

Follow up on the Action Program for Corporate Governance Reform 2024 and Future Policy Priorities

- Draft -

I. Introduction

A decade has passed since the creation of Japan's Stewardship Code in 2014 and the introduction of the Japan's Corporate Governance Code in 2015. Progress has been made on corporate governance reform under both codes. On the other hand, it is noted that to achieve sustainable corporate growth and increased corporate value in the mid- to long-term, both companies and investors are supposed to actively pursue corporate governance reform instead of merely adopting a box ticking approach.

In this context, based on discussions at 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: From Form to Substance" was published in April 2023. The Action Program stated that the issues should be addressed through *"various measures to promote constructive dialogue between companies and investors, such as enhancing quality disclosure and encouraging self-motivated changes to take place in the mindsets of companies and investors"* and that the timing of revisions to both Codes would not be bound by the previous review cycle.

Subsequently, the "Action Program for Corporate Governance Reform 2024: Principles into Practice," published in June 2024, indicated the direction of *"going back to the spirit of the Stewardship Code and the Corporate Governance Code, which is to ensure sustainable corporate growth and increased corporate value over the mid- to long-term. From this perspective, emphasis should be placed on initiatives for encouraging the management with an awareness of profit-making and growth, and each initiative, including the effective implementation of stewardship activities, should be taken for putting corporate governance reform 'into practice' [...] through examining and sharing specific initiatives."*

It is suggested that the future policy focus should remain on the effectively implementing corporate governance reform by encouraging companies and investors to adopt self-motivated changes in their mindsets. At the same time, it is essential to create environments, potentially by reviewing Japan's Corporate Governance Code, to promote dialogue based on "a relationship of cautious trust" that truly contributes to the

sustainable corporate growth and increased corporate value over the mid- to long-term. What are the experts' views on the overall suggested direction?

In the review process, attention should be paid to costs and disclosure burdens for listed companies. In this regard, the Code should be streamlined. For example, provisions should be deleted, integrated, or simplified if they have already become part of corporate practices since the establishment and revisions of the Code. Additionally, there are provisions that now duplicate mandatory requirements established after the last revision of the Code in 2021 and could be streamlined. Furthermore, efforts will be made to once again promote understanding of the principles-based and the "comply or explain" approach that the Code adopts.

II. Following up on the Action Program and suggested future policy priorities

1. Driving value creation capacity

It is important for companies to operate with an awareness of their responsibilities to various stakeholders, including their fiduciary responsibilities as those entrusted with management by shareholders. Japan's Corporate Governance Code aims to promote "growth-oriented governance" by ensuring transparency and fairness in companies' critical decision-making process, and by encouraging companies to make prompt and resolute decisions. The Code emphasises promoting healthy entrepreneurship to achieve sustainable corporate growth and increased corporate value over the mid- to long-term, rather than placing excessive emphasis on "compliance-oriented governance," which focuses on risk avoidance and control and preventing misconduct. It is important to return to the original intent of the Code to advance corporate governance reform that enhances companies' "value creating capacity."

In March 2023, the Tokyo Stock Exchange (hereafter "TSE") issued a request titled "Request for management conscious of cost of capital and stock prices" to companies listed on the Prime Market and the Standard Market. As of April 2025, 92% of companies listed on the Prime Market and 51% of companies listed on the Standard Market disclosed relevant business management plans. This indicates that a growing number of listed companies are striving to enhance corporate value while engaging and communicating with shareholders and investors. The request states clearly that "*the TSE does not necessarily expect companies rely solely on buybacks, increased dividends or resolve issues with a one-time response. Efforts are expected at a fundamental level to achieve profitability that exceeds the cost of capital on a sustained basis and to attain sustainable growth.*" It also states that "*management is expected to take the lead in appropriately allocating resources while giving due consideration to the cost of capital and profitability. This involves advancing initiatives such as investing in R&D and human capital to create intellectual property and intangible assets, investing in equipment and facilities, and restructuring the business portfolio, all of which contribute sustainable growth.*" However, the cash and deposits held by Japanese

companies have been consistently increasing for a long time, and it has been noted that there is potential to improve resource allocation to achieve sustainable growth.

[Future policy priorities]

- Do the experts agree that the TSE and the Financial Services Agency of Japan (hereafter “FSA”) should continue supporting companies' efforts to achieve management that is mindful of capital cost and stock prices, and to encourage dialogue between companies and investors?
- What are the experts' views on potentially reviewing Japan's Corporate Governance Code to promote the effective oversight of boards and enhance quality disclosure in line with each company's strategies and challenges, to achieve the efficient allocation of available resources by companies? The following points should also be considered:
 - (i) There are various investment opportunities allocating for available resources, including: plants and equipment; R&D; establishing bases in regional core urban areas, startups, and other growth investments, and; investments in human capital and intellectual property. It is important for management to seize these diverse opportunities.

Regarding investments in intellectual property and other intangible assets, the FSA will continue to collaborate with relevant institutions and share best practices to promote initiatives aligned with Japan's Corporate Governance Code.

In addition, the FSA will require additional disclosure, in annual securities reports (hereafter “ASR“), of human capital management strategies connected to each issuer's business strategy, a policy on employee compensation, and the year-over-year rate of change in average employee compensation. The FSA also plans to consolidate the sections detailing employee compensation in the ASR.

(ii) Consideration should also be given to clarifying the board's accountability in verifying whether each company appropriately assesses its current resource allocation, such as whether it is holding more cash than necessary.

2. Enhancing quality disclosure and promoting dialogue with investors

To enhance the effectiveness of investors' engagement with companies, the FSA revised Japan's Stewardship Code in XX 2025 to promote collective/collaborative engagement that fosters constructive dialogue and to promote the transparency of beneficial shareholders. Additionally, in an effort to return to the essence of a principles-based approach, the Code was streamlined, for example by removing, consolidating,

and simplifying sections that have already become integral to stewardship practices since the Code's initial development and subsequent revisions.

Additionally, to enhance the effective implementation of stewardship activities, the FSA published a document titled "Practices on stewardship activities," which consolidates and analyses the practices of asset managers, asset owners, and proxy advisers.

Regarding the disclosure of the ASR before annual general meetings (hereafter "AGM"), the FSA established the "Liaison council for the preparation for the environment for disclosing annual securities reports before annual shareholders meetings" in December 2024. They worked together with both public and private sector stakeholders to consider the appropriate timing for ASR disclosure and to identify practical challenges. Furthermore, on 28 March, 2025, the Minister of State for Financial Services issued a formal letter to all listed companies recommending that it is most desirable to submit the ASR at least three weeks before the AGM. As a first step, listed companies that have not previously issued the ASR before the AGM are encouraged to consider submitting the ASR one day or several days prior to the AGM.

The TSE amended the securities listing regulations, which took into effect on 1 April, 2025, requiring mandatory disclosure of financial statements in English. In October 2024, to "visualise" a group of companies that proactively and eagerly meet global investors' expectations, the TSE published a list of indicators for companies in the JPX Prime 150 Index. These indicators include factors related to the capital profitability, market valuations, growth potential, and corporate governance such as the appointment of independent outside directors and the ratio of female executives.

Additionally, concerning the "request for management conscious of cost of capital and stock prices," the TSE published the "Essentials from the investors' perspective" and "Cases studies that do not aligned with investors' perspectives."

The presence of investors with varied perspectives on investment policies and differing time horizons is essential for creating vibrant financial markets made up of diverse participants. To foster increased corporate value and sustainable growth through constructive purposeful dialogue, it is essential to establish "a relationship of cautious trust" between companies and investors. To build a trusting relationship, it is useful for companies to disclose information that is both high reliability and detailed. Meanwhile, investors should conduct in-depth analyses of companies based on the disclosed information and consider various unconventional measures. Conversely, any dialogue that threatens the trust relationship fails to foster increased corporate value, ultimately providing no benefit to either companies or investors. Given the progress in dialogue between companies and investors since the introduction of Japan's Stewardship Code, it is now considered important to thoroughly discuss engagement in detail, taking into account the combination of companies' growth stages and investors' investment policies.

[Future policy priorities]

- To further promote constructive dialogue by improving the quality of stewardship activities and corporate disclosure that meets investors' expectations, it may be helpful to establish a discussion forum for companies and investors. Do the experts support this idea and the forum gathering and sharing good practices for engagement, for example by updating the document "Practices on stewardship activities"?
- What are the experts' views on the next steps for disclosing the ASR before the AGM, specifically, the FSA's following up on disclosure practices in response to the Minister's request letter. Additionally, what are the experts' views on reviewing Japan's Corporate Governance Code to encourage listed companies to disclose the ASR prior to the AGM?
- To support companies in providing appropriate information before the AGM, the FSA could collaborate with related ministries to update the legal framework that includes the full digitalisation of AGM materials.
- What are the experts' views on refining and potentially streamlining the disclosure items required by the ASR, while balancing their usefulness investment decision-making against the burden they place on companies?

3. Improving board effectiveness

To enhance board effectiveness, the FSA gathered and analysed best practices for dialogue between independent outside directors and investors, as well as actions taken by the boards' secretariats. The outcome was published as a document titled "Case studies on board effectiveness."

It is important for listed companies to consider their surrounding environment effectively and fully utilise each function of their organisation with creativity and innovation. The board is expected to make swift and decisive decisions and to effectively oversee management and directors from an independent and objective perspective. It is also expected to promptly and appropriately address scandals and misconduct. From this perspective, it is suggested that listed companies, especially those that are globally competitive, should separate the board's decision-making and supervisory functions from management function.

For boards to fulfil the roles described above, it is important to be creative in setting the agenda and structuring operations to ensure that discussions are effective. The secretariat of the board plays an important role by operating independently from the executives and providing support to the chair, as well as the independent and other directors. It is noted that as boards increasingly focus on their monitoring role, the

secretariat will become even more crucial as a link between non-executives and executives, and plays a vital role during emergencies.

By the end of 2024, 98% of Prime listed companies had appointed independent outside directors to at least one-third of their boards. This suggests that the structure of the boards of Japanese listed companies has improved. On the other hand, there are instances where directors are repeatedly appointed from another company with which there is a longstanding capital relationship, and these directors are reported as independent directors. However, to effectively ensure independence, it has been noted that consideration should be given to whether independent directors with certain ties to the company can truly be regarded as "persons who are not likely to have conflicts of interest with general shareholders," as defined in the TSE guidance for reporting independent directors.

Independent outside directors are expected to play a crucial role in helping changes in the business environment and incorporate these forecasts into their business strategies. Specifically, the effectiveness of boards could be enhanced by including members with diverse management experience that extends beyond the company in question, and incorporating their skills into board discussions. Considering the roles expected of independent outside directors, it is important to appoint a sufficient number of them and to have appropriate processes for their appointment and dismissal. In particular, from the standpoint of the board's role in effectively overseeing management and directors from an independent and objective perspectives, it is noted that companies listed on the Prime Market that are globally competitive should appoint a majority of independent outside directors, while assessing an increasing trend in their quality. It is also suggested that the role of auditors should be reconsidered in the recent context.

[Future policy priorities]

- To discuss the extended roles of independent outside directors and to enhance the functions of the board secretariats (corporate secretaries), do the experts agree with establishing a platform called the "Consortium for the effective implementation of corporate governance" to collect and analyse good practices to update the "Case studies on board effectiveness"?

4. Addressing issues in the market environment

4.1. Strategic shareholdings

Regarding the disclosure of strategic shareholdings by listed companies, in the review of the AGM for the fiscal year 2023, the FSA examined the disclosure of shares whose holding purpose was re-categorised from "strategic shareholdings" to "pure investment." As a result, the FSA identified an issue where holding such shares was effectively the same as continuing to hold strategic shareholdings. To address this issue,

the Cabinet Office Ordinance on Disclosure of Corporate Affairs was amended to include additional disclosure items needed when reclassifying the purpose of shareholding from "strategic shareholding" to "pure investment." Additionally, the Disclosure Guideline was updated to provide a definition of pure investment purpose.

Additionally, the publication titled the "Results of the review of the 2024 annual securities report and points to consider in light of the review's findings," released in April 2025, highlighted that:

- Multiple cases were identified in which a company with strategic shareholdings pressured another company holding those shares not to sell them, mainly to ensure stable shareholders for the issuing company, by suggesting that transactions between them might be reduced.
- Supplementary Principle 1.4.1 of the Corporate Governance Code states that companies should not obstruct the sale of strategic shareholdings. If a company exerts pressure on its holding company, both at the operational and executive levels under the management' instructions, not to sell its shares, while their corporate governance report claims adherence to the supplementary principle of the Code, it undermines the intent of the Code and presents a significant governance issue.

[Future policy priorities]

- What are the experts' views on the FSA continuing to analyse and publish practical issues and good practices for disclosure regarding strategic shareholdings (including re-categorisation of the purpose of holding)?
- Given the instances where some companies exert pressure to prevent the sale of strategic shareholdings, do the experts agree that it is necessary to consider effective measures to ensure that practices align with the Code, taking into account the findings from the aforementioned review of the ASR.

4.2. Large shareholding reporting rules

With the revision for the Financial Instruments and Exchange Act enacted in May 2024, the FSA published draft revisions to the cabinet orders and cabinet office ordinances to clarify the objective criteria of "joint holders" under the large shareholding reporting rules. The revisions aim to promote constructive dialogue between companies and investors by appropriately addressing situations that may threaten market fairness, such as instances where multiple investors secretly fail to submit reports.

To deter violations of the large shareholding reporting rules, the 2008 revision of the Financial Instruments and Exchange Act made the failure to submit reports of large shareholding and the submission of false statements subject to the administrative monetary penalty. However, it has been pointed out that the current level of the

administrative monetary penalty is not sufficient to ensure the large shareholding reporting rules.

[Future policy priorities]

- What are the experts' views on raising the level of administrative monetary penalty for violating the large shareholding reporting rules to enhance deterrence against such violations?
- From the perspective of promoting constructive dialogue between companies and investors, it is important to enhance the fairness of markets and securities transactions. The Cabinet Office Ordinance was revised to additionally require the disclosure of whether the necessary large shareholding reports have been submitted, which must be included in the tender offer statement. The revision aims to prevent situations where tender offers are initiated without the proper filing of large shareholding reports. Taking into account the revision, consideration should be given to whether there are any other measures to be taken.

4.3. Parent-subsidiary listings

There is growing attention on parent-subsidiary listings, reflecting the demand for management that is mindful of cost of capital and stock prices. This is a critical issue not only in terms of protecting minority shareholders but also in ensuring the appropriate allocation of available company resources. Some investors claim that parent-subsidiary listings have not been sufficiently examined in terms of whether they are the best way to increase the corporate value of the group and the subsidiary and enhance capital efficiency. Based on the discussions in the "Study Group to review Minority Shareholder Protection and other Framework of Quasi-Controlled Listed Companies," the TSE published a document titled the "Investor's perspective on such matters as parent-subsidiary listings" in February 2025 to encourage consideration and disclosure regarding group management and the protection of minority shareholders.

In the context of an increase in management buyouts and the acquisition of 100% ownership of subsidiaries, the TSE revised its Code of Corporate Conduct to encourage the protection of general shareholders by enhancing function of the special committees and by improving disclosure necessary for investment decisions by general shareholders.

[Future policy priorities]

- The TSE will continue to encourage active consideration and disclosure regarding group management and the protection of minority shareholders. Furthermore, it could be advisable to consider updating listing rules to protect minority shareholders, such as by ensuring the independence of independent outside

directors for listed subsidiaries and equity-method affiliated companies.

5. Encouraging management to be aware of sustainability issues

Progressive companies are advancing initiatives to clarify sustainability-related frameworks and responsibilities, involving both the executives and the monitoring sides. They are also disclosing what was discussed by the executives and reported to the board. It is noted that the desirable practices should be widely implemented, reflecting the fact that the last revision of the Corporate Governance Code in 2021 clarified the board's responsibility for sustainability issues. It is also important to clearly show how financial information and non-financial information are connected, since managing a company with an understanding of sustainability issues, such as investment in human capital, can lead to better financial results.

In March 2025, the Sustainability Standards Board of Japan (called "SSBJ") released a set of national standards (called the "SSBJ standards") that are designed to deliver functionally aligned outcomes with the International Sustainability Standards Board standards (called "ISSB standards").

The mandatory disclosure of sustainability information in the ASR is currently being discussed by the Financial System Council. A broad consensus was reached to adopt a flexible approach, carefully monitoring trends both in Japan and globally, and considering discussions on assurance. It adopts a phasing approach, requiring disclosure based on SSBJ standards. This should be applied to all or some companies listed on the TSE Prime Market, and specifically to companies with market capitalisations of three trillion yen or more by the end of March 2027. Regarding mandating assurance for sustainability information, the FSA is discussing the registration system, business restrictions, obligations, and assurance standards as necessary requirements for practitioner staff providing assurance services.

Regarding gender and other types of diversity among directors and senior officers, as well as corporate culture, good practices were highlighted in the "Case studies on board effectiveness."

Additionally, companies are facing increasingly uncertain environments and are exposed to various risks throughout their supply chains, including geographical and cybersecurity risks. It remains important to focus on resilience under emergencies.

[Future policy priorities]

- Regarding initiatives to ensure gender and other types of diversity, do the experts agree with the FSA continuing to gather and update case studies in the "Consortium for the effective implementation of corporate governance"?

- Sustainability disclosure and assurance standards need to be discussed further, with an emphasis on ensuring global comparability and staying informed about global regulatory trends. In particular, each company is expected to disclose sustainability-related information that they think is material and sustainability disclosure often includes estimates and qualitative information, both accompanied with uncertainty. Accordingly, companies and management might be hesitant to disclose such information because of the possibility of being accountable for false statements. Taking into account this point, it might be beneficial to clarify the scope of responsibility for false statements and to mitigate risks for being subject to such responsibility. Therefore, do the experts agree that it may be beneficial to revisit the responsibility for false statements by management to set a safe harbour rule to enhance the disclosure of non-financial information in the ASR and to clearly define the scope of responsibility.
- Regarding sustainability disclosure in the area of human capital, the ISSB is launching a new research project. The Japanese government will actively contribute to discussions and share opinions while collaborating with domestic stakeholders to develop standards that meet investors' needs.