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Japan
CORPORATE GOVERNANCE

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This country-specific Q&A provides an overview of corporate governance laws and regulations applicable in Japan.

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JAPAN
CORPORATE GOVERNANCE

1. What are the most common types of corporate business entity and what are the main structural differences between them?

The most common type of corporate business entity in Japan is a stock company (*kabushiki kaisha* or KK), and its organisational structure typically consists of (i) shareholders, (ii) a board of directors, (iii) representative directors, and (iv) statutory auditors, with some notable exceptions (see question 3).

Stock companies may generally be divided into two groups according to restrictions on the transfer of shares by their articles of incorporation as follows:

Closed KKs

Closed KKs require the company's approval for any acquisition or transfer of the company's shares. Most existing KKs are closed KKs. Closed KKs may simplify the organisational structure, and some organs, like a board of directors, representative directors, or statutory auditors may not be mandatory.

Open KKs

Open KKs are companies without any provisions requiring the approval of the company for acquisition or transfer of all or some of their shares in the articles of incorporation. Generally, only securities issued by open KKs can be listed on a securities exchange in Japan. The Tokyo Stock Exchange (TSE) is the most well-known securities exchange in Japan, and it is one of the largest equity markets in the world, listing over 3,820 companies (as of 4 January 2022), including major Japanese companies.

The applicable requirements and practice thereunder regarding corporate governance may significantly differ depending on whether a company is a closed KK or an open KK, and whether the company is listed. In order to simplify the discussion, however, we assume that the corporate entities mainly discussed herein are listed companies on the TSE, unless otherwise noted.

2. What are the current key topical legal issues, developments, trends and challenges in corporate governance in this jurisdiction?

First, the amendment to the current Companies Act (Act No. 86 of 2005) (CA) adopted on 4 December 2019 (the 2019 CA Amendment) partially came into effect on 1 March 2021 (see question 5). Aside from the amended provisions themselves, there have been some notable updates in the corporate governance environment based on sources other than the Companies Act of Japan, such as the listing regulation of the TSE, which requires listed companies to have at least one independent officer (see question 8), and revisions of Japan's Corporate Governance Code (CGC), which took effect on 11 June 2021, and the like.

Second, the role of independent directors will become more important. Based on recent discussions on corporate governance in Japan, it will be indispensable for them to be actively involved in discussions regarding appointment and dismissal of top management such as CEOs, and remuneration for members of the governing body.

Third, it is still very important for listed companies to improve the contents of their disclosures. While the form and requirements regarding disclosure have been expanded or modified year to year, each listed company should keep in mind what information shareholders and investors really want. At the same time, the role of shareholders is becoming more important, encouraging them to review company disclosure materials more carefully and to engage in fruitful dialogue with the company for the sustainable growth and the creation of mid to long-term corporate value.

3. Who are the key persons involved in the management of each type of entity?

While a shareholders' meeting is the ultimate governing body, other key persons may differ depending on the

structure of the management body, which can be classified into three types: (i) a company with statutory auditors; (ii) a company with an audit and supervisory committee; and (iii) a company with three committees.

(i) Company with statutory auditors

Shareholders elect both directors and statutory auditors, and the directors constitute a board of directors. The board of directors appoints representative directors, who can bind the company and take general responsibility for the management and operation of the company on a daily basis, from among the directors.

Directors must monitor the performance of duties of other directors, and statutory auditors must audit the management of the company by the directors. Important decisions of the company provided by law or the articles of incorporation must be resolved at a board meeting. Most listed companies fall into the category of a large company (companies with capital of JPY 500 million or more or with total debts of JPY 20 billion or more), and the statutory auditors of a large company must form a board of statutory auditors with three or more members.

(ii) Company with an audit and supervisory committee

Shareholders elect directors who are members of the audit and supervisory committee and other directors separately, and all of those directors constitute the board of directors. No statutory auditor is appointed.

The board of directors appoints one or more representative directors from among the directors who are not members of the audit and supervisory committee, and such representative directors are given the same authority as in a company with statutory auditors.

The audit and supervisory committee is empowered with broader audit authority than the statutory auditors in a company with statutory auditors, and it is authorised to state its opinions on the election, dismissal, and remuneration of directors who are not members of the audit and supervisory committee at the shareholders' meeting.

(iii) Company with three committees

Shareholders only elect directors, and the directors form a board of directors and elect the members of three committees from among these directors. No statutory auditor is appointed. The three committees are (a) the audit committee, which mainly audits the directors and executive officers, (b) the nominating committee, which determines proposals to be submitted at the shareholders' meeting regarding the appointment and dismissal of directors, and (c) the compensation committee, which determines compensation for each director and executive officer.

The board of directors appoints executive officers (*shikko-yaku*) who manage and operate the company on a daily basis, and directors and the board of directors supervise the executive officers. The board generally cannot manage and operate the company by itself; thus, it needs to delegate the authority to make important decisions to executive officers to enable the company to make various decisions timely. If two or more executive officers are elected, the board of directors must select representative executive officers.

Historically, (i) is the most common corporate structure for listed companies in Japan. However, the number of (ii), which were introduced in 2014, is gradually growing, and over 1,270 companies listed on the TSE have adopted this new structure as of 4 January 2022. While (iii) was introduced in 2002, it is less popular than the other two structures in number, as only approximately 80 companies have adopted this structure as of 4 January 2022.

No matter which structure is adopted, each of the directors and executive officers take responsibility for the management of the company. As shareholders' responsibility is limited to the amount of their invested capital, shareholders generally do not have any responsibilities.

4. How are responsibility and management power divided between the entity's management and its economic owners? How are decisions or approvals of the owners made or given (e.g. at a meeting or in writing)

In listed companies, their operations and management of the company is the responsibility of directors (in the case of companies with three committees and executive officers, please see question 3) and only material issues must be approved by a shareholders' meeting under the Companies Act, unless otherwise provided for in the articles of incorporation.

Under the Companies Act, any decision and approval by the shareholders can be made in writing if the shareholders agree unanimously. However, since it is not possible in practice within listed companies, they are resolving decisions and giving their approval at a meeting.

5. What are the principal sources of corporate governance requirements and practices? Are entities required to comply with a specific code of corporate governance?

The primary sources of corporate governance requirements and practices in Japan may be generally categorised as regulatory and non-regulatory sources:

(i) Regulatory sources

(a) Companies Act (Act No. 86 of 2005) (CA)

The CA sets forth the basic principles that a company needs to abide by regarding the rights and obligations of management members, organs, the disclosure of information, etc. The CA applies to all types of companies, irrespective of whether they are listed.

Meanwhile, on 4 December 2019, the Diet passed a law to amend the current CA (the 2019 CA Amendment). The 2019 CA Amendment partially came into effect on 1 March 2021. We briefly refer to the content of the 2019 CA Amendment as necessary.

(b) Financial Instruments and Exchange Act (Act No. 25 of 1948) (FIEA)

The FIEA generally requires that listed companies (x) disclose issues relating to corporate governance in their annual securities reports or quarterly reports, (y) timely disclose material information in their extraordinary reports, and (z) submit internal control reports to the authorities, etc.

(c) The securities listing regulations published by the TSE (TSE Regulations)

The main corporate governance requirements for listed companies under these regulations are (x) to submit corporate governance reports, and (y) to elect and disclose the name of at least one independent officer (see question 8).

(ii) Non-regulatory sources

(a) Articles of incorporation

All companies are required to establish articles of incorporation that regulate their corporate governance, including organs and the number of directors.

(b) Japan's Corporate Governance Code (CGC)

Japan's CGC, published in May 2015 (and revised in June 2018 and June 2021) by the Council of Experts Concerning the Corporate Governance Code established by the TSE and the Financial Services Agency, offers fundamental principles for effective corporate governance of listed companies in Japan.

(c) Proxy voting criteria provided by investor groups

Some investor groups, including the Pension Fund Association, who may be subject to the Principles for Responsible Institutional Investors introduced in February 2014 (and revised in May 2017 and March 2020) (Japan's Stewardship Code or SSC), provide criteria for proxy voting that influence the corporate governance of listed companies.

6. How is the board or other governing body constituted?

The governing body is the board of directors, the members of which are appointed by the shareholders' meeting. The board supervises the execution of duties by each of the directors and executive officers and, at the same time, appoints its representative directors (in the cases of a company with statutory auditors and a company with an audit and supervisory committee) and executive officers (in the case of a company with three committees). Since these executives can concurrently serve as directors, the so-called two-tier board structure is not employed in Japan.

It is worth mentioning, however, that if a company has statutory auditors, the statutory auditors are appointed by a shareholders' meeting separately from directors. These statutory auditors cannot concurrently serve as directors.

7. How are the members of the board appointed and removed? What influence do the entity's owners have over this?

Directors are elected by an ordinary resolution at a shareholders' meeting. Generally, the board of directors nominates director candidates; however, in the case of companies with three committees, this must be done by the nominating committee.

Directors (other than directors who are members of the audit and supervisory committee) can be dismissed at any time by an ordinary resolution at a shareholders' meeting, unless a higher threshold is provided for in the articles of incorporation. Directors who are members of an audit and supervisory committee can be dismissed by an extraordinary resolution at a shareholders' meeting. Directors can seek damages for dismissal from the

company if they are dismissed without justifiable grounds.

8. Who typically serves on the board? Are there requirements that govern board composition or impose qualifications for board members regarding independence, diversity, tenure or succession?

Executive directors are often elected from shareholders or employees, but this is not a statutory requirement to being a director. In regard to the board composition, the 2019 CA Amendment introduced a mandatory obligation under which listed companies, as well as some large non-listed companies, must appoint at least one outside director. In addition, all listed companies are required to elect and disclose the name of at least one independent officer pursuant to the TSE Regulations. To qualify as an independent officer, he/she must be an outside director or outside statutory auditor defined under the CA, and must also not (even potentially) have a conflict of interest with shareholders. In addition, if the company has a board of statutory auditors, at least half of the statutory auditors must be outside statutory auditors under the CA.

With respect to the committees, the majority of audit and supervisory committee members and three committees members must be outside directors. Other than these, there is no specific requirement concerning independence, diversity, and succession of the board.

Although not a requirement, under the CGC which was revised in June 2021, listed companies are encouraged to present their policies and goals for ensuring diversity in the promotion to core human resources, such as the promotion of women, foreign nationals, and midcareer hires to middle managerial positions, and to disclose the status of their progress.

9. What is the role of the board with respect to setting and changing strategy?

The leading role of the board with respect to setting and changing strategy is generally exercised by the representative director (in the cases of a company with statutory auditors and a company with an audit and supervisory committee) or (representative) executive officers (in the case of a company with three committees) based on the discussion or resolution at the board as necessary. Representative directors must be appointed from among directors. The (representative) executive officers need not be appointed from among directors, but usually at least one executive officer concurrently serves as a director.

10. How are members of the board compensated? Is their remuneration regulated in any way?

For a company with statutory auditors, the remuneration of directors must be approved at a shareholders' meeting. In practice, most companies approve only a maximum aggregate amount of remuneration for all directors and delegate the board of directors to determine the amount for individual directors, and the board determines the distribution of remuneration among the directors, or further delegates these responsibilities to one of the directors (typically, the representative director).

For a company with an audit and supervisory committee, the remuneration of directors must be approved at a shareholders' meeting, and that of members of the audit and supervisory committee must be approved separately from that of other directors. In practice, most companies approve only a maximum aggregate amount of remuneration for all directors who are members of the audit and supervisory committee, and the members of the audit and supervisory committee determine the distribution of remuneration among themselves.

In the case of a company with three committees, the compensation committee determines the remuneration of each director and executive officer in accordance with the remuneration policy prescribed by the committee. The approval of a shareholders' meeting is not required.

Historically, directors' remuneration has consisted mainly of fixed cash compensation, and performance-based remuneration has accounted for a relatively small portion of total remuneration. Equity-based incentives such as stock options are not widely utilized. The CGC encourages listed companies to include incentives in remuneration packages such that they reflect mid to long-term business results and potential risk, in order to promote healthy entrepreneurship.

11. Do members of the board owe any fiduciary or special duties and, if so, to whom? What are the potential consequences of breaching any such duties?

Under Japanese law, directors and executive officers must perform their duties (i) with the care of a prudent manager, (ii) in compliance with all laws and regulations and resolutions of shareholders' meetings, and (iii)

loyally. It is said that the duties of (i) and (iii) are not clearly distinguishable in Japan, and that these duties include so-called fiduciary duties owed by directors and executive officers to the company or all the shareholders. There is no legally binding concept of fiduciary duty owed by majority shareholders to minority shareholders in Japan.

Directors who neglect their duties are liable to the company for the resulting damages. Where directors are grossly negligent or knowingly fail in performing their duties, such directors are liable to third parties and their shareholders directly for the resulting damages.

12. Are indemnities and/or insurance permitted to cover board members' potential personal liability? If permitted, are such protections typical or rare?

Insurance covering board members' potential personal liability is permissible, and purchasing such insurance is typical in Japan. The 2019 CA Amendment included some explicit language concerning not only such insurance, but also indemnification agreements, allowing companies to indemnify directors and executive officers against third-party claims under certain conditions.

13. How (and by whom) are board members typically overseen and evaluated?

Each board member is overseen by other board members and evaluated by his/her performance, and if it is not satisfactory, he/she will not be nominated by the board of directors (in the cases of a company with statutory auditors and a company with an audit and supervisory committee), or by the nominating committee (in the case of a company with three committees).

However, there has been criticism that there is no specific criteria for the evaluation of board members or that evaluation does not function well. As such, the CGC encourages the board to appropriately evaluate company performance and reflect the evaluation in its assessment of senior management.

14. Is the board required to engage actively with the entity's economic owners? If so, how does it do this and report on its actions?

Companies are required to disclose various information pursuant to the CA, the FIEA, and the TSE Regulations (see question 5). At the same time, they are encouraged to actively and constructively engage in dialogue with investors and shareholders in accordance with the CGC.

Companies are also encouraged by the CGC not only to disclose information, but to engage in constructive dialogue including financial information briefings, IR conferences, individual meetings, and public relations in various forms.

15. Are dual-class and multi-class capital structures permitted? If so, how common are they?

Dual or multi-class capital structures have been permitted at the TSE since 2008; furthermore, in 2014, a certain company actually listed its class shares on the TSE. However, no other such company has listed its shares on the TSE since then, and this company has been the only example of a dual-class listing company in Japan.

16. What financial and non-financial information must an entity disclose to the public? How does it do this?

Stock companies are required to disclose their financial statements such as balance sheets every year under the CA. Also, in the case where the stock company is required to file an Annual Securities Report and other disclosure documents under the FIEA, most typical financial and non-financial information is included in the disclosure documents.

17. Can an entity's economic owners propose matters for a vote or call a special meeting? If so, what is the procedure?

Under the CA, qualified shareholders are permitted to make shareholder proposals. To be a qualified shareholder, a shareholder must hold the lesser of one percent of all voting rights or 300 voting rights; moreover, it must have continuously held such shareholding for six months or longer. Shareholder proposals have to be made no less than eight weeks before the date of the shareholders' meeting.

Considering that there were some cases in which shareholders abused this right, and made a large number of proposals, the 2019 CA Amendment introduced a limit of the number of proposals a shareholder can make at a shareholders' meeting to ten.

Any shareholder holding three percent or more of the company's voting rights for six months or longer may demand that directors call a special meeting. When the board does not call a special meeting without delay, the shareholder can obtain court permission, and once such permission is obtained, the shareholder can call the special meeting for the company.

18. What rights do investors have to take enforcement action against an entity and/or the members of its board?

Investors may seek enforcement action against the entity or the members of the board mainly in several ways: (i) investigation or enjoinment of the director's act; and (ii) bringing suits to recover damages.

First, investors are entitled to request an investigation of a director's act that is illegal or in breach of the articles of incorporation by a court-appointed inspector. If the company has statutory auditors, investors may ask the statutory auditors to investigate or enjoin the illegal act by the director on behalf of the company. Also, investors are entitled to request an injunction of a director's act under certain requirements.

Second, investors are entitled to initiate a lawsuit on behalf of the company (i.e., a derivative claim) or to pursue board members directly as individuals (i.e., a direct claim).

Before filing a derivative claim, the shareholders need to request that the company sue such members of the management body, and if the company does not sue the management members within 60 days of such a request, the shareholders may sue the members on behalf of the company. These claims are usually brought on the basis of a breach of fiduciary duty by the directors, statutory auditors, or executive officers.

If a shareholder suffers damage due to the wilful misconduct or gross negligence of the directors, statutory auditors or executive officers in the performance of their duties, the shareholder may directly claim for damages against such members.

19. Is shareholder activism common? If so, what are the recent trends? How can shareholders exert influence on a corporate entity's management?

Shareholder activism has become more common in Japan in recent years, and there have been several movements that require attention every year.

Recently, there have been an increasing number of cases where activist shareholders positively propose to conduct M&A transactions to companies, or activist shareholders intervene to prevent a company from conducting M&A transactions or propose to seek better conditions.

20. Are shareholder meetings required to be held annually, or at any other specified time? What information needs to be presented at a shareholder meeting?

In Japan, companies are required to hold a shareholders' meeting annually (ordinary shareholders' meeting), and commonly hold their ordinary shareholders' meetings within three months after the end of each fiscal year under the provision in the articles of incorporation to that effect. In this meeting, shareholders vote on items such as the appointment of directors/statutory auditors and the distribution of dividends. Companies may also hold extraordinary shareholders' meetings when necessary.

Before an ordinary shareholders' meeting, a convocation notice, including reference materials for exercising voting rights, financial statements and business reports, must be provided to shareholders at least two weeks before the date of the meeting.

Under the current CA, companies are required to send these materials to their shareholders in writing, unless each shareholder provides consent to receive the materials via the Internet. The 2019 CA Amendment will allow companies to make these materials available on the Internet, thereby providing them without obtaining the consent of each shareholder, under certain conditions. The 2019 CA Amendment on this point will come into effect on 1 September 2022.

21. Are there any organisations that provide voting recommendations, or otherwise advise or influence investors on whether and how to vote (whether generally in the market or with respect to a particular entity)?

In Japan, proxy advisors, such as Institutional Shareholder Services (ISS) and Glass Lewis, commonly provide voting recommendations for investors of listed companies on how to vote in accordance with their respective voting policies.

22. What role do other stakeholders, including debt-holders, employees and other workers, suppliers, customers, regulators, the government and communities typically play in the corporate governance of a corporate entity?

No laws provide a specific role for other stakeholders, such as debt-holders, employees, suppliers and customers, in the context of corporate governance of the company. However, the CGC encourages companies to fully recognise that their sustainable growth and the creation of mid to long-term corporate value can be achieved as a result of the resources and contributions from a range of stakeholders, including employees, customers, business partners, creditors, and local communities.

As such, companies are encouraged to make efforts to appropriately cooperate with these stakeholders. Based on this principle, many listed companies consider that these stakeholders are important and indispensable for them to increase their corporate value sustainably.

23. How are the interests of non-shareholder stakeholders factored into the decisions of the governing body of a corporate entity?

The governing body generally needs to make decisions considering how to maximise the interests of shareholders. The governing body should also consider other stakeholders as being very important and indispensable to increase corporate value sustainably pursuant to the CGC (see question 22).

24. What consideration is typically given to ESG issues by corporate entities? What are the key legal obligations with respect to ESG matters?

There are no legally binding requirements relating to corporate social responsibility. However, enhancement of the disclosure of governance information in securities reports has been actively discussed and such an atmosphere encourages listed companies to report voluntarily on social, environmental, and ethical issues in their securities reports. For example, the Ministry of Economy, Trade and Industry (METI) of Japan established a study group in 2018 to discuss the importance for the companies to take appropriate approaches toward integrating SDGs into their management and attracting ESG investments. Based on the discussion, METI published “The Guide for SDG Business Management,” which explained the best practices for such efforts in May 2019. In addition, the CGC provides that companies should take appropriate measures to address social and environmental issues. Recently, it is relatively common for corporate entities to voluntarily publish reports containing information regarding social, environmental, and ethical issues.

25. What stewardship, disclosure and other responsibilities do investors have with regard to the corporate governance of an entity in which they are invested or their level of investment or interest in the entity?

The Principles for Responsible Institutional Investors introduced in February 2014 (Japan’s Stewardship Code or SSC) was revised in May 2017 and March 2020. The SSC sets out principles that are considered helpful for institutional investors in fulfilling their stewardship responsibilities with regard for both their clients and beneficiaries and the investee companies. It offers the principles to be followed for a wide range of institutional investors to appropriately discharge their stewardship responsibilities, with the aim of promoting sustainable growth of investee companies. These principles include that institutional investors should have a clear policy on how they fulfil their stewardship responsibilities, and they should publicly disclose such a policy and the results of how they exercised their voting rights.

26. What are the current perspectives in this jurisdiction regarding short-term investment objectives in contrast with the promotion of sustainable longer-term value creation?

It is said that short-termism may bring about under-investment in tangible and intangible assets, including R&D, which may cause damage to long-term value. Recently, such risks of short-termism have been widely recognized. Under the circumstances, various efforts to create corporate value over the mid- and long-term have been promoted to maximize Japanese companies’ profits for sustainable economic development in Japan. Both CGC and SSC in Japan have been introduced as part of such efforts.

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