

Updates on the corporate governance reforms in Japan

27 September, 2024



金融庁

Financial Services Agency, the Japanese Government

Action Program for Corporate Governance Reform 2023 & 2024

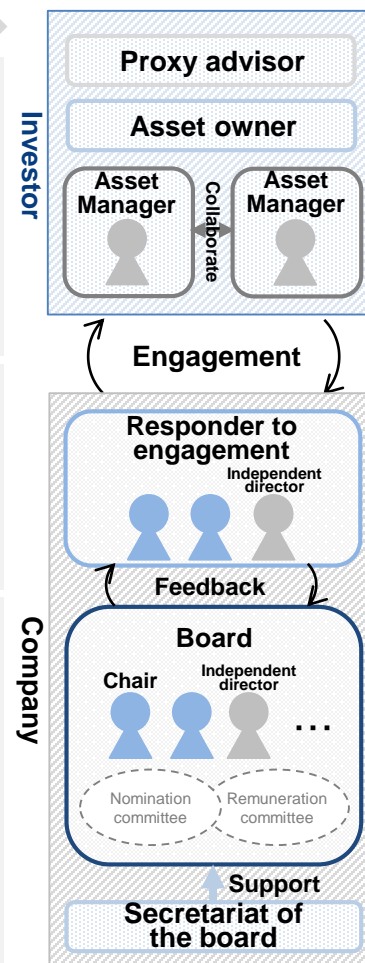
- In April 2023, the FSA published the “Action Program for Accelerating Corporate Governance Reform” (the "**Action Program**"), addressing the following key issues:
 1. Effective implementation of **stewardship activities** and resolving legal issues
 2. Improvement of the **effectiveness of the board**
 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.**”

Action Program for Corporate Governance Reform 2024: Principles into Practice

- Various initiatives are taken based on the “Action Program for Accelerating Corporate Governance Reform” established in April 2023. It is necessary to follow-up on the progress of each measure and consider the future initiatives continuously.

➤ 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**, the following initiatives should be undertaken for putting corporate governance reform **“into practice”** based on self-motivated changes in the mindsets of companies and investors through examining and sharing specific measures.

| Issues | Follow up | Future Initiatives |
|--|---|--|
| Effective implementation of stewardship activities | <ul style="list-style-type: none"> ✓ 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 (in May 2024). | <ul style="list-style-type: none"> ✓ 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 compliance with the Stewardship Code by investors (asset managers, asset owners, proxy advisors, etc.) |
| Improvement of the effectiveness of the board | <ul style="list-style-type: none"> ✓ Published "The Basics of Being an Independent Director" to ensure and improve the quality of independent directors (in January 2024). ✓ The private sector continues to conduct educational activities for directors. | <ul style="list-style-type: none"> ✓ Share specific 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 | <ul style="list-style-type: none"> ✓ “Visualized” companies that make efforts in order to implement management that is conscious of the cost of capital and stock prices, including PBR, based on the request from the TSE (from January 2024). | <ul style="list-style-type: none"> ✓ Follow up on the status of each company's initiatives continuously to encourage them to take substantial 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 occur. |



Action Program for Corporate Governance Reform 2024 (cont.)

| Issues | Follow up | Future Initiatives |
|---|--|---|
| <p>Enhancing the quality of disclosure and promoting dialogues with global investors</p> | <ul style="list-style-type: none"> ✓ Requested to disclose information about dialogues with investors, and published sufficient and insufficient cases of explanations (in March 2023). ✓ Revised the TSE's Listing Rules toward mandatory English disclosures (financial results and timely disclosure information) from April 2025 (in May 2024). | <ul style="list-style-type: none"> ✓ 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. |
| <p>Resolving market environment issues</p> | <ul style="list-style-type: none"> ✓ Requested the enhancement of information disclosures of quasi-controlled listed companies (in December 2023). ✓ Published issues and good practices regarding disclosures of cross-shareholdings (in March 2024). | <ul style="list-style-type: none"> ✓ 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. |
| <p>Encouraging the management with an awareness of sustainability issues</p> | <ul style="list-style-type: none"> ✓ Added metrics on diversity such as the ratio of women in managerial positions and the gender pay gap in Annual Securities Reports (from the fiscal year ended March 31, 2023). ✓ Published a booklet of companies' good disclosure practices on sustainability issues such as human capital (in December 2023). ✓ Amended the TSE's Listing Rules to set numerical targets for the ratio of female executives at companies (at least 30% by 2030) (in October 2023). | <ul style="list-style-type: none"> ✓ Discuss disclosures and assurances of the 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. |

(The image of a list)
The status of JPX Prime 150 Index Constituent Stocks

| Company name | Status of various indicators | | Governance items expected by global investors | |
|--------------|------------------------------|-----|---|--------------------------------|
| | PBR (times) | | Ratio of Independent Directors (%) | Ratio of female executives (%) |
| A | 2.5 | | 37.5 | 18.2 |
| B | 1.1 | | 41.7 | 8.3 |
| C | 1.2 | | 44.4 | 23.1 |
| D | 1.2 | ... | 44.4 | 22.2 |
| E | 5.3 | | 33.3 | 13.3 |
| F | 5.8 | | 66.7 | 22.2 |
| G | 1.8 | | 60.0 | 20.0 |
| H | 6.7 | | 40.0 | 13.3 |
| I | 15.8 | | 37.5 | 18.7 |

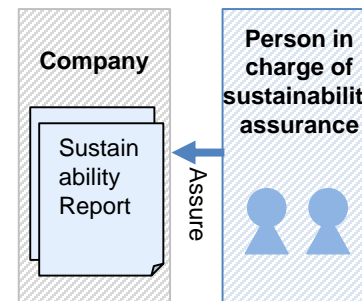
Annual Securities Report

Part 1: Company Information

...

IV. Information on the Company Submitting Financial Reports

The purpose of holding each issue of cross-shareholdings is not stated specifically.



Cross-shareholdings

- ❑ Cross-shareholdings mean shares held by companies to maintain and strengthen relationships with business partners, rather than for pure investment purposes.
- ❑ In Japan's Corporate Governance Code, the following is stipulated.

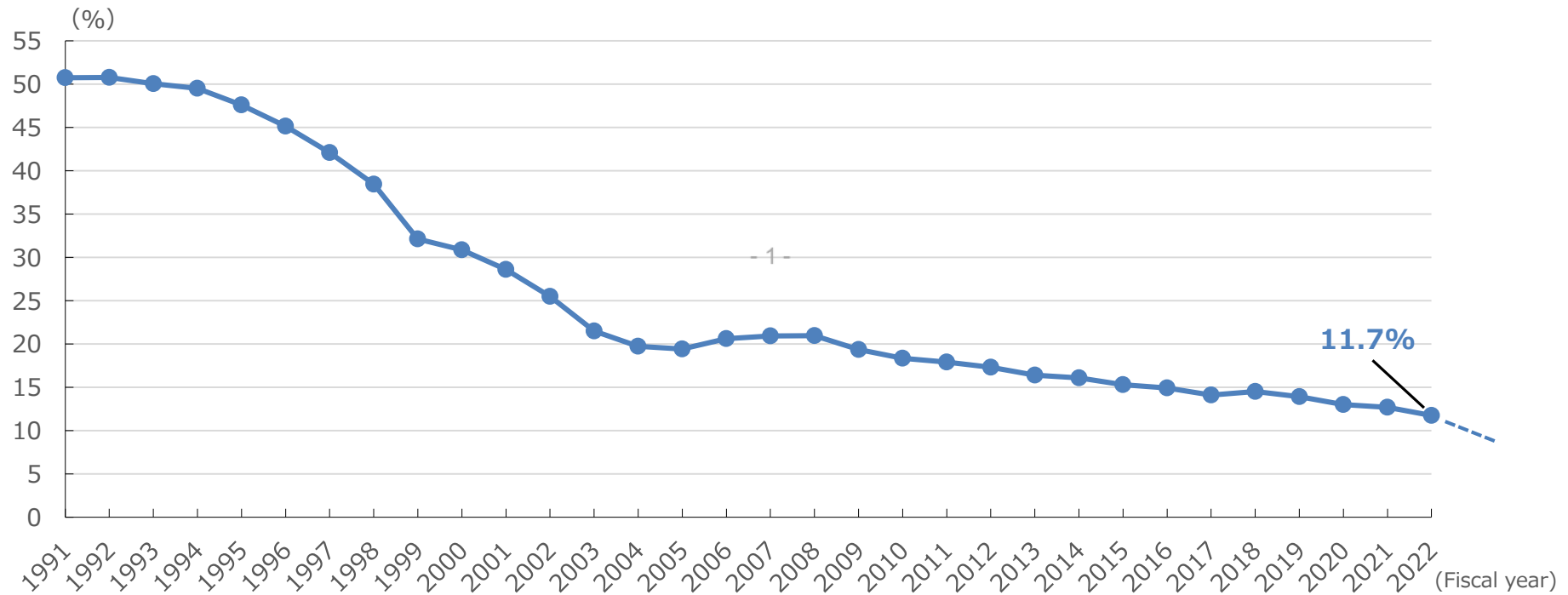
Principle 1.4 Cross-Shareholdings

When companies hold shares of other listed companies as cross-shareholdings, **they should disclose their policy with respect to doing so, including their policies regarding the reduction of cross-shareholdings.** In addition, the board should **annually assess whether or not to hold each individual cross-shareholding,** specifically examining whether the purpose is appropriate and whether the benefits and risks from each holding cover the company's cost of capital. The results of this assessment should be disclosed.

Companies should establish and disclose specific standards with respect to the voting rights as to their cross-shareholdings, and vote in accordance with the standards.

Cross-Shareholdings

- ✓ Cross-shareholdings have **decreased** thanks to acceralated **corporate governance reforms**, through the Corporate Governance Code



***Three major non-life insurance companies** announced to **reduce their cross-shareholdings to zero** by the end of FY 2029 or FY 2030 (around ¥9 trillion in total) .

*According to Nikkei, **the sales of cross-shareholdings** by listed companies (excluding financial companies) in FY 2023 was **around 3.6 trillion yen, a record high (up 86% yoy)**.

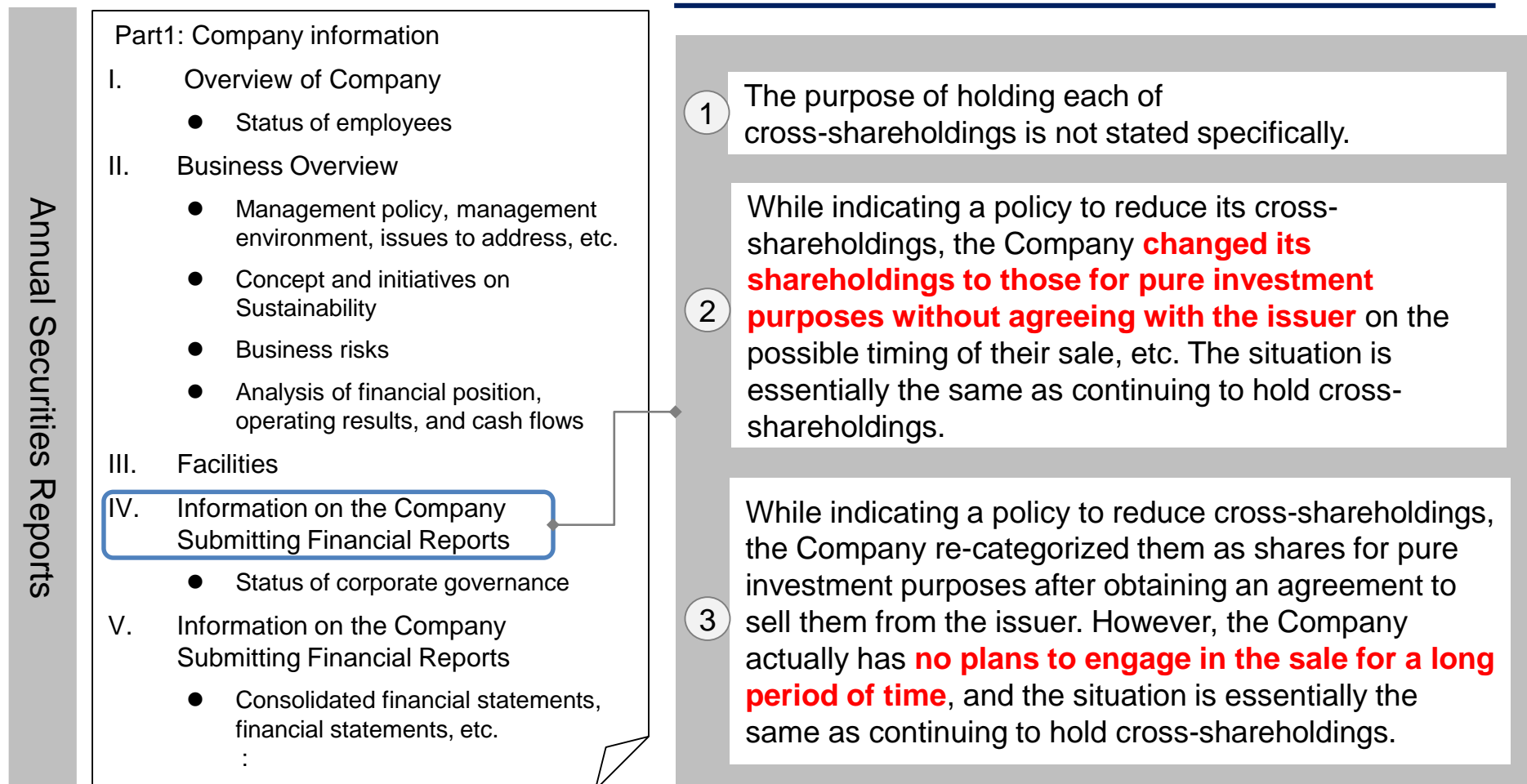
Source: Nomura Institute of Capital Markets Research

Note: The ratio of shares (market value) of listed companies held by other listed companies to the total market capitalization of the market. It only includes shareholdings for purposes other than investment.

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



2024 Securities Report Review

[2024 Examination related to Amendments to Acts and Orders]

- In connection with the 2024 Examination related to Amendments to Acts and Orders, we plan to review the appropriateness of **the classification of stocks held for cross-shareholdings and those held for pure investment purposes** by using questionnaires for all listed companies as to whether to include the following in the stocks held for pure investment purposes and relevant reasons if applicable:
 - ❑ stocks held or to be held for more than one year subsequent to changing the classification of the stocks from those held for cross-shareholdings to those held for pure investment purposes
 - ❑ stocks with restrictions for swift sales due to cross-shareholdings and agreement with or request from the issuer of the stocks, etc.

Overview of Revision for the Financial Instruments and Exchange Act and Act on Investment Trusts and Investment Corporations (May 2024)

Develop a new system for asset management (AM) business, large shareholding reports and tender offers to revitalize the Japanese capital market by enhancing the capability and diversification of AM business and promoting dialogue between investors and companies and ensuring transparency and fairness in the market

Enhance the capability and diversification of AM business

Implement the following measures to improve corporate value and returns to investors, including households, and revitalize startups by enhancing the capability and diversification of asset management by assisting new entrants.

Promoting new entrants

- Introduce a voluntary registration system for middle and back-office operations, and deregulate the requirement on the personnel structure of an AM company if entrusting the business to a registered entity.
- As in Europe and the US, where the division of AM businesses is advancing, AM companies will specialize in fund management functions (planning) and will be able to fully entrust their asset management (investment instruction/execution) authority to various AM companies.

Vitalizing Circulation of Unlisted Securities

- Take the following measures in order to promote new entrants into the brokerage business of unlisted securities issued by startups and vitalize the circulation.
 - Deregulate the requirements for Type I Financial Instruments Business only dealing with unlisted securities for professional investors basically without receiving deposits.
 - Allow registered Type I Financial Instruments Business Operators to operate a PTS* for unlisted securities without authorization if the transaction volume is limited.

* PTS (Proprietary Trading System) is a trading system that uses electronic technology to provide transaction intermediation services.

Promote constructive dialogue between investors and companies

To promote constructive dialogue from a mid- to long-term perspective, the following policies are to be implemented

Clarifying the Large Shareholding Reporting Rule

Large Shareholding Reporting Rule: Ex post facto disclosure of shareholdings when the shareholder holds more than 5% of shares

- **Clarify the scope of “joint holders”** subject to aggregation of the ownership ratio (in cases of acts of proposal not directly related to corporate control without a continuous agreement, the application is to be excluded)

Ensure transparency and fairness in the capital market

To ensure transparency and fairness in the capital market, the following policies are to be implemented

Enlarging the scope of the tender offer rule

Tender Offer Rule: To require disclosure of the purpose and terms of purchase in advance and give all shareholders an equal opportunity to sell their shares regarding a purchase of listed shares exceeding a certain ratio

- Make transactions through **a market trade (on-floor transaction) subject to the application of the tender offer rule**
- **Lower the threshold for a tender offer to be implemented from “1/3” to “30%” of the voting rights**

Clarifying “Joint Holders” in relation to the Large Shareholding Reporting Rule

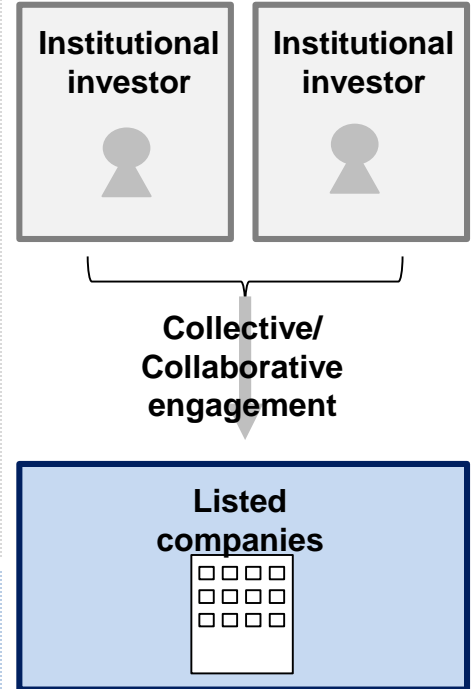
(May 2024, not yet enacted)

- To promote constructive dialogue from a mid- to long-term perspective, the scope of “joint holders” is to be clarified

Issues and policy measures

Issues

- As investors are expected to engage in dialogue with companies based on their in-depth understanding of individual companies, it is important to compensate for the lack of investors’ qualitative and quantitative resources and increase the effectiveness of dialogue by means of collective or collaborative engagement.*
 - * Refers to the effort to engage in dialogue with individual companies in collaboration with other institutional investors about specific topics
- However, it is pointed out that joint holders as defined under the large shareholding reporting rule may have room for legal ambiguity and hinder collective or collaborative engagement.
 - ※ If two or more investors (Investor A ■%, Investor B □%) fall under the category of "joint holders" (i.e. persons who have agreed to jointly exercise voting rights and other rights as shareholders) and the combined ownership ratio (■%+□%) exceeds 5%, they will be required to submit a large shareholding report.



Policies

- In light of promoting constructive dialogue from a mid- to long-term perspective, the scope of “joint holders” is to be clarified at the level of acts.

Clarifying “joint holders” in relation to the Large Shareholding Reporting Rule

Law revision

- **Unless two or more investors reach an agreement which would have a material impact on a company’s management,* they should not be required to aggregate their ownership ratio as “joint holders”**

* Assuming a case where two or more investors jointly make a proposal that is not directly related to corporate control, such as a change in dividend policies or capital policies

(Ref.) On the other hand, in order to appropriately respond to cases that may threaten the fairness of the capital market, such as cases in which two or more investors stealthily failed to submit reports, a cabinet order is to be revised to deem a joint holder when there are certain external facts, such as an officer concurrent position relationship and a funding relationship.

Report of the Working Group on Capital Market Regulations and the Asset Management Task Force of the Financial System Council (published on December 12, 2023) (excerpt)

- The Asset Management Task Force of the Financial System Council had discussed efforts for the effective implementation of stewardship activities. Consequently, in a report published in December 2023, the Task Force made recommendations for promoting collective or collaborative engagements.*

(*) Refers to the effort to engage in dialogues with individual companies in collaboration with other institutional investors about specific topics.

V. Efforts for the Effective Implementation of Stewardship Activities

Institutional investors, who play a core role in the investment chain, are required to fulfill stewardship responsibilities to promote the increase of corporate value by engaging with companies from a med - to long- term perspective. In that case, **it is necessary to engage with individual companies based on in-depth knowledge of the circumstances of each company, rather than a formalistic or one-size-fits-all response** based simply on uniform numerical criteria or proxy advisor’s voting recommendations. In order to provide appropriate incentives for such activities, it is important to share the cost of stewardship activities among the investment chain and establish an environment including policy support.

For effective implementation of stewardship activities through such engagements, **it is important to encourage institutional investors to make efforts for engagement depending on their status (size, investment policy, etc.) in line with the Stewardship Code**. In order for institutional investors to more actively make such efforts, on the one hand, it is useful to increase the benefits that institutional investors can derive from stewardship activities, and on the other hand, it is also useful to reduce the costs of such activities. In light of this, **it is beneficial for institutional investors to use collective or collaborative engagements actively from the perspective of supplementing qualitative and quantitative resources and reducing costs**.


As an example of specific initiatives in this direction, certain asset owner is adopting passive investment models focusing on stewardship activities in which the management fee structure is different from that of ordinal passive investment with the aim of improving the overall market through stewardship activities, as well as diversifying and enhancing how to approach stewardship activities. In addition, there are initiatives such as collective or collaborative engagement in which the investor engages with companies in collaboration with other investors and monitoring of asset managers by multiple asset owners collaboratively. **It is expected that the effective implementation of stewardship activities will further progress as the number of investors implementing these various efforts increases**.

- ❑ For the transparency of beneficial shareholders, the working group recommends as follows.

Overview of the current rule

- ❑ Under the current rule, companies and shareholders can ascertain the status of nominal shareholders through disclosure of the status of shareholders, such as the shareholder registry under the Companies Act and Annual Securities Reports.
- ❑ On the other hand, there is no system under which companies and shareholders can ascertain the status of beneficial shareholders,* except for those who are subject to the large shareholding reporting rule (holding over 5%).

* Shareholders who are not a shareholder on the shareholder registry (nominee shareholder) but who have the authority to give instructions on voting rights or the authority to invest in relevant shares

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- From the viewpoint of promoting dialogues between companies and shareholders/investors, in order to efficiently identify the beneficial shareholders, **relevant authorities should consider taking the following measures;**
 - (1) Call on **institutional investors to respond when issuer companies ask them** about the status of their holdings by clearly stating principles of conduct for institutional investors, and
 - (2) **Make the above responses mandatory under law**

Japan's Stewardship Code (excerpt)

Guidance 4-1.

Institutional investors should endeavor to arrive at an understanding in common^{13,14} with investee companies through constructive dialogue^{15,16,17} with the aim of enhancing the companies' medium- to long-term value and capital efficiency, and promoting their sustainable growth. In case a risk of possible loss in corporate value is identified through the monitoring of and dialogue with companies, institutional investors should endeavor to arrive at a more in-depth common understanding by requesting further explanation from the companies and to solve the problem.¹⁸

16 Constructive dialogue between institutional investors and investee companies should not be merely driven by the size of shareholdings. That being said, there are cases when it is appropriate for institutional investors to explain to investee companies how many shares they own/hold.

Guidance 4-5.

In addition to institutional investors engaging with investee companies independently, it would be beneficial for them to engage with investee companies in collaboration with other institutional investors (collaborative engagement) as necessary.²⁰

Promoting Dialogues with Global Investors: "Visualizing" the Group of Companies

- ❑ From the viewpoint of promoting dialogues between companies and global investors, it is conceivable to publish a list in order to "visualize" companies that are willingly and actively engaging in value-creating management from the viewpoint of investors and have already achieved results.
 - ❑ As a specific list, it is suggested that the following items be disclosed with respect to JPX Prime 150 Index Constituent Stocks, which are selected as "the leading Japanese companies that are estimated to create value," from the viewpoints of profitability and market valuation.
 - Various indicators, such as profitability, market valuation, and growth potential
 - Information about corporate governance (the ratio of independent directors, attributes of the chair of the board, and the ratio of female executives – areas of particular interest to global investors)
- * Items listed are subject to revision as necessary.

The status of JPX Prime 150 Index Constituent Stocks as of dd/mm/yyyy

| Code | Company name | Status of various indicators (profitability, market valuation, growth potential, etc.) | | | | Governance items expected by global investors | | |
|------|--------------|---|----------------|------------|----------------|---|--|--------------------------------|
| | | Market capitalization (trillion yen) | PBR (times) | ROE (%) | PER (times) | Ratio of Independent Directors (%) | The Chair of the Board (Inside / Outside) | Ratio of female executives (%) |
| xx10 | aaaaa001 | 1.1 | 2.5 | 18.4 | 15.2 | 37.5 | Inside | 18.2 |
| xx20 | bbbb001 | 0.9 | 1.1 | 14.8 | 7.9 | 41.7 | Outside | 8.3 |
| Xx30 | aaaaa002 | 2.8 | 1.2 | 14.3 | 9.1 | 44.4 | Inside | 23.1 |
| xx40 | bbbb002 | 2.1 | 1.2 | 11.9 | 11.0 | 44.4 | Inside | 22.2 |
| xx50 | aaaaa003 | 0.3 | 5.3 | 18.7 | 25.6 | 33.3 | Inside | 13.3 |
| xx60 | bbbb003 | 0.3 | 5.8 | 19.0 | 39.2 | 66.7 | Outside | 22.2 |
| xx70 | Aaaaa004 | 1.1 | 1.8 | 10.7 | 19.4 | 60.0 | Inside | 20.0 |
| xx80 | bbbb004 | 0.4 | 6.7 | 33.7 | 21.6 | 40.0 | Inside | 13.3 |
| xx90 | aaaaa005 | 0.3 | 15.8 | 30.8 | 43.9 | 37.5 | Inside | 16.7 |



Thank you for your attention.

**We look forward to hearing from you at
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