

Corporate Governance Reform in Japan

Japan Corporate Governance Forum



金融庁

Financial Services Agency, the Japanese Government

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June 2023

History of Corporate Governance Reform in Japan

✓ Since 2013

- ❑ **Joint efforts** by Financial Services Agency, Ministry of Economy, Trade and Industry, Ministry of Justice and Tokyo Stock Exchange (Japan Exchange)
- ❑ To **achieve sustainable growth and to increase corporate value** of listed companies over the mid-long term
- ❑ Through **effective board oversight** and **shareholder engagement**

✓ 2 codes as catalysts

- ❑ **Stewardship Code** since 2014
signed up by 324 institutional investors as of April 30th, 2023
- ❑ **Corporate Governance Code** since 2015
mandatory to all listed companies on “comply or explain” basis

Achievements and Challenges

✓ Improvement of governance structure

□ Independent directors

Over 90% of “Prime market” listed companies have **1/3 or more** independent directors (March, 2023)

□ Nomination Committee and Remuneration Committee

Over 80% of “Prime market” listed companies have Nomination Committee and Remuneration Committee (incl. non-statutory) (2022)

✓ Sustainable growth and corporate value, still in progress

□ TOPIX500 increased 2.43 times since 2013 (vs S&P500 2.95 times)

□ 43% of TOPIX500 have PBRs below 1.0 (vs only 5% of S&P500)

▶ **Need to move our focus from “Form to Substance”**

✓ Thanks to overseas investors

□ Japan Corporate Governance Forum

Meetings with ACGA, ICGN and US investors since fall, 2022

✓ Top priorities: Profit-making and Sustainability

✓ Keys: Board effectiveness and Stewardship activities

Action (1) : Profit making

✓ Improving profitability of listed companies

- **TSE** requested **“Prime and Standard markets” listed companies to analyze their own costs of capital and stock prices and to make plans for improvement** (March 31st, 2023)

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

<https://www.jpx.co.jp/english/news/1020/e20230414-01.html>

- **Cross-shareholdings** should also be addressed.

▶ **Please give feedback about the analyses and plans disclosed by listed companies!**

Action (2) : Sustainability

✓ Statutory disclosure of sustainability information

- Annual disclosure of sustainability information in “Annual Securities Reports” has been legally required for listed companies since the FY ended March 2023.

Listed companies are required to submit “Annual Securities Reports” in accordance with Financial Instruments and Exchange Act. It is similar to a Form 10-K.

✓ Set the target for female representation

- “Prime market” listed companies are to make efforts to achieve
 - 30% target of female representation at board or executive level by 2030
 - at least 1 female representation at board or executive level by 2025
- “Prime market” listed companies are encouraged to make action plans.

Action (3) : Board effectiveness

✓ Educational activities for board directors

- ❑ Promote various private-sector educational activities for independent directors.

✓ Disclosure of board activities

- ❑ Annual disclosure of the activities of boards and nomination, remuneration and audit committees in “Annual Securities Reports” has been legally required for listed companies since the FY ending March 2023.

Action (4) : Stewardship activities

✓ Corporate disclosure to facilitate engagement

- ❑ Disclosure in English, disclosure ahead of Annual General Meetings, and timely disclosure are strongly called for by global investors.
- ❑ As a new initiative, TSE requested “Prime market” listed companies to disclose summarized information related to dialogue with shareholders (March 2023).

✓ Encouraging stewardship activities

- ❑ Discuss, among the investment community, the issue of lack of engagement resources, and appropriate incentives for engagement.
- ❑ Review the governance of asset managers and asset owners.
- ❑ Review the legal framework of large shareholding reporting, etc.

Action (5) : Dialogue with global investors

✓ List of “the companies” to be published

□ A list of the companies that respond to the expectations of global investors in terms of corporate governance will be published.

▶ what should be the criteria?

- Board composition
- Board diversity
- Disclosure for global investors
E.g. disclosure in English, disclosure ahead of AGM,
adoption of IFRS
- Cross-shareholdings
E.g. disclosure of voting policy and individual voting results



Thank you for your attention.

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



Public Relations Magazine
ACCESS FSA



Reference Material : Corporate Governance Reform in Japan

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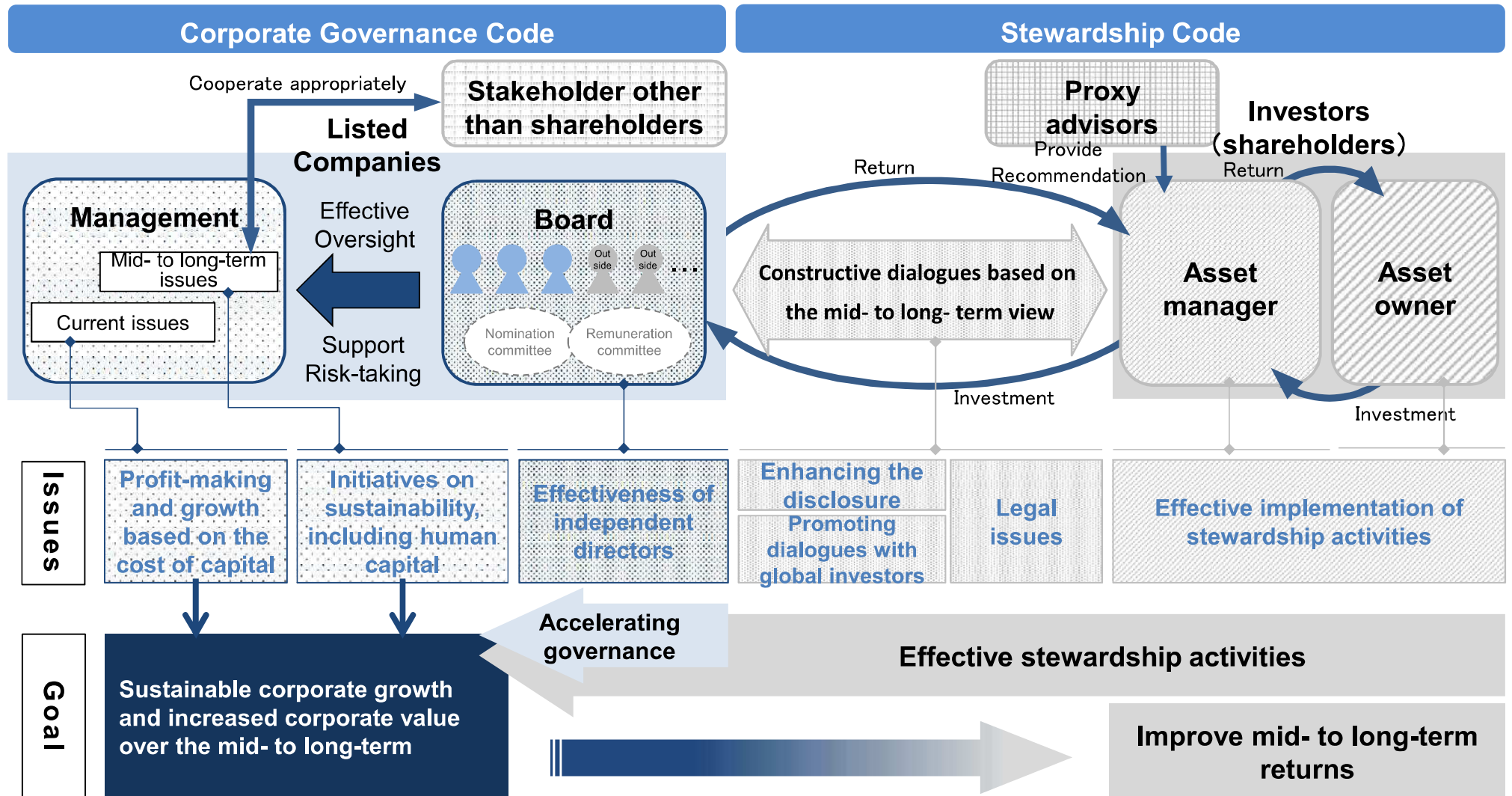
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Issues for corporate governance reforms

- ❑ In order to realize sustainable corporate growth and increased corporate value over the mid- to long-term through corporate governance reforms, it is vital for management, the board, investors, and various other stakeholders to cooperate appropriately.
- ❑ The following is a diagram of cooperation among stakeholders and a summary of issues pointed out in the previous meeting of the Council, JCGF, and the survey of institutional investors.



Action Program

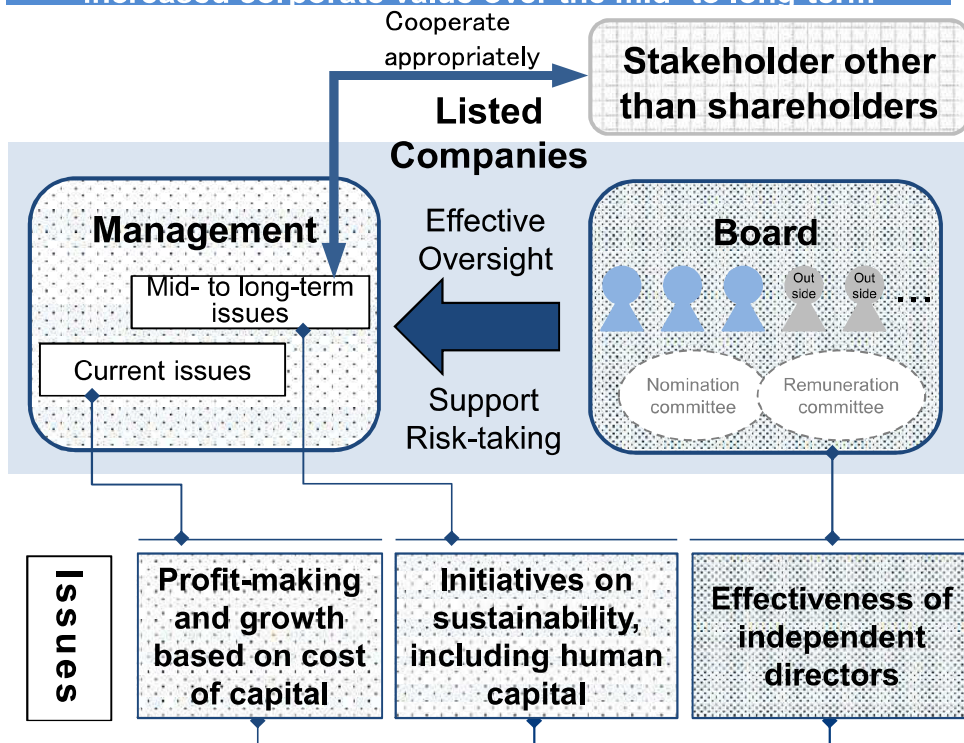
- The Council published recommendations regarding "Action Program" as of April 26. The Council will review the implementation status from time to time and consider whether additional measures are needed.

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).

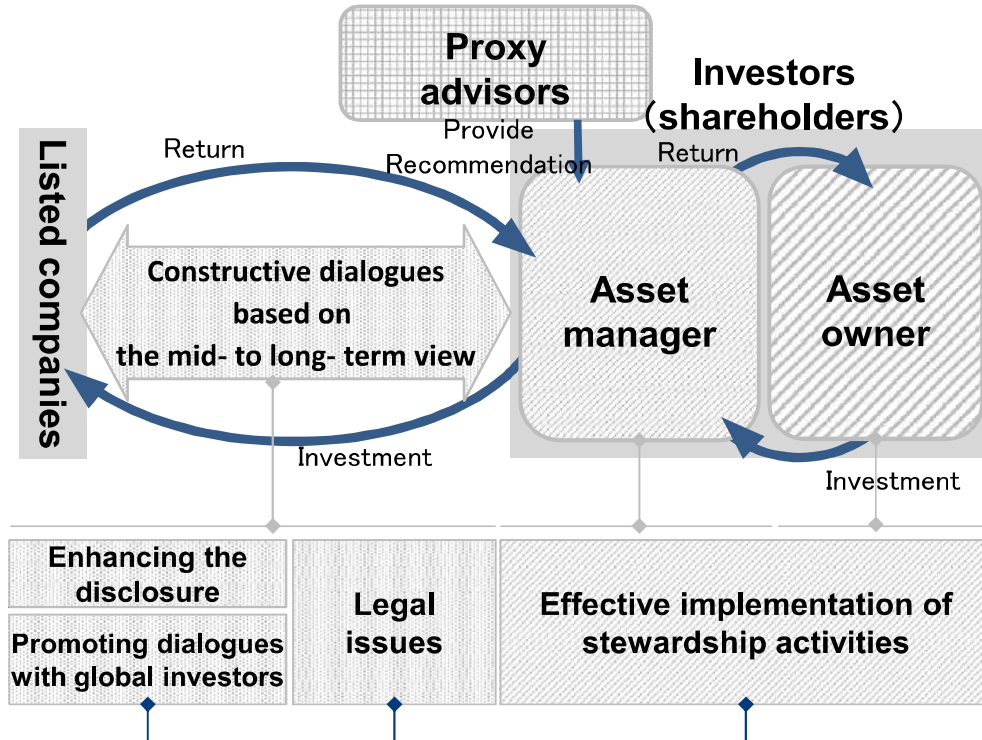
C) Improving the effectiveness of independent directors

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.

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 held on Tuesday, September 27, 2022, with Asian Corporate Governance Association
- 2nd Forum held on Monday, October 3, 2022, with International Corporate Governance Network
- 3rd Forum held on Thursday, January 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.**

Survey on Stewardship Activities (1)

- ❑ In order to promote more effective implementation of stewardship activities, JFSA commissioned Mizuho Research & Technologies to conduct a survey of actual stewardship activities by institutional investors, analyze issues, and make recommendations based on these results. From January to March 2023, the survey, in the form of a questionnaire survey of 136 institutional investors and an interview survey of 16 companies, was conducted.
- ❑ As a result of the survey, the following issues were pointed out: (1) Lack of resources (human resources and time) for engagement, (2) Insufficient behavioral changes and attitudes at investee companies, (3) Room for improvement in process development (PDCA cycle), (4) Lack of incentives to allocate costs and budgets to activities. In addition, the individual efforts of each asset manager to address these issues were aggregated.

Issues pointed out as a result of the survey

<div style="display: flex; align-items: center; justify-content: center;"> 1 <div style="padding-left: 10px;">Lack of resources (human resources and time) for engagement</div> </div>	<ul style="list-style-type: none"> ● There is a shortage of human resources with the necessary skills and capabilities to conduct effective stewardship activities at each asset management firm and in the industry as a whole. ● In cases where it is difficult to secure and develop sufficient human resources in-house, it is expected that external knowledge will be utilized through collaboration with other asset managers, including collaborative engagement. However, the interpretation of "joint holders" under the large shareholding reporting rule is unclear, and the burden of the collaboration is concentrated in some asset managers, so resources may not be sufficiently supplemented through the collaboration. ● As a result of the selection of companies for engagement, small and medium-sized companies tend to be excluded.
<div style="display: flex; align-items: center; justify-content: center;"> 2 <div style="padding-left: 10px;">Insufficient behavioral changes and attitudes at investee companies</div> </div>	<ul style="list-style-type: none"> ● Engagement (dialogue) and exercise of voting rights by asset managers may be perceived by companies as formalistic and may not lead to behavioral changes because companies are not convinced by them. ● There is a possibility that in-depth engagement has not been conducted because the interpretation of "act of making important suggestions" is unclear under the large shareholding reporting rule.
<div style="display: flex; align-items: center; justify-content: center;"> 3 <div style="padding-left: 10px;">Room for improvement in process development (PDCA cycle)</div> </div>	<ul style="list-style-type: none"> ● Asset owners may not have sufficient evaluation and monitoring resources.
<div style="display: flex; align-items: center; justify-content: center;"> 4 <div style="padding-left: 10px;">Lack of incentives to allocate costs and budgets to activities</div> </div>	<ul style="list-style-type: none"> ● Stewardship activities by asset managers may not be appropriately reflected in the selection and compensation of asset managers.

Survey on Stewardship Activities (2)

- Based on the results of the survey, the following recommendations were made: (1) in order to promote more substantial stewardship activities (i) wide-ranging collaborative efforts among asset managers, (ii) efforts between asset managers and asset owners, (iii) wide-ranging collaborative efforts among asset owners should be promoted; and (2) administrative authorities should appropriately follow up on these efforts so that all concerned parties can work together to improve the effective implementation of stewardship activities.

Initiatives to Resolve Issues	1	Wide-ranging collaborative efforts among asset managers	<ul style="list-style-type: none"> ● Based on the self-assessment of each asset manager's individual issues, it is worth considering the establishment of a forum in which asset managers can widely cooperate to exchange views on the appropriateness of the issues recognized by each asset manager and the effectiveness of efforts to resolve them, and to examine specific measures. ● As an issue for the whole asset management industry, an appropriate framework should be established to avoid a situation in which some asset managers are forced to bear an excessive burden in terms of collaboration with other asset managers, including collaborative engagements. It is also expected that the asset management industry as a whole will cooperate in efforts to attract new talent.
	2	Efforts between asset managers and asset owners	<ul style="list-style-type: none"> ● Asset managers should report to asset owners on their own issues and efforts to resolve them, as well as appropriately reflecting evaluations received from asset owners in future efforts. ● Asset owners should appropriately evaluate the appropriateness of the asset manager's recognition of issues and the effectiveness of efforts to resolve them based on the above reports, and appropriately monitor future efforts. It is also expected that the results of evaluation and monitoring will be reflected in the selection of the asset manager and the setting of compensation.
	3	Wide-ranging collaborative efforts among asset owners	<ul style="list-style-type: none"> ● It is important for asset owners to have sufficient knowledge and operational resources for assessment and monitoring. ● In cases where it is difficult for each asset owner to secure sufficient knowledge and operational resources independently, it is worth considering taking measures such as evaluating and monitoring asset managers in collaboration with asset owners who have sufficient knowledge and operational resources as needed.
	4	Follow-up by the administrative authorities	<ul style="list-style-type: none"> ● The administrative authorities should appropriately follow up on the effectiveness of each of the above initiatives and, if necessary, take further measures to promote them. ● Regarding the ambiguity of the interpretation of "joint holders" and "important suggestions" under the large shareholding reporting rule, efforts should be made to resolve the issues. At the same time, the transparency of beneficial shareholders should be improved so that companies that are not subject to engagement by asset managers can themselves ask for dialogue with asset managers.

Review of the tender offer rule & the large shareholding reporting rule

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Review of the tender offer rule & the large shareholding reporting rule

✓ As a part of Action Program for Accelerating Corporate Governance Reform

✓ Issues for discussion

□ Tender offer rule:

- (i) Should transactions in which more than 1 / 3 of the voting rights are acquired through market trades, be subject to tender offer rule?
- (ii) Should the scope of the partial tender offer be limited?

□ Large shareholding reporting rule:

Should the scope of the “material proposal” and “joint holders” be limited or clarified in order to promote effective engagement, including collective or collaborative engagement?

□ Beneficial Shareholders

Should the transparency of beneficial shareholders be improved in order to promote dialogue between companies and investors?

Review of the tender offer rule & the large shareholding reporting rule

- At a joint session of the general meeting of Financial System Council and the meeting of Sectional Committee held in March 2023, the following consultation was delivered: **in light of securing transparency and fairness of the market and promoting constructive dialogue between companies and investors, the tender offer rule and the large shareholding rule should be reviewed.**
- **A working group was established** to consider the following main issues based on recent changes in circumstances on **June 5, 2023.**

Recent Changes in Circumstances

Main Issues

Tender offer rule

- Increase in cases of unsolicited M&A through on-market transactions
- Diversification of M&A

- **Review of the scope of application of the tender offer rule (market trades, thresholds)**
- **Measures against coercive tender offers**
- **Flexibility in tender offer rule**

Large shareholding reporting rule

- Increase in passive investment
- Expansion of collaborative engagement
- Growing importance of constructive dialogues between companies and investors

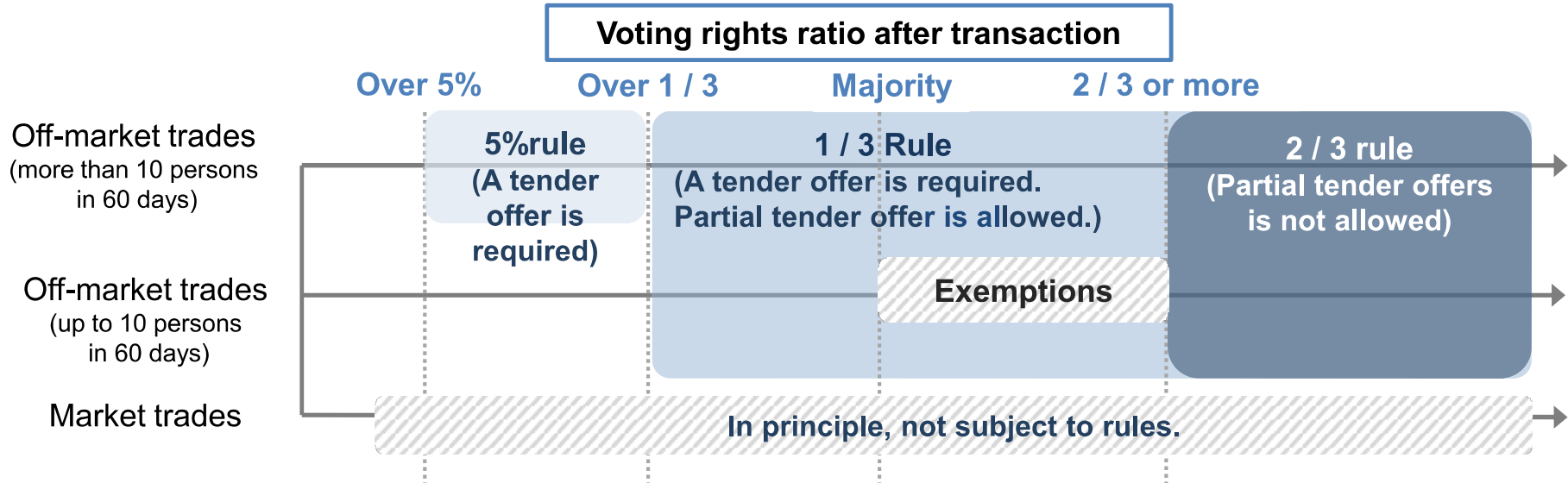
- **Clarification of eligibility to use special reporting**
- **Clarification of the scope of joint holders**
- **Clarification of treatment of cash-settled equity derivatives**

Beneficial shareholders transparency

- **Measures to ensure transparency of beneficial shareholders**

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.

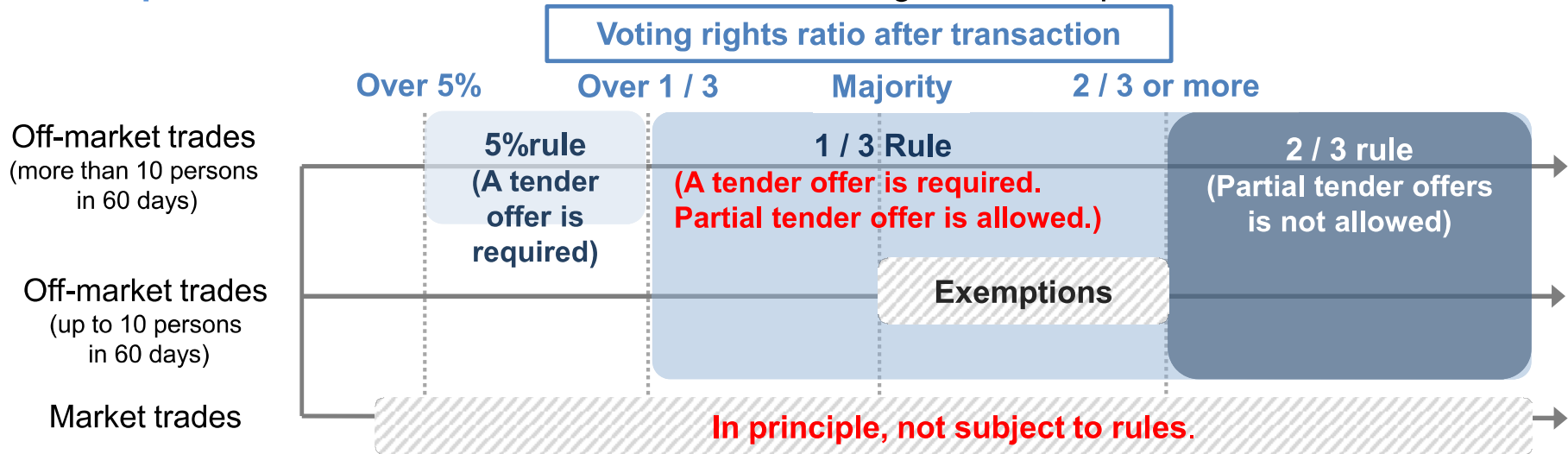


- The main regulations on the implementation of a tender offer are as follows:

Disclosure regulations	<ul style="list-style-type: none"> ✓ 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	<ul style="list-style-type: none"> ✓ 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.

Issues to consider

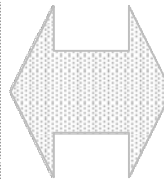
- It has been pointed out that (i) transactions in which more than 1 / 3 of the voting rights are acquired through market trades should also be subject to tender offer rule and (ii) the scope of the partial tender offer should be limited referring to the European tender offer rules.



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.
- ✓ A offeror is required to initiate a tender offer for acquiring shares which would exceed the threshold (ex-ante approach).



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.
- ✓ A offeror is required to initiate a tender offer after acquiring shares exceeding the threshold (ex-post approach).

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 and deadline for submissions.

<Details of the relaxation>

Only **to submit a "large shareholding report" and "change report" on the pre-registered bi-monthly reference date** and submit the report within five business days of the reference date.

< 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

Outline of Joint Holders Rule

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.

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

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Transparency of beneficial shareholders

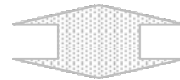
- ❑ It has been pointed out that **the transparency of beneficial shareholders should be improved with reference to systems in other countries** in order to promote dialogue between companies and investors.

(*)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%).
- ❑ Many companies outsource (at cost) the search for beneficial shareholders to research firm.



Systems in other countries

US



- An institutional investment manager that exercises investment discretion over \$100 million or more in Section 13(f) securities such as equity securities that trade on a national securities exchange must report 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 (or to have been interested in previous 3 years) in the company's voting shares
- 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 number of shares and the identity of persons interested in the shares in question within such reasonable time as may be specified in the notice.