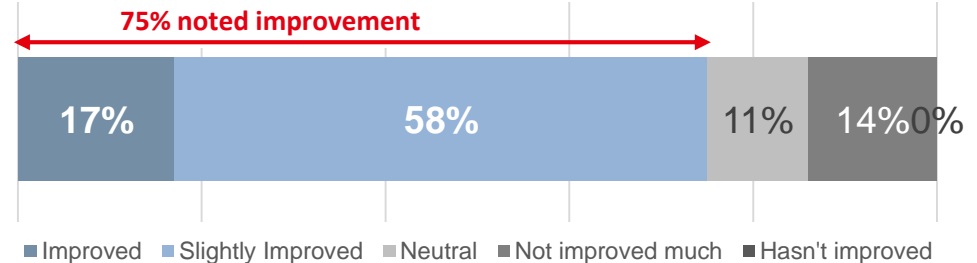
English disclosure rate (Prime Market)



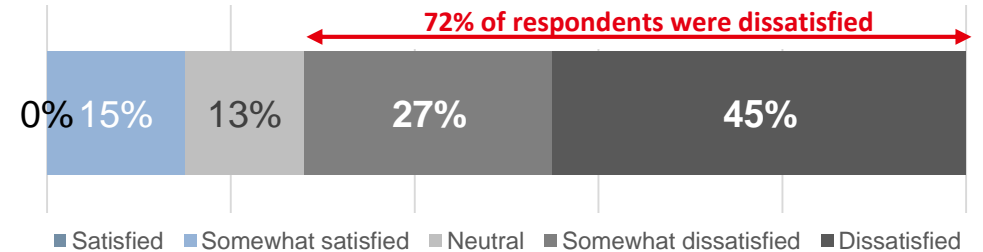
Source: Results of "Availability of English Disclosure Information by Listed Companies" Survey
 Note: The English disclosure rate is the percentage of companies that answered that they provide English disclosure for any of the following documents: Earnings reports, general meeting of shareholders announcements, corporate governance reports, securities reports, IR briefing materials, and other English disclosure materials.

Assessment by overseas investors

Assessment of improvement



Satisfaction with current English disclosure



Source: Prepared based on the results of a survey of overseas investors regarding English disclosure.

❑ The Prime Market is for companies that focus on constructive dialogue with global investors.

- The 2021 update to the Corporate Governance Code stated that Prime Market listed companies should disclose and provide necessary information in English among their disclosure documents (supplementary principle 3-1 (ii)).

❑ Disclosure in English has been increasing among Prime Market listed companies in light of the revised code.

- While overseas investors also positively rated the progress of these initiatives, 72% were "dissatisfied" or "somewhat dissatisfied" with the current situation, with many citing the difference in the amount of information compared to Japanese, the time lag in disclosure, and the lack of English disclosure for small cap stocks as reasons for their dissatisfaction.

Resolving market environment issues

[Follow-up on the Action Program]

- In December 2023, the TSE published request statements regarding information disclosures and governance of dependent listed companies.
 - ❑ “Enhancement of Information Disclosure on Protection of Minority Shareholders and Group Management”
 - ❑ “Roles Expected of Independent Directors in Listed Companies with Controlling/Quasi-controlling Shareholders”
- From the fiscal year ending March 31, 2023, the FSA enhanced the disclosure requirement on cross-shareholdings in the Annual Securities Reports. The FSA continues to **follow up the status of reduction of cross-shareholdings** with a combination of regulatory and supervisory measures, including an **in-depth review of the accuracy and sufficiency of the actual disclosure practices**.

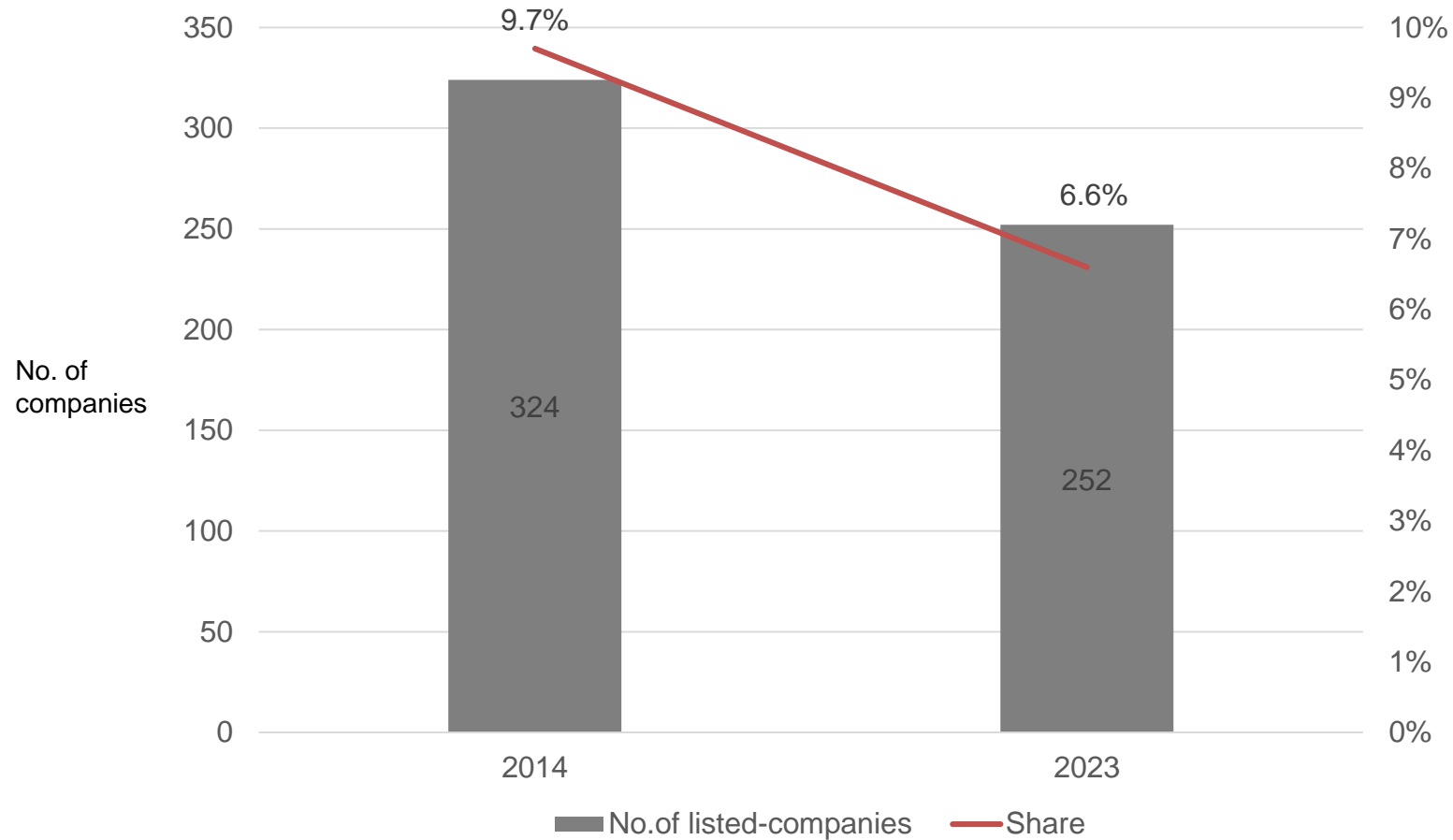


[Future initiatives]

- Encourage companies to **examine their rationale of cross-shareholdings** in light of the Corporate Governance Code (e.g. whether appropriate disclosures based on actual situations be made in the Annual Securities Reports) to avoid a formalistic response.
- Conduct a **comprehensive review of the accuracy and sufficiency of the disclosure of cross-shareholdings for all listed companies**.

Trends in listed subsidiaries, etc.

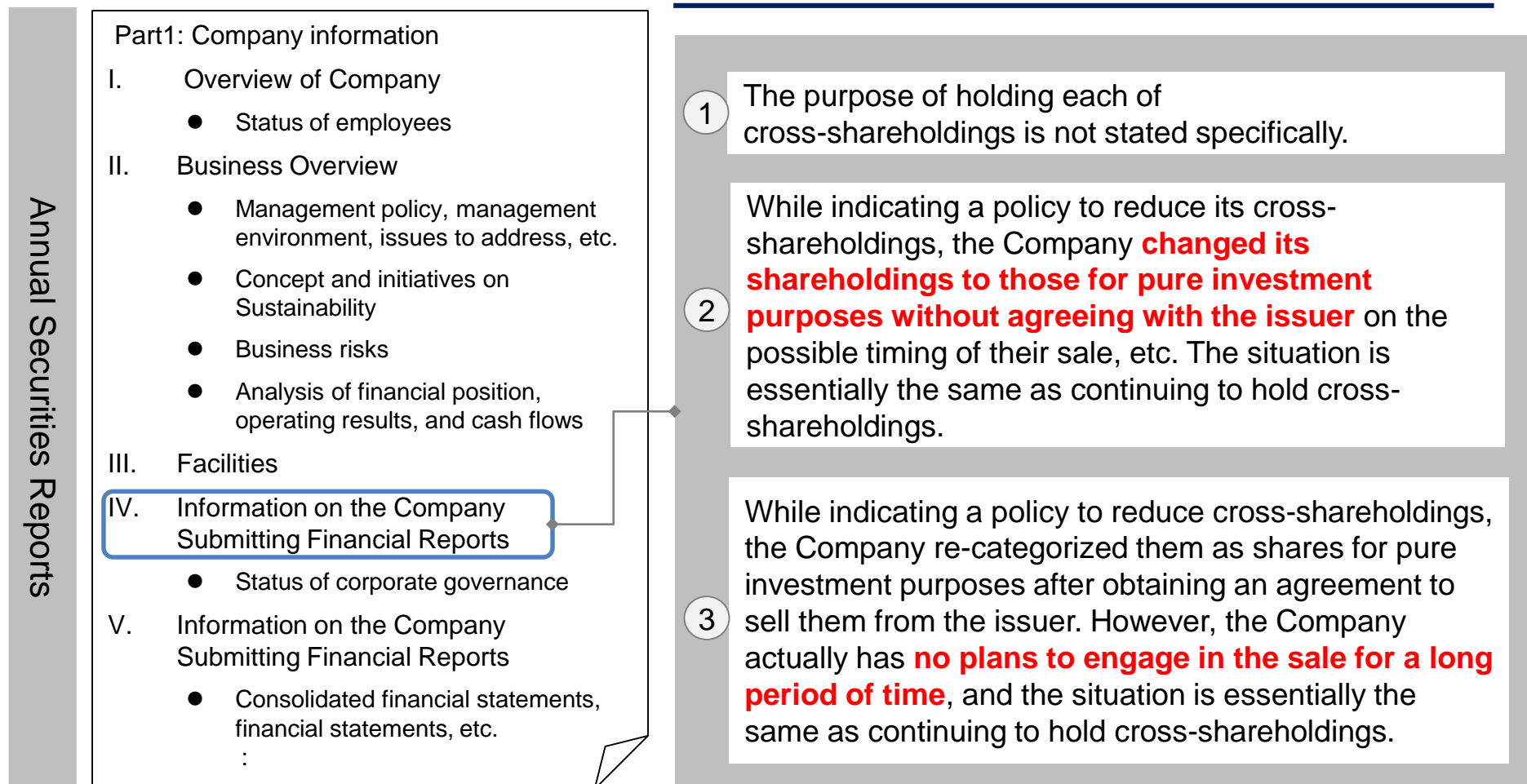
<Number of listed subsidiaries>



Results of the 2023 Securities Report Review and Matters to Be Noted (Excerpt)

- In the Results of the 2023 Securities Report Review and Matters to Be Noted, the following were pointed out as key issues regarding cross-shareholdings.

Key Issues



Encouraging the management with an awareness sustainability issues

[Follow-up on the Action Program]

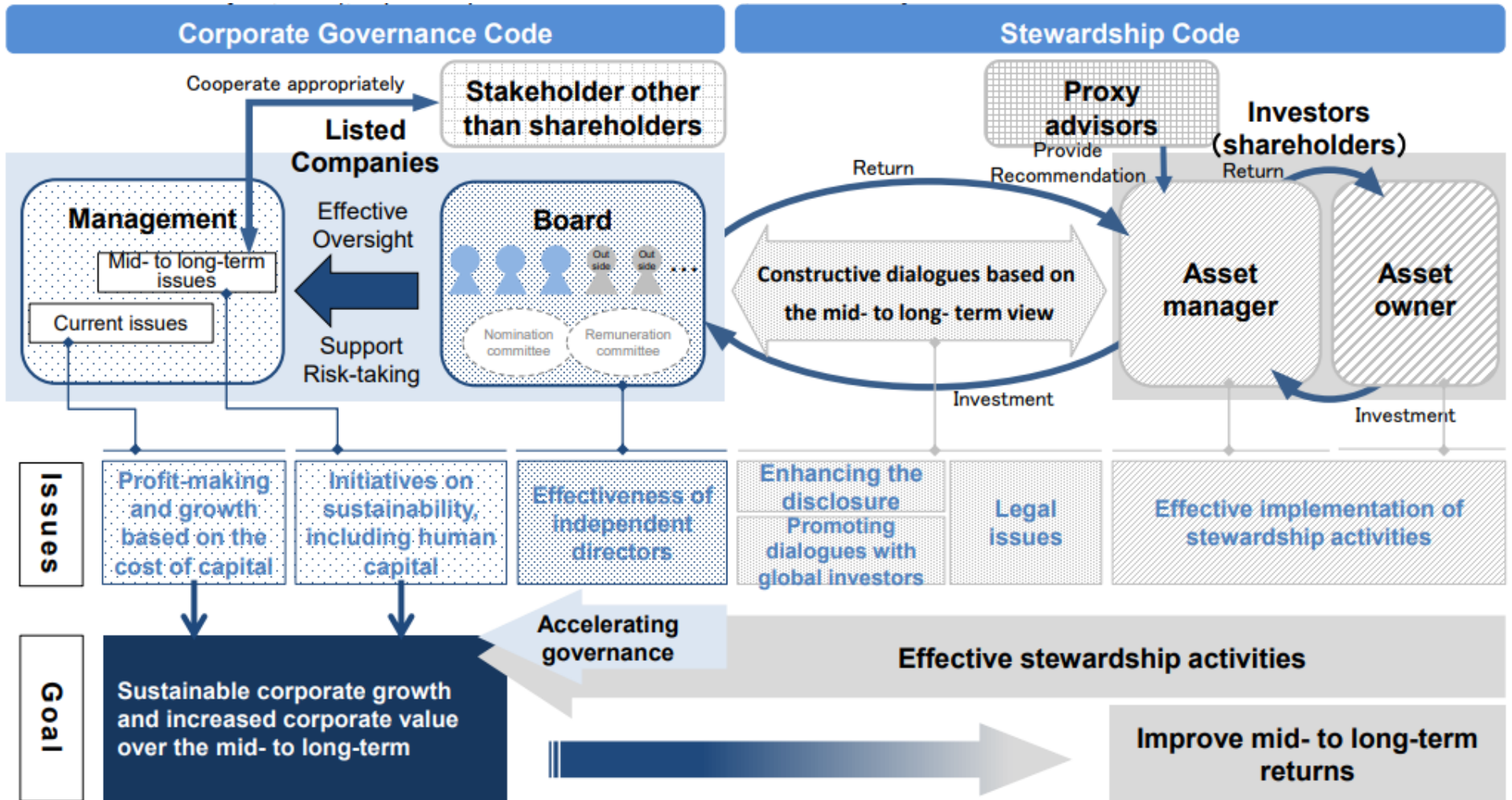
- Since the fiscal year ending March 31, 2023, all companies have been required to **disclose sustainability information** in the Annual Securities Report.
- In October 2023, the TSE amended its listing rules to set numerical targets for the ratio of female executives at companies listed on the Prime Market (at least 30% by 2030).
- In December 2023, the FSA published a booklet of companies' **good disclosure practices on sustainability issues**, such as human capital. In March 2024, the FSA updated the booklet regarding corporate governance issues. The booklet has 237 pages and includes good disclosure practices of 70 companies with 219 highlighting points. It also includes 58 comments on what investors and analysts expect from the disclosure.
- In February 2024, the general meeting of the Financial System Council consulted on discussions on sustainability disclosures and assurances, and discussions are underway at the Working Group on Disclosure and Assurance of Sustainability-related Financial Information of the Financial System Council. In March 2024, the Sustainability Standards Board of Japan released **exposure drafts based on IFRS S1** (General Requirements) and **S2** (Climate-related Disclosures). These standards will be finalized by March 2025.



[Future initiatives]

- Develop a comprehensive regulatory framework regarding **disclosures and assurances of sustainability-related information** while ensuring international comparability.
- Share specific **good examples**, such as the awareness of the outcome of increasing corporate value as well as management and dialogues with an awareness of corporate culture.

Overview of the corporate governance reform





Thank you for your attention.

**We look forward to hearing from you at
jcgf.secretariat@fsa.go.jp**



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APPENDIX

- ❑ With the aim of effective implementation of stewardship activities, the JFSA conducted a series of interviews with individual companies in order to understand the situation of engagements and well-designed improvement of the effectiveness of their boards.
- ❑ JFSA selected 12 companies from among those listed on the Tokyo Stock Exchange Prime Market, including those interviewed at the 27th Follow-up Meeting and suggested by Keidanren (Japan Business Federation).

Interviewed companies (in alphabetical order)

- ANA HOLDINGS INC.
- Ebara Corporation
- Inabata & Co., Ltd.
- Kao Corporation
- Kobe Steel, Ltd.
- Mitsui Chemicals, Inc.
- Nitori Holdings Co., Ltd.
- Omron Corporation
- SANYO SHOKAI LTD.
- Sony Group Corporation
- TDK Corporation
- Yamaha Corporation

The JFSA expresses sincere gratitude to all the interviewed companies

Overview of Interviews with Companies (1): Situation of Engagements

- ❑ Sharing of examples of other companies that serve as useful references based on the company's situation and continuous engagements by investors who are familiar with the company's business are likely to lead to constructive dialogue. Companies welcome any opinions, even if severe, that are considered to contribute to the enhancement of corporate value.
- ❑ On the other hand, although such cases are rare, in cases where investors do not listen to the company's explanation at all and communicate their requests one-sidedly, or do not ask additional questions in response to the company's answer and just continue one-sided questions, it's hard to make two-way communication and develop constructive dialogue.
- ❑ Institutional investors need to pay attention again to whether their engagements enhance corporate value and capital efficiency from a mid- to long-term perspective and promote sustainable growth instead of engagements themselves to objects.

Engagements from company's view

Tendency in meaningful engagements

- Investors bring new awareness to companies based on their present situation.
- It is possible to learn about good practices of other companies that can be used as a reference when promoting our own initiatives.
- Continuous dialogue from a mid- to long-term perspective develops into advice tailored to the company's changing circumstances and growth phase.
- Investors well-versed in the business are engaged in dialogue.
- The theme of the dialogue is set according to the company's responders, such as the CEO, CFO, and other people in charge.
- While it is not comfortable to listen, there are indications that will contribute to sustainable growth and increased corporate value over the mid- to long-term.
- Companies can obtain objective assessments based on insights gained from data facts.

Tendency in meaningless engagements

- (There are few meaningless engagements, so companies can obtain some kind of awareness and viewpoints in most cases)
- Without considering the present situation of the company, investors pursue the company severely only with idealism.
 - There is no concrete advice on how the ideal theory demanded by investors will be realized.
 - Discussions progress only by pointing out the appropriateness of formal numerical standards, and there is a lack of explanation of why the standards are necessary.
 - Even if companies answer each checklist in the template one by one, there is no additional questions from investors and these simple question-and-answer sessions tend to be continued in a matter-of-fact manner.
 - Some investors ask questions from a short-term perspective and persistently demand figures that cannot be disclosed.

Overview of Interviews with Companies (2): Situation of Engagements

- ❑ In response to TSE’s requests, companies are changing their behavior and utilizing engagements as a tool for increasing corporate value.
- ❑ In order to meet the expectations of companies, diverse institutional investors also need to make careful preparations and engage in dialogue in order to fulfill their own roles.
- ❑ In order to make engagements that contribute to the sustainable growth and the enhancement of corporate value over the mid- to long-term, both sides need to cooperate with each other and continuously confirm the objectives and effects of the dialogue.

With the aim of improving the engagements	Company's Initiatives	Before the dialogue	<ul style="list-style-type: none"> ● By introducing materials before the engagement, we guide investors to read the materials in advance. ● We recognize the necessity of engagements more through repeating them and we strengthen the IR department.
		At the time of dialogue	<ul style="list-style-type: none"> ● When CEOs or CFOs engage in dialogue directly, they explain the company's big vision and discuss investors' views towards it. ● The board believes that engaging by independent directors only will contribute to promoting investor's understanding, so we provide various opportunities to do so.
		After the dialogue	<ul style="list-style-type: none"> ● We feed back the results of engagements internally, including to the board, in addition, the feedback is provided to investors. ● We analyze and disclose issues that investors frequently ask questions about, such as business-specific ROIC and M&A reviews.
	Requests to institutional investors	Before the dialogue	<ul style="list-style-type: none"> ● We would like investors to review our disclosure materials in advance so that we can start the engagement within a limited time under the same viewpoints. ● We would like investors to inform us of the engagement agenda in advance so that we can assign appropriate explainers.
		At the time of dialogue	<ul style="list-style-type: none"> ● It is easier to explain and convince management and directors if there are good examples that have led to improved performance and increased corporate value. ● Regarding shareholder returns, we would like to discuss whether we should invest in growth business or return to shareholders based on our stage.
		After the dialogue	<ul style="list-style-type: none"> ● We would like to make improvements based on the advice from investors and report them at the next engagement so that we can obtain additional advice. ● Since we have to provide overlapping explanations to multiple teams from the same asset management company, we would like investors to share our basic information within the asset management company.

Overview of Interviews with Companies (3): Implementation of Corporate Governance Reforms

- Through dialogues, companies are making creative efforts to implement initiatives of corporate governance reforms.

(Improvement of the effectiveness of the board)

- Appointing independent directors as chairs and the majority of the board improved the objectivity and transparency of the discussions.
- In addition to the board meetings, we provide opportunities for informal and frank communication which lead to the vitalization of the board.
- Most time of the board meeting is spent on strategic discussions (medium-term plan, human resources development, M&A, etc.) and exchange of opinions.
- The secretariat of the board plays an important role to improve the effectiveness of the board. We would like to discuss the secretariat's initiatives with other companies.
- The board clearly documents and discloses the policy regarding culture, roles and responsibilities of the board that is basis for the creation of corporate value.

Key Takeaways

(Impressions for TSE's requests)

- We are facing the requests seriously and carrying them out honestly. We are using them as leverage to finish reforming our weak points.
- The requests are a natural trend in the world, and we believe that proactive efforts are appreciated by the market.
- The requests are excellent, but management with an awareness of capital cost and stock price does not seem to be fully penetrated in Japan.
- The necessary levels of ROE and other figures grasped through engagements are utilized in discussions on strategy and plan formulation at the board meetings.

Encouraging the management with an awareness of profit-making and growth

(Human Capital)

- We would like to ascertain the essential objectives that Global Excellent Companies set, not the domestic perspective.
- We disclose employee engagement scores as KPIs by conducting a survey not only at domestic bases but also globally.
- Depending on the characteristics of the business, we set ambitious KPIs in order to increase the number of female managers and directors.

(Enhancement of non-financial activities)

- We try managing by visualizing how non-financial activities are linked to financial indicators and lead to the enhancement of corporate value.

(Resilience)

- Resilience is important from the perspective of sustainability for long-term management. We focus on supply chain resilience.

Encouraging the management with an awareness of sustainability issues