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Action Program for Corporate Governance Reform 2024 : Principles into Practice

The Council of Experts Concerning the Follow-up of Japan's Stewardship Code
and Japan's Corporate Governance Code
Opinion Statement No. 7

I. Introduction

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

The Action Program stated that in order to achieve sustainable corporate growth and increase corporate value over the mid- to long-term, sufficient results cannot be expected based on only satisfying matters of form – matters of substance also matter. The Action Program also suggested an acceleration of corporate governance reform by promoting self-motivated changes to take place in the mindsets of companies and investors and recognition of its importance has been widely shared.

In order to accelerate this trend, we conducted a follow-up on the progress of each measure based on the actual situation and concluded a follow-up on the major initiatives of the measures set out in the Action Program and a proposal for future initiatives.

Going forward, the following initiatives should be undertaken, as well as 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" based on self-motivated changes in the mindsets of companies and investors through examining and sharing specific measures.

II. Following up on the Action Program and Future Initiatives

1. General

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

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

Issues

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

In addition, as a more specific factor of such "differences," it has been pointed out that while many investors engage with large companies, there are not enough investors who engage with small- and medium-sized companies.

Future Initiatives

It is necessary to go back to the spirit of each Code, which takes a principles-based and Comply or Explain approach, and consider necessary measures in detail according to the scale and situation of each entity, instead of requiring all companies and investors to take the same initiatives. From this viewpoint, it is important to explain politely why each entity does not comply with each Code rather than complying with each Code in a formalistic manner. Based on this approach, it is important for both companies and investors to pay sufficient attention to the efforts of each entity, including Explain, and to engage in two-way dialogues.

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

2. Effective implementation of stewardship activities

The Asset Management Task Force of the Financial System Council discussed initiatives toward the effective implementation of stewardship activities. In a report published in December 2023, the Task Force made recommendations for promoting collective/collaborative engagements. In addition, the Working Group on Tender Offer Rule and Large Shareholding Reporting Rule of the Financial System Council discussed rules for

promoting dialogues between investors and companies. In a report published in December 2023, the Working Group made recommendations for the revision of the large shareholding reporting rule and ensuring the transparency of beneficial shareholders. In response, the law to amend the Financial Instruments and Exchange Act, including clarification of the scope of “joint holders” in the large shareholding reporting rule, was enacted in May 2024.

Issues

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

In addition, it has been pointed out that effective engagement that integrates dialogues and the exercise of voting rights is not being conducted, for example, because the divisions in charge of dialogues and those in charge of the exercise of voting rights are separated and do not sufficiently cooperate with each other.

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

Future Initiatives

Based on the recommendations in the reports of the Financial System Council, in order to make engagement more effective, the Stewardship Code should be reviewed with the aim of promoting collective/collaborative engagements that contribute to constructive and purposeful dialogues and ensure the transparency of beneficial shareholders. The review should also take into account the viewpoint that it is important to recognize that dialogues and the exercise of voting rights are interrelated and consideration should be given to how dialogues prior to the exercise of voting rights should be conducted and it is also important to be aware of and assess the outcome of engagement.

In addition, in order to resolve the above issues, it is useful to share specific cases and certain viewpoints on desirable and undesirable

engagements, taking into account the opinions of investors, companies, etc¹.

In light of these viewpoints, the Financial Services Agency (hereinafter the “FSA”) should assess compliance with the Stewardship Code by asset managers, asset owners, proxy advisors, etc. in cooperation with related parties.

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

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

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

Issues

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

Future Initiatives

In order to improve the effectiveness of boards, it is important to once again share an understanding of the roles and functions to be performed by independent directors, the chairs of boards, and the chairs of nomination and remuneration committees and to appoint individuals who can fulfill these roles and functions. Efforts to achieve this include ensuring a highly transparent process to nominate independent directors and fostering awareness of the roles and functions of independent directors through

¹ In the interviews conducted by the FSA and the TSE, for example, there were opinions expressed that sharing examples of other companies' initiatives by investors was helpful in promoting companies' own initiatives, including their internal feedback, and that ongoing discussions, rather than one-time discussions, contribute to constructive dialogues.

dialogues between independent directors and investors as well as through evaluations of the effectiveness of boards, including evaluations of individual directors after their appointment.

In order for these roles and functions to be fully performed, it is also important for the secretariats of boards and other committees to implement efforts to encourage substantive discussions at boards and at each committee.

In order to promote the implementation of the above efforts to improve the effectiveness of boards, specific examples of these efforts should be shared among the related parties.

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

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

Issues

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

Future Initiatives

In light of the above, investors and related parties, such as the FSA and the TSE, should follow up on the status of each company's initiatives continuously to encourage them to take substantial measures. In doing so, it is important to focus on whether the content of disclosure differs from the actual initiatives, whether boards are committed to the initiatives proactively and actively, whether specific discussions are conducted during dialogues with investors, whether resources are secured for these efforts, and whether analyses and evaluations are conducted with an awareness of specific outcomes from the perspective of increasing corporate value over the mid-

to long-term occur.

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

In March 2023, the TSE published "Better Dialogue with Shareholders and Related Disclosure" to encourage companies listed on the Prime Market to disclose information about dialogues with shareholders.

In addition, the TSE has been discussing mandatory English disclosures by companies listed on the Prime Market. In May 2024, the TSE revised its Listing Rules which make mandatory English disclosures of financial statements and timely disclosure information (effective on or after April 1, 2025).

Issues

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

Furthermore, it has been pointed out that in order to further increase corporate value, it is necessary to actively engage in dialogues with global investors, particularly for companies listed on the Prime Market, and disclose information on a timely basis in English.

Future Initiatives

In order to substantially enhance corporate disclosure, it is important to be aware that improving transparency through information disclosure leads to trust in the market.

With regard to corporate disclosure, it is important to provide information in an effective and efficient manner, and consideration should be given to develop the environment that will lead more companies to disclose their Annual Securities Reports prior to general shareholders meetings. Considering that there are limits to companies' efforts, the FSA, cooperating with related parties, should examine the actual situation and advance discussions on the fundamental development of an environment, including enhancing the efficiency of disclosures of duplicate information in Annual

Securities Reports required by the Financial Instruments and Exchange Act and Business Reports required by the Companies Act.

With regard to promoting dialogues with global investors, it is necessary to follow up on the situation in light of the mandatory English disclosures. In addition, a specific list that shows indicators regarding profitability, market valuation, growth, and the status of corporate governance, such as the appointment of independent directors, the attributes of chairs of boards and those of nomination and remuneration committees, and the ratio of female executives, should be published in order to "visualize" the group of companies that willingly and actively respond to the expectations of global investors, which is the initiative presented in the Action Program.

6. Resolving market environment issues

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

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

Issues

It has been pointed out that while companies are making efforts to reduce cross-shareholdings, appropriate measures have not been taken, such as disclosures based on actual situations including the status of the exercise of voting rights. In particular, it has been pointed out that actual situations are unclear because disclosure of the reason for changing the purpose of a holding to pure investment is not required. It has also been pointed out that this is due to, for example, differences in awareness among internally

related parties in each company (such as those in charge of IR and sales). On the other hand, it has been pointed out that it is not necessarily desirable to sell them merely as a formalistic response, and it is necessary to appropriately examine them because there are cases where the rationality of cross-shareholdings can be explained as support for the management of the issuing company.

Future Initiatives

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

With regard to cross-shareholdings, investors and related parties, such as the FSA and the TSE, should encourage companies to examine their rationale of holding cross-shareholdings once again in light of the Corporate Governance Code. It is important that appropriate disclosures based on the actual situation be made in the Annual Securities Report to avoid a formalistic response. Therefore, the FSA should conduct a more in-depth review of actual disclosures and, based on the results, take necessary measures, such as the enhancement of disclosures as necessary.

7. Encouraging the management with an awareness of sustainability issues

From the fiscal year ended March 31, 2023, a section for sustainability information was newly created in Annual Securities Reports. In addition, metrics on diversity, such as the ratio of women in managerial positions and the gender pay gap, were added. In December 2023, the FSA published a booklet of companies' good disclosure practices on sustainability issues. In October 2023, the TSE amended its listing rules to set numerical targets for the ratio of female executives at companies listed on the Prime Market. In February 2024, the general meeting of the Financial System Council consulted on discussions on sustainability disclosures and assurances, and discussions are underway at the Working Group on Disclosure and Assurance of Sustainability-related Financial Information of the Financial System Council.

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

Resilience.

Issues

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

In addition, it has been pointed out that in order to ensure diversity, it is important not only to achieve numerical targets but also to ensure the necessary abilities and develop human resources within the company. Furthermore, it has been pointed out that not only being aware of diversity from the viewpoints of internationality and gender but also ensuring the diversity of "opinions" based on these factors contributes to improving the effectiveness of management.

It has also been pointed out that each company's corporate culture² forms the foundation for creating and maintaining corporate value and that an awareness of corporate culture in management and dialogues is important for further enhancing corporate value over the mid- to long-term.

Future Initiatives

When addressing sustainability issues aimed at increasing corporate value over the mid- to long-term, the awareness of the connection between financial information and non-financial information as well as the outcome of increasing corporate value, the role of supervision by the board of directors and management, and dialogues with an awareness of corporate culture are important.

In order to ensure diversity, it is necessary to pay attention to investment in human capital, including global human resources, and formulating human resource development policies.

In addition, given that corporate management is exposed to various risks, such as pandemics, cybersecurity risks, and geopolitical risks, throughout the

² There were opinions expressed that it should be noted that the term "corporate culture" here refers to a mode of thinking and behavior that cannot be explained by superficial rationality alone, and boards are responsible for fostering and establishing it, and therefore, it differs from so-called "kigyo-bunka" in Japanese.

entire supply chain, management with an awareness of "resilience," such as demonstrating resilience in times of emergency, is important.

Based on the above viewpoints, disclosures and assurances of sustainability-related information while ensuring international comparability should be considered, and specific examples of management with an awareness of sustainability issues should be shared among related parties.