ICGN Virtual Forum: Global Governance Innovations – Overview of Changes to Japan's Corporate Governance Code & ICGN Global Principles.
July 14, 2021

Kerrie Waring, CEO, ICGN

Welcome everyone to ICGN's Forum on Global Governance Innovations, hosted by the Tokyo Stock Exchange and Japan Exchange Group. We are grateful for endorsement from the FSA, METI, MOJ and Keidanren and for the support from our many partners. I am particularly grateful for the continued support of ICGN initiatives in Japan from Konuma san of the TSE and Furusawa san of the FSA, both joining us today.

Before we start, I would just like to pause to remember Nakanishi San, former Chairman of Keidanren, who sadly passed away this month. Nakanishi San offered the hand of friendship to ICGN in 2019 to build relationships between Japanese companies and global investors for which we are very grateful. We welcome this engagement and are pleased that Hibino san from Keidanren is providing keynote remarks today.

Turning to our meeting today, the fact that nearly 900 people have registered from 25 countries really demonstrates the importance of Japan as a major market to ICGN Members. Our aim is to discuss the recent changes to Japan's Corporate Governance Code and to the ICGN Global Governance Principles.

For those of you who might not know ICGN, we were established over 25 years ago to advance the highest standards of corporate governance and investor stewardship worldwide in pursuit of long-term value creation, contributing to sustainable economies, society, and environment. Our work programme is led by investors responsible for assets of $59 trillion, based mainly in Europe and North America but with growing Asia representation, particularly in Japan.

ICGN has supported reforms in Japan for over two decades, contributing to regulatory consultations and convening international meetings in Tokyo. Since 2017, I have had the privilege of serving on the Council of Experts convened by the FSA and TSE to advise on Japan's Code which has been a rewarding experience – not just for my own knowledge but also to help inform revisions to ICGN's own Principles this year as part of a three-year review cycle.

Reviewing the two Codes at the same time has been hugely beneficial in highlighting national and international priorities, enabling innovations to be shared, inspired by market-led practice and regulatory initiatives. So, today I will share my perspectives firstly on the Japan Code and then introduce you to some of the changes to ICGN's Principles.

Japan Corporate Governance Code

In terms of the Japan Code, as you have heard from Mr Furusawa, this year's revision has gone further than ever before with stricter requirements around independence, diversity as well as new references to climate change and human capital management.

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Independence

1. We welcome the increased requirement for companies listed on the Prime Market to appoint at least one-third of the board to be independent directors. Generally, we believe that all listed company boards (whether in the standard or growth market) should comprise at least one-third independent directors and preferably a majority.

Appointments

2. A formal and transparent approach to board director appointments is important based on relevant and objective selection criteria, led by an independent Nomination Committee. This helps ensure board refreshment aligned with the company's long-term strategy, succession planning and diversity policy.

Committees

3. We welcome disclosure around board committees and prefer a three-committee system in Japan as an optimal governance structure with fully independent Audit and Remuneration Committees and a majority independent Nomination Committee.

Diversity

4. We welcome disclosure of diversity policies. ICGN's own Principles encourage effective, equitable and inclusive decision-making across the board and workforce. And we have specific guidance for gender diversity with a preference for at least one-third of board positions to be held by women.

Leadership

5. ICGN encourages independent board leadership, and welcome new reference to whether the Chair of the Board is independent or not in Japan's Guidelines. Additionally, it would be helpful to have public disclosure around the roles of Chair and CEO to help clarify the difference between the two functions.

Evaluation

6. We think it is good practice for the board to be evaluated every three years by an external consultant.

Cross-shareholdings

7. We note that there was no change to the Code Principle on cross-shareholdings. This could be strengthened to encourage companies to disclose the nature of the cross-shareholding (e.g., parent company, subsidiary, or supplier) and a period over which they will be reduced or eliminated.

<u>Capital allocation</u>

8. We welcome the new principle for boards to disclose their policy on the status of the company's overall business portfolio. We encourage boards to annually review capital allocation to manage company, investor and stakeholder interests, while maintaining sufficient liquidity to ensure resilience.

<u>Climate change</u>

9. We welcome the new principle requiring climate change related disclosure and encourage this to be applied to all listed companies. ICGN's Principles also refers to climate change and the board's role in assessing business impacts and how it will be adapted to meet the needs of a net zero economy by reducing carbon emissions over a specified period.

<u>Reporting</u>

10. And finally, we recommend that governance and sustainability information be disclosed in the annual securities report, in English and prior to the AGM. I recognise this is referenced in the Guidelines, but this should be elevated to the Code itself.

ICGN Global Governance Principles

So, there are many positive developments in Japan's Code and – as with any other market – there are areas for continued improvement. But let me talk you through some of the changes to ICGN's Global Principles. Published over 20 years ago, many ICGN Members default to the ICGN Principles as a bellwether for their own voting policies and company engagements.

<u>Company purpose</u>

1. Firstly, we clarify the need for the board to publicly disclose a company purpose to guide management's approach to strategy, innovation and risk. This also helps to identify key stakeholders and how their interests are considered.

<u>Directors' duties</u>

2. We clarify directors' duties to promote the success of the company to preserve and enhance share value, while contributing to a sustainable economy, society and environment.

Risk oversight

3. On risk, we have added that board oversight should include threats to the company's business model, cyber-security, supply chain resilience, performance, solvency, liquidity and reputation. And we refer to systemic events including ecological degradation, social inequality and digital transformation.

Human capital management

4. There is new reference to human capital management including workforce recruitment, retention, training, and succession planning, linked to strategy.

Human rights

5. There is new guidance on human rights (inc. modern slavery) and workforce safety focused on how companies identify and mitigate risk in their operations and supply chains.

Remuneration

6. Remuneration plans should be designed to align the interests of the CEO fairly and effectively with the workforce and long-term company strategy, including the use of sustainability-related metrics.

Materiality

7. We have new reference to 'double' materiality for reporting on a company's external impacts on society and the environment, as well internal impacts on the company's own financial performance. We also refer to 'dynamic materiality' recognising that materiality evolves over time alongside emerging technology, product innovation, regulatory developments and so on.

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Fiscal policy

8. We have acknowledged public debate around corporate tax avoidance by emphasising the board's role in overseeing a company's fiscal policy - not only in a legal context but within the bounds of acceptable social norms.

Reporting

9. We encourage companies to use sustainability-related accounting and reporting frameworks to facilitate consistency and comparability and to contribute to the global consolidation of standards.

AGMs

10. Finally, and primarily instigated by the Covid crisis, we have added new Principles emphasising the importance of shareholder participation at AGMs (particularly virtual AGMs) to ensure they are efficiently, democratically and securely facilitated to enable constructive interactivity between shareholders and the board.

There are many more changes to ICGN's Principles this year – much of which is echoed in Japan's Code - and ICGN will be organising a series of workshops next month to explain how to put these principles into practice. We have a very prestigious faculty who will be sharing their experience with us so we hope you can join us.

Let me conclude by saying that corporate governance reform is a journey – not a destination. All countries are evolving at different stages taking account of national rules, regulations, corporate culture and share ownership models. Fundamentally, corporate governance is the system by which companies are directed and controlled – the Japan Corporate Governance Code and the ICGN Global Governance Principles offer roadmaps on how this is achieved with standards of fairness, accountability, responsibility, and transparency.
Boards are responsible for promoting the long-term success of companies through managerial oversight, strategic direction, and reporting. Investors are responsible for holding boards to account, on behalf of their beneficiaries, through the exercise of share-ownership rights including company monitoring, voting and engagement. Both share a common global obligation - to preserve and enhance long-term corporate value contributing to economic growth, social prosperity, and a healthy environment now and into the future.

Thank you.