

Japan's Revised Corporate Governance Code



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A. Introduction

On June 11, 2021, Tokyo Stock Exchange, Inc. (“TSE”) released the latest revision to Japan’s Corporate Governance Code (the “**Code**”).¹ The Code was put together in 2015 and first revised in 2018. It establishes the fundamental principles for effective corporate governance at listed companies in Japan.

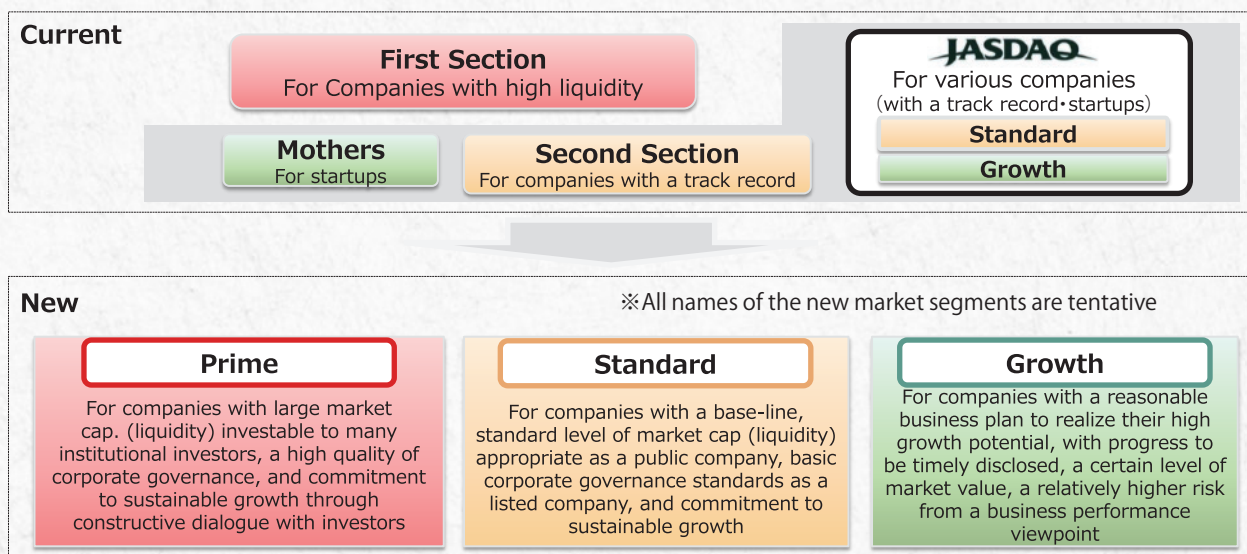
The recent second revision of the Code aims to advance governance reforms to promote the continuous growth of companies and increase their corporate value over the mid- to long-term in light of the changing environment surrounding business firms triggered by the COVID-19 pandemic.

As a prerequisite knowledge to understanding the above revision of the Code, it is necessary to mention the

upcoming restructuring of the cash equity market. TSE is planning to restructure the cash equity market from April 4, 2022 by reorganizing the current five market segments, namely, the First Section, Second Section, Mothers, and JASDAQ (Standard and Growth), into three new market segments, namely, Prime, Standard and Growth.² The Code has been revised, in part, to set a higher standard for companies to be listed on the Prime Market. The Prime Market will be a market for companies whose market capitalization (liquidity) is large enough (at least JPY 10 billion) to attract investments from many institutional investors. They must have a high quality of corporate governance as well as a commitment to sustainable growth and mid- to long-term improvement of their corporate value with a focus on constructive dialogues with investors.

1. A provisional translation of the revised Code is available at <https://www.jpx.co.jp/english/news/1020/b5b4pj0000046kxj-att/b5b4pj0000046l0c.pdf>.

2. See <https://www.jpx.co.jp/english/equities/improvements/market-structure/index.html>.



Source: TSE.³

B. Overview of the Revision of the Code

The main points of the revisions to the Code are shown in the table below. The revision addresses issues concerning enhancing board independence, promoting diversity, and attention to sustainability and environmental, social and governance (“ESG”). In addition, it addresses the terms related to (a) group governance, (b) ensuring confidence in audits, internal control and risk management, (c) matters related to general shareholders’ meetings, and (d) business portfolio management. Notably, the use of electronic voting platforms and disclosures in English are being promoted for Prime Market listed companies.

The Main Points of the Revisions to the Code⁴

1. Enhance Board Independence

- Increased the minimum number of independent directors from two to one-third of the board for Prime Market listed companies (a majority of the board members must be elected as independent directors whenever necessary) (Principle 4.8)
- Create a nomination committee and a remuneration committee (appoint enough independent directors to have them form a majority of the committee members for Prime Market listed companies) (Supplementary Principle 4.10.1)
- Disclose a skill matrix of board members that is consistent with the business strategy of the company (Supplementary Principle 4.11.1)
- Appoint independent directors with managerial experience from other companies (Supplementary Principle 4.11.1)

3. Outline of the New Market Segments dated February 21, 2020, at <https://www.jpx.co.jp/english/equities/improvements/market-structure/b5b4pj000002rxte-att/b5b4pj000003b0f1.pdf>, p. 5.
4. Japan Exchange Group, Publication of Revised Japan's Corporate Governance Code (June 11, 2021), <https://www.jpx.co.jp/english/news/1020/20210611-01.html> (with some additional points added by the author).

2. Promote Diversity

- Disclose policy and voluntary measurable targets that promote diversity in senior management, such as by appointing women, non-Japanese/foreigners and mid-career professionals (Supplementary Principle 2.4.1)
- Disclose human resource development policies that ensure diversity, including the status of their implementation (Supplementary Principle 2.4.1)

3. Give Attention to Sustainability and ESG

- Develop a basic policy and disclose the sustainability initiatives of the company (Supplementary Principles 4.2.2 and 3.1.3)
- For Prime Market listed companies, enhance the quality and quantity of climate-related disclosures based on the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD) or equivalent international frameworks (Supplementary Principle 3.1.3)

4. Other Notable Major Points

- Appoint enough independent directors to have them form a majority of the board or create an independent special committee at Prime Market listed subsidiaries to address conflicts of interest between their parent company and their own minority shareholders (Supplementary Principle 4.8.3)
- Establish on an enterprise basis effective internal control and proactive enterprise risk management systems and oversee their operational status (Supplementary Principle 4.3.4)
- Establish a system, which enables the internal audit department to appropriately report directly to the board as well as the audit and supervisory board (*kansayaku* board) (Supplementary Principle 4.13.3)
- Promote the use at Prime Market listed companies of electronic voting platforms and disclosures in English (Supplementary Principles 1.2.4 and 3.1.2)
- Present the basic policy decided by the board regarding the business portfolio and the status of the review of such portfolio (Supplementary Principle 5.2.1)

The Code will continue to adopt a “comply or explain” approach in light of the fact that the optimal governance system from the perspective of promoting the continuous growth of companies and increasing their corporate value over the mid- to long-term varies depending on their respective circumstances.

C. Implementation of the Revised Code

Companies are required to submit their corporate governance reports⁵ reflecting the revised Code by December this year. In this regard, TSE will implement its new market segmentation from April 4, 2022. Some of the principles and supplementary principles of the revised Code will apply only to companies listed on the Prime Market, while others will apply to companies listed on other markets, or to all listed companies. The status of implementation of the principles and supplementary principles that are applicable only to Prime Market listed companies must be included in their corporate governance reports, which must be submitted without delay after the holding of their general shareholders’ meetings on or after April 4, 2022.

From the perspective of enhancing constructive dialogues between institutional investors and companies, it would be beneficial for companies to proactively explain their own specific initiatives in conjunction with their implementation of each applicable principle of the Code.

Lastly, depending on their situation, it would also be desirable for companies listed on other markets to take voluntary initiatives to improve their governance by using as a reference the items of the Code that apply to Prime Market listed companies.

5. TSE requires every listed company to prepare this report on corporate governance, which provides investors with information on its corporate governance in a comparable format.



D. Conclusion

It is hoped that the investors and directors of listed companies, including the independent directors, will work together to address various social issues while realizing sustainable growth and mid- to long-term improvement of their corporate value.

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