Provisional translation

Opinion Statement on the "Action Program for Substantiating Corporate Governance Reforms (draft)" of the Council of Experts Concerning the Follow-up of Japan's Stewardship Code and Japan's Corporate Governance Code

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The following expresses in writing our views on the document mentioned in the title.

Keidanren's previous statements on this question have always been based on the view that each company should proactively establish its own corporate governance in line with its purpose. From this perspective, the corporate governance reform that is needed today is not to set detailed rules in the Corporate Governance Code ("Governance Code"), but rather to increase the effectiveness and substance of the reforms already in place, and to support steps taken by companies based on their own initiatives to improve mid- to long-term profitability and productivity. Accordingly, we agree with the proposal by the Financial Services Agency to enhance the substance of corporate governance reform through the formulation of the Action Program for Substantiating Corporate Governance Reforms.

In pursuing this, we want to reemphasize the importance of adhering to the principles-based approach and the comply-or-explain approach of the Governance Code.

We hope that shareholders and investors will appreciate the ingenuity and measures explained by companies and that all parties will engage in constructive dialogues so that corporate governance reform will contribute to companies' sustainable growth and the enhancement of corporate value over the mid- to long-term. From this perspective, the following lays out our opinion on individual sections of the Action Program.

1. Managing companies with focus on profitability and growth

It is important for companies to make effective use of the capital entrusted to them by shareholders, and to enhance their added value. The Government should develop measures and policies that will encourage research and development within companies that will help solve social issues, and investment that will contribute to sustainable growth, including human capital investment. At the same time, there is a need to make sure that the Government's corporate governance reform and the stock exchange's market rules do not encourage actions taken by companies which are short-sighted.

For example, companies should not be taking capital policy measures that rely too heavily on certain means such as share buybacks as a result of excessive focus on the price book value ratio (PBR).

In recent years the need has grown for a more effective use of stock-based compensation, which motivates management and employees to work to enhance corporate value over the mid- to long-term and ensures that values are shared among management, employees and shareholders. There should be discussions about the systemic steps required to expand the use of stock-based compensation.

2. Sustainability-conscious management

In encouraging sustainability disclosure, we welcome steps to put in place an environment that helps companies tackle sustainability issues, including publishing examples of best practice. In addition, since sustainability issues are quite diverse, and since in many cases the approaches to solutions and evaluation methods have not been set, it is important to allow for a flexible response that suits the circumstances of each company.

Also, steps should be taken to ensure that views from Japan are appropriately reflected in the international discussions at which international sustainability disclosure standards will be developed as a global baseline. Similarly, as sustainability assurance standards are developed, it will be important that members from Japan participate in those discussions to proactively put forward Japan's opinions.

3. Improving the function of independent outside directors

At present, there is a lack of independent outside directors who can contribute to corporate management. It will be important to analyze this situation and find an appropriate response to mitigate this. We expect that the fact-finding survey, which the government is planning to implement, will be helpful in this regard. Also, educational activities for independent outside directors should not be limited to offering formal opportunities for training or sharing information about corporate reality. Instead, there should be effective and meaningful activities that will improve these directors' understanding of the circumstances of the company and contribute to dialogue with executive officers, employees, and shareholders.

4. Enhancing the substance of stewardship activities

Alongside the Governance Code, measures to make the Stewardship Code more substantive and effective are also extremely important. We hope that steps will be taken to improve the quality of stewardship activities, and to bring about a two-way dialogue that will be worthwhile for both companies and institutional investors, while remaining aware of the perspective of the ultimate beneficiaries. At the moment, it is pointed out that stewardship activities are purely formal for some institutional investors, and that in some cases, the personnel and systems working on stewardship activities are insufficient compared to the size of the portfolios under management. The government should provide policy support to help construct an ecosystem that will encourage institutional investors to assign sufficient resources to hold dialogues with companies. Also as an incentive for institutional investors, we ask that policies to address the cost burden of stewardship activities by asset owners, and the establishment of a system to reward institutional investors for outstanding stewardship activities be considered.

Also, with regard to proxy advisory firms ("advisory firms"), numerous companies have expressed dissatisfaction with the quality of dialogues or are concerned that dialogues do not take place at all, and that this leads to biased views on evaluations. The recommendations made by advisory firms have significant impact on whether agenda items are approved or not, and it is important that advisory firms engage in appropriate dialogues with companies that will lead to reasonable and adequate recommendations. In addition to looking to improve the stewardship activities of institutional investors as mentioned above, the Financial Services Agency should proactively look to play the role of an active intermediary, at least by establishing an advisory function for companies, or by requiring advisory firms to engage in proper dialogue with companies.

5. Revising legal systems to encourage dialogue with investors

Increasing transparency on the shareholder side will also be an essential part of encouraging dialogues between companies and shareholders. While bearing in mind the current situation and issues with related laws including the Financial Instruments and Exchange Act, the Government should act promptly to put necessary systems in place, including by establishing a system that will help companies to identify their shareholders.

6. Enhancing information disclosure

In considering measures and policies to enhance information disclosure, it is essential to ensure that there is adequate dialogue among all parties involved. There needs to be a thorough analysis and consideration that weighs the balance of the improved effectiveness of information required against the burden involved for each party to implement them.

Under the current regime, companies already endeavor to disclose information useful to investors in a timely manner, by announcing financial results within 45 days of the end of a period and disclosing materials explaining their results, for example, as well as by making information on notices of ordinary general meetings of shareholders available as soon as possible online.

With regard to the suggestion that companies should “provide the information that investors need prior to general meetings of shareholders,” assuming this implies companies making securities reports available in advance of the shareholders meeting, this would impose immeasurable additional administrative burden on companies, requiring them to implement significant revisions and restructuring of their work processes involving a wide range of company affairs, including appointment of directors, dividends, and tax filing. Corporate information useful to investors is already made available in various forms, not only in Securities Reports, and we do not believe that this suggestion represents an effective and efficient means of improving information disclosure.

7. Promoting dialogue with global investors

The idea of promoting “visualizing” companies with outstanding corporate governance, which meet expectations of global investors, is worth studying. However, the idea of further disclosure in English (including making English materials a requirement in Prime markets, for example) requires careful consideration, since the situations of companies differ considerably with regard to their financial and human resources availability.

8. Addressing issues with the market environment

When the stock exchange is establishing market rules or making requests to listed companies with a view to improving the market environment, it is essential that communication with listed companies is conducted in advance, rather than having rules drawn up in isolation.

With regard to information disclosure and governance designed to protect minority shareholders of listed subsidiaries, we hope that realistic measures and policies will be considered, having listened carefully to the opinions of those responsible for these matters within such companies.