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International Corporate Governance Network



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

Tomoyuki Furusawa, Director-General of the Policy and Markets Bureau, Financial Service Agency

I am Tomoyuki Furusawa, Director-General of the Policy and Markets Bureau, Financial Services Agency. Thank you for taking the opportunity to talk about the progress of corporate governance reform in Japan today. First of all, I would like to thank Kerrie Waring, the CEO of ICGN. Since October 2017, she has made significant contributions as a member of the Financial Services Agency's Council of Experts, which discusses and considers Japan's corporate governance reform. In this revision of the Corporate Governance Code, at the beginning of many meetings, she spoke about the location and direction of issues and led the discussions of the entire meetings. Based on her inputs, the content of the revision of the Code addresses issues related to sustainability such as climate change and investment in human capital, and ensuring diversity in core human resources of companies, captures them in an international context, and gives them solutions at this moment. Corporate governance is an endless movement.

I would like to continue to discuss Japanese and global governance reforms with CEO Waring and other ICGN members. As you can see, corporate governance in Japan is undergoing major changes. We finalized the revised Code on June 11th, but this does not just mean that the revised Code was published in time for this year's Japanese shareholders' meeting season. It is our message and answer to global sustainability challenges. That is, on sustainability, especially on climate change issues, a communique from the G7 Finance Ministers and Central Governors published on June 5 stated that it supports moving towards mandatory climate-related financial disclosures that are based on the TCFD framework in line with domestic regulatory frameworks. In response to this global movement, we decided to require in the Code that Prime Market-listed companies enhance the quality and quantity of climate change disclosures based on the TCFD recommendations or an equivalent international framework.

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Looking ahead to COP26 in November this year, it is expected that international policy coordination on climate change issues and discussions on rule formation will progress after this summer. Japan will actively participate in these international movements. Now, I would like to introduce the idea behind the revision of Japan's Corporate Governance Code.

As you can see here, there are three main pillars of revision. The first is to enhance board independence, the second is to promote diversity, and the third is attention to Sustainability and ESG. In making these revisions, the first discussion was how to perceive the impact of COVID-19 on the economy and society, that is, how to relate corporate governance reform to the impact of COVID-19 under the economic situation in which COVID-19 is occurring. The first big theme and challenge is how we should think about it. The answer and idea we got in that discussion is that the spread of COVID-19 does not change the theme we have been working on in governance reform. Rather, the idea is that the impact will accelerate the said changes and encourage further responses.

Looking inside the economic and social structure under the influence of COVID-19, discontinuous changes are occurring, in which digital reforms must be promoted and then supply chain risk must be addressed. In order to grasp these discontinuous changes head-on and realize new growth that opens up business in it, the role of the board of directors that supports and oversees the exercise of leadership in management, and the diversity of the management and core human resources that support it, are more of a governance issue than ever before. This way of thinking is behind the three pillars I mentioned earlier.





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Let me explain each pillar. The first pillar is enhancing board independence. As I mentioned earlier, the changes in the environment surrounding companies' businesses are extremely drastic. The board of directors is required to make important decisions that support the swift and decisive risk-taking of management, as well as to provide effective oversight. For this reason, independent directors are expected to play important roles in the board of directors.

At the time of the start of Japan's corporate governance reform in 2014, about 20% of the companies listed on the First Section of the Tokyo Stock Exchange in Japan had appointed two or more independent directors. However, as of 2020, more than 95% of such companies have appointed two or more independent directors, and this movement is progressing rapidly. But we can't stay here. It has been pointed out that the board of directors needs to be further strengthened independence. Therefore, in this Code revision, we require that more than one-third of the board of directors will be independent in companies listed at Prime Market that will be born in April next year and where companies have higher levels of market capitalization, liquidity and governance. We also urge them to appoint an independent director and, if necessary, a majority. Needless to say, in order to promote the functioning of the board of directors, it is necessary to pay attention not only to the number of independent directors but also to their quality.

For this reason, this revision requires listed companies to identify the skills that the board of directors should have in light of business strategies, and then disclose the combination of skills possessed by directors inside and outside the company, that is, the skill matrix. In particular, we consider that management experience in another company is an important skill, and we strongly encourage the inclusion of independent directors with such skills in the board of directors. The second pillar of the Code revision is to promote diversity. In order for companies to lead the discontinuous



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change after COVID-19 mentioned earlier, the existence of diverse perspectives and values supported by various experiences, skills and attributes is indispensable. Therefore, in this revision of the Code, we require that companies will present their policies and voluntary and measurable goals for ensuring diversity in the promotion of women, foreign nationals, midcareer hires to managerial positions, promoting them to core human resources, and ensuring such diversity.

In addition, in view of the importance of human resources strategies for increasing corporate value over the medium to long term, we require companies to disclose their policies for human resource development and internal environment development to ensure diversity, together with the status of their implementation. As you can see, for example, looking at the hiring of women, the ratio of female executives in Japanese companies is 6.2% as of 2020, and diversity is still in the middle of the road. However, various changes have already taken place.

By the way, the secretariat of the Financial Services Agency, which supports this Code revision, is composed of actually 6 people in total, 3 of which are women, and 4 of which are members from outside the Financial Services Agency. We ourselves want to improve diversity through these efforts. The third pillar is attention to Sustainability and ESG.

In order to increase corporate value over the medium to long term, it is becoming increasingly important for companies to proactively and actively respond to issues related to sustainability and disclose them appropriately. So far, Japan has already promoted voluntary efforts by the private sector, such as disclosure in line with TCFD recommendations. As a result, as of the end of May, the number of organizations supporting TCFD recommendations in Japan was 410 of the 2,205 organizations in the world, which is the highest level in the world. Furthermore, as seen in the G7



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communique mentioned earlier, there is a growing demand for further enhancement of disclosure based on TCFD recommendations.

The focus here is on the IFRS Foundation's commitment to unified sustainability standards since last year. Originally, it is said in the world that "diversified, mutually incomparable, incommensurable ideas coexist and compete with each other", and the issue of sustainability can be said to be a typical example.

In other words, looking at traditional financial accounting standards, "providing information that is useful for capital market stakeholders in estimating the value of a company" becomes the basis of the conceptual framework of that standard. Based on this, the concept of various factors such as balance sheet, profit and cash flow are developed and used as the basis of the standard. On the other hand, as for the basis for developing disclosure standards for sustainability, the purpose of disclosure itself is not necessarily agreed, as symbolized by discussions such as single materiality and double materiality.

Under these circumstances, as you know, there are at least 230 sustainability standards according to an article. At the same time, there is a rapid movement toward the consolidation of disclosure standards for sustainability. As you know, the IFRS Foundation is currently in the process of conducting public consultations on the proposed amendments to the IFRS Foundation Constitution. Prior to COP26 in November of this year, the establishment of a sustainability standard-setting body will be finalized.

In June of this year, there is another move that the IIRC and the SASB were integrated, and they established the Value Reporting Foundation. It was agreed that the initiatives of the IFRS Foundation were welcomed in the G7 communique introduced earlier, and

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the movement toward the establishment of unified standards for sustainability will surely accelerate in the future, centered on the IFRS Foundation. In light of these movements, this revision of the Corporate Governance Code requires that companies formulate basic policies regarding their sustainability from the perspective of improving corporate value and disclose their measures.

In addition, it is important that there is a comparable and consistent disclosure of sustainability in terms of facilitating constructive dialogue on sustainability between investors and companies. Moreover, in addition to the scope of global environmental issues such as climate change, from the perspective of deepening efforts related to society and social elements, respect of human rights, employee health, fair and appropriate treatment of the workforce are explicitly stated as elements of sustainability. In addition, we require companies to disclose information regarding investment in human capital in an easy-to-understand manner. These are the three pillars of this revision. Japan's corporate governance reforms have progressed rapidly in the seven years since the Stewardship Code was formulated in 2014 under the so-called Abenomics. Looking at the example in the United Kingdom, the Code of Best Practice was formulated in 1992, nearly 30 years ago. Compared to that, you can understand how short the history of corporate governance reform in Japan is. However, it is necessary to pay close attention not to fall into a formalistic approach that is too contentless to rush reforms and to flow into more formalistic than in substance. It is also important to develop a foundation that supports dialogue between the companies and investors in order to further enhance the efforts of these two. For example, the Tokyo Stock Exchange is reforming its market structure to make it even more attractive to domestic and foreign investors, such as by reviewing the market classification of listed companies and the listing standards themselves. We will also enhance corporate



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disclosure, which is the basis of dialogue, based not only on soft law but also on hard law.

Through these efforts, we would like to strive to create a market that is even more attractive to investors. Finally, I would like to thank all the members of ICGN again for their great contributions to the progress of corporate governance reform in Japan. ICGN-sponsored conferences, including the ICGN General Assembly held in Tokyo in July 2019, have renewed discussions on corporate governance among relevant stakeholders and have gave us important opportunities to develop governance practices in Japan.

We believe that this conference will be more fruitful than ever, thank you for your attention.

