

Follow up on the Action Program and future initiatives (draft)

I. Introduction

In April 2023, following discussions at the meeting of the Council of Experts Concerning the Follow-up of Japan’s Stewardship Code and Japan’s Corporate Governance Code, the “Action Program for Accelerating Corporate Governance Reform” (hereinafter the "Action Program") has been established.

As stated in the Action Program, in order to achieve sustainable corporate growth and increase corporate value over the mid- to long-term, sufficient results cannot be expected based on only satisfying matters of form – matters of substance also matter. It is important to promote self-motivated changes to take place in the mindsets of companies and investors.

From this perspective, it is necessary to follow-up on the progress of each measure based on the actual situation and continue considering the future direction.

The following is a follow-up on the major initiatives of the measures set out in the Action Program and a proposal for future initiatives.

II. Following up on the Action Program and suggested future initiatives

1. General

As described below, various initiatives are being implemented by the relevant ministries and agencies and the Tokyo Stock Exchange (hereinafter the “TSE”) in accordance with the measures set out in the Action Program.

Based on these initiatives, there are opinions that both companies and investors are reforming their mindsets.

Issues

On the other hand, looking at the practical efforts by companies and investors, it has been pointed out that some companies and investors are merely conducting formalistic responses to the Corporate Governance Code and the Stewardship Code, and that there are significant differences in the quality of efforts by each entity.

In addition, as a more specific factor of such "differences," it has been pointed out that while many investors engage with large companies, there

are not enough investors who engage with small- and medium-sized companies.

Suggested future initiatives

It may be necessary to go back to the spirit of each Code, which takes a principles-based and Comply or Explain approach, and consider necessary measures in detail according to the scale and situation of each entity, instead of requiring all companies and investors to take the same initiatives. From this viewpoint, it may be important to explain politely why each entity does not comply with each Code rather than complying with each Code in a formalistic manner.

In addition, it may be important for each entity not only to consider and disclose initiatives toward the effective implementation of corporate governance reforms but also to steadily implement them.

2. Effective implementation of stewardship activities

The Asset Management Task Force of the Financial System Council discussed initiatives toward the effective implementation of stewardship activities. In a report published in December 2023, the Task Force made recommendations for promoting collective/collaborative engagements. In addition, the Working Group on Tender Offer Rule and Large Shareholding Reporting Rule of the Financial System Council discussed rules for promoting dialogues between investors and companies. In a report published in December 2023, the Working Group made recommendations for the revision of the large shareholding reporting rule and ensuring the transparency of beneficial shareholders.

Issues

It has been pointed out that some investors engage in dialogues to fill in the check boxes and fail to engage in constructive dialogues based on in-depth knowledge of companies or two-way dialogues. It has also been pointed out that it is important for collective/collaborative engagements not only to engage with each other but also to focus on specific themes and have meaningful dialogues.

In addition, it has been pointed out that effective engagement that integrates dialogues and the exercise of voting rights is not being conducted, for example, because the divisions in charge of dialogues and

those in charge of the exercise of voting rights are separated and do not sufficiently cooperate with each other.

Furthermore, compliance with the Stewardship Code is not generally verified, so it has been pointed out that it may be necessary to check actual stewardship implementation.

Suggested future initiatives

Based on the recommendations in the above reports, in order to make engagement more effective, it is conceivable to review the Stewardship Code with the aim of promoting collective/collaborative engagement and ensuring the transparency of beneficial shareholders. In addition, it is important to recognize that dialogues and the exercise of voting rights are interrelated and consider how dialogues prior to the exercise of voting rights should be conducted. It is conceivable to review the Stewardship Code from this perspective. In doing so, what points should be noted and what other points need to be reviewed?

In addition, in order to resolve the above issues, it is considered useful to share specific cases and certain viewpoints on desirable and undesirable engagements, taking into account the opinions of investors, companies, etc. In the interviews conducted by the FSA and the TSE, for example, there were opinions expressed that sharing examples of other companies' initiatives by investors was helpful in promoting companies' own initiatives, including their internal feedback, and that ongoing discussions, rather than one-time discussions, contribute to constructive dialogues. What do you think of these opinions? (See pages 26 to 29 of Secretariat Briefing Pack.) In light of these viewpoints, how should compliance with the Stewardship Code be checked in order to realize more effective engagement?

3. Improvement of the effectiveness of the board (improvement of the effectiveness of independent directors)

In January 2024, the Ministry of Economy, Trade and Industry (METI) jointly with the FSA and the TSE published "The Basics of Being an Independent Director" as part of their efforts to ensure and improve the quality of independent directors.

In addition, the private sector, including international organizations, continues to conduct training, disseminate proposals, give awards and conduct other educational activities for directors, including independent

directors.

Issues

While progress is being made in appointing independent directors and establishing nomination and remuneration committees, it has been pointed out that there is still a lack of shared recognition of the roles that independent directors and the chairs of each committee should play, and boards are not yet functioning effectively. In addition, it has been pointed out that the quality of such independent directors is not substantially evaluated.

Suggested future initiatives

In order to improve the effectiveness of boards, it is considered important to once again confirm the roles of related parties and whether constructive discussions are being held at the board meetings. Specifically, for example, what measures can be considered to share the understanding of the roles and functions that should be fulfilled by independent directors, the chairs of the board or each committee, and secretariats of boards, and to enable these roles and functions to be performed more appropriately? (See page 29 of Secretariat Briefing Pack.)

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

In March 2023, the TSE made a request to companies listed on the Prime Market and the Standard Market to implement a series of actions in order to implement management that is conscious of the cost of capital and stock prices. From January 2024, the TSE published a list of companies that disclosed information based on this request. In February 2024, the TSE published key points considering the investors' points of view and case studies.

Issues

It has been assessed that many listed companies are making efforts based on the above requests. On the other hand, investors in Japan and overseas have expressed their expectations for further progress in these efforts. For example, it has been pointed out that actions based on requests are polarized between companies that position them as important management issues with a sense of tension and companies that only take formalistic

responses.

Suggested future initiatives

In light of the above, it is necessary to continuously follow up on the status of each company's initiatives and encourage them to take substantial measures. In doing so, what points are considered to require special attention? For example, (as pointed out in 5. below), it is possible to focus on whether the content of disclosure differs from the actual initiatives, and whether specific discussions are conducted at the board and dialogues with investors. Are there any other points?

5. Enhancing the quality of disclosure and promoting dialogues with global investors

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 February 2024, the TSE published an outline of revision of the Listing Rules in order to expand English disclosures, which prioritizes making mandatory English disclosures of financial statements and timely disclosure information.

Issues

While information disclosure by companies is becoming more extensive, it has been pointed out that the content of information disclosed differs from the actual initiatives. In addition, with regard to the timing of information disclosures, it has been pointed out that it is necessary to provide the information required by investors effectively and efficiently, including disclosures of Annual Securities Reports before the general shareholders meeting.

Furthermore, it has been pointed out that in order to further increase corporate value, it is necessary to actively engage in dialogues with global investors, primarily for companies listed on the Prime Market.

Suggested future initiatives

Improving transparency through information disclosure is considered to lead to trust in the market. What points should be noted for companies to substantially enhance disclosures?

Going forward, in addition to following up on the situation in light of the mandatory English disclosures, it may be advisable to create a specific list in order to "visualize" the group of companies that willingly and actively respond to the expectations of global investors, which is the initiative presented in the Action Program. (See page 25 of Secretariat Briefing Pack.) What initiatives, including these initiatives, should be advanced to promote dialogue with global investors?

6. Resolving market environment issues

In December 2023, the TSE published "Enhancement of Information Disclosure on Protection of Minority Shareholders and Group Management" and "Roles Expected of Independent Directors in Listed Companies with Controlling/Quasi-controlling Shareholders" regarding information disclosures and governance of dependent listed companies.

With regard to measures to address cross-shareholdings, from the fiscal year ended March 31, 2023, the FSA enhanced disclosures of cross-shareholdings in Annual Securities Reports to require companies to provide a summary of their business alliance with the issuing companies. The FSA published a booklet of companies' good disclosure practices on this matter in March 2024. In addition, issues were pointed out in "Results of the 2023 Securities Report Review and Matters to Be Noted," which was published in March 2024. Furthermore, the FSA will continue monitoring financial institutions' progress in reducing cross-shareholdings and evaluating the significance of holding cross-shareholdings.

Issues

It has been pointed out that while companies are making efforts to reduce cross-shareholdings, appropriate measures have not been taken, such as disclosures based on the actual situations including the status of the exercise of voting rights. In particular, it has been pointed out that actual situations are unclear because disclosure of the reason for changing the purpose of holding to pure investment is not required. It has also been pointed out that this is due to, for example, differences in awareness among internally related parties in each company (such as those in charge of IR and sales). On the other hand, it has been pointed out that it is not necessarily desirable to sell them merely as a formalistic response, and it is necessary to appropriately examine them because there are cases where

the rationality of cross-shareholding can be explained as support for the management of the issuing company.

Suggested future initiatives

With regard to quasi-controlled listed companies, it is considered important for each company to continue to promote initiatives, including disclosures, toward the protection of minority shareholders, based on the above request by the TSE. What other points are considered necessary?

With regard to cross-shareholdings, it is important once again to review and disclose the appropriateness of the purpose of cross-shareholding in light of the Corporate Governance Code. What do you think of this approach?

7. Encouraging the management with an awareness of sustainability issues

In December 2023, the FSA published a booklet of companies' good disclosure practices on sustainability issues. 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. 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.

Internationally, the G20/OECD Principles of Corporate Governance were revised in September 2023 to include a new chapter on Sustainability and Resilience.

Issues

It has been pointed out that in promoting management with an awareness of sustainability, it is necessary to be aware of the connections between social value and economic value and between non-financial information and financial information. It has also been pointed out that addressing sustainability issues is viewed as an execution issue, and there is a lack of awareness of the role of supervision by boards.

In addition, it has been pointed out that in order to ensure diversity, it is important not only to achieve numerical targets but also to ensure the necessary abilities and develop human resources within the company. Furthermore, it has been pointed out that not only being aware of diversity

from the viewpoints of internationality and gender but also ensuring the diversity of "opinions" based on these factors contributes to improving of effectiveness of management.

It has also been pointed out that each company's corporate culture forms the foundation for creating and maintaining corporate value and that an awareness of corporate culture in management and dialogues is important for further enhancing corporate value over the mid- to long-term.

Suggested future initiatives

As pointed out above, when addressing sustainability issues aimed at increasing corporate value over the mid- to long-term, for example, the awareness of the connection between financial information and non-financial information, the role of supervision by the board of directors and management, and dialogues with an awareness of corporate culture are considered important. What other points are considered important?

In order to ensure diversity, it is necessary to pay attention to investment in human capital, including global human resources, and formulating human resource development policies. What other points are considered important?

In addition, given that corporate management is exposed to various risks, such as pandemics, cybersecurity risks, and geopolitical risks, throughout the entire supply chain, how do you think about management with an awareness of "resilience," such as demonstrating resilience in times of emergency?