

Corporate Governance Reform in Japan

Japan Corporate Governance Forum



金融庁

Financial Services Agency, the Japanese Government

- I. Action Program for Accelerating Corporate Governance Reform
- II. Encouraging the management with an awareness of profit-making and growth
- III. Encouraging the management with an awareness of sustainability issues
- IV. Resolving legal issues

Japan Corporate Governance Forum

- ❑ To accelerate and strengthen corporate governance reforms, JFSA established the Japan Corporate Governance Forum (hereinafter the “JCGF”) to hear a wide range of opinions from stakeholders, including overseas investors.
- ❑ In JCGF, while some praised the improvements in corporate governance, the following issues were pointed out: (1) management issues, such as encouraging management with an awareness of profit-making and growth based on the cost of capital and promoting initiatives relating to sustainability, including human capital; (2) issues related to the effectiveness of independent directors; and (3) issues related to dialogues between companies and investors.

Prime Minister Kishida’s Remarks at the New York Stock Exchange (NYSE) September 22, 2022

JCGF event history

One very important policy is corporate governance reform. [...] We will accelerate and further strengthen corporate governance reforms in Japan, such as **establishing a forum in the near future to hear from investors from around the world.**

- 1st Forum (September 27, 2022) and 4th Forum (May 25, 2023) with Asian Corporate Governance Association
- 2nd Forum (October 3, 2022) and 6th Forum (June 21, 2023) with International Corporate Governance Network
- 3rd Forum (January 12, 2023) and 5th Forum (June 12, 2023) with U.S. investors, etc.

Main opinions in JCGF

General

- **Corporate governance reform, including corporate mindset, has begun to make substantial progress. Although there are still some issues, we look forward to further progress.**

Issues related to management and effectiveness of independent directors

- **The importance of capital efficiency is being recognized, but it is not recognized by all companies.** Issues include accumulation of cash, low ROE, and a large number of companies with PBR below 1.
- **Board diversity, including gender perspective, and disclosure on human capital** are needed.
- **Effectiveness of independent directors, such as strengthening the roles of the nomination / remuneration committee and ensuring the independence of the board** are needed.

Issues related to dialogue between companies and investors

- Fiduciary responsibilities in index investment have not been fully fulfilled, and it is necessary to improve the treatment of investment personnel.
- It is necessary to **enhance disclosure**, such as submission of Annual Securities Reports prior to general shareholders meetings.
- It would be useful to **enhance English disclosure and make visible companies with good corporate governance.**
- It is **necessary to review the legal system** from the perspective of promoting and substantiating engagement and protecting minority shareholders.
- **There are concerns that listed subsidiaries may harm the interests of minority shareholders** and that there is **a large number of cross-shareholdings.**

Action Program for Accelerating Corporate Governance Reform

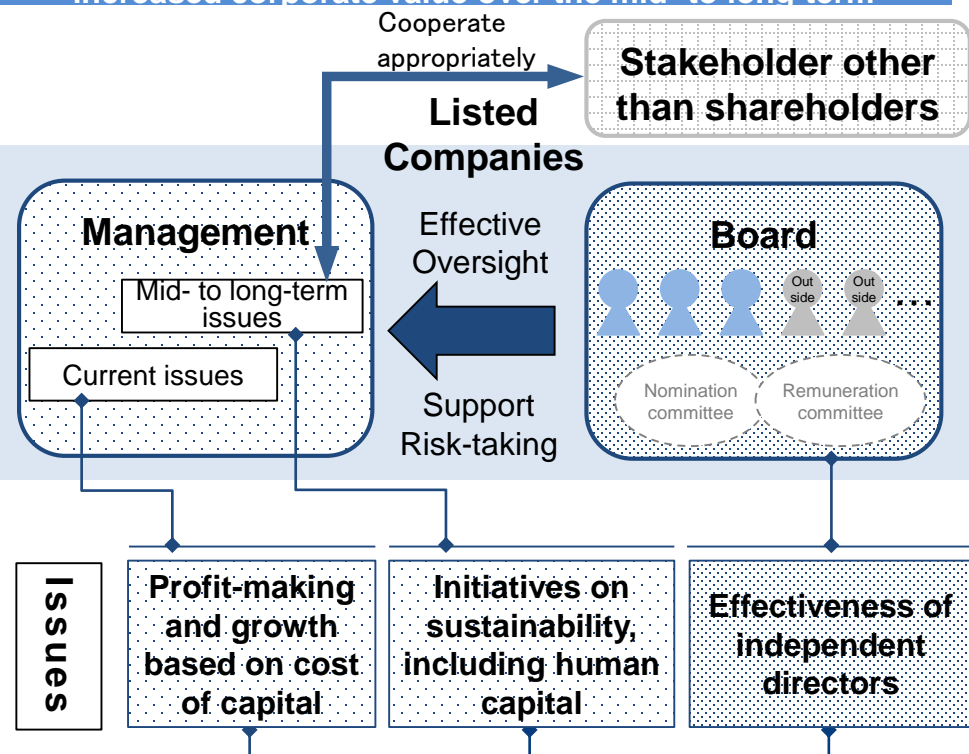
- The Council of Experts Concerning the Follow-up of Japan's Stewardship Code and Japan's Corporate Governance Code published recommendations regarding "Action Program" as of April 26. The Council will review the implementation status from time to time and consider whether additional measures are needed.

Action Program for Accelerating Corporate Governance Reform: From Form to Substance

Approach to future initiative

- It is vital to move the focus of reform from form to substance in resolving the issues. To this end, it is necessary to create an environment that promotes self-motivated changes in the mindsets of companies and investors, as well as to make the dialogues between companies and investors more productive and more effective.
- It is appropriate to examine the timing of the revision of each Code in a timely manner based on the status of progress from the viewpoint of the effective implementation of corporate governance reform, not necessarily following the review cycle in the past years.

1. Issues for seeking sustainable corporate growth and increased corporate value over the mid- to long-term



Specific measures

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

Encourage the management with an awareness of profit-making and growth based on the cost of capital (such as the proper allocation of management resources toward risk-taking, including a business portfolio review and investments in human capital, intellectual properties and R&D)

B) Encouraging the management with an awareness of sustainability issues

Encourage companies to take actions on sustainability through publication of companies' good disclosure practices. Consider measures to improve the diversity of the board and core human resources, such as increasing the percentage of female executives (target of 30% or more by 2030).

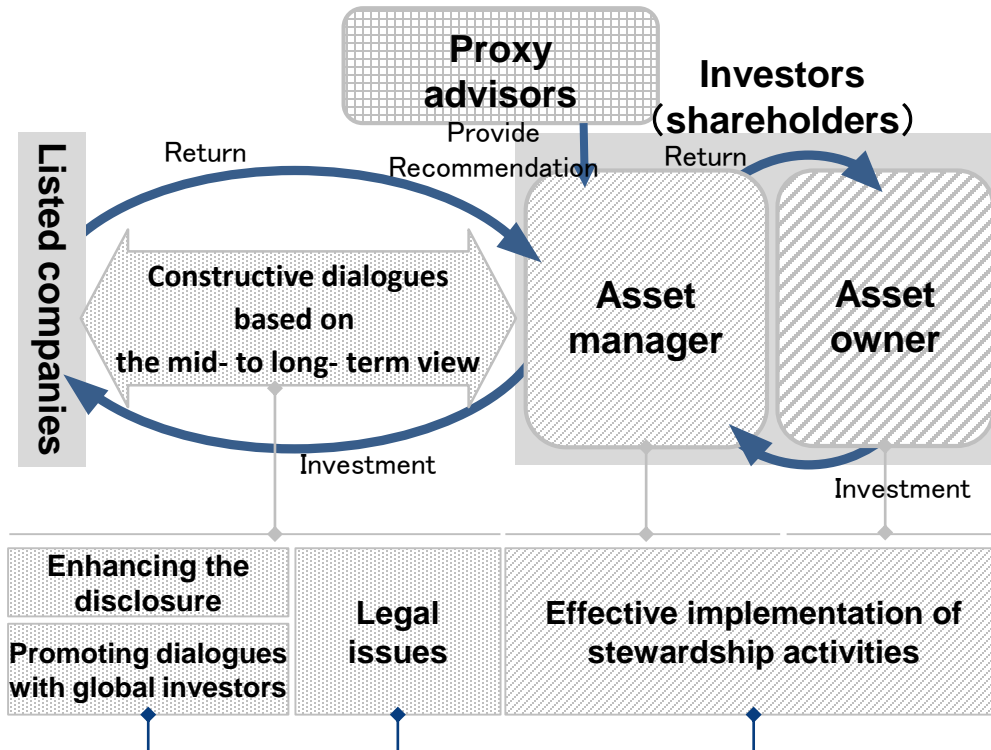
C) Improving the effectiveness of independent directors

Promote further improvement of the effectiveness of independent directors through compilation and publication of the actual status and examples of a board, nomination committee and remuneration committee, and educational activities to promote understanding of the roles expected of independent directors

Action Program (cont.)

Action Program for Accelerating Corporate Governance Reform: From Form to Substance

2. Issues related to dialogue between companies and investors



Specific measures

A) Effective implementation of stewardship activities

Promote the efforts of asset managers and asset owners to deal with the issues relating to the stewardship activities (including allocating sufficient resources, providing incentives for stewardship activities, establishing governance structures of asset owners).

B) Enhancing the disclosure as a basis for dialogue

Request to disclose the status of dialogues and make clear sufficient and insufficient cases of "Explain".
Consider measures to provide investors with the information they need prior to the general shareholder meeting and to promote timely disclosure of corporate information.

C) Promoting dialogues with global investors

Promote dialogues between companies and global investors by "visualizing" companies that willingly and actively respond to the expectations of global investors and further expand the coverage of English disclosure.

D) Resolving legal issues

Consider clarification of "act of making important suggestions" and "joint holders" under the large shareholding reporting rule, transparency of beneficial shareholders, and how to protect minority shareholders in the case of a partial takeover bid.

E) Resolving market environment issues

Consider the disclosure and corporate governance issues with regard to quasi-controlled listed companies, follow up on the progress of reduction of cross-shareholdings and consider whether further measures are called for.

[...] we will reform the asset management sector as well as asset ownership, which will manage the expanding funds.

The funds managed in the Japanese asset management sector have skyrocketed by 50% during the last three years, and now stand at 800 trillion yen. We will push hard to encourage sophisticated asset management and to solicit new entrants. To start with, we will rectify Japan's unique business practices and resolve barriers to entry, and will also introduce a new program to assist new entrants. We will also promote deregulation to enable asset management firms to outsource their back-office operations.

To encourage new entry from overseas, we will establish special business zones tailored specifically for asset management business where administrative procedure can be completed solely in English. In these zones, we will take measures to improve the business and living environment tailored to needs of overseas asset managers. To ensure that our reforms reflect the needs of global investors, I will launch an asset management forum consisting of U.S. and Japan institutions as core members, including those of you participating today.

In parallel, [we will strengthen the effectiveness of corporate governance reforms. We will systematically follow up the developments to encourage management to place importance on price book-value ratio \(PBR\), as well as to promote formulation, disclosure, and implementation of their business reform plans.](#)

The vision I spoke today will be put in concrete action as a policy package. To garner support for this vision, we will hold a “Japan Weeks” event this autumn, and invite investors around the world. I would be delighted if you would join us in this endeavor.

I met a globally influential investor the other day who said to me, "You know Mr. Prime Minister, I've been watching the Japanese economy every year for 30 years, and I have never seen it more positive than it is now." I would urge you to evaluate what we are doing in my country, look at the underlying strength of our economy and our plans for the future and then invest in Japan. [...]

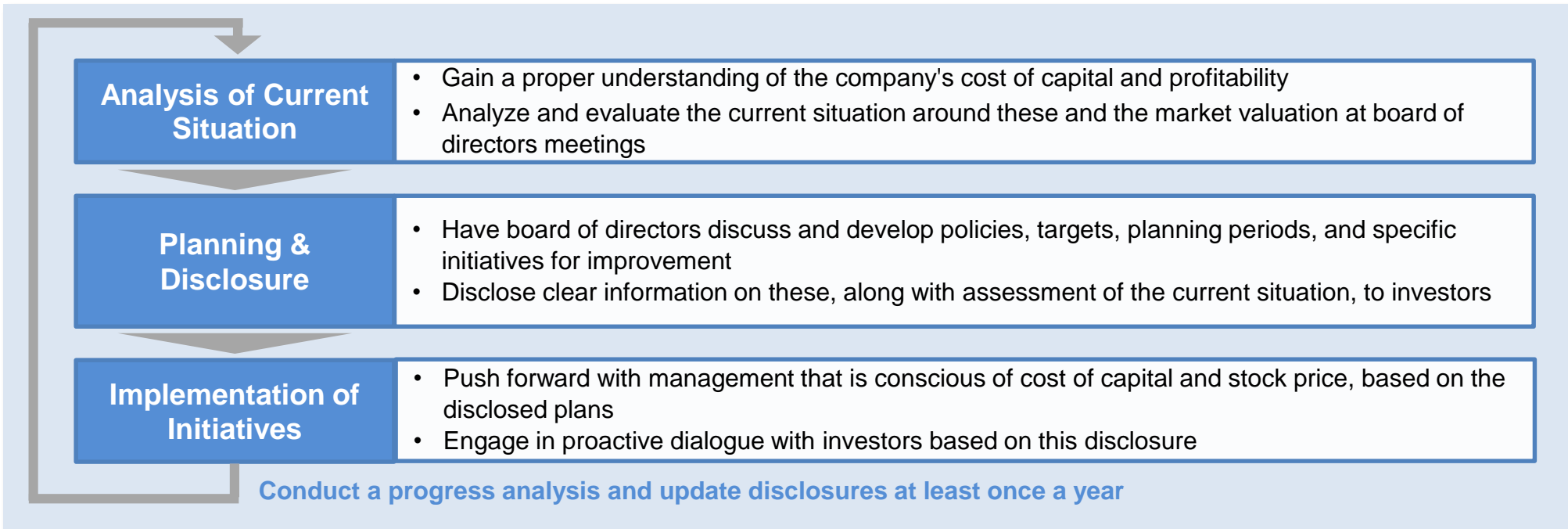
- I. Action Program for Accelerating Corporate Governance Reform
- II. Encouraging the management with an awareness of profit-making and growth
- III. Encouraging the management with an awareness of sustainability issues
- IV. Resolving legal issues

Request for “Action to Implement Management that is Conscious of Cost of Capital and Stock Price”

- TSE issued notices to all companies listed on the Prime and Standard Market which requested as follows in March.

Requested Action

- In order to implement management that is conscious of cost of capital and stock price, please implement the following series of actions on an ongoing basis.



Start Date

- Since analysis and discussion of the current situation must be carried out sufficiently before planning and disclosure can begin, TSE is not specifying a timeframe for the start date of disclosure, but requests as prompt a response as possible.

Note: If it takes some time to analyze and discuss the current situation, disclosure could be expanded in stages, for example by first indicating the level of progress of plan development and preparation for disclosure and the expected timing of disclosure, and then disclosing specific details once the plan is developed.

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

- TSE compiled information on the disclosure status of listed companies based on their corporate governance reports* in response to the request in March for “Action to Implement Management that is Conscious of Cost of Capital and Stock Price.” The data was compiled as of mid-July, when updated CG reports were available for companies whose fiscal year ended in March.

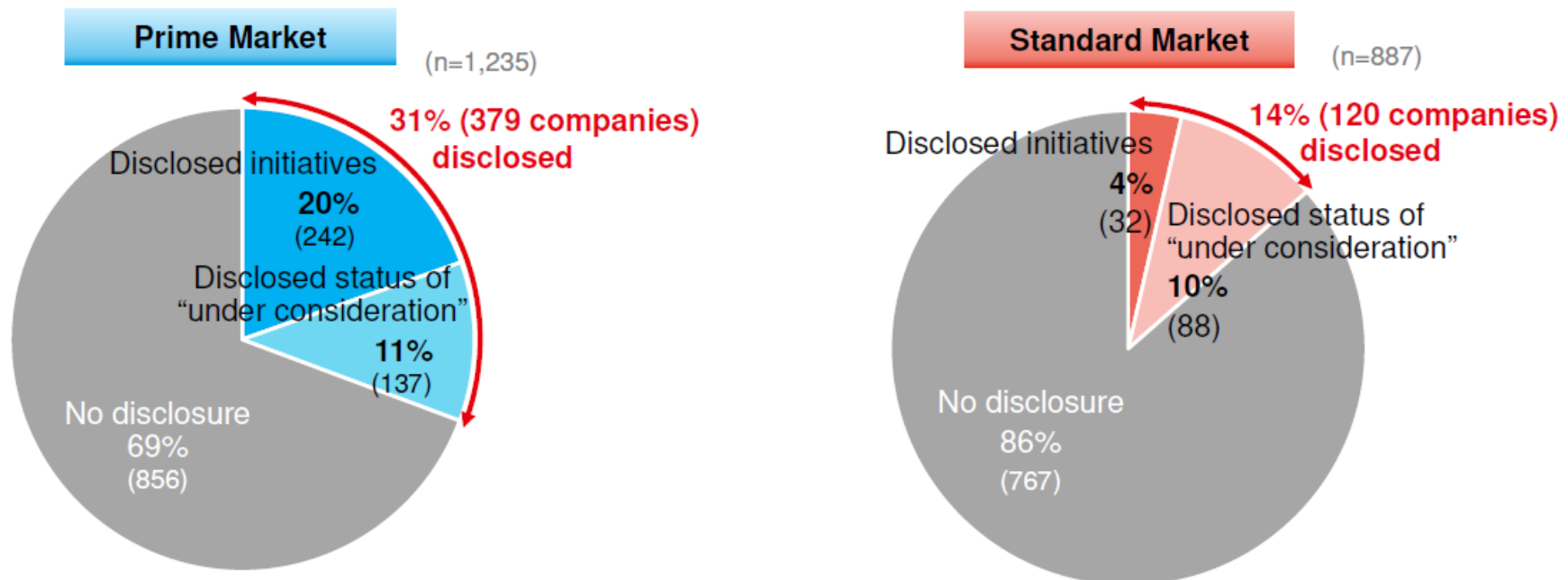
Note: Although the current request does not specify which documents should be disclosed, it requires companies to state in their CG reports that they are disclosing this information and how to access it.

- The request does not set a specific deadline for disclosure, since sufficient analysis and study of the company’s state of affairs are required as a precondition for formulating and disclosing plans, yet **31% (379 companies) of Prime Market listed companies and 14% (120 companies) of Standard Market listed companies have already disclosed information** (based on data for companies whose fiscal year ends in March).

Note: Among companies with fiscal years that do not end in March, 20 companies in the Prime Market and 28 companies in the Standard Market disclosed information.

- Of these, a certain number of companies disclosed a status of “under consideration (TBA)” (about one-third in the Prime Market and two-thirds in the Standard Market of those that disclosed).

Status of disclosure in response to the request for “Action to Implement Management that is Conscious of Cost of Capital and Stock Price”

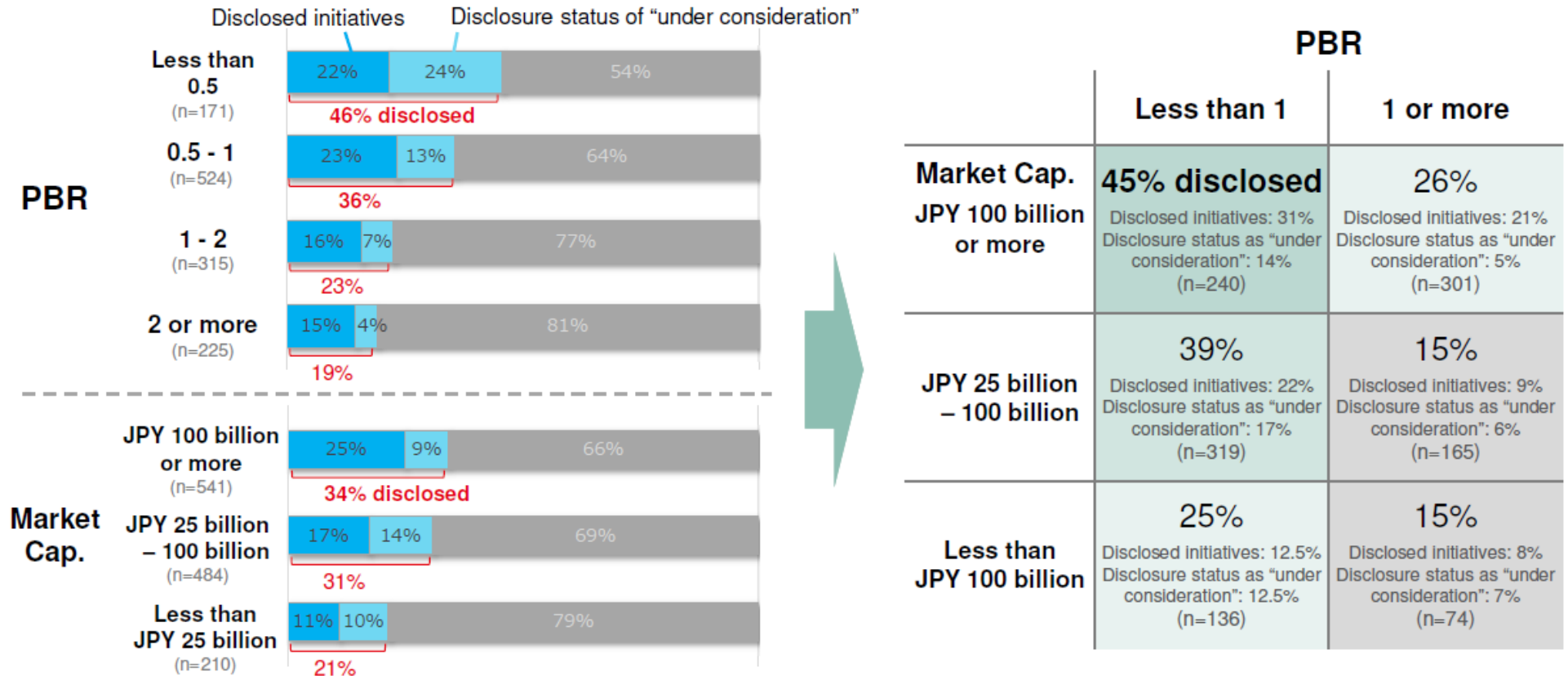


Note: Based on corporate governance reports and other information as of July 14, 2023 for Prime Market listed companies with fiscal years ending in March.

Disclosure Status by PBR and Market Cap. Levels (Prime Market)

- Disclosure progress is further along among companies with low PBRs and large market capitalizations, with 45% of Prime Market listed companies with PBRs below 1x and market capitalizations of JPY 100 billion or more disclosing information.
- On the other hand, companies with high PBRs and small market capitalizations have made relatively little progress with disclosure.

Disclosure Status by PBR and Market Cap. Levels (Prime Market)



Note: Based on corporate governance reports and other information as of July 14, 2023 for Prime Market listed companies with fiscal years ending in March.

Follow-up From TSE

Current Assessment and Issues

- The request has been taken seriously by companies with low PBRs. A number of companies are taking action, and domestic/foreign investors have given positive feedback about the changes.
 - However, even in cases where efforts have already been disclosed, they may **still be considered insufficient from the investor's perspective.**
- Given the **relative delays in taking action among companies with high PBRs and small market cap.**, the following could be the causes/challenges for those that have not yet made progress:
 - **Misconception that the current request is irrelevant if PBR is > 1**
 - **Management does not fully understand the significance and necessity of responding**
 - **Resources are not in place to proceed with the response**

Follow-up From TSE

- Based on the above issues, we would first like **to promote the following measures to further encourage companies to consider and disclose their efforts to improve return on capital and market valuation:**
 - The council will **continue to follow up on the status of corporate disclosure/initiatives, related issues, and investors' evaluations, and disseminate those** to the market.
 - For companies with high PBRs, reiterate the purpose of the request and that **all companies on the Prime/Standard Markets are requested to respond regardless of their P/B ratio levels.**
 - **Compile/disseminate key points of responses based on investors' perspectives** (including cases under consideration) **and examples of desirable approaches**, taking care not to induce companies to take formal measures.

- I. Action Program for Accelerating Corporate Governance Reform
- II. Encouraging the management with an awareness of profit-making and growth
- III. Encouraging the management with an awareness of sustainability issues
- IV. Resolving legal issues

Improve the diversity of the board and core human resources - Increase the percentage of female executives

- ❑ The government of Japan set the targets for the ratio of female executives in Prime Market-listed companies.
- ❑ TSE aims to implement the revisions to Listing Rules by October 2023.

Excerpt of the Intensive Policy for Gender Equality and the Empowerment of Women 2023

(1) Setting numerical targets for the ratio of female executives at companies listed on the Prime Market, etc.

As an important and symbolic first step to accelerate the promotion of women in the corporate sector, numerical targets for the ratio of female executives in Prime Market-listed companies will be set to increase the ratio of female executives.

Promote initiatives to include the following provisions in exchanges' regulations by the end of 2023:

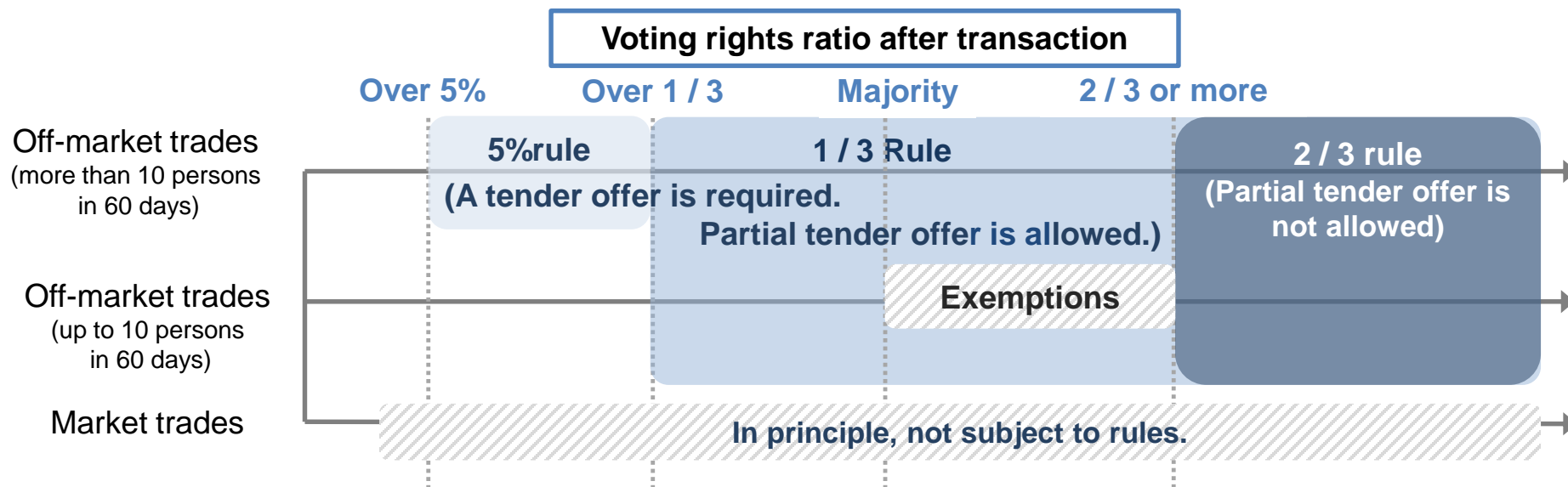
- Each company listed on the Prime Market shall strive to appoint at least one female executive by 2025
- Each company listed on the Prime Market shall aim to raise the ratio of female executives to 30% or more by 2030
- Each company listed on the Prime Market is recommended to formulate its action plan to achieve the aforementioned goals.

Additionally, based on the Action Program for Accelerating Corporate Governance Reform, the Cabinet Office and the Financial Services Agency will explore additional measures, depending on company progress, to increase diversity on boards and in core human resources including the increase in the ratio of female executives.

- I. Action Program for Accelerating Corporate Governance Reform
- II. Encouraging the management with an awareness of profit-making and growth
- III. Encouraging the management with an awareness of sustainability issues
- IV. Resolving legal issues

Overview of the Tender Offer Rule

- The tender offer rule forces a tender offer for the following transactions, and requires (i) prior information disclosure and (ii) equal treatment of shareholders in order to ensure the "transparency and fairness" of securities transactions that may have an impact on corporate control.



- The main regulations on the implementation of a tender offer are as follows:

Disclosure regulations

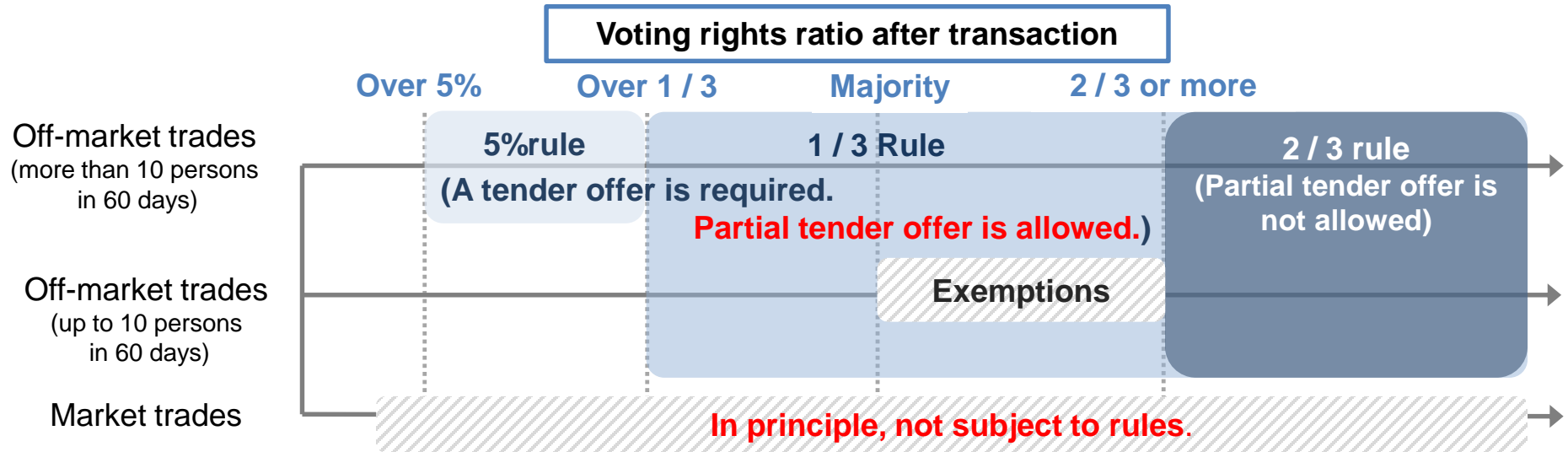
- ✓ The offeror must disclose the volume to be purchased, the tender offer price and tender offer period in advance.
- ✓ The target company must disclose the opinion with respect to the tender offer.

Other regulations

- ✓ A minimum tender offer period of 20 business days (a maximum of 60 business days) must be set.
- ✓ The tender offer price shall be the same for all shareholders.
- ✓ During the tender offer period, the offeror must not purchase shares other than through a tender offer.
- ✓ The offeror must not change the terms and conditions to the disadvantage of shareholders.

Main issues to consider

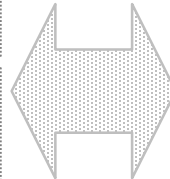
- It has been pointed out that (i) **transactions in which more than 1 / 3 of the voting rights are acquired through market trades should also be subject to tender offer rule** and (ii) **the scope of the partial tender offer should be limited** because the partial tender offer could be coercive.



Japan 

- ✓ Transactions in **which more than 1 / 3** of the voting rights are **acquired through market trades** are **not subject to** tender offer rule.

- ✓ **Partial tender offer** is **allowed** if **the ratio of voting rights** after the tender offer is **less than 2 / 3**.



Europe  

- ✓ **Regardless of the type of transaction, a tender offer is required** when a **certain threshold** is exceeded.

- ✓ In principle, **partial tender offer** is **not allowed**.

Main issue (1): Market trades

- ❑ It has been pointed out that market trades should be subject to the tender offer rule (1/3 rule).

Comments on the Current Rule

- ❑ The current tender offer rule does not apply to a market trade unless it falls under so-called “rapid accumulation,” given that a certain degree of transparency and fairness is ensured.
- ❑ On the other hand, recently, there have been cases of acquiring more than 1/3 of the voting rights through market trades. In such transactions, it has been pointed out that general shareholders are not given sufficient information or time necessary for investment decisions and that there are issues of coercion (see the decision of the Tokyo High Court below). Therefore, it has been pointed out that market trades should be subject to the tender offer rule (1/3 rule).

Tokyo High Court, decision of November 9, 2021

“The appellants purchased shares whose ownership ratio of share certificates exceeds 1/3 in a short period of time through acquisition of shares on market trades that is not subject to the tender offer rule. Such purchase does not provide general shareholders with sufficient information and time necessary for investment decisions and tends to make general shareholders take actions to avoid such risks if they think that the corporate value of the company may be damaged by the acquisition of control by the purchaser. Therefore, such purchase is recognized to have an incentive to sell or pressure to sell (coercion) for general shareholders.”

Issues to be discussed

- ◆ What is your view on **making transactions for acquiring more than 1/3 of the voting rights through market trades subject to the tender offer rule?**

Main issue (2): Measures against Coercive Tender Offer

- ❑ It has been pointed out that certain measures should be taken against a coercive tender offer.

Comments on the Current Rule

- ❑ In the case of a tender offer that is expected to reduce the corporate value of the target company after the acquisition of control, there is a problem in that general shareholders have an incentive to apply for the tender offer in order to avoid disadvantages due to the reduction in corporate value (so-called coercive tender offer). There is a risk that general shareholders may be forced to accept the tender offer price at an unreasonably low price, and that acquisitions that reduce corporate value will tend to be more successful. It has also been pointed out that these risks are more likely to occur in a partial tender offer (tender offer with an upper limit) than in a tender offer without an upper limit. (Note).
- ❑ In order to address the issue of the coercive tender offer, the following measures could be taken with reference to the Takeover Code in the UK.

Measures to eliminate or reduce the risk of coercion

I

A measure to lower the threshold (currently 2/3) at which a partial offer is allowed.

II

A measure that requires an additional tender offer period after the tender offer is successful.

III

A measure that allows the implementation of the partial tender offer only when shareholders with a majority of the voting rights approve it.

Issues to be discussed

- ◆ What is your view on the **implementation of measures to address the issue of coercive tender offer and the content of such specific measures?**

(Note) In the case of a tender offer without an upper limit, since the tender offeror must purchase all the tendered shares, in order to make it economically viable for the tender offeror, the tender offer price must be set lower (compared to the case of a partial tender offer), and it has been pointed out that it is likely to be possible for each shareholder to choose not to tender predicting that other shareholders will also not subscribe.

Overview of the large shareholding reporting rule

- ❑ The large shareholding reporting rule requires large shareholders to disclose the status of shareholdings in order to improve the transparency and fairness of the market by promptly providing the information.
- ❑ This rule is divided into “**general reporting**,” which is a basic disclosure type (cf. Regulation 13D in US), and “**special reporting**,” which allows special measures for institutional investors (cf. Regulation 13G in US).

General Reporting

Obligations of Large Shareholders

1. If an investor becomes a large shareholder (**more than a 5% stake**):
 - The investor must **submit a large shareholding report within five business days** of acquiring more than a 5% in a company.
2. If there are any significant changes, such as **a 1% or greater increase/decrease** in the percentage of shareholdings following the submission of the large shareholding report:
 - The investor must **submit a “change report” within five business days of the change**.

Special Reporting

Outline of the Special Reporting Rule

The rule allows institutional investors who repeatedly and continuously execute buy/sell transactions of shares in their daily operations to report under relaxed frequency of submissions.

<Details of the relaxation>

Only **to submit a “large shareholding report” and “change report” within five business days of the pre-registered reference date set twice a month**.

<Eligibility to use special reporting>

1. The investor’s ownership ratio does not exceed 10%.
2. **The investor is not committing to the Act of Material Proposal.**
3. It is necessary to register the reference date to the authority.

Joint Holders

Treatment of Joint Holders

A shareholder is required to calculate its shareholding ratio by including the shareholding of a person that corresponds to any one of the following (“Joint Holder”).

1. A person that **has agreed to obtain or assign shares in cooperation with the shareholder**.
2. A person that **has agreed with the shareholder to jointly exercise voting rights** and other shareholder rights.
3. A person that has a special relationship with the shareholder, such as a certain capital relationship or a family relationship.

Main issues to consider

- ❑ From the viewpoint of promoting effective engagement with companies by investors, it has been pointed out that **the scope of "material proposal" should be limited or clarified.**
- ❑ It has been pointed out that **the scope of "joint holders" should be limited or clarified** from the viewpoint of promoting collective or collaborative engagement.

General Reporting

Obligations of Large Shareholders

1. If an investor becomes a large shareholder (more than a 5% stake):
 - The investor must submit a large shareholding report within five business days of acquiring more than a 5% in a company.
2. If there are any significant changes such as a 1% or greater increase/decrease in the percentage of shareholdings following the submission of the large shareholding report :
 - The investor must submit a change report within five business days of the change.

Special Reporting

Outline of the Special Reporting Rule

The rule allows institutional investors who repeatedly and continuously execute buy/sell transactions of shares in their daily operations to report under relaxed frequency of submissions.

<Details of the relaxation>

Only to submit a "large shareholding report" and "change report" within five business days of the pre-registered reference date set twice a month.

<Eligibility to use special reporting>

1. The investor's ownership ratio does not exceed 10%.
- 2. The investor is not committing to the Act of Material Proposal.**
3. It is necessary to register the reference date to the authority.

Joint Holders

Treatment of Joint Holders

A shareholder is required to calculate its shareholding ratio by including the shareholding of a person that corresponds to any one of the following ("Joint Holder") .

1. A person that has agreed to obtain or assign shares in cooperation with the shareholder
- 2. A person that has agreed with the shareholder to jointly exercise voting rights and other shareholder rights.**
3. A person that has a special relationship with the shareholder, such as a certain capital relationship or a family relationship.

Main issue (1): Scope of the Act of Material Proposal

- It has been pointed out that the scope of "the act of material proposal" is unclear so that it becomes an obstacle to effective engagement between companies and investors.

Comments on the Current Rule

- Under the large shareholding reporting rule, a special reporting rule has been established for institutional investors to ease the frequency of submission. However, in order to be eligible for the rule, it is necessary that the purpose of shareholding is not to engage in "the act of a material proposal" to investee companies.
- Although the interpretation of "the act of material proposal" was clarified when formulating the Stewardship Code, it has been pointed out that further clarification is necessary in order to promote effective engagement.

Guideline published in 2014

1	Request explanation of management policies.	May not be considered "Material Proposal"
2	Explanation for a specific plan for exercising voting rights	
3	Request for an explanation of the stance given on ②	
4	Ask questions at a general shareholders meeting	
5	Request for resolution of specific matters at a general shareholders meeting	May be considered "Material Proposal"
6	Request changes in business policies	

Issues to be discussed

- What is your view on **limiting or clarifying the scope of "the act of material proposal"** in order to promote effective dialogue between companies and investors?

Main issues to be addressed

This arrangement has become a certain interpretation guideline. However, the following points are raised.

- The subject of the material proposal is comprehensive and as **the proposal relates to capital policy or business strategy, it may be regarded as a material proposal.**
- Issues can only be communicated indirectly through inquiries with the company, and **proposals cannot be communicated directly, so the company cannot understand the intention.**

Main issue (2): Scope of the Joint Holders

- ❑ It has been pointed out that the scope of "joint holders" is so unclear that it becomes an obstacle to collective or collaborative engagement.

Comments on the Current Rule

- ❑ Under the large shareholding reporting rule, shareholders are required to calculate their shareholding ratio including the shareholdings of "joint holders."
- ❑ At the time of formulating the Stewardship Code, the interpretation of "joint holders" was clarified. However, in light of the recent increase in collective or collaborative engagements, it has been pointed out that the scope of "joint holders" needs to be further clarified.

Guideline published in 2014

In principle, the following cases may not be considered "joint holders":

- ✓ The agreement between an investor and another investor remains within the scope of shareholders' general activities that are unrelated to the exercise of legal rights.
- ✓ In the situation where an investor in discussions with another investor communicates their plan for the exercise of voting rights and finds that the plan is the same as the other investor.

Main issues to be addressed

This arrangement has become a certain interpretation guideline. However, the following points are pointed out.

- There is a concern that if an investor who participated in the collective or collaborative engagement submits a shareholder proposal, and then the other investor agrees to it, the other investor may be considered as a "joint holder";
- The concept of "joint exercise of voting rights" can be read as a very comprehensive regulation, with no limitations on the purpose of controlling management.

Issues to be discussed

- ◆ Given that it has been pointed out that the interpretation of "joint holder" is unclear when conducting collective or collaborative engagements, what is your view **on limiting or clarifying the scope of "joint holders"?**

Transparency of beneficial shareholders

- It has been pointed out that **the transparency of beneficial shareholders should be improved with reference to systems in other countries** in order to promote dialogue between companies and investors.

(*)The term "**Beneficial shareholder**" here **means** a person who is not a shareholder on the shareholder register (nominee shareholder) but **who has the authority to give instructions on voting right and investment**.

Japan



- As for nominee shareholders, there is a system for companies and other shareholders to identify through shareholder register or disclosure of major shareholders in annual securities reports.
- On the other hand, as for beneficial shareholders, there is no system for companies or other shareholders to identify unless they are subject to the large shareholding reporting rule (more than 5%).

Systems in other countries

US



- An institutional investment manager that exercises investment discretion over \$100 million or more in securities that trade on a national securities exchange must report details of its holdings including the name of the issuer and class, the CUSIP number, the number of shares and the total market value quarterly on Form 13F with SEC. Form 13F filings are publicly disclosed on EDGAR database.

UK



- A public company may give notice to any person whom the company knows or has reasonable cause to believe to be interested in the company's shares with voting rights issued to confirm the fact.
- Those who received such notice are required to confirm whether or not it is the case, and if he or she holds or has held any such interest, to give further information including the information enough to identify persons interested in the shares in question and the number of shares within such reasonable time as may be specified in the notice.

Issues to be discussed

- What is your view on **the necessity and content of measures to enable the company and other shareholders to effectively identify beneficial shareholders?**



Thank you for your attention.

**We hear from you at
jcgf.secretariat@fsa.go.jp**



Public Relations Magazine
ACCESS FSA

