



**ICGN**

International Corporate Governance Network  
*Inspiring good governance & stewardship*

**Nikkei Virtual Global Forum on the International Financial Hub  
Corporate Governance Developments and Challenges for Japanese Companies**

**Keynote Remarks from Kerrie Waring, CEO, ICGN  
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Thank you for inviting me to your prestigious event to talk about latest corporate governance developments and challenges for Japanese companies.

This event is very timely as many of you will be aware that ICGN was kindly hosted by the Tokyo Stock Exchange and Japan Exchange Group earlier this month to launch the ICGN Japan Governance Priorities.

For those who may not know ICGN, we were established in 1995 and our purpose is to convene capital market participants to develop, promote and embed high standards of corporate governance and investor stewardship worldwide to preserve and enhance long-term value, contributing to sustainable economies, societies, and the environment.

ICGN Members, many of whom are investors responsible for assets of around \$70 trillion, are based in over 40 countries - largely in Europe and North America, with growing representation in Asia, particularly in Japan.

Japan is a important market for our Members with overseas investors holding around 30% of shares in JPX listed companies. We have actively supported reforms for over two decades by responding to regulatory consultations and convening international meetings in Tokyo. I also participate in the Council of Experts convened by the FSA and TSE to advise on developments to both the Japan Corporate Governance Code and Stewardship Code.

**ICGN Japan Governance Priorities**

So, I am pleased to introduce the ICGN Japan Governance Priorities, updated from our 2019 guidance to inform regulators, companies, and stakeholders around matters of significance to investors which may influence company voting, engagement, and investments. This takes account of changes last year to Japan's Corporate Governance Code and ICGN's own Global Governance Principles.

There are five priorities, and over 30 recommendations which I will attempt to summarise:

**Corporate reporting**

**Firstly, corporate reporting, ICGN welcomes the Report of the Disclosure Working Group** convened by the FSA to enhance the content, format, timeliness and publication of corporate governance and sustainability related information.

**We also applaud the work of the Japan Sustainability Standards Board** and encourage alignment with global standards to facilitate rigorous, consistent, comparable, and verifiable reporting, backed by regulation and enforcement. This will enable shareholders to properly

assess and price sustainability related risk, opportunity, and resilience in investee companies. This information should be mandatory and included in the Securities Report **published in English at least 30 days ahead of the AGM.**

This report provides valuable information for shareholders around the business model, corporate strategy, audited financial results, Key Audit Matters, and other corporate governance related information such as cross-shareholdings and executive remuneration.

Japan is the only market in the world where this vital information is posted after the AGM, and it is a huge barrier to shareholders fulfilling their stewardship obligations to oversee the quality of corporate governance through voting on AGM resolutions.

I understand that 31 companies published the Securities Report ahead of the AGM this year which is a great start. I encourage more companies to do this – well ahead of the AGM and with the full document in English.

**We would also like AGM Notices in English** - 76% of Prime Market companies do this so lets make it 100% and publishing 30 days ahead of the AGM would be terrific.

**Companies having a fully independent Audit Committees is another ICGN priority**, with all members being financially literate. We would like the Committee Mandate, disclosed including the committee role for the integrity of the financial statements, key accounting policies, internal control, risk management, audit quality and independence.

The names of committee members as well as a summary of key subjects discussed, and attendance records should also be disclosed in the annual report.

More generally the committee should report to shareholders on any significant issues arising from the audit and the effectiveness of the audit process including auditor tender, tenure, independence, fees, and the provision of any non-audit services.

**Finally, it is good practice for companies to publish a Board Mandate** clarifying its governance structure and the Board's accountability for financial and sustainability related information.

We encourage more companies to adopt the three-committee system in Japan. It is curious to me that around 60% of JPX listed companies with a supervisory committee board structure have voluntarily adopted either a Remuneration or Nomination committee. It can't therefore be too difficult to formally switch to becoming a board with a mandatory three-committee structure – and we now have a good pool of independent directors to make this possible.

We also encourage Japanese companies to reduce the number of board meetings by delegating standardised agenda items to the executive. The board could then concentrate on strategic direction, risk, financial discipline, reporting and managerial oversight.

## **Independence**

**This brings me to ICGN's second priority which is around board independence.** We welcome that 92% of Prime Market companies now have one third or more independent directors on the Board.

Independent directors play a crucial role in constructively challenging management, free from external influence. By drawing on their personal competencies and experience, they

can contribute a diversity of opinion to generate healthy debate in the boardroom and are well placed to represent the interests of minority shareholders.

**I am aware that 295 companies listed on the Prime Market have not yet complied** with the requirement for one-third of the board to be independent and I encourage them to expedite their efforts. Ideally, companies - whether in the standard or growth market - should be aiming for a majority of independent directors in the very near future.

This is particularly important for companies having controlling shareholders with 30% or more voting rights where independent directors are relied upon to act as a sufficient check on controlling owner influence and ensure minority shareholder rights are upheld.

**Independent director appointments should be subject to a formal and transparent procedure** based on relevant and objective criteria. This can help ensure board composition aligned with the company's long-term strategy, succession planning and diversity policy.

**Individuals should demonstrate competency for the role of director** and be subject to director training to ensure periodic refreshment of knowledge. In this regard ICGN's own Excellence in Corporate Governance Programme developed for Japan takes place on-line next month if you would like to attend and information is available on our website.

**And board diversity is important** – on the board and across the workforce. This will help to ensure effective, equitable and inclusive decision-making in alignment with the company's purpose, succession plan and long-term strategy. Boards should annually report against the Diversity Policy which should include goals, recruitment plans and measurable, time-bound objectives.

Japan measures quite poorly compared to international counterparts on the proportion of women on boards – I understand that around 33% of companies of the former TSE First Section do not yet have a single female director.

I appreciate that the pool of available females with senior business experience is shallow in Japan but we should promote more women to senior managerial roles to redress this.

And the pool could be widened by looking overseas. Japan's Corporate Governance Code stipulates the need for boards to have 'international experience.' Perhaps this should be reconsidered as 'international diversity' to encourage boards to appoint more foreign directors. This is particularly important for companies with substantial overseas operations.

### **Board evaluation**

Our third priority concerns board evaluation and the role of Nomination Committees.

**Japan's Corporate Governance Code requires evaluation of the performance of the Board.** We believe this should be extended to committees, individual directors, and the Chairperson. This will help improve diversity, independence, and succession planning.

**We would like more disclosure from companies around the process for evaluation,** communication flows and decision-making and, as far as reasonably possible, information around the discussion topics, conclusions, and actions taken forward.

**Nomination Committees comprised of an independent Chair and a majority of independent directors** should lead the annual internal evaluation and be responsible for appointing an independent consultant to conduct an external evaluation at appropriate intervals (e.g., once every three years).

**The Committee Mandate should be disclosed** in the annual report along with the names of committee members, independence status, summary of key subjects discussed, and attendance records.

**The rationale for all director appointments (executive and independent) should be disclosed** including how their experience relates to a Skills Matrix with indicators that are clearly defined as aligned with the company purpose, long-term strategy, succession plan, Diversity Policy and any factors affecting their independence

**Director tenure should be contingent on individual performance** and annual re-election premised on satisfactory evaluations of his or her contribution to the Board free from potential conflicts of interest.

### **Capital allocation**

**Our fourth priority is for better disclosure around capital allocation.** We understand that it is prudent for companies to take a conservative approach in these challenging times to manage efficiency, mitigate risk, and ensure resilience. But, compared to other markets, Japanese companies are distinctly risk adverse as evidenced in the continual build-up of retained earnings and cash deposits.

**A clear capital allocation policy should be disclosed** and reviewed annually by the Board to help ensure that cash is employed in activities which are aligned with the company's purpose and strategic objectives and to guide capital allocation in accordance with a long-term strategy – for example in relation to acquiring new businesses, making large capital investments, discontinuing existing businesses and research and development expenditure.

In particular, **the rationale for holding non-strategic assets** that may not be core to the company's own business or sector should be disclosed. If such assets are deemed to be value destructive, investors will call for them to be sold, and proceeds either used to invest in value enhancing activities or returned to shareholders.

**And in relation to shareholder returns**, again, Japan's takes a very conservative approach to dividend pay-out ratios compared to other markets. Boards should be able to explain the rationale for the dividend level, and what the ongoing policy will be.

### **5. CEO and executive remuneration**

**ICGN's final governance priority for Japan concerns better disclosure around how pay plans** are designed to align the interests of the CEO and senior executives fairly and effectively with the workforce and long-term company strategy.

Over 85% of JPX Prime Market companies have **established a Remuneration Committee** responsible for developing and disclosing policies and reports. The committee is responsible for providing a rationale to shareholders on how awards are determined and deemed appropriate in the context of the company's underlying performance in any given year.

We encourage improved disclosure around the **remuneration setting process** as well as the rationale for individual levels including how it fits within the overall context of the company's human resource strategy.

We would like more information around the **proportions** of fixed pay, bonus, long-term incentives, and historical pay levels. And this extends to non-cash benefits such as director and officer insurance, pension provisions and terms of severance packages if any.

We also think that the **rule requiring disclosure above 100 million yen** should be abolished and a new rule be enacted to require annual disclosure of CEO and senior executive pay on an individual basis without a specified limit – or perhaps disclosure for all executives who serve on the board of directors.

The rationale for remuneration awards aligned to sustainability related objectives should be clearly disclosed with **key performance indicators** and progress towards achievement.

And we think that **independent director pay** should be structured in a way which ensures independence, objectivity, and alignment with the long-term interests of the company and should also be disclosed to shareholders.

## **Conclusion**

I know this seems like a long list – and it is. The formal ICGN statement is available on the ICGN website. I think it is important to remember that corporate governance reform is a journey – not a destination. All markets are at different stages of evolution to suit their individual practices, corporate culture, share ownership structure and legal and regulatory framework.

ICGN acknowledges the many positive governance, stewardship, reporting and audit reforms that have taken place in Japan under the late Abe Administration. Our recommendations are intended to encourage continued momentum under the Kishida Administration aligned with international acceptance, that effective corporate governance based on the principles of fairness, accountability, responsibility, and transparency directly contribute to successful companies and sustained value creation.

**ENDS.**