

Japan's Revised Corporate Governance Code

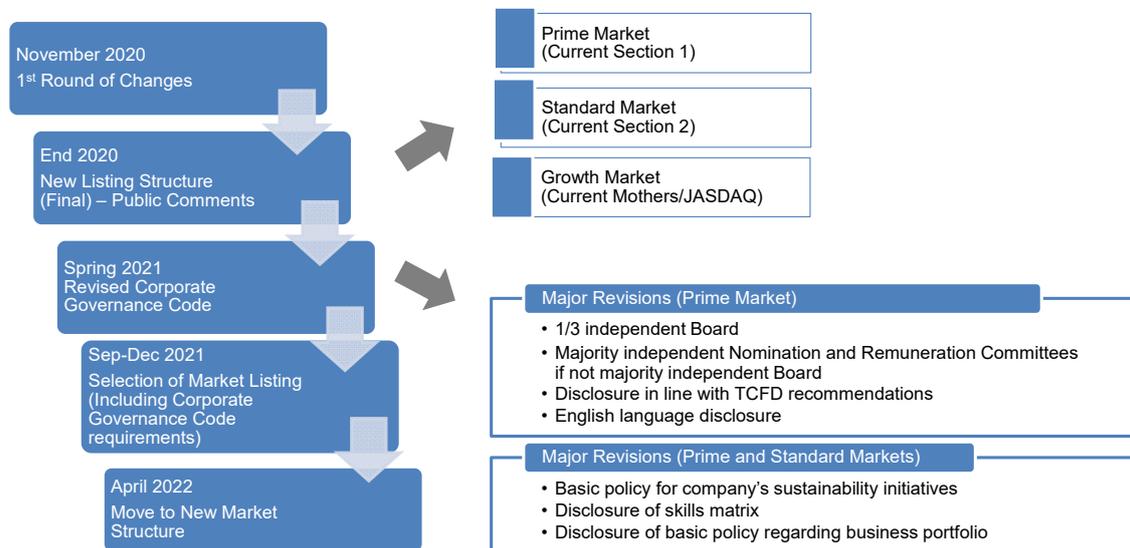
The objective of this paper is to outline the main revisions to Japan's Corporate Governance Code, including the more stringent requirements for companies listing on the new Prime Market of the Tokyo Stock Exchange. It also outlines the changes to proxy voting guidelines made by major institutional investors in anticipation of the revisions.

Please note this paper is based on the final draft of the Japan's revised Corporate Governance Code (<https://www.fsa.go.jp/en/news/2021/20210406/02.pdf>) released on 7 April and opened up to public comments until 7 May. There were no changes from the preliminary version of the draft released on 31 March. The final version of the document reflecting public comments is expected to be released some time in June.

1. Restructuring of the Tokyo Stock Exchange and Prime Market

As many will be aware, the revision of the Corporate Governance Code is being carried out in tandem with a restructuring of the Tokyo Stock Exchange listing structure.

Chart 1: Review of Tokyo Stock Exchange Listing Structure and Corporate Governance Code



Source: Tokyo Stock Exchange

Listing standards for what is now the 1st Section and is being renamed the Prime Market will become more strict, based on market capitalization, free float and profitability. Companies who wish to list on the Prime Market will also be required to demonstrate a higher level of

corporate governance.¹

2. Outline of Changes in Corporate Governance Code

A total of 16 changes have been made (5 new provisions and 11 revisions).

Looking at the number of changes by category, the three categories with the largest number of changes are: five “Effectiveness of Board of Directors” changes, four “Medium-to Long-Term Sustainability” changes and three “Reliability of Audit” changes. (These are categories employed by the Council of Experts Concerning the Follow Up of Japan’s Corporate Governance Code in their discussions.)

Chart 2: List of Changes in Corporate Governance Code

Category	Principle	Outline
Effectiveness of Board of Directors	4.8	Effective Use of Independent Directors <ul style="list-style-type: none"> • 1/3 Board independence for Prime Market companies • Majority independence as required by individual circumstances of companies
	4.10.1	Independent Nomination and Remuneration Committees <ul style="list-style-type: none"> • Succession planning by Nomination Committee • Majority independent Committees for Prime Market companies, disclosure of mandates of Committees
	4.11	Board Diversity <ul style="list-style-type: none"> • Addition of work experience and age as desirable diversity characteristics
	4.11.1	Board Diversity Disclosure (“Skills Matrix”) <ul style="list-style-type: none"> • Disclosure of “skills matrix” or combination of skills • Independent director(s) with management experience at other companies
	5.1.1	Dialog with Shareholders <ul style="list-style-type: none"> • Role of senior management and directors, including independent directors and kansayaku, to dialog with shareholders

¹ Revisions to Listing Rules to Enhance Functions for Raising Funds through the Capital Market (First set of revisions pertaining to cash equity market restructuring), Tokyo Stock Exchange, July 29,2020
<https://www.jpx.co.jp/english/equities/improvements/market-structure/b5b4pj000002rxte-att/ensum.pdf>
 Development of Listing Rules for Cash Equity Market Restructuring (second set of revisions), Tokyo Stock Exchange, released December 25, 2020
<https://www.jpx.co.jp/english/rules-participants/public-comment/detail/d01/b5b4pj000003twnu-att/b5b4pj000003twpy.pdf>

Chart 2: List of Changes in Corporate Governance Code (Contd.)

Category	Principle	Outline
Medium- to Long-Term Sustainability	2.3.1	Dealing with Sustainability Issues <ul style="list-style-type: none"> List of sustainability issues Earning opportunities as well as risk mitigation
	2.4.1	Disclosure of Diversity Policy <ul style="list-style-type: none"> Disclosure of diversity policy, measurable goals and status Disclosure of human resource development policy and internal environment development policy to ensure diversity
	3.1.3	Disclosure of Sustainability Initiatives <ul style="list-style-type: none"> Disclosure on investments in human capital and intellectual property Disclosure of climate change risk in line with TCFD recommendations or equivalent framework by Prime Market companies
	4.2.2	Board Supervision of Sustainability Initiatives <ul style="list-style-type: none"> Basic sustainability policy to be set out by Board Supervision by Board of allocation of management resources and implementation of business portfolio strategy
Reliability of Audit	4.3.4	Effective Internal Control and Proactive Enterprise Risk Management Systems <ul style="list-style-type: none"> Board oversight, utilizing Internal Audit Department
	4.4	Roles and Responsibilities of Kansayaku and the Kansayaku Board <ul style="list-style-type: none"> Kansayaku and Kansayaku Board roles and responsibilities in appointment and dismissal of Kansayaku
	4.13.3	Coordination between Internal Audit Department, Directors and Kansayaku <ul style="list-style-type: none"> Internal Audit Department to report directly as appropriate to the Board and Kansayaku Board
AGM	1.2.4	Electronic Voting Platform <ul style="list-style-type: none"> Electronic Voting Platform to be made available to institutional investors by Prime Market companies
	3.1.2	English Language Disclosure <ul style="list-style-type: none"> Disclosure in English by Prime Market companies
Cost of Capital Conscious Management	5.2.1	Disclosure of Business Portfolio Policy <ul style="list-style-type: none"> Disclosure of basic policy regarding business portfolio
Group Governance	4.8.3	Governance of Companies with Controlling Shareholder <ul style="list-style-type: none"> 1/3 independent Board where controlling shareholder Either majority independent Board or special independent Committee for Prime Market companies with controlling shareholder

(Prime Market companies: marked in [blue](#)).

Six provisions requiring a higher standard of corporate governance have been set out for companies listing on the new Prime Market. They can be categorized as calling for 1) a higher

level of independence and 2) better disclosure. As can be seen from Chart 3 below, they aim to bring corporate governance at Japan’s top companies into line with global standards.

Chart 3: Provisions for Prime Market companies

Independence			Disclosure		
Effectiveness of Board of Directors	4.8	1/3 Board independence	AGM	1.2.4	Electronic voting
	4.10.1	Independent Nomination and Remuneration Committees		3.1.2	English language disclosure
Group Governance	4.8.3	Majority independent Board or independent Committee where controlling shareholder	Medium- to Long-Term Sustainability	3.1.3	TCFD disclosure

Companies listing on the Prime and Standard Market will be required to comply (or explain) with all the General Principles, Principles and Supplementary Principles, whereas companies listing on the Growth Market will be required to comply (or explain) with the General Principles only.

3. Major Changes: Effectiveness of Board of Directors and Sustainability

The Council of Experts Concerning the Follow-up of Japan’s Corporate Governance Code met a total of seven times starting October 2020 and ending March 2021. The deliberations were streamed via YouTube and materials and minutes were made public (in Japanese only.)

As the Opinion Document released by the Council of Experts in December 2020² makes clear, discussions were held in the context of the necessity for proactive governance and diverse perspectives to remain competitive and sustainable in response to rapid change due to digitalization and COVID.

“To achieve new growth in the post-COVID era, each company must recognize the challenges and get ahead of the changes..... As changes around companies are

² Board Effectiveness and Ensuring Diversity in the Core Human Resources in Companies for Post-COVID Transformation of Companies, The Council of Experts Concerning the Follow-up of Japan’s Stewardship Code and Japan’s Corporate Governance Code, December 18, 2020
https://www.fsa.go.jp/en/refer/councils/follow-up/statements_5.pdf

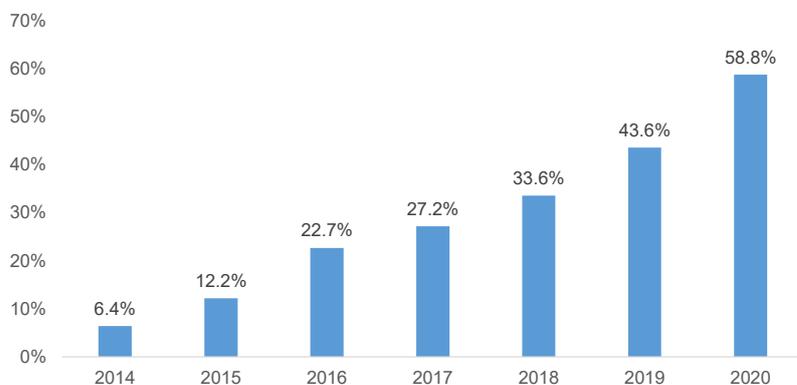
accelerating, it is imperative that they reform their corporate governance to achieve growth-oriented governance and sustainable growth while increasing corporate value over the mid-to long-term. It is necessary to work quickly on reforms,..... In particular, in order to lead non-linear changes in the post-COVID economy, society and industrial structure, and to achieve renewed growth, it is essential for a company to have diverse perspectives and values reflecting a variety of experiences, abilities and characteristics.”

3.1 Effectiveness of Board of Directors

3.1.1 Board Independence

There were many voices calling for majority and not just 1/3 independence for the Prime Market, and the revised Code asks Prime Market companies to appoint a majority of independent Directors depending on the industry, company size, business characteristics, organizational structure and other circumstances surrounding the company. For example, if a company operates globally (industry), has a large market capitalization (size), requires rapid decision-making (business characteristics) or has a three-committee Board structure (organizational structure). Other circumstances might include a controversy and a failure of governance.

Chart 4: TOPX Companies with 1/3 or More Independent Directors



Source: Tokyo Stock Exchange Corporate Governance White Paper 2021

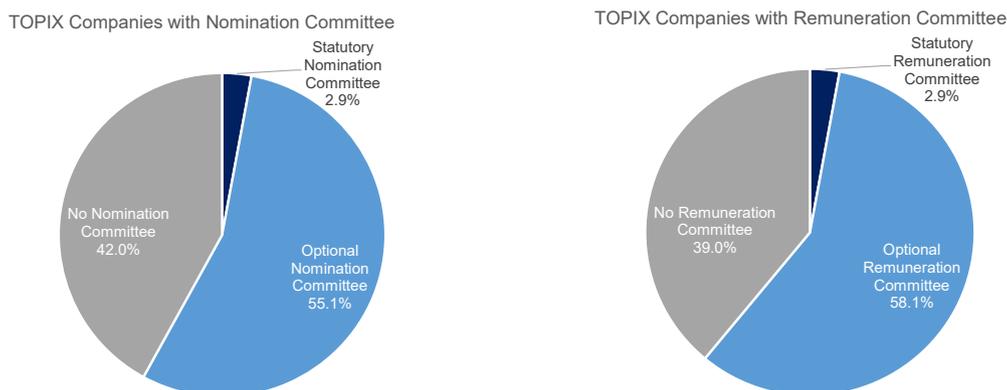
The Opinion Document from the Council of Experts called for an independent Chair; we at JSS believed that the revised Code might effectively require a lead independent director, however, the final wording remained unchanged (we believed the “for example” (underline ours) might be removed):

“Independent directors should endeavor to establish a framework for communicating with the management and for cooperating with kansayaku or the kansayaku board by, for example, appointing the lead independent director from among themselves.”

3.1.2 Independent Committees

The revised Code calls for all companies without majority independent Boards to have majority independent Nomination and Remuneration Committees.

Chart 5: TOPIX Companies with Nomination and Remuneration Committees



Source: Tokyo Stock Exchange Corporate Governance White Paper 2021

Source: Tokyo Stock Exchange Corporate Governance White Paper 2021

As three committee Board structures companies (which are required to have majority independent Boards) already count Nomination and Remuneration Committees as one of their three committees, the revised Code effectively calls for all companies to have these two Committees. It is to be noted that succession planning has been added in parentheses as one of the responsibilities of the Nomination Committee.

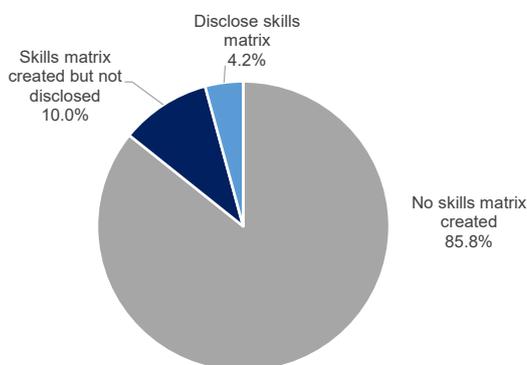
3.1.3 Diversity

As stated previously, diversity was seen by the Council of Experts as being crucial to maintaining competitiveness in a digital, post-COVID world, and discussions centred less on gender and international diversity only, and more on work experience and age; these have been added to the desirable qualities in terms of diversity in Principle 4.11:

“The board should be well balanced in knowledge, experience and skills in order to fulfill its roles and responsibilities, and it should be constituted in a manner to achieve both diversity, including gender and, international experience, work experience and age, and appropriate size.” (underline ours)

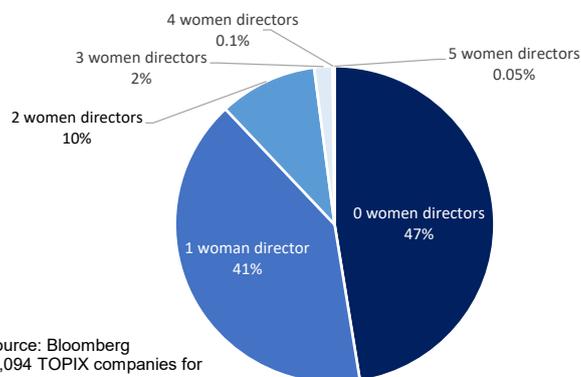
It should be noted that in addition to a skills matrix, or other framework to disclose the diversity of skills in the Board of Directors, the revised Supplementary Principle 4.11.1 calls for external directors with management experience in other companies.

Chart 6: Percentage of Companies with Skills Matrix



Source: METI
Practical Guidelines for Independent Directors Nov 2019 to Jan 2020 Survey
TSE Section 1 and 2 Companies (868 Responses)

Chart 7: Number of Women Directors at TOPIX Companies



Source: Bloomberg
*2,094 TOPIX companies for which Bloomberg has data

Discussions on diversity also emphasized the need for corporate human resource systems to cultivate diversity from within, and Supplementary Principle 2.4.1 calls for companies to disclose policies and measurable goals to ensure diversity in the promotion of women, foreign nationals and midcareer hires in middle management positions, as well as policies for human resource development toward diversity. Not many companies currently disclose policies or quantitative targets in regard to midcareer hires or human resource development toward diversity outside of gender. (During deliberations some concerns were expressed in regard to quantitative targets, including with respect to gender.)

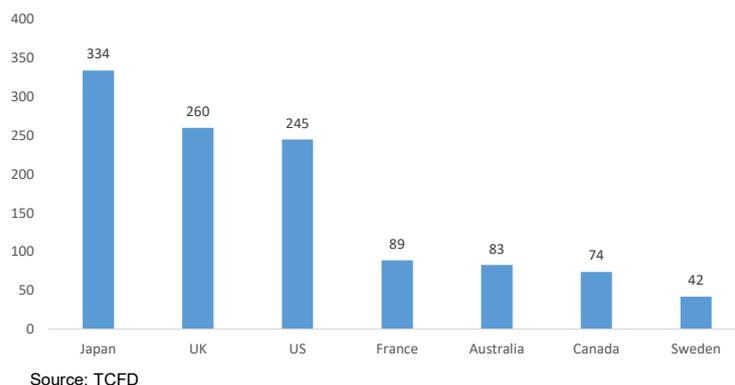
3.2 Medium- to Long-Term Sustainability

Medium- to Long-Term Sustainability is the category with the second largest number of changes. Supplementary Principle 2.3.1 has been effectively re-written and three new supplementary principles have been created in regard to medium-to-long-term sustainability: Supplementary Principle 2.4.1, Supplementary Principle 3.1.3 and Supplementary Principle 4.2.2.

Supplementary Principle 4.2.2 calls for Boards to develop a sustainability policy and to supervise the allocation of resources and the implementation of business portfolio strategies to ensure the sustainable growth of the company. Supplementary Principle 2.3.1 gives climate change, human rights, treatment of workforce and working environment, transactions with suppliers and natural disaster management as examples of ESG issues which Boards should address, making the previous language more specific. Language has also been added that these should be seen as opportunities as well as risks. Supplementary Principle

3.1.3 calls for companies to disclose their sustainability initiatives, and for Prime Market companies to disclose their climate change risks and opportunities in line with the TCFD or equivalent framework. Supplementary Principle 2.4.1, as previously mentioned, calls for companies to disclose measurable goals and policies to ensure diversity.

Chart 8: Number of TCFD Supporters (December 2020)



Some may have been a little surprised by the substantial amount of language added on sustainability. However, as previously noted, discussions surrounding the revisions to the Code were held in the context of the necessity for proactive governance to remain competitive and sustainable in response to rapid changes in the business environment. There is a new emphasis on human capital in the language, not only in the sections on sustainability but also on diversity, as one of the most important capitals in the generation of corporate value. As a side note, the role of Sustainability Committees was discussed by the Council of Experts; many felt however that sustainability was too important and should be the responsibility of the whole Board.

4. Proxy Voting Guidelines of Major Investors in Japan

Preempting changes in the Corporate Governance Code, major institutional investors in Japan have been reviewing their Proxy Voting Guidelines for Japanese listed companies.

BlackRock and Nissay Asset Management have introduced 1/3 Board independence requirements from 2022.

Chart 9: BlackRock - Major Changes

Item	Old	New
Board Composition	2 independent directors	1/3 independent directors (from 1 Jan 2022)
Female directors	N/A	At least one female director or statutory auditor (kansayaku) at TOPIX100 companies
Climate Change	N/A	Hold directors accountable where disclosures and/or practices are inadequate

<https://www.blackrock.com/corporate/literature/fact-sheet/blk-responsible-investment-guidelines-japan.pdf>

Chart 10: Nissay Asset Management - Major Changes

Item	Old	New
Board Composition	1/3 independent directors at One Tier Board with Audit Committee and Three Committee Structure Board companies listed on TSE Section 1 (from June 2021)	1/3 independent directors at (all) Prime market listed companies; majority independence for companies with a controlling shareholder (from June 2022)
Board Tenure	N/A	Directors will no longer be seen as independent after more than 10 years on the Board of Directors

<https://www.nam.co.jp/company/responsibleinvestor/pdf/voting2106.pdf> (Japanese only)

Daiwa Asset Management now requires at least one female director at TOPX100 companies. Nomura has also included a female director as a minimum requirement for its new “Monitoring-type” Board category in its updated Guidelines. While many global institutional investors already require female directors, these are the Japanese institutional investors to introduce gender diversity voting guidelines. (BlackRock will also require at least one female director from 2021.)

Chart 11: Daiwa Asset Management - Major Changes

Item	Old	New
Board Composition	At least 1 external director for non TOPIX companies	At least 2 external directors for all companies, regardless of listing
Female Directors	N/A	At least one female director or statutory auditor (kansayaku) at TOPIX100 companies

Chart 11: Daiwa Asset Management – Major Changes (Contd.)

Item	Old	New
Director Remuneration	N/A	Vote against seniority based director remuneration (retirement bonuses etc.) which do not incentivize increase in corporate value

https://www.daiwa-am.co.jp/company/managed/guideline_03.pdf (Japanese only)

Nomura Asset Management: Major Changes

Nomura Asset Management has introduced a “Monitoring-Type Board” category in its updated Guidelines. Japanese Boards have traditionally been either “Management” or “Advisory” in nature, rather than “Monitoring” (supervisory) as in Anglo-Saxon governance systems.

Minimum requirements for “Monitoring-Type” Boards are as follows:

- Majority independent directors
- Statutory or voluntary Nomination or Remuneration Committee with majority outside directors
- At least one female director
- No anti-takeover measure in place
- Strategic shareholdings less than 10% of invested capital
- One year term of office for directors at two tier Statutory Board of Auditor companies
- Outside Chair at companies with a controlling shareholder(s)

Nomura will in principle not vote against remuneration increases or the payment of bonuses at companies with “Monitoring-type” Boards where ROE has been below 5% for 3 consecutive years (this criterion is currently suspended due to COVID-19.) Nomura will also in principle not vote against payment of remuneration to external parties at “Monitoring –type” Boards if such remuneration is subject to performance achievement conditions.

Chart 12: Nomura Asset Management - Other Changes

Item	Old	New
Board Composition	2 independent directors (1/3 independent directors at companies with a controlling shareholder)	Greater of 2 or 1/3 independent directors (greater of 2 or 20% independent directors at One - Tier Statutory Auditor Board companies without a controlling shareholder until October 2021)

Chart 12: Nomura Asset Management - Other Changes (Contd.)

Item	Old	New
Board Tenure	N/A	Directors will no longer be seen as independent after more than 11 years on the Board of Directors

https://global.nomura-am.co.jp/responsibility-investment/pdf/vote_policy_g.pdf

Appendix (Proxy Voting Guideline Changes at Major Investors in Japan)

Asset Management One (from 1 April 2021)

Item	Old	New
Composition of Board of Directors	2 or more or 20% or more external directors	2 or more or 25% or more external directors

<http://www.am-one.co.jp/img/company/16/guideline202104.pdf> (Japanese only)

Mitsubishi UFJ Kokusai Asset Management (from 1 April 2021)

Item	Old	New
Appropriation of surplus	N/A	If the authority to determine dividends, etc. is vested in the Board of Directors and the appropriation of surplus is not proposed as an agenda item at the General Meeting of Shareholders, our views will be expressed through our voting for the elections of directors.
Remuneration payable to Directors, etc., Severance payments	N/A	In principle vote against any agenda item for bonus payments to statutory auditors.
Others	N/A	Voting against the election of directors will be considered if there are no corrective actions without good reason, despite continuous requests for improvements through dialogue and other means with regard to matters deemed to be issues for the Company.

https://www.am.mufg.jp/corp/pdf/giketsu_210226.pdf (Japanese only)

Mitsubishi UFJ Trust and Banking (from 1 April 2021)

The reason for the change is as follows:

"In light of a remuneration system for directors according to their respective roles from a perspective of the Company's medium- to long-term corporate value enhancement, we expect that considering as an option the granting of stock-based remuneration to outside directors, will increase the effectiveness of the Board of Directors."

Item	Old	New
Persons eligible to be granted stock options and stock-based remuneration, etc.	<p>< In principle vote Against IF ></p> <p>In the case of grants to directors who are outside directors or Audit & Supervisory Committee members, statutory auditors (kansayaku), or outsiders (officers and employees of subsidiaries are eligible for such grants).</p> <p>However, vote for grants to directors who are outside directors or Audit & Supervisory Committee members if the amount is not excessive (5 million yen or less at fair market value).</p>	<p><In principle vote Against IF ></p> <p>In the case of grants to statutory auditors, outsiders (officers and employees of subsidiaries are eligible for such grants), etc.</p>

https://www.tr.mufig.jp/houjin/jutaku/pdf/unyou_kabu_6_pdf.pdf (Japanese only)

Resona Asset Management (from 1 January 2021)

Item	Old	New
Number of outside directors at companies with Board of Statutory Auditors	Greater of 2 and 20% outside directors	Greater of 2 and 25% outside directors
Number of outside directors at companies with a parent company or a controlling shareholder	1/3 outside directors	Majority outside directors
Cooling-off period in regard to independence standards for outside directors	10 years	5 years
Tenure	N/A	Establish new tenure criterion: 12 years

Going forward, Resona Asset Management is considering the introduction of guidelines for 1/3 outside directors at companies with a Board of Statutory Auditors and the election of female directors. Resona Asset Management is also considering the introduction of criteria for cross-shareholdings.

https://www.resona-am.co.jp/investors/pdf/kijun_hoshin.pdf (Japanese only)

https://www.resona-am.co.jp/investors/pdf/kijun_kokunai.pdf (Japanese only)

Sumitomo Mitsui Trust Asset Management (from January 2021)

Sumitomo Mitsui Trust Asset Management may vote against the election of directors if either of the following two cases applies.

1. Company has serious ESG issues and either 1) is unwilling to dialogue or 2) shows no progress after repeated dialogue.
2. Company holds excessive strategic shareholdings and either 1) is unwilling to dialogue or 2) shows no progress after repeated dialogue.

When Sumitomo Mitsui Trust Asset Management introduced its requirement for 1/3 outside directors in 2020, it included an interim measure whereby it would not vote Against if no ill effects could be seen in the Company's ROE. This interim measure was not abolished in the guideline revisions for 2021 General Meetings of Shareholders.

https://www.smtam.jp/file/62/votinggl_dom_202101.pdf (Japanese only)

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Japan Shareholder Services
Address: 1-4-5 Marunouchi, Chiyoda-ku, Tokyo
Tel: 81-(0)3-3212-6371
Email: s-hoshino@jss-ltd.jp