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## **Introduction**

Good morning. First of all, I would like to thank the Embassy of Japan for organizing this Industry Roundtable. It is a pleasure to have this opportunity to discuss corporate governance issues with experts here in London.

Today, I would like to look back on Japan's corporate governance reforms to date, outline our current assessment and the challenges we face, and explain the next steps. Japan introduced the first edition of its Corporate Governance Code in 2015, learning in part from the UK's Code. Ten years have passed since then, and governance practices among Japanese companies have made significant progress.

## **Corporate Governance Reform as Part of Growth Strategy**

The corporate governance reform in Japan was initiated by the government as part of its growth strategy during Abenomics. Japan introduced its Stewardship Code in 2014, with the aim of encouraging institutional investors to promote companies' sustainable growth over the medium- to long term through dialogue and engagement. In the following year, the Corporate Governance Code was introduced to realize what we refer to as assertive governance by promoting swift and decisive decision-making by companies.

Today, corporate governance reform is one of the key pillars of the government's initiative to promote Japan as a leading asset management center. Started in 2023, this initiative aims for creating a virtuous cycle of capital that enhances Japanese companies' corporate value, raises household income, and thereby supports economic growth.

Following these efforts, improvement in corporate governance practices is steadily gaining momentum. In response to a request from the Tokyo Stock Exchange, or TSE, more than 90 percent of companies listed on its Prime Market have disclosed their business plans that reflect cost of capital and stock price considerations. As such, corporate mindset appears to be shifting.

Mr. Yamaji, Group CEO of JPX, will perhaps elaborate on their efforts later.

As many of you are aware, Japan's economy is now at a turning point. For example, the Nikkei Stock Average reached an all-time high just last week—approximately five times its level at the end of 2012, when Abenomics began.

Now, Japan is moving away from the long-standing deflationary, cost-cutting economy toward a growth-oriented one supported by increased investment and higher productivity.

Against this backdrop, the government led by Prime Minister Takaichi is committed to developing a growth strategy package aimed at realizing a robust economy. As part of this, the government plans to expand the current initiative and develop a new comprehensive financial services strategy by the summer.

In the new strategy, corporate governance reform will continue to be indispensable part of Japan's growth strategy to strengthen companies' profitability and value creation.

## **Current Assessment of Progress and Challenges**

Let me now turn to discuss the progress made on and the remaining challenges with corporate governance reform in Japan.

Corporate governance in Japan has improved significantly since the introduction of the Stewardship Code and the Corporate Governance Code a decade ago. For example, 98 percent of the companies listed on the TSE's Prime Market have appointed independent directors to comprise at least one-third of their board members, and 26 percent have appointed them to comprise the majority of the boards. Investors both at home and abroad now give positive feedback with regard to their engagement with Japanese companies.

The Financial Services Agency (FSA) and the TSE have also followed up on companies' governance practices through annual analyses of their corporate governance reports, as well as by publishing guidelines for investor-company dialogue and case studies on initiatives to strengthen board effectiveness.

At the same time, challenges remain. Some companies still retain the mindset that formal compliance with the text of the Code is sufficient. It is therefore necessary to further instill the fundamental philosophy of corporate governance reform: that companies should maximize the use of their own

resources to enhance their corporate value in a sustained manner. This, in turn, would contribute to corporate growth, benefit shareholders, employees and other stakeholders, and ultimately support overall economic growth.

We refer to this as a substantive enhancement of corporate governance, and started publishing annual Action Programs to advance such enhancement in 2023. In the latest edition published last June, the FSA set out the direction of further reform, including revisions to the Corporate Governance Code.

## **Revision of the Corporate Governance Code**

Let me now introduce to you the four key objectives of the revision of the Corporate Governance Code currently under consideration.

### *Streamline the Code and reinforce its principles-based nature*

First, the FSA is working to streamline the Code and reinforce its principles-based nature, thereby making the Code more substantive.

Japan's Code adopts a principles-based approach rather than a rules-based approach that prescribes detailed conduct. Accordingly, companies are expected to assess whether their actions are aligned with the spirit and intent of each principle, rather than focus on compliance with the wording or descriptions of the Code.

However, it has been pointed out that some listed companies aim to comply with the Code in a purely box-ticking manner. In this connection, the Code currently consists of more than 80 principles and supplementary principles, following several revisions to the Code in the past. This may be contributing to such behavior.

We therefore believe that the principles-based nature of the Code needs to be reinforced to urge companies to focus on core efforts to enhance their corporate value in the medium- to long term. To this end, we are reviewing the Code so that it provides greater clarity and focus, including by removing provisions that overlap with requirements already stipulated in laws and regulations.

This does not mean that we intend to loosen the Code. It rather reflects higher expectations for companies. By returning to the essence of the principles-based approach, we will seek to encourage companies to shift their mindset from formal compliance with the Code to substantive enhancement of

governance to pursue greater value creation.

### *Ensure appropriate allocation of resources*

Second, the FSA intends to clarify expectations regarding appropriate allocation of resources by companies. It is an issue that is directly linked to companies' ability for value creation.

In part reflecting a deflationary economy, Japanese companies' cash and deposit holdings were on an increasing trend from the late 1990s until after the COVID-19 shock, while the ratios of capital expenditure and R&D investment to sales have remained relatively low.

As Japan' economy is overcoming deflation, it is essential that companies examine the wide range of opportunities for investment, including in R&D, human capital, and capital equipment.

From the perspective of further promoting value creation, we are considering revisions to the Code that would encourage companies to look at various investment opportunities and examine whether their allocation of resources is appropriate.

### *Accelerate pre-AGM disclosure of financial statements*

Third, the FSA will promote the disclosure of annual securities reports prior to the company's annual general shareholders' meeting (AGM). Such prior disclosure will provide investors with information that is useful in exercising their shareholder rights, thereby supporting constructive dialogue between companies and investors.

To promote early disclosure by listed companies further, we are engaged in discussions with other government ministries, including on possible integration of business reports under the Companies Act and annual securities reports under the Financial Instruments and Exchange Act. These discussions are underway alongside consideration of revisions to the Code.

### *Promote stronger board secretariat functions*

Fourth, the FSA is exploring ways to strengthen the board secretariat functions of listed companies.

For companies' boards to make swift and decisive decisions and to exercise effective oversight from independent and objective standpoints, they should be engaged in a substantive discussion to ensure that they and their directors can execute their functions, whether executive or supervisory, in an effective manner.

To enhance the effectiveness of board deliberations, we are considering revisions to the Code that would promote stronger board secretariat functions, including in agenda setting and the provision of information to board chairs and independent directors.

## **Conclusion**

Today, we see a lot of positive signs in Japan's economic indicators. For example, Corporate ordinary profits have reached a record high of JPY 131 trillion, or approximately GBP 655 billion.

As the economy is on an upward trajectory, I believe that now is an opportune time for Japanese companies to improve the effectiveness of their corporate governance and to take bold steps to enhance their corporate value.

Japan's growth strategy is not inward-looking. We will strive to make sure that Japan continues to be an attractive investment destination for global investors. I would greatly appreciate candid views from many leading asset owners and asset managers based in London.

Thank you.