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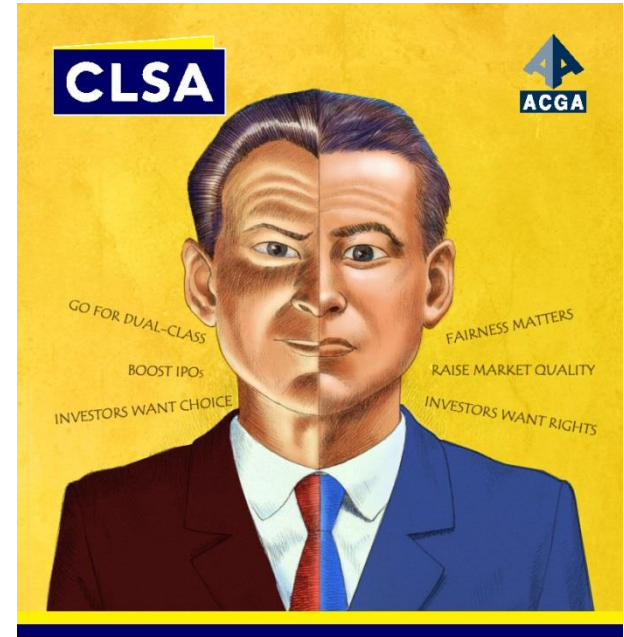
Asian Corporate Governance Association (ACGA)

“CG Watch 2018 –
Why Japan’s ranking fell. Next steps.”

Presentation by:
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BDTI Seminar
Tokyo, 29 January 2019

Topics

1. Key conclusions on Japan
2. CG Watch 2018: Market rankings
3. Survey methodology
4. Japan's CG ecosystem:
Strengths / Weaknesses
 - Government & Public Governance
 - Regulators
 - CG Rules
 - Listed Companies
 - Investors
 - Auditors & Audit Regulators
 - Civil Society & Media
5. Next steps



CG WATCH 2018

Hard decisions

Asia faces tough choices in CG reform

Special report

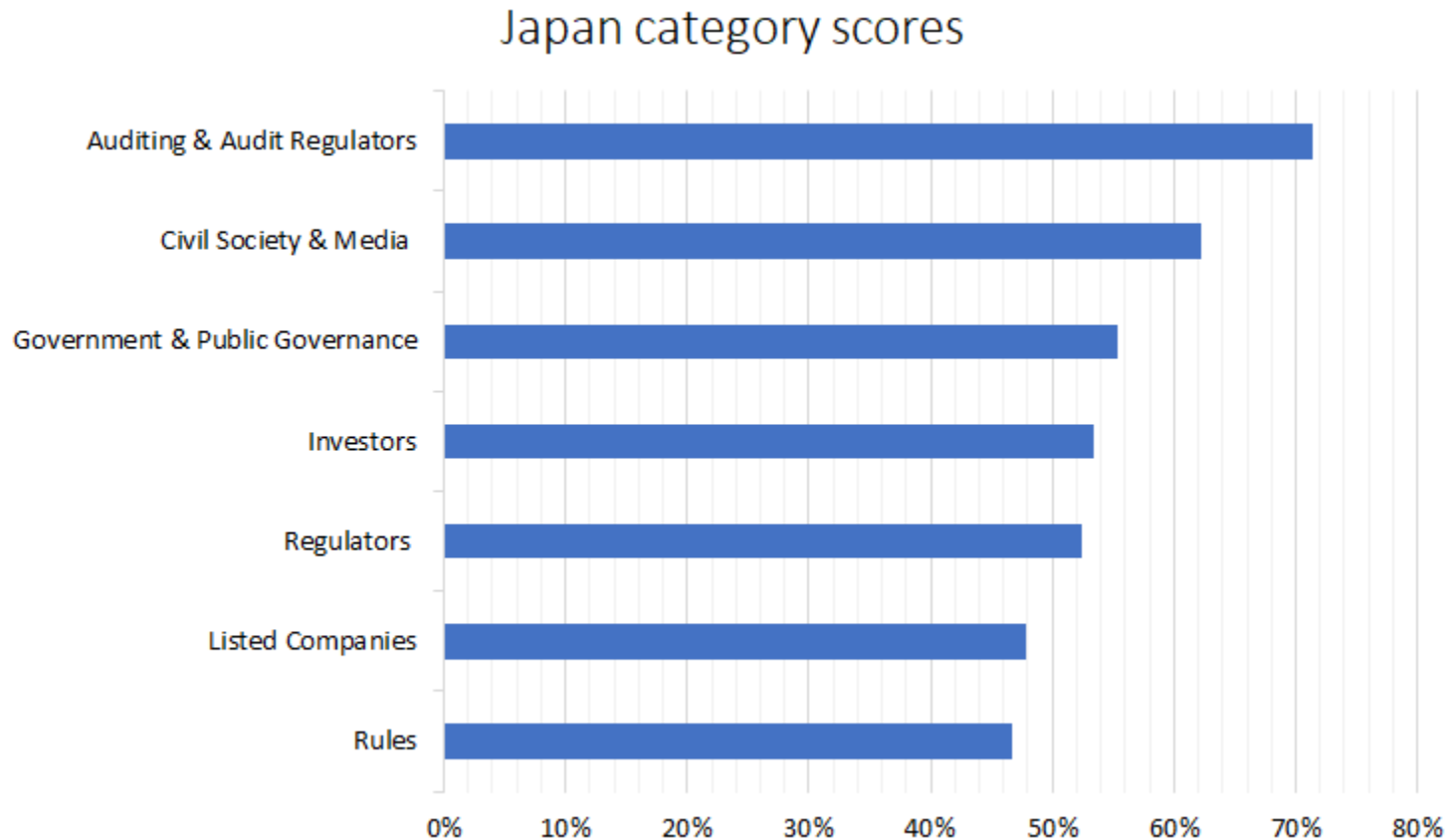
November 2018

1. Key conclusions on Japan

1. Government policy leadership on corporate governance has been relatively strong (in regional terms) and the revised Stewardship and CG Codes mark a step forward. Yet there has been much more focus on “soft law” than “hard law”—and shareholder rights remain weak in many areas.
2. Financial regulators are rethinking their role—“from checklists to engagement”—yet enforcement outcomes are curiously limited for such a large market.
3. Impressive growth in numbers of “independent directors” and new-style “audit committees”, yet systemic impact appears limited. (Japan risks following the same trajectory as the rest of Asia: “form over substance”).
4. Depth and quality of corporate disclosure—financial, CG, ESG (integrated reporting)—is well below what one would expect from an advanced market.
5. More positively, Japan scores well for the work of institutional investors (asset owners and managers) and in civil society/media.
6. Japan also scores reasonably well for accounting and auditing, and gained points for introducing an audit firm governance code. But it is well behind on key audit matters (KAMs).

Note: While Japan has undertaken numerous CG reforms since 2013, the fact is that most Asian markets started the same process much earlier: in the early 2000s.

Japan category scores



Source: Asian Corporate Governance Association

2. Asia-Pacific market rankings

CG Watch market scores, 2018		
Market	Total (%)	Key CG reform themes and questions
1. Australia	71%	Bank governance needs overhaul, time for a federal ICAC
2. Hong Kong	60%	Going backwards on DCS, about to go forwards on audit regulation
3. Singapore	59%	Going backwards on DCS, reform direction reflects contradictory ideas
4. Malaysia	58%	Can new government rid the system of corruption and cronyism?
5. Taiwan	56%	Moving forward, yet piecemeal reforms hinder progress
6. Thailand	55%	Moving forward, yet corruption and decline in press freedom are concerns
=7. India	54%	Bank governance needs overhaul, new audit regulator disappoints
=7. Japan	54%	Heavy focus on soft law needs to be balanced with hard law reforms
9. Korea	46%	Stewardship code gaining traction, but sadly so is DCS
10. China	41%	Reinforcement of Party Committees raises numerous questions
11. Philippines	37%	CG reform low on the government's priorities, direction unclear
12. Indonesia	34%	CG reform low on the government's priorities, direction unclear

Source: Asian Corporate Governance Association

Changes in market rankings

Market rankings: CG Watch 2016 and 2018

Blue = Rising market.

Red = Falling market

2016	2018
1. Australia	1. Australia
2. Singapore	2. Hong Kong
3. Hong Kong	3. Singapore
4. Japan	4. Malaysia
5. Taiwan	5. Taiwan
6. Thailand	6. Thailand
7. Malaysia	=7. Japan, India
8. India	-
9. Korea	9. Korea
10. China	10. China
11. Philippines	11. Philippines
12. Indonesia	12. Indonesia

Source: Asian Corporate Governance Association

Category scores, 2018

Categories	AU	CH	HK	IN	ID	JP	KR	MY	PH	SG	TW	TH
1. Government & Public Governance	65%	31%	63%	38%	26%	55%	52%	42%	23%	55%	60%	45%
2. Regulators	57%	56%	69%	60%	21%	52%	56%	61%	25%	54%	60%	50%
- Funding, Capacity, Reform	54%	48%	60%	60%	22%	48%	56%	62%	24%	48%	60%	52%
- Enforcement	60%	64%	78%	60%	19%	57%	55%	59%	26%	59%	60%	49%
3. Rules	78%	58%	74%	68%	35%	47%	45%	70%	43%	68%	63%	68%
4. Listed Companies	73%	36%	55%	62%	43%	48%	38%	57%	44%	63%	56%	63%
5. Investors	63%	18%	26%	36%	19%	53%	33%	38%	21%	32%	33%	30%
6. Auditing & Audit Regulators	84%	50%	74%	39%	61%	71%	69%	84%	63%	79%	70%	71%
7. Civil Society & Media	78%	22%	60%	71%	44%	62%	31%	47%	38%	62%	51%	51%

Source: Asian Corporate Governance Association

3. Survey methodology

1. Size of survey
 - Increased from 95 questions in 2016 to 121 questions in 2018.
2. Structure of survey
 - Expanded from five categories in 2016 to seven in 2018.
 - Categories reorganised from “thematic” to “stakeholders”.
3. A new and more systematic company survey
 - 15 large caps and 10 mid-caps per market.
4. New scoring methodology
 - A six-point scoring system (0,1,2,3,4,5), with no middle score. This avoids the potential for “neutral bias”.
5. Bigger team
 - 9 researchers in 2016; 20 researchers in 2018 (including support from Asia Research & Engagement in Singapore)

New survey framework

CG Watch 2016	CG Watch 2018
1. CG Rules & Practices	1. Government & Public Governance
2. Enforcement (public, private)	2. Regulators 2.1 Funding, Capacity Building, Regulatory Reform 2.2 Enforcement
3. Political & Regulatory Environment	3. CG Rules
4. Accounting & Audit	4. Listed Companies
5. CG Culture	5. Investors
	6. Auditors & Audit Regulators
	7. Civil Society & Media

Goal: Assess the different components of the CG “ecosystem” more precisely and produce more comparable data on stakeholder groups in the 12 markets. “CG Culture” questions are now included under Listed Companies, Investors, and Civil Society/Media.

New company survey

More systematic company survey:

- First, a deep dive into 15 large caps per market representing a cross-section of sectors, market-cap size, and ownership models.
 - 19 high-level questions with 74 sub-questions.
 - A total of 180 large caps and more than 13,000 data points.
- Second, a review of 10 mid-caps per market, also representing a cross-section of sectors, sizes, ownership.
 - 4 high-level questions with 27 sub-questions.
 - A total of 120 mid caps and more than 3,000 data points.
- The results have been aggregated to produce market-level scores.

Our company survey was developed in collaboration with Asia Research & Engagement (ARE).

Member outreach and feedback

1. ACGA began developing the new survey in July 2017. Further work done in December 2017 and Q1 2018.
2. April 2018: Briefed the ACGA Investor Discussion Group on the new survey and sought explicit feedback on two sections:
 - Listed Companies and Investors
3. May 2018: Workshops for members on the final survey. Invited members to discuss survey content and process. Further feedback provided to ACGA.

4. Japan's CG Ecosystem

1. Government & Public Governance

4th / 55%

Strengths

- Consistent high-level political support for “soft law” CG development
- Active involvement of METI as well as FSA
- Expert consultative committees
- Robust bank oversight

Weaknesses

- Political support for “hard law” CG reform seems absent
- Different government entities not always integrated in policy terms: MOJ, METI, FSA
- Regulatory consultations too short
- No national independent commission against corruption

Japan's CG Ecosystem

2. Regulators

9th / 53%

Strengths

- New rules/guidance on *sodanyaku/komon (S/K)*, fair disclosure, and streamlining of corporate reporting
- Revised Stewardship and CG Codes
- FSA transformation plan: making supervision more meaningful
- SESC disclosure quite comprehensive

Weaknesses

- FSA funding is limited relative to leading markets
- Appetite for “hard law” reform is limited
- Enforcement outcomes (SESC, JPX) are low in number, with an emphasis by the former on fines rather than criminal charges
- Inconsistency in enforcement approaches: Olympus, Toshiba, Nissan

Japan's CG Ecosystem

3. CG Rules

9th / 47%

Strengths

- Improvements over time in board composition, financial reporting, CG Reports.
- Robust rules on quarterly reporting, substantial ownership disclosure, price-sensitive information.
- Enhanced stewardship: eg, voting disclosure to the company level.
- Enhanced CG Code: eg, CEO appointment, cost of capital, cross-shareholdings

Weaknesses

- Takeover rules/squeeze outs
- Remuneration disclosure
- Short AGM windows (leads to clustering of meetings)
- Collective engagement / joint-holder rules / the “act of making important suggestions”
- Definition of independent directors (IDs)
- Audit committees
- Third-party allotments

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Statements & Submissions - Japan

7 May 2017

Revised Japan Stewardship Code

On May 7, 2017, ACGA wrote to the Financial Services Agency (FSA) of Japan to give comments on the consultation of the revised Japan Stewardship Code, “Principles for Responsible Institutional Investors”. We believe the FSA has reviewed the Code within a reasonable period of time and in response to lessons learned from its first ...

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White Papers - Japan

Japan White Paper



On 15 May 2008, ACGA published its first original policy document on a single market—the "ACGA White Paper on Corporate Governance in Japan".

日本のコーポレート・ガバナンス白書



2008年5月15日、ACGAは、単一の市場に対するオリジナルの政策文書としては初となる「日本のコーポレートガバナンス白書」を発表しました。

Other White Papers



Taiwan White Paper

On 24 February 2011, ACGA launched a major policy paper on Taiwan, the "ACGA White Paper on Corporate Governance in Taiwan". This was our third ...

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India White Paper

On 19 January 2010, ACGA launched a new policy document on India, the "ACGA White Paper on Corporate Governance in India". The "India White ...

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Japan's CG Ecosystem

4. Listed Companies

8th / 48%

Strengths

- Companies are adapting to new CG rules and standards (eg, voluntary S/K disclosure).
- Rapid growth in ID numbers.
- Improvements in ROE, share buybacks, dividends.
- More companies willing to engage with investors.
- Relatively quick release of (first) annual audited accounts in Business Reports.

Weaknesses

- Multiple problems in financial disclosure: limited notes, little detail on operating expenses and receivables/payables.
- CG reporting formulaic: board committees, director training, board evaluation, executive remuneration.
- ESG (integrated) reporting is better, but often does not answer the big questions.
- Board diversity.
- ID value?
- Audit committees?

Japan's CG Ecosystem

5. Investors

2nd / 53%

Strengths

- Japan led the way in adopting a Stewardship Code. Investors sign up.
- GPIF has become a powerful asset-owner advocate.
- Domestic investor discussion forums have emerged.
- Institutional Investors Collective Engagement Forum (IICEF).
- Life Insurance Association forms engagement group.

Weaknesses

- Quantity over quality in stewardship: are investors all being pushed to do the same thing?
- What does “engagement” mean? Companies sometimes complain about superficial engagement.
- Domestic investors also frustrated by tough rules on collective engagement.
- How meaningful is voting disclosure so far?

Japan's CG Ecosystem

6. Auditors & Audit Regulators

5th / 71%

Strengths

- Regulators have been responding to accounting frauds: audit firm governance code in March 2017.
- CPAAOB produces detailed disclosure on its inspection programme and the Japanese auditing industry.
- Large firm account preparation and audits generally robust.

Weaknesses

- Follows four accounting standards. Voluntary adoption of IFRS quite slow.
- Behind in the adoption of key audit matters (KAMs).
- CPAAOB funding is limited—and not changing much.
- Independence of external auditors varies.
- HR capacity concerns among mid-sized and small CPA firms.

Japan's CG Ecosystem

7. Civil Society & Media

3rd / 62%

Strengths

- Director training expanding
- Professional and CG associations well-established and undertaking research
- Private firms (finance, accounting) active in CG/ESG
- Academics participate/chair government committees, undertake research
- Media coverage and expertise in CG improving

Weaknesses

- Civil society initiatives often seem fragmented. Is there more scope to work together?
- Much discussion of issues takes place in small groups. How can the impact be magnified?
- Strong opposition of certain business chambers to CG reform. Who is engaging with them?

5. Next steps: Some immediate ideas

1. Support the implementation of the CG Code with a stronger ecosystem of director training.
2. Allow institutional investors more flexibility around company engagement, especially collective engagement and “making important suggestions”.
3. Modernise shareholder rights in takeovers and capital raisings.
4. Modernise board practices and disclosure around evaluation, ID nomination, and executive/director remuneration disclosure.
5. Extend the AGM window to at least four months. (Introduce quota system for maximum number of AGMs per day?)
6. Finalise firmer definition of “independent director”.
7. Require companies to disclose how they vote on any cross- or equity-shareholding.
8. Streamline corporate financial and CG reporting!

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