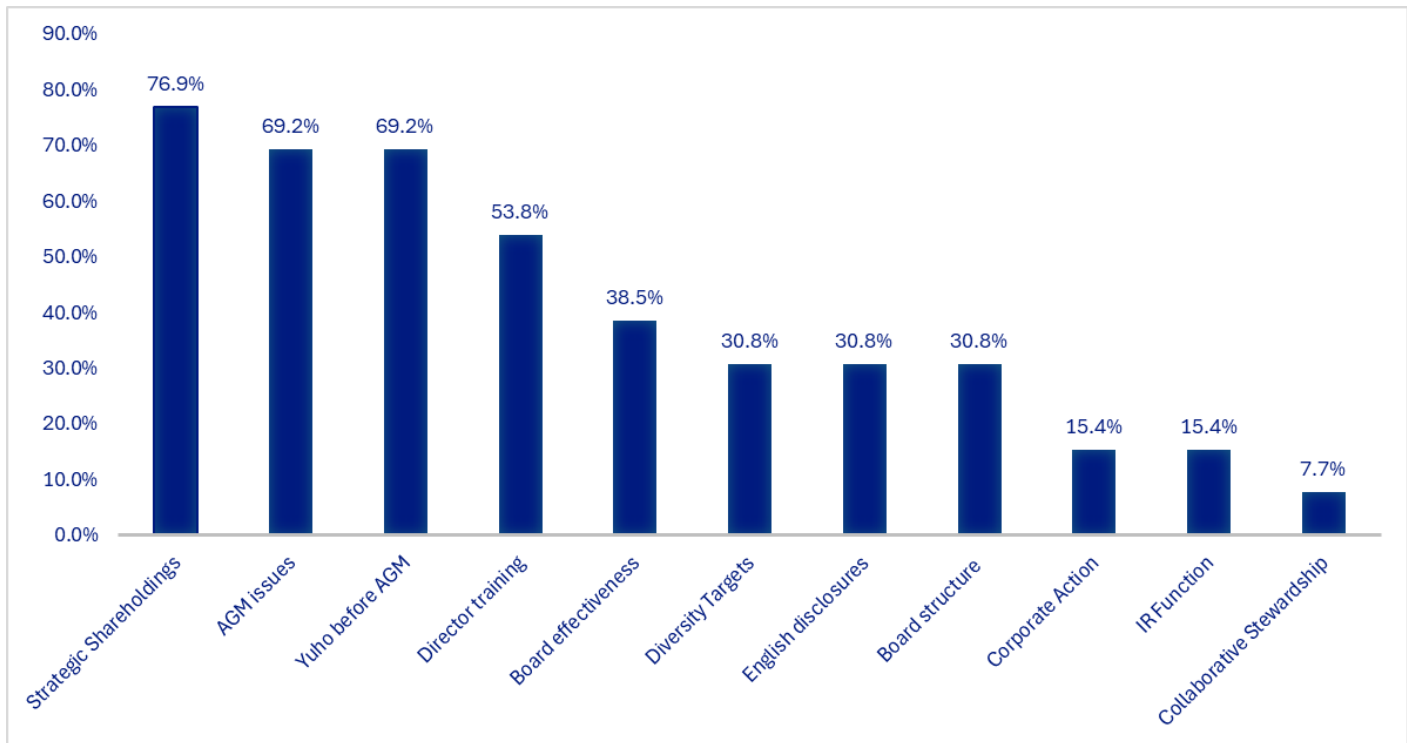


17 October 2024

### **ACGA Open Letter: 2024 Japan Delegation Feedback**

From 24–27 September 2024 the Asian Corporate Governance Association (ACGA) led an in-person delegation to Japan, where 31 investor members from 25 institutional investor organizations including asset owners had tightly scheduled meetings with regulators, industry bodies and corporates. Delegates were impressed by the resolve and commitment shown by government, corporates and regulators to enhance corporate value-creation. Substantial work has been done since 2012 when structural reforms were first announced as the third arrow of Abenomics. We appreciate the openness of regulators on what more can be done to continue to grow corporate value sustainably. Hence, following our delegation, ACGA has prepared this letter to summarize the views of our delegate members on recommendations for areas that would indicate international norms or best practices.

The Future Initiatives Regarding “Action to Implement Management that is Conscious of Cost of Capital and Stock Price” was released in August 2024 by the Tokyo Stock Exchange (TSE) which rightly re-emphasized constructive dialogue with investors that supports medium- to long-term improvements in corporate value. The graph below represents the support from ACGA delegates who have provided feedback on recommended areas that regulators could address. Among these recommendations are areas that are especially relevant if the Company Law is being reviewed by a METI Working Group. We have aimed to summarize these views succinctly by topic below as initial feedback following our delegation at the end of September. *We recommend not just further regulations, but in in the spirit of real substance that Japanese companies serious about corporate value creation be evaluated similarly with global peers and to adopt global common practices to carry the reform momentum forward in Japan.*



**Japan delegation: Member feedback on reforms**

**1. Strategic Shareholdings**

ACGA has written about strategic shareholdings being a concern in an [open letter](#) dated 26 April, 2024. Strategic shareholdings continue to remain a concern of the ACGA delegation, as this often leads to poor corporate governance, inefficient use of capital and potential anti-competitive practices. Many companies have been reducing cross-shareholdings in the last few years. However, we continue to hear some companies are reluctant and cautious about unwinding certain holdings, citing reasons which do not appear convincing financially or for economic value. We also heard of some companies that continue to purchase shares in their “strategic” investee companies.

The economic argument to pursue unwinding of cross-shareholdings vigorously is underscored by a recent report by UBS<sup>1</sup> - If all cross-shareholdings, estimated to account for 12% of Japanese shares, are eliminated by the repurchase and cancellation of treasury shares, then it is estimated that ROE of the market would rise to 10% from 9% due to the elimination of excess capital.

The specific points below were made by ACGA delegates including GMO Usonian Japan Equity, T. Rowe Price International (TRP), Legal & General Investment Management (LGIM), Pension Fund Association (PFA), Capital Group, Norges Bank Investment Management (NBIM).

<sup>1</sup> UBS -Japan Corporate Governance: Is this time different? May 2024

- 1.1 Currently the disclosures on cross-shareholdings made in line with the CG code provisions are of a high level and do not provide meaningful information on the rationale why these are needed. Our members believe that the TSE could take a more forceful approach as part of its Cost of Capital action to set targets for cross-shareholdings (in relation to net assets) which companies would be required to work towards. Even if non-binding, these could be effective to encourage Japanese corporates to gradually wind down these holdings. An alternative policy tool is to require specific evaluation by corporates of how the return on equity has been evaluated for crossholdings specifically.
- 1.2 Companies should disclose rationale for the reclassification of strategic shares to pure investments to avoid regulatory arbitrage. As mandated by the stewardship code for investors, companies should also publish information on the exercising of voting rights for greater transparency and to reassure stakeholders that companies are acting as responsible shareholders.
- 1.3 As a practical example of how asset managers take this into account for voting, LGIM scrutinizes these holdings when assessing director independence. It votes against the re-election of top executives if a company allocates 20% or more of its net assets to cross-shareholdings without clear justification or a strong reduction policy. LGIM sees this threshold as a temporary benchmark, expecting continuous efforts to reduce cross-shareholdings to zero.
- 1.4 Addressing other potential loopholes such as business partner share ownership plans ("torihikisaki mochikabukai") is seen as necessary to strengthen oversight.
- 1.5 The next area of focus could be oversight of the use of proceeds from divestment of these investments. Attention is on the potential to improve shareholder returns and growth investments, in addition to improving governance.

## **2. AGM issues**

### *AGM concentration*

In late June this year, over 1,600 AGMs took place during a single week. A record 650 AGMs, representing 29.5% of companies with a March business year-end, were held on 27 June. The concentration rates for 2021 - 2023 were between 26.0% to 27.3%. The concentration of AGMs has gradually declined since 1988 when 91% of AGMs were held on a single day but has remained high at nearly 30% since 2016<sup>2</sup>.

### *AGM attendance with speaking rights*

AGM clustering which reduces the ability of foreign institutional investors to attend AGMs with speaking rights is a high priority issue for ACGA delegates. Foreign institutional investors often encounter difficulties attending AGMs, due to the requirement of physical attendance or the need

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<sup>2</sup> [https://blog.lgim.com/categories/esg-and-long-term-themes/reflecting-on-the-2024-japan-agm-season/#\\_ftnref2](https://blog.lgim.com/categories/esg-and-long-term-themes/reflecting-on-the-2024-japan-agm-season/#_ftnref2)

to be a registered shareholder. The ability to ask questions is also restricted in general. Therefore, institutional investors are generally not able to use the annual shareholder meeting as an opportunity for dialogue, to enhance long term corporate value among Japanese corporates and to discuss this with board representatives at the AGM.

It also places great pressure on the scarce resources of proxy advisors, likely to impact the quality of their voting recommendations. The three months period for the annual securities report means this is very rarely published before the AGM, and very rarely in English; foreign investors thus often have limited information to make informed voting decisions.

The specific points below were made by GMO Usonian Japan Equity, TRP, PFA, LGIM, NBIM as well as other delegates.

2.1 ACGA members recommend to change the record date in Company Law so that corporates are not required to hold their AGMs within three months of the end of the financial year, i.e. by end-June. This would enable Japanese companies to hold their AGMs later and investors would have the latest Yuho available ahead of the AGM rather than now getting these reports either concurrently or after the AGM. This would enable investors to make better informed voting decisions through acting on the latest available information.

2.2 In other markets, these dates are both later and staggered. For example, in the UK under the Companies Act 2006, public companies are required to hold an AGM within six months of the financial year-end, while the listing rules require companies to publish annual reports within four months of the financial year-end. ACGA members believe extensions to this timeline would be in the best interests of investors, companies and other stakeholders.

2.3 Some of our members are of the view that corporate law change could require substantial shareholders to disclose their shares if they are asked by the companies. We believe that such disclosure should come along with the right to attend AGMs. Currently, companies require multiple steps to attend AGMs if shares are held under custodian names, and sometimes those shareholders are not allowed to ask questions, a violation of their right as shareholders. Our members believe that a change in law requiring disclosure of substantial shareholder ownership should include a provision that allows the disclosed shareholders to have full rights as a shareholder at the AGM.

### **3. Availability of Yuho before AGM**

Around 80% of Japanese companies publish the Yuho report on the day of AGM or post-AGM; this prevents investors from making fully informed voting decisions. Earlier disclosure of the Yuho report, and the relevant sections to be available in English, at least four weeks before AGM would allow for fully informed voting decisions and support more meaningful investor-corporate dialogue. Effective stewardship requires crucial information (such as shareholding details and emerging

sustainable/climate disclosures) and fully audited financial statements to inform voting prior to AGMs. This is the norm in global developed markets; ACGA and our members believe Japan should be no exception with the relevant information available in English given that global investors make up 30% of the Japanese equity market.

The specific points below were made by ACGA delegates including TRP, Neuberger Berman, LGIM, NBIM as well as other members.

To further improve the dialogue between investors and companies regarding AGM items, as well as to improve the recommendations of proxy advisors, ACGA members encourage an extension of the timelines that Boards are required to provide notice of AGM to shareholders. We recognize that there are restrictions currently on the ability to do this, due to the requirement for the AGM to be held within three months of the financial year-end. We welcome the 2019 amendments to the Companies Act to require listed companies to make these materials available online at least three weeks before the date of the meeting. Our members refer to the ICGN's Global Governance Principles which recommend that the shareholder meeting agenda and materials to be posted one month prior to the meeting.

- 3.1 As an immediate priority, investors should get a limited set of information if it is too onerous to have all the information. Cross-shareholding is seen as one of the crucial parts of disclosure, including mandatory disclosure of voting results for cross-held shares.
- 3.2 ACGA members welcome regulatory adjustments such as streamlining the Company Act, FIEA audit requirements, extending the AGM timeframe, in addition to encouraging efforts to separate the record date from the fiscal year-end to make this change more feasible for Japanese companies and audit firms. ACGA and its members support holding AGMs later in the year if it enables the Yuho to be published before the AGM and allows AGMs to be spread out beyond the current concentration of meetings in the last week of June.

#### **4. Mandatory disclosure of director training**

According to JACD data as of July 2024, 77.8% of Prime companies now have between one-third to half independent directors on their boards. As the quantity of outside directors increases, there is greater focus on the quality and skills of the directors. As an example, lack of comprehensive board understanding on cost of capital could undermine board oversight over management on this issue and hinder raising profitability ratios beyond short-term one-off measures.

The specific points below were made by Neuberger Berman, NBIM and other delegates:

- 4.1 Board training should be made mandatory with a specified list of topics to include financial literacy, capital allocation and business strategy. These are key to enable Japanese outside directors to perform their functions effectively, especially if lacking finance or industry skills at the

outset. Regulators should ideally work towards a board training institute which could possibly be done via strengthening the JACD.

4.2 To enhance the effectiveness of outside directors, improve the profitability of Japanese companies, and the efficiency of the Japanese economy, our members consider that further clarification of the duties of loyalty and care of Japanese directors under the Companies Act would be beneficial. This would support the stated goals of METI, the FSA and TSE. Currently, there remains uncertainty over how this is interpreted by the courts. We welcome the recent clarification by METI in their 'Guidelines for Corporate Takeovers', which applies a quantitative definition of 'corporate value and the shareholders' common interests'. To be effective, this should go together with directors' training to ensure that they are able to effectively fulfil these duties.

4.3 Outside directors are not necessarily independent. While it is laudable that the first objective is to bring in outside directors, our members consider that a priority should include to leapfrog towards bringing in independent board members, encouraging a culture of open discussion and allowing diversity of opinions for robust debate and ultimately better decision making by company boards.

## **5. Board effectiveness**

ACGA and its members believe regulators should continue to press for improved board effectiveness through more stringent requirements for independence and diversity, as well as promoting director training and board evaluation. We hope to see further strengthening of the roles of board committees, including the nomination and remuneration committees. There is concern that the committees are not sufficiently independent and may not have autonomy from insiders on the board and management.

The specific points below were made by LGIM, NBIM and ACGA delegates:

5.1 Consideration should be given to establishing a Lead Independent Non-Executive Directors (INEDs) role as a key contact point for engagement with investors. If this is too challenging in the short term, outside directors should be incentivized to meet independently of executive management on a regular frequency.

5.2 Investors suggest a concerted effort to systematically identify board talent from outside of the usual network. This should include skill sets found outside of Japan especially for global businesses and companies be open to "internationalize" board talent and overcome the language/translation inconveniences.

5.3 Boards of Directors that are majority independent are important to further improve protection of minority shareholders and would be positive for attracting foreign investment into Japan. This would also increase confidence in the reforms being made by METI and the FSA to promote a more effective market for corporate takeovers is translating to meaningful changes in board structures.

## 6. Diversity Targets

An expressed target of 30% women in senior positions by 2030 is impressive but requires systematically identifying women who are ready, willing and able to step up into the C-suite and board roles. As of 2023, Prime listed companies have 13.4% paid female directors/officers. Increasing the pool of female inside or executive directors needs to be a focus.

The specific points below were made by TRP, LGIM and other ACGA delegates.

6.1 ACGA members recommend completing the baselining effort by the Gender Equality Bureau which plans to survey companies on the number of female executive officers in their firms. Investors need consistency to use this metric in voting and engagement activities.

6.2 Members note that the government's and accordingly the TSE's target of "30% by 2030" applies to "executives" or *yakuin*, which includes, but is not limited to, board members. The definition seems to be not clearly fixed, allowing companies the discretion to determine who qualifies as an executive. While a one-size-fits-all approach may not be appropriate, our investor members focus on diversity at the board level (excluding *kansayaku*) and assess diversity at the executive level where feasible. Investors would like to see the target's scope narrowed, or for the 30% target to apply to each level: the board, executive roles (with clear definitions from companies), etc. Please see ACGA [open letter](#) on gender diversity on Japan's Tokyo Stock Exchange (TSE) Prime market of 19<sup>th</sup> October 2022.

6.3 Additionally, investors recognize that the TSE's diversity listing rules are not binding. Members believe that even if they remain voluntary, they could be enhanced from their current not clearly defined state.

6.4 Some women may come "ready made" with the right skills to fill the board skills matrix. But for others, a concerted effort in talent spotting is necessary to identify those with potential and resources provided for training them. Learning by observing "gold standard" boards is a good way of learning by apprenticeship in other jurisdictions. Board experience is never gained unless new members are given a chance to try out where one could start with smaller companies and then move into larger listed companies when more experience is gained.

6.5 The Cabinet office has mapped out programmes in the pipeline to encourage women to return to the workforce, which is commendable. A bottom-up approach in these matters would also be impactful: companies should be encouraged to take the lead in providing childcare support (which could include on-site facilities) and flexible working arrangements for women and men. C-suite leaders should set an example in showing that they too have childcare duties, and it is quite appropriate and acceptable to attend to family matters as required away from the workplace.

## **7. English disclosures**

Given that some 31.8% of Japanese stocks have foreign ownership<sup>3</sup> financial reporting in English is helpful both to attract investments and promote productive dialogue. There is room for significant improvement in English reporting of financials and annual reports.

The specific points below were made by Neuberger Berman, NBIM and other ACGA delegates.

7.1 TSE rules for English disclosure from Apr 2025 are a significant advance but not enough. This should not be limited to just Prime companies but broadened to other segments as well.

7.2 For companies that are already providing reporting in English, investors find a significant gap in terms of information contained the English and Yuho reports. This gap could contribute to material omission of information for English audiences; members suggest issuing guidance to clarify requirements for companies offering translated documents. There could be a requirement for simultaneous translation which is not just limited to financial information but sustainability information as well.

## **8. Board Structure**

There was only limited discussion during the delegation of encouraging Japanese companies to adopt the more common international board structure with three committees. This governance framework appears to be the most robust, although there is appreciation to consider its effectiveness and market-specific factors.

The specific points below were made by LGIM and other ACGA delegates:

8.1 Expectation of fully independent committee structure for at least board with Two Tier committee with statutory auditor and absence of CEO in the committee. The guideline stating that CEO leave the meeting when committee members are discussing his/her pay is not sufficient; it is difficult to assess actual practice of CEO influence on his/her compensation.

8.2 Under the Companies Act, it appears that companies have interpreted that the authority determine the contents of proposals regarding the election and dismissal of director to solely sit with the nomination committee, under a three-committee structure. This appears to be a barrier to convergence towards the 'Company with three committee' structure. Our members recommend clarification of the role of the nomination committee. In other markets, for example in the UK, the role of the nomination committee is clarified in the Corporate Governance Code to lead the process for appointment and dismissal of board directors and senior management. These decisions are usually still discussed and decided by the board as whole, usually by a majority

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<sup>3</sup> <https://www.jpix.co.jp/english/markets/statistics-equities/investor-type/index.html>



independent board. Moving to such a structure would encourage a shift towards a 'Company with three committees' structure.

### **9. Code of conduct in MBO transactions and corporate takeovers**

METI and TSE have released helpful guidelines to enhance shareholder value while considering takeover bids even if they are unsolicited and there have been some successful case studies. Global investors would like to see more transparency and public consultations in this area.

The specific points below were made by Capital Group and another ACGA delegate.

9.1 TSE is shifting its emphasis to raising the quality of listed companies rather than the number of listed companies. Amid these changes, a growing number of companies have gone private through management buyouts (MBOs) in recent years, and it is likely that number will increase further. It was positive to confirm that TSE is committed to drive further reform and appreciated that President Yamaji joined the discussion with our delegation. We could not fully cover during the meeting with TSE but look forward to TSE's leadership and role in the upcoming review of Code of Corporate Conduct to support the METI's Fair M&A guidelines, given the increase in MBO transactions.

9.2 ACGA and our members believe that a board of directors that is majority independent is important to give comfort regarding protection of minority shareholders and should help to further attract foreign investment into Japan. This would also increase confidence in the reforms being made by METI and the FSA to promote a more effective market for corporate takeovers.

### **10 Collaborative Stewardship and the IR function**

TSE has emphasized constructive dialogue between investors and companies to create medium- to long-term corporate value. We believe the opportunity to have a joint collaborative would increase the chances of a collection of shareholder voices being heard and improve the quality of these discussions.

The specific points below were made by TRP, Neuberger Berman and NBIM.

10.1 Companies (at least Prime listed) should be mandated to publish contact details on their website for their IR teams. This will enable much more effective engagement, which is currently hindered both by the poor availability of English information for global investors and the difficulty at times engaging IR teams.

10.2 Having an IR function is imperative to having collaborative stewardship meetings on a regular basis. This would also bring Japanese companies in line with global norms and make them more accessible to international investors.

10.3 Greater clarity on the "joint holders" rule: the intent is helpful in terms of direction of travel but the draft on what activities is permitted could be made clearer.



We truly appreciate the meetings that METI, TSE, FSA, the Cabinet Office Gender Bureau as well as Keidanren granted our delegation in late September and are grateful for the opportunity to express our views. We hope this feedback will be helpful to shape the path forward and maintain the corporate governance momentum in Japan. Thank you.

Yours sincerely,

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