

Corporate Governance Reform in Japan

Japan Corporate Governance Forum



金融庁

Financial Services Agency, the Japanese Government

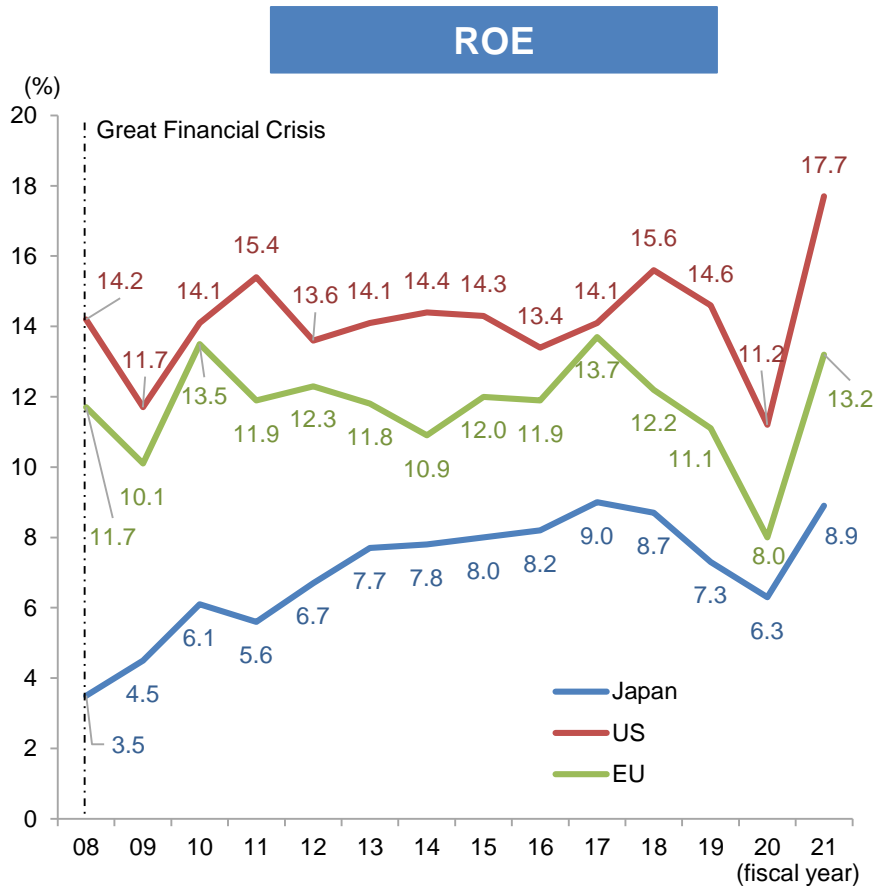
January 12, 2023

Overview

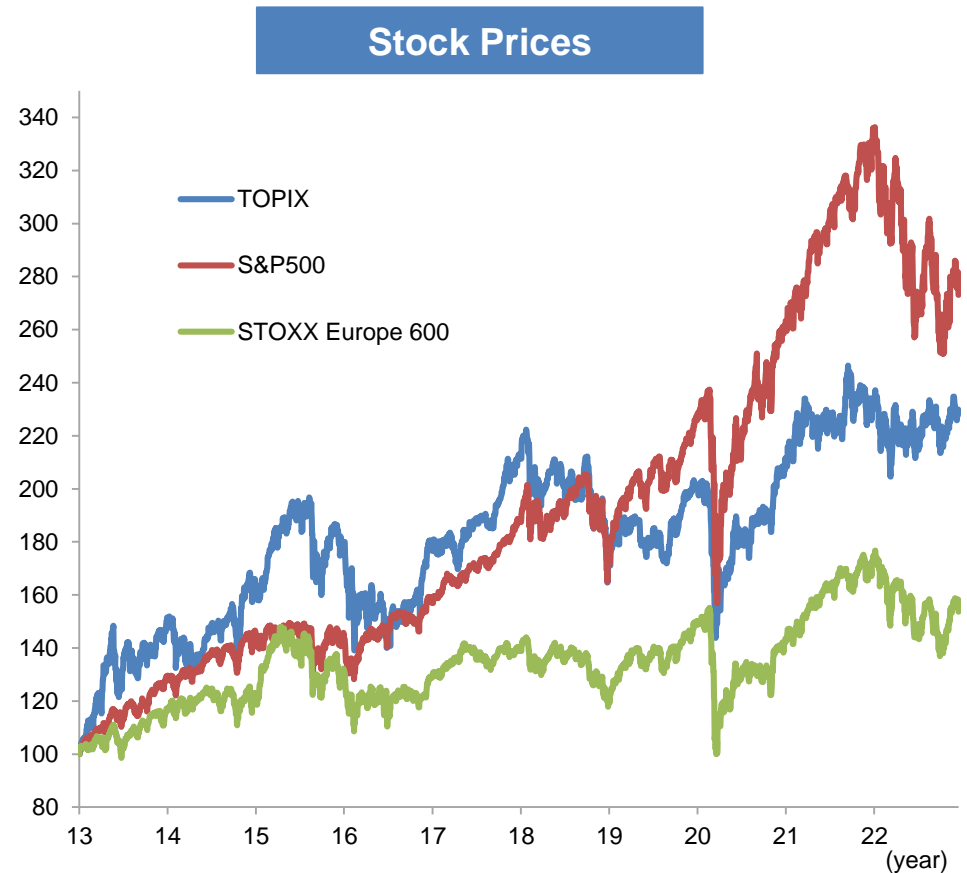
- ❑ To promote sustainable growth of companies and their mid- to long-term increase in value, it is required to further deepen corporate governance reform from form to substance.
- ❑ Especially, it is important to enhance engagement between companies and investors. Also, it is important for us to hear from investors in US and globally.
- ❑ Beyond the Corporate Governance Reform, we are accelerating;
 - ◆ To further enhance the corporate disclosure, sustainability reporting is to be incorporated into statutory reporting framework.
 - ◆ Asset-Income Doubling Plan realizes a “virtuous cycle of growth and asset income”.
 - ◆ Japan aims to become an international financial center that attracts more investment through various initiatives.

Financial indicators

- ❑ The Return on Equity (ROE) of Japanese companies has been more than doubled after the Great Financial Crisis.
- ❑ Stock Prices of Japanese companies has been on the upward trend. TOPIX has outperformed STOXX Europe 600 in the last decade.



Note: ROE is the median of ROE of the companies which constitute following stock index. Japan: TOPIX500 / US: S&P500 / EU:BE500
Source: Prepared by the JFSA from Bloomberg.



Note: Local currency based indexes. Rebased to 100 as of 2013 Jan.1.
Source: Bloomberg.

Speech by Prime Minister KISHIDA Fumio at the New York Stock Exchange (1) (September 22, 2022)

□ Corporate Governance Reform

One very important policy is corporate governance reform.

As a result of numerous reforms Japan has made in the last decade, the behavior of Japanese companies has significantly changed.

ROE ratios have soared, and almost all companies now have independent outside directors. We also expect more companies to appoint women and foreign talent to their boards.

We have witnessed more companies undertaking vast corporate reforms not seen in the past, such as divesting non-core businesses and pivoting to new fields.

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.

It has been three decades since the burst of the "bubble" economy in Japan. Since then, Japan has cut costs by tackling excessive debt, excessive investments and excessive capital. We have achieved a slim, cost-sensitive economy as a result. But clearly more is required.

We face the challenge of investing in the future and developing an economy that consistently creates new value.

□ Asset-Income Doubling Plan

My fourth point is our Asset-Income Doubling Plan.

We now have 2,000 trillion yen in personal financial assets. Only around 10% of this is invested in stocks. In order to double a asset income and enable long-term asset building for retirement, it is essential to make our small investment tax exemption system for individuals permanent.

Speech by Prime Minister KISHIDA Fumio at the New York Stock Exchange (2) (September 22, 2022)

□ Human Capital

Let me share Japan's five priorities.

First is to invest in people.

Digitalization and greening have drastically changed the economy. We know that a source of a great deal of added value will be intangible, not tangible, assets. And in particular, it will be human capital.

So, **we will advance a society where human capital is central.**

Labor market reform is my priority. Japanese labor management will be updated, from a seniority-based, lifelong employment system into a new Japanese system where job-based pay is located at its core, through the cooperation between the government and business community.

This will facilitate labor mobility and give birth to a cycle in which paying higher wages attracts highly skilled personnel, thereby increasing labor productivity and level of salaries.

We will further bolster our support for the reskilling of workers in digital and other fields, while encouraging labor mobility.

Japan's future depends upon the vitality that women bring to our economy. "Women empowerment" is crucial. There has been a clear shift in the attitudes of the younger generation. Over the past 10 years, the percentage of full-time female employees under the age of 35 has increased by 10% or by 0.6 million -even though the population of this generation decreased by 1.2 million over the same period.

We are determined to clear the obstacles that hinder women's advancement because women must be at the core of the Japanese economy.

We need women to pursue their careers and have families. There is no reason we cannot pursue both and help the declining birthrate. In April of next year, we will establish the Child and Family Affairs Agency to consolidate child-rearing policies. This is a landmark policy that aims to meet the structural challenges of our population decline.

Reforming the wage system, investing in people, and women empowerment. **All of these efforts will be promoted in a transparent manner as we establish disclosure protocols for human capital, and we will lead the international rule-making process as well.**

Corporate Governance Reform: Future issues and Initiatives

- With the aim of promoting the sustainable growth of companies and their medium- to long-term increase in value, it is required to proceed with initiatives toward the substance of corporate governance reform.

Assumed Initiatives

- Enforce the disclosure form of non-financial information, including human capital investment and climate change.
- Examine whether corporate governance reform has contributed to enhancing corporate value, and further improve the substance.
 - ✓ Enhance the quality of stewardship activities and stewardship report of institutional investors.
 - ✓ Examine the effectiveness of institutions' incorporation of the revised Code. (Applying the PDCA cycle.)
- Review the large shareholding reporting system to facilitate dialogue between companies and investors.
 - ✓ Clarify the range of (i) "joint holder" and (ii) an "act of making important suggestions."

Set up a Forum to hear a wide range of opinions from stakeholders, including global investors, and compile an Action Program to take action on corporate governance reform in terms of substance.

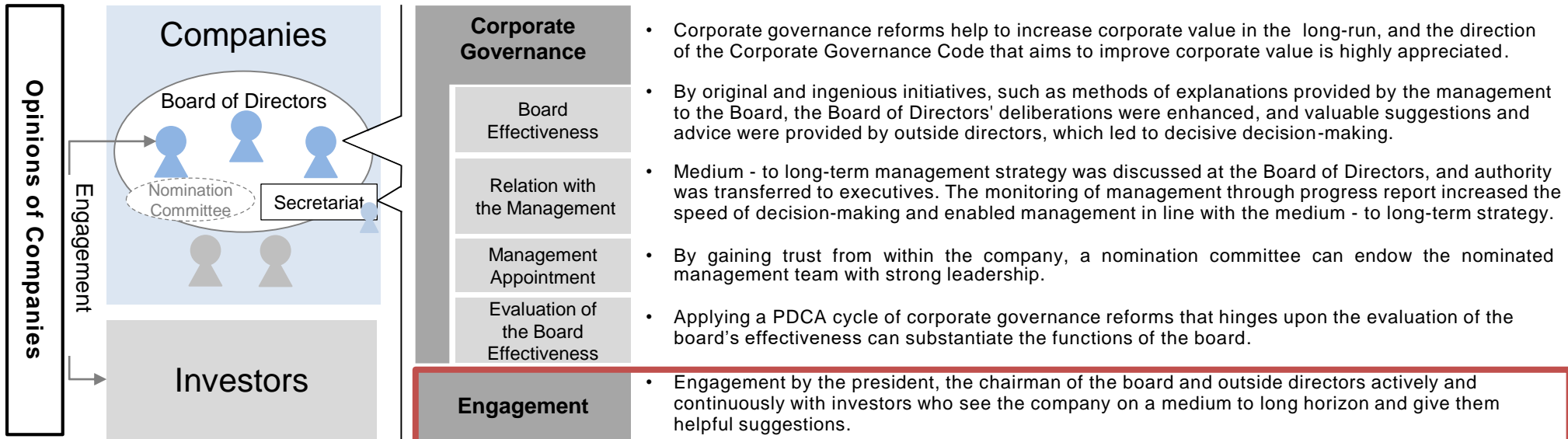
Overview of the interviews with companies on corporate governance reforms

- FSA, with the cooperation of Keidanren (Japan Business Federation), conducted a series of interviews with companies in order to look into their corporate governance initiatives and their views.

[Interviewed companies (in alphabetical order)]

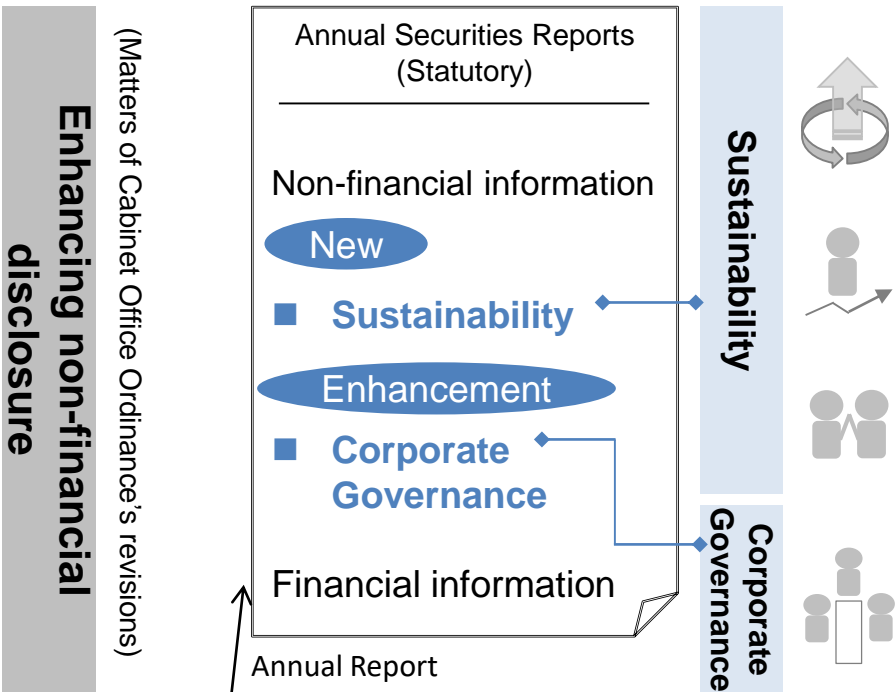
Astellas Pharma, Ebara, FP Corporation, Omron, Kao, Sun Frontier Fudosan, Shin-Etsu Chemical, Suzuki Motor, Sumitomo Electric Industries, TDK, Nitori HD, Fujitsu, Mitsui & Co., Mitsui Fudosan, Yamaha, Yokogawa

Key Takeaways	Evaluation of the Corporate Governance Reforms	<ul style="list-style-type: none"> • Most companies, including the management side, said that enhanced deliberations by the board of directors and deepened discussions on medium- to long-term business strategies had a positive impact on their business, and that engagement with investors gives useful suggestions to the management, suggesting that the direction and effectiveness of corporate governance reforms are widely supported.
	Key Issues	<ul style="list-style-type: none"> • Given the pressure to comply on the companies' side, if the Corporate Governance Code refers to even details of businesses, it may lead to formalistic responses by companies, resulting in an insubstantial reforms. • High-quality engagement should be promoted by addressing issues such as exercise of voting rights based on a check-the-box by institutional investors, the lack of opportunities for engagement at medium-sized and smaller companies, and the difficulty for companies to identify beneficial owners.



Summary of Report by the Working Group on Corporate Disclosure of the Financial System Council (published on June 13, 2022)

■ The Working Group on Corporate Disclosure has discussed enhancing disclosure of non-financial information and improving efficiency of disclosure in light of recent changes in economic and social circumstances. The summary below is based on the discussions.



General

- A new section for disclosure of sustainability information will be created
 - "Governance" and "Risk Management" will be disclosed by all issuers.
 - "Strategy" and "Metrics and Targets" will be disclosed under materiality judgement by an issuer.

Human capital

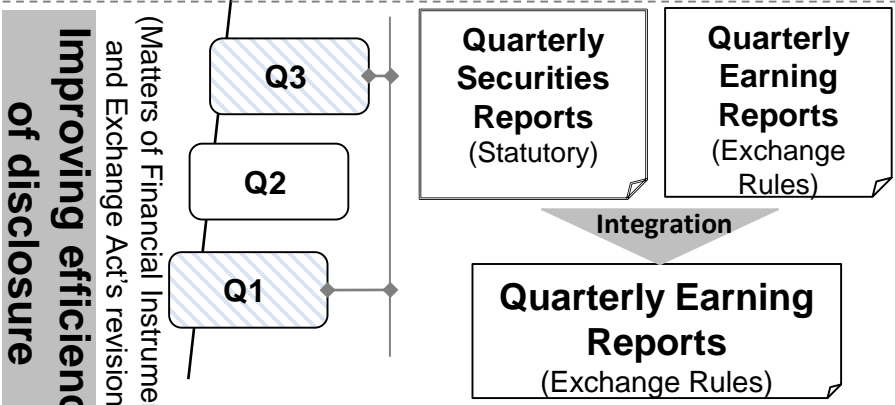
- "Human resource development policies" and "Policies on improving workplace environment" will be added to disclosure items.

Diversity

- "Gender pay gap," "Ratio of women in managerial positions," and "Ratio of male workers taking childcare leave" will be added to disclosure items.

Functioning of the Board of Directors

- A new section for disclosure of activities of the Board of Directors, Nomination Committee, and Remuneration Committee will be created.



Revision of Quarterly Disclosure System

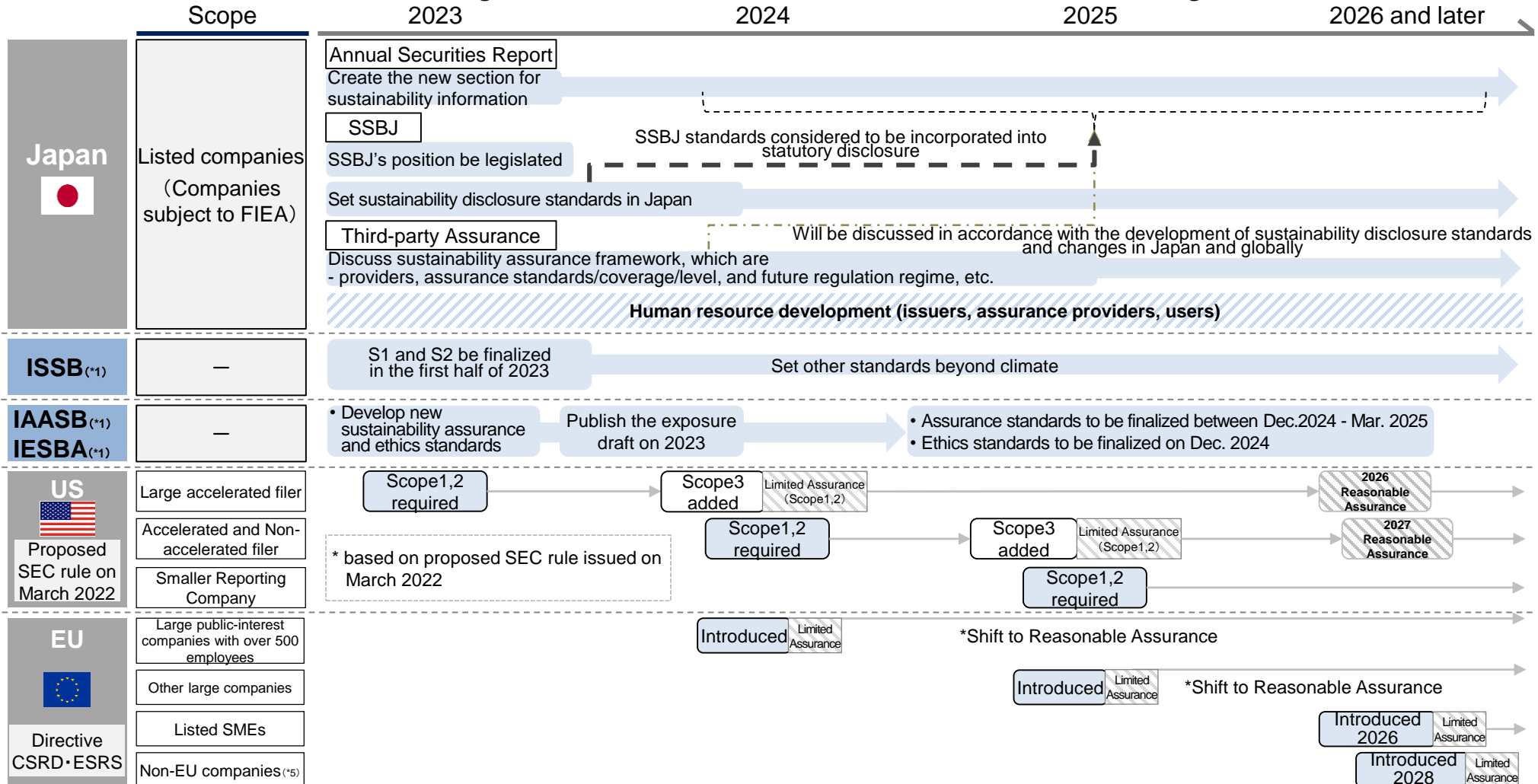
- The quarterly disclosure requirements under the Financial Instruments and Exchange Act (Q1 and Q3) will be abolished and integrated into quarterly earning reports based on the Exchange Rules.
- Continue discussions on issues for materializing the integration, such as consideration regarding disclosure obligation, content of disclosure, enforcement against false statements and review by audit firms.

(Note) In addition to the above, clarification of disclosure requirements for material contracts entered into by companies with other parties, and promotion of disclosure in English have been also summarized.

Interim Roadmap for sustainability disclosure in Japan

Provisionally translated based on Presentation Materials of the forth meeting of the Working Group on Corporate Disclosure of the Financial System Council

- In order to enhance the disclosure of sustainability information in Japan, the following initiatives can be considered while reviewing them as needed in accordance with future changes in circumstances.



(*1) ISSB: International Sustainability Standards Board, IAASB: International Auditing and Assurance Standards Board, IESBA: International Ethics Standards Board for Accountants (*2) For ISSB and US, description of proposed rules for climate-related disclosure (*3) For US, Large accelerated filer is an issuer which meets the conditions including an aggregate worldwide market value of \$700 million or more, Accelerated filer is an issuer which meets the conditions including an aggregate worldwide market value of \$75 million or more, but less than \$700 million, Non-accelerated filer is an issuer which doesn't meet the conditions for large accelerated filer and accelerated filer, and Smaller Reporting Company is an issuer which meets the conditions including a public float of less than \$250. (*4) In CSRD, SMEs are defined as all enterprises with less than 250 employees. (*5) Non-EU companies with substantial turnover in the EU (*6) In UK, the government published the roadmap for greening finance on October 2021. It is indicated in the roadmap to incorporate ISSB standards into statutory annual reporting, as the initiatives for one to two years from 2023.

Overview of Asset-Income Doubling Plan (1)

Approved by Council of New Form of Capitalism
Realization on November 28, 2022

□ Basic Concept

- Looking at New Form of Capitalism from the viewpoint of the flow of funds, it is important to increase income from financial assets in addition to earned income by utilizing cash deposits in households for investment.
- If an environment is developed in which it is easy for the middle class to invest in assets with high returns, household income from financial assets will expand. If household funds become the source of growth investment for companies, corporate value will increase. If corporate value increases, household income from financial assets will further expand, realizing a "virtuous cycle of growth and asset income".
- In the past, there was an image that investment in stocks and investment trusts was carried out by some wealthy people. However, with the progress of digitalization, it is possible to greatly expand the asset income of the middle class by developing a system in which a wide range of people, including those with little investment experience, can participate in asset formation.

□ Goal

1. In five years, double the total number of NISA* accounts (from 17 million to 34 million) and the amount of NISA purchases (from 28 trillion yen to 56 trillion yen).
2. Thereafter, aim to double household investment (the total balance of stocks, investment trusts, bonds, etc.), and through achieving these goals, also aim to double asset management income itself as a long-term goal.

*Short for Nippon Individual Savings Account, the small investment tax exemption system for individuals.

□ Direction

- Given the importance of making NISA simple, easy to understand and use, the need to widely disseminate the effectiveness of diversified long-term deposit investment, and the need to develop an adviser system that is neutral and reliable for consumers, promote the following seven pillar initiatives in an integrated manner toward doubling asset income.
- Tax measures will be considered in the future tax reform process.

Overview of Asset-Income Doubling Plan (2)

Approved by Council of New Form of Capitalism
Realization on November 28, 2022

□ Seven Pillars

1: Fundamentally expand and make permanent NISA, which shifts household financial assets from savings to investment

Make the NISA system permanent, and at the same time, make the tax-free holding period indefinite and raise the tax-free limit.

2: Reform the iDeCo (individual-type Defined Contribution pension plan) system, including raising the minimum age for participation

Raise the participation age to 70; reach a conclusion on raising the contribution limit and the age at which people can start receiving benefits in conjunction with the 2024 fiscal review of public pensions.

3: Create mechanisms to encourage consumers to provide neutral and reliable advice

Establish the public organization to promote financial and economic education, which certifies neutral advisors, and ease registration requirements for targeted investment advisors.

4: Strengthen asset formation for employers

Encourage companies to make efforts to utilize neutral certified advisors in their work areas.

5: Enhance financial and economic education to instill the importance of stable asset formation

Establish the public organization to promote financial and economic education, and formulate the "Basic Policy" as a national strategy for comprehensive and systematic promotion of education throughout the country.

6: Realize a global financial center open to the world

Comprehensively promote the revitalization of financial and capital markets, the globalization of financial administration and taxation systems, the improvement of living conditions and business environment, and the effective dissemination of information.

7: Ensure Customer-Oriented Business Conduct

Review the "Principles for Customer-Oriented Business Conduct" and develop necessary rules.

Japan as an International Financial Center

- ❑ What makes fund managers consider the relocation of their resources?
 - ✓ Increased focus on business continuity during the pandemic (i.e., multiple offices)
 - ✓ Growing geopolitical uncertainties in East Asia
- ❑ Japan's advantages for attracting more investment to Japan and the Asia include:
 - ✓ A solid democracy and the rule of law;
 - ✓ Safe and secure living and business environment;
 - ✓ A large real economy and stock market; and huge household financial assets

Tax and financial regulation

- Financial Market Entry Office for English consultation and supervisory interaction
- Effective promotion and outreach
 - Direct outreach to overseas managers
 - Increased media coverage
- New easy-entry schemes for overseas asset managers
- Corporate, inheritance and income tax reforms
- Review of the remaining tax obstacles

Living and business environment

- Financial start-up support program for financial license and visa acquisition
- Preferential immigration treatment for asset management professionals
- Smooth opening of a bank account

Business opportunities

- Support for startups
- ESG bond market
- Corporate governance reforms
- Investment in human capital by JP firms
- Review of firewall regulations



Thank you for your attention.

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



Public Relations Magazine
ACCESS FSA



Reference

Key Points to the Second Revision to Japan's CG Code

- ❑ To increase corporate value by improving the ability of Japanese companies to respond to changes in the business environment and to gain recognition from investors in Japan and overseas, Japan's Corporate Governance Code was revised on June 11, 2021 (second revision).

Key Points

1. Enhancing Board Independence

- ✓ Increase in **the number of independent directors** from at least two to **at least 1/3 of the board for Prime Market listed companies**
- ✓ Establish a **nomination committee** and a **remuneration committee**

2. Promoting Diversity

- ✓ Disclose **a policy and voluntary measurable targets** in respect of **promoting diversity in senior management by appointing females, non-Japanese and mid-career professionals**

3. Attention to Sustainability and ESG

- ✓ Enhance **the quality and quantity of climate-related disclosure based on TCFD recommendations** or equivalent international frameworks at Prime Market listed companies

Other major points

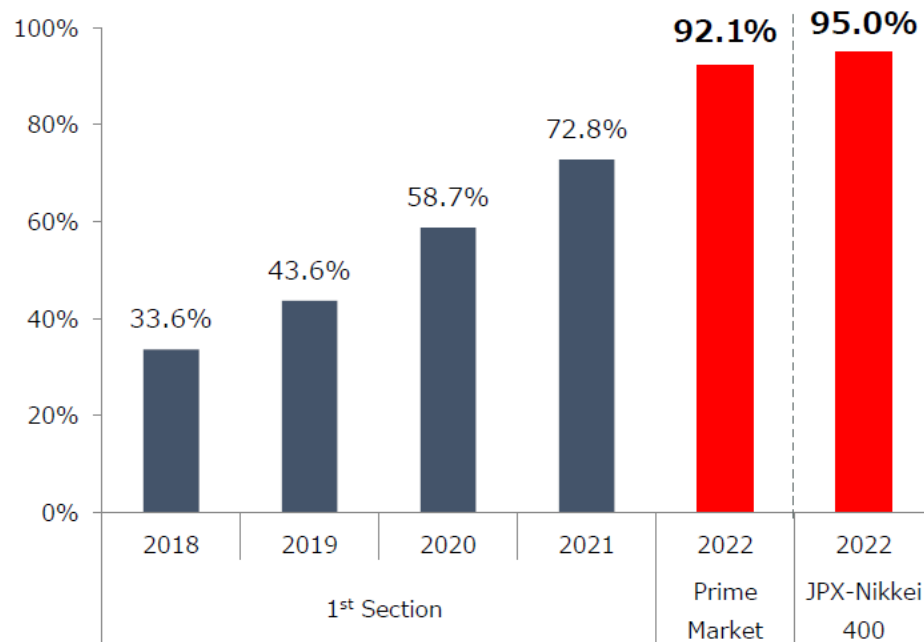
- ✓ Appoint independent directors enough to have them form **a majority of the board** or establish **an independent special committee** at Prime Market listed subsidiaries so as to cope with conflicts of interest between their parent company and minority shareholders
- ✓ Promote the use of **electronic voting platforms** and **disclosure in English** at Prime Market listed companies

Proportion of Independent Directors in the Prime Market

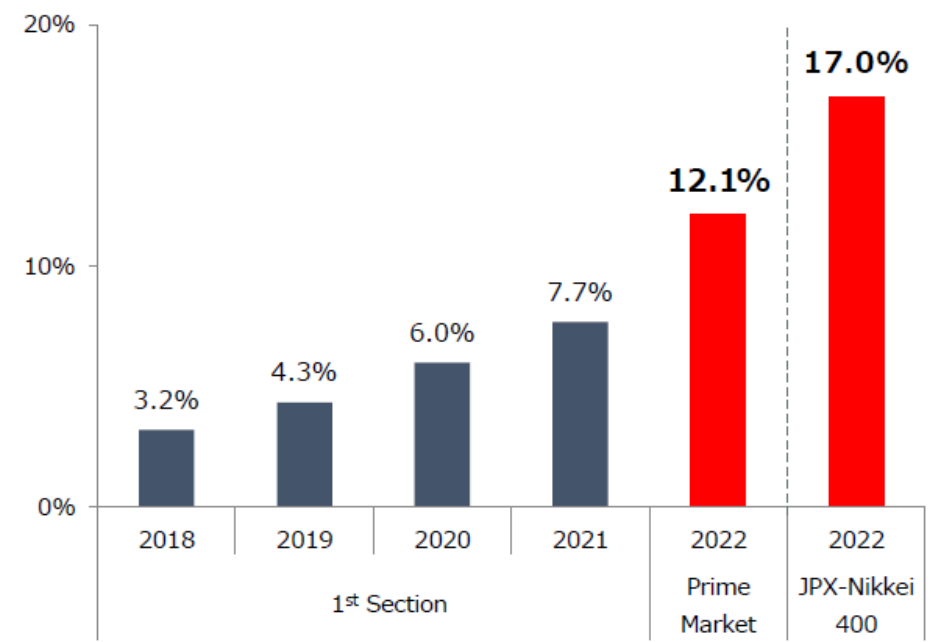
[Principle 4.8 of the CG Code]

- Over 90% Prime Market listed companies have 1/3 or more independent directors.
- 17% of JPX Nikkei 400 have a majority of independent directors.

[Companies with 1/3 or more Independent Directors]



[Companies with Majority Independent Directors]



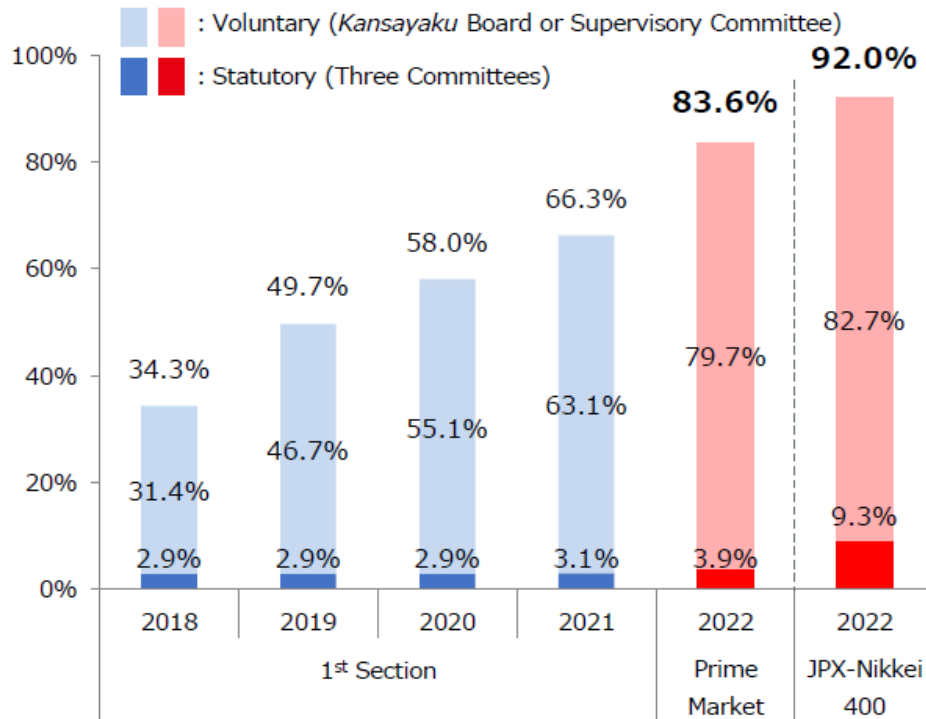
Source: Excerpts from "Response of Listed Companies regarding Revised Corporate Governance Code (As of July 14, 2022)", Tokyo Stock Exchange, Inc. August 3, 2022", partially processed by FSA

Nomination / Remuneration Committees

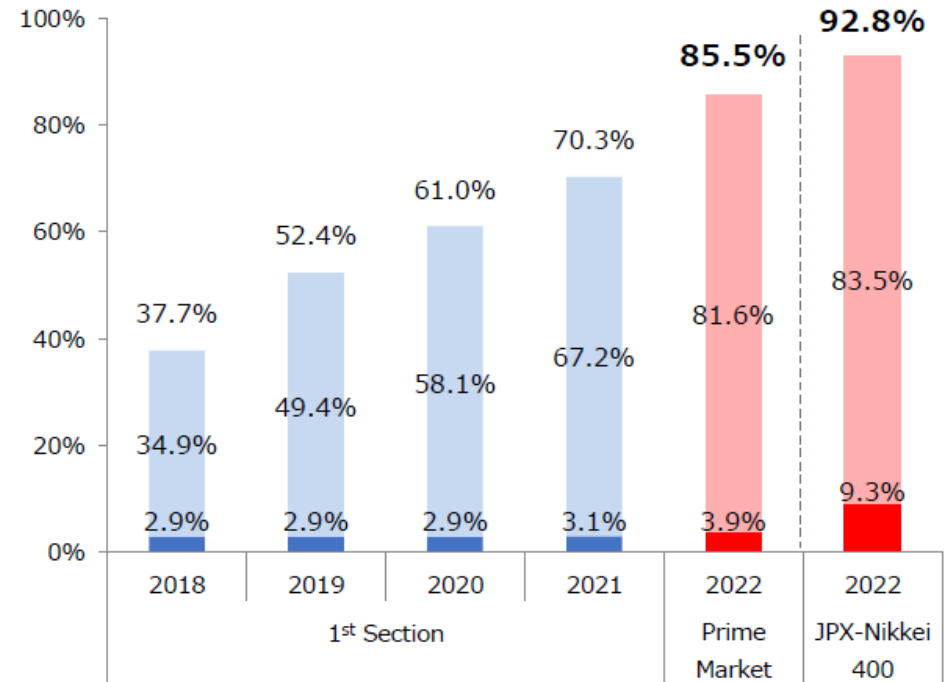
[Supplementary Principle 4.10.1 of the CG Code]

- **About 80%** of companies at Prime Market have established statutory or optional Nomination / Remuneration Committees.

[Companies with nomination committee]



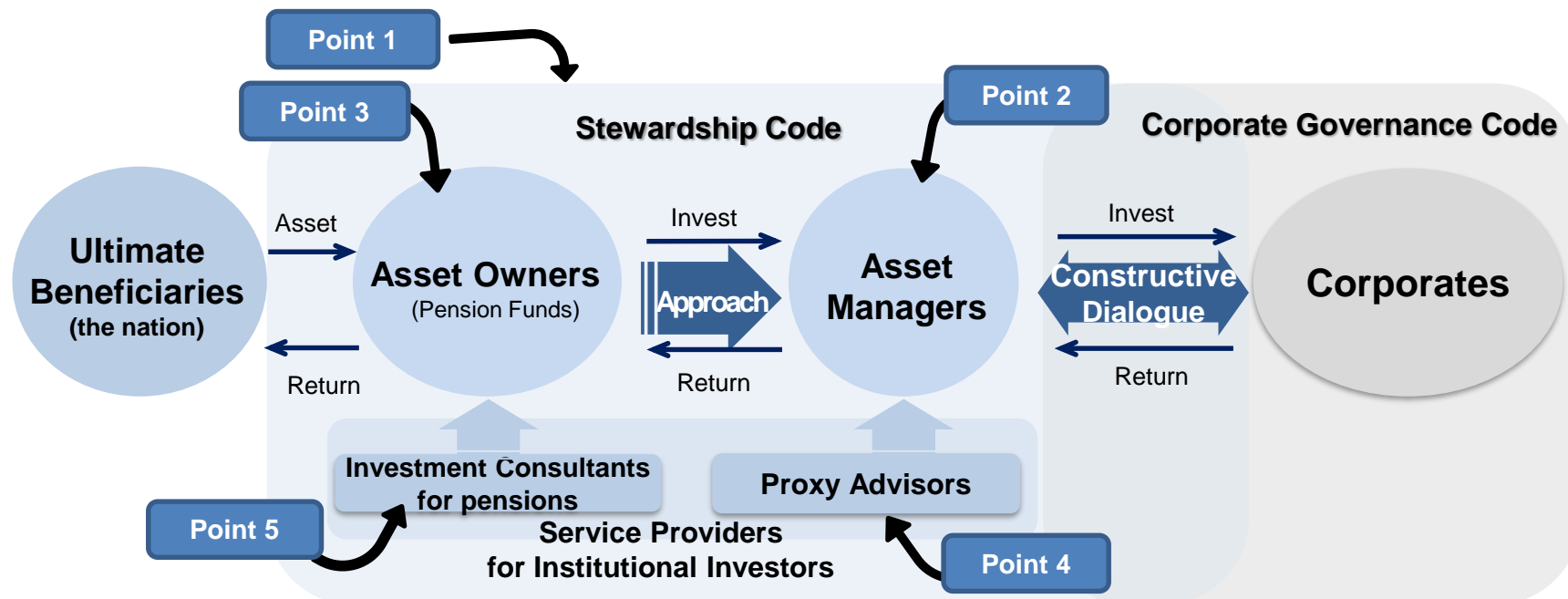
[Companies with remuneration committee]



Source: Excerpts from “Response of Listed Companies regarding Revised Corporate Governance Code (As of July 14, 2022)”, Tokyo Stock Exchange, Inc. August 3, 2022”, partially processed by FSA

Key Points to the Second Revision to Japan's Stewardship Code

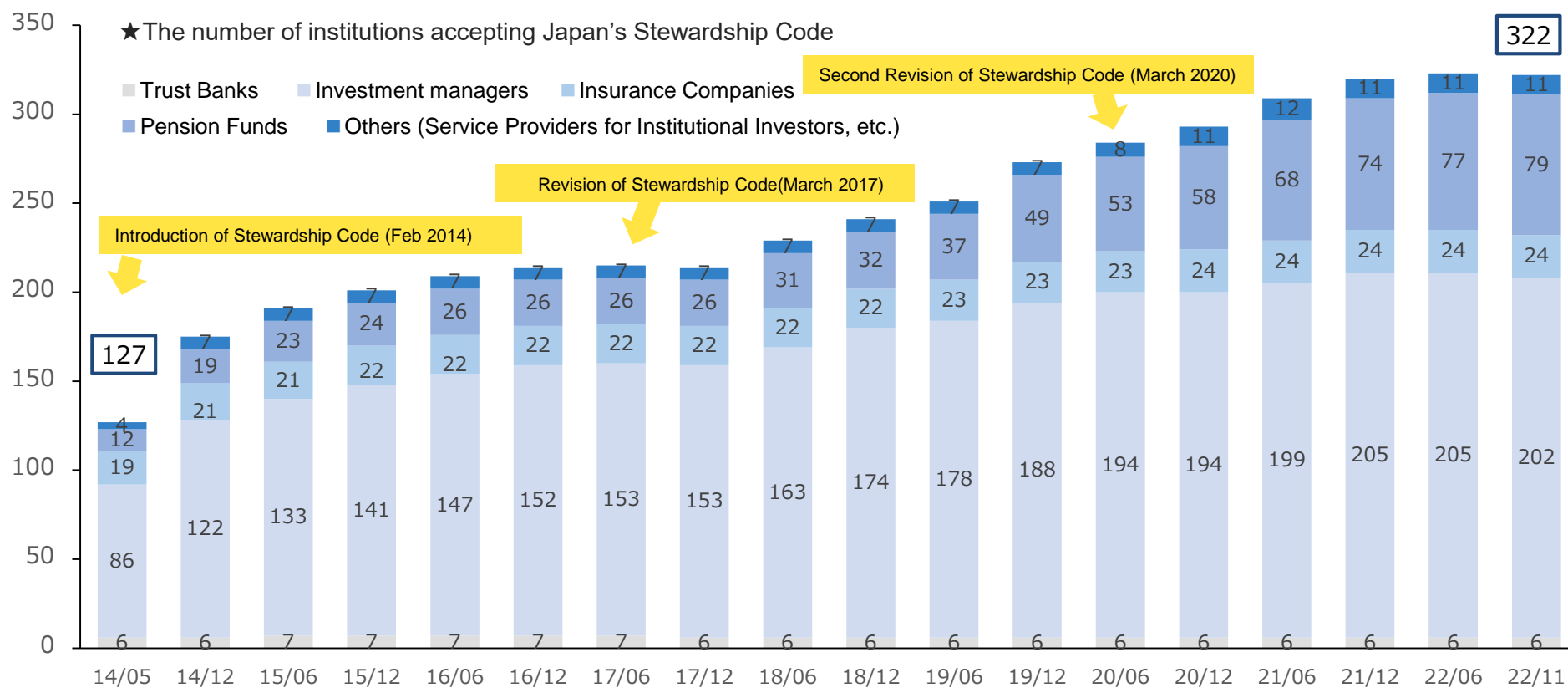
- To further promote the effectiveness of corporate governance reform, Japan's Stewardship Code was revised on March 24, 2020 (second revision).



(1) General Discussions	(1) Consciousness of “medium- to long-term increase of corporate value” (2) Consideration of “sustainability” (medium- to long-term sustainability) (3) Applying to other asset classes
(2) Asset Managers	Improvement of disclosure to promote constructive dialogue
(3) Asset Owners	Support for the stewardship activities of corporate pension funds
(4) Proxy Advisors	
(5) Investment Consultants for pensions	Improvement of quality of services for institutional investors

Changes in number of institutions accepting Japan's Stewardship Code

- The number of institutions accepting Japan's Stewardship Code has continued to increase since the introduction of the Code on February 2014. 322 institutional investors have accepted the Code as of November 30, 2022.
- 296 institutional investors* have accepted 2020 revised version of Japan's Stewardship Code as of November 30, 2022. (* 6 Trust Banks, 183 Investment managers, 24 Insurance Companies, 73 Pension Funds, 10 Others)



Issues regarding institutional settings that support engagement (1) – Collaborative engagement

- ❑ The Council of Experts on the Stewardship Code pointed out issues on institutional settings that support engagement, such as the legal framework for collaborative engagement.
- ❑ In the most recent survey, more than half of investors mentioned the lack of clarity in the terms "joint holder"^(Note 1) and "act of making important suggestions"^(Note 2) as a challenge in collaborative engagement.

(Note 1) Under the large shareholding reporting system, shareholders are required to calculate their holding ratio of share certificates, etc. by including the shareholding of "persons who have agreed with another shareholder to jointly exercise voting rights and other shareholder rights." ("joint holders").

(Note 2) An "act of making important suggestions" means suggesting matters specified in Article 14-8-2, Paragraph 1 of the Order as those that will cause material changes or materially influence the issuer's business activities at a general shareholders meeting of investee companies or to their corporate directors.

For institutional investors, the deadline for submission of a large shareholding report, etc. is relaxed by a special reporting rule in consideration of the excessive clerical burden of disclosure. However, this rule does not apply to cases where the purpose of holding is an "act of making important suggestions."

Issues regarding collaborative engagement

Proposed Revisions to the Stewardship Code (December 2019)

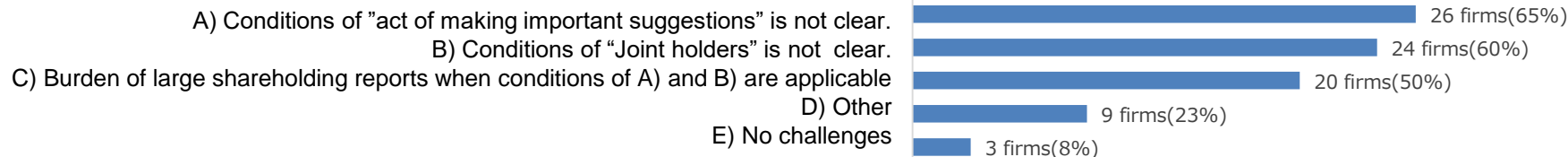
In addition, the following comments were also raised during the discussion of the Council. Further review by the Council based on actual conditions is considered necessary. The Financial Services Agency is also expected to review them.

- With the expansion of passive investment, is it necessary to reconsider how to improve engagement?
- Some people point out that the "Clarification of Legal Issues Relating to the Development of Japan's Stewardship Code" does not give sufficient clarification on the scope of collaborative engagement. Is it necessary to deal with these arguments?

c.f.) Responses to public comments to the draft revised Stewardship Code (March 2020)

As it was pointed out that the "Clarification of Legal Issues Relating to the Development of Japan's Stewardship Code" does not give sufficient clarification on the scope of collaborative engagement, it is expected that the FSA will consider how to respond to such issues as requested in "Second Revision of the Stewardship Code."

Survey on challenges for collaborative engagement



Note 3: Respondents were 40 institutional investors that had outstanding Japanese equity investment as of the end of June 2021 that had "undertaken" or "planned to undertake" collaborative engagement activities as of the end of August 2021.

Source: Prepared by JFSA from "Results of the 8th Questionnaire on Responses to the Japanese Version of the Stewardship Code (October 2021)", Japan Investment Advisers Association

Issues regarding institutional settings that support engagement (2) – Collaborative engagement

Problems arising from lack of clarity in the legal terms related to collaborative engagement

The 19th Follow-up Meeting (April 2019) Kerry Wailing Member

ICGN Members would welcome further clarity around their ability to act collaboratively with other investors without being considered a ‘concert party.’ It would therefore be helpful for the FSA to publish guidance on what constitutes acceptable engagement subjects to ensure they will not breach rules regarding collective holding thresholds above which would trigger onerous reporting requirements.

The 7th Follow-up Meeting (April 2016) Ueda, Ryoko Member

(T)he UK investors and investors’ associations [...] often tell us about their concerns: if they take part in collective engagement in Japan, it will be regarded as “acting in concert,” and they will become subject to regulations on large volume holding of shares. [...] Even though the FSA has already sorted out and published legal issues related to the Stewardship Code, such doubts have not been easily cleared up. Then we many need to consider other methods.

The Council of Experts on the Stewardship Code (October 2019) Tanaka, Wataru Member

The large shareholding report regulations are still said to be having a chilling effect. Regardless of the comprehensive management control indicated by “Act of Making Important Suggestions,” in addition to the breadth of the original provisions in which all actions of a certain level of importance were seemingly included among the “Act of Making Important Suggestions,” the concept of “joint exercise of shareholder rights” can be read as having extremely comprehensive application because, unlike in the UK and other countries, there are no requirements that it be for the purpose of management control. In the end, I think it would be best to resolve this through legislation. Because such provisions exist under the current legal system, I have heard it said that an investor wanting to make a suggestion has no choice but to do so in the form of a question, that is, to ask the management team what they think about a particular matter. [...] the people I have spoken to have made it clear that ideas are not being conveyed, saying that the investor’s intent is not communicated to corporate managers, or at least to certain corporate managers, simply by asking questions. An approach must be developed to allow things to be stated more directly.

Overview of TSE Market Restructuring

- On April 4, 2022, TSE restructured the cash equity market to incentivize sustainable growth and medium- to long-term corporate value creation at listed companies, thereby providing an attractive market that gains support from various types of investors both domestic and overseas.

Old Market Divisions

1st Section

For companies with high liquidity

Mothers

For startups

2nd Section

For companies with a track record

JASDAQ

For various companies

Standard

Growth

Indicated Issues

- Ambiguity in the market division concepts
- Poor incentives for sustainable growth

Transition to new market segments on April 4, 2022

New Market Segments



Prime

The market oriented to companies which center their business on constructive dialogue with global investors

Standard

The market oriented to companies with sufficient liquidity and governance levels to be investment instruments

Growth

The market oriented to companies with high growth potential

Basic Concepts

- Criteria are set according to the concept of each market segment
- Initial listing criteria and continued listing criteria for each market segment have been standardized in principle.

the Code of Conduct for ESG Evaluation and Data Providers

- ❑ The Technical Committee for ESG Evaluation and Data Providers compiled a draft "Code of Conduct" to ensure transparency and fairness of **ESG evaluation and data providers** that evaluate corporate ESG initiatives. The draft report, published in July 2022, set out recommendations for ESG evaluation and data providers, institutional investors, and companies.
- ❑ Based on the Technical Committee's report the FSA published a draft **Code of Conduct for public consultation (from July to September 5) and finalized it in December 2022.**

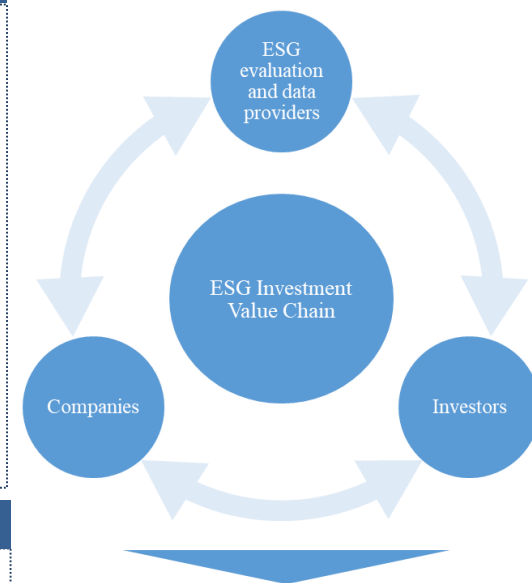
note) The FSA calls for voluntary endorsement of the Code from ESG evaluation and data providers that provide services in Japan. The Code will not be laws or regulations, but are designed to be voluntary on a "comply or explain" basis, where the providers supporting the Code will either comply with the principles and guidelines of the Code, or explain the reasons why they do not comply with a particular item.). The FSA will publish the status of endorsement regarding evaluation by June 2023 and that regarding data by June 2024.

Recommendations for ESG evaluation and data providers (Code of Conduct)

- **Ensuring Transparency**
Disclosing the objective, approach and basic methodology of ESG evaluations.
- **Human Resource Development**
Securing necessary professional human resources as organization and developing their own professional skills.
- **Avoiding or managing the risks of conflicts of interest**
Identifying their own activities and situations that could undermine the independence, objectivity, and neutrality of their business, and avoiding or reducing the risks of, potential conflicts of interest.
- **Communication With Companies**
Clarifying a contact point with a company, allowing it for confirmation and correction of input data for evaluation, and disclosing these procedures in advance.

Recommendations for institutional investors and companies

- Clarifying the basic approach of how they utilize ESG evaluation and data in their investment decisions (investors)
- Disclosing ESG information in an easy-to-understand manner and contact point for responding to inquiries from ESG evaluation and data providers (companies)



Through mutual encouragement of the market as a whole, improve the quality of evaluations, etc