The Legal 500 Country Comparative Guides

Japan: Corporate Governance

This country-specific Q&A provides an overview to corporate governance laws and regulations that may occur in Japan.

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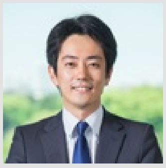

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1. **What is the typical organizational structure of a company and does the structure typically differ if the company is public or private?**

The most common corporate entity form 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 2).

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

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

Open KKs. Open KKs are companies without articles of incorporation requiring the approval of the company for acquisition or transfer of all or part of their shares. 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 is one of the largest equity markets in the world, listing over 3,700 companies (as of January 31, 2020), including major Japanese companies.

The applicable requirements and practice thereunder regarding corporate governance may significantly differ depending on whether a company is closed KK or open KK, and whether the company is listed or not. 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. **Who are the key corporate actors (e.g., the governing body, management, shareholders and other key constituencies) and what are their primary roles? How are responsibilities divided between the governing body and management?**

While a shareholders' meeting is the ultimate governing body, other key corporate actors 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 under 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 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 and needs to delegate the authority to make important decisions to executive officers to enable the company to make various decisions in a timely manner. 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 the listed companies in Japan. However, the number of (ii), which were introduced in 2014, is gradually growing, and nearly 1,0000 companies listed on the TSE have adopted this new structure as of January 31, 2020. While (iii) was introduced in 2002, it is less popular than the other two structures in number, as approximately 70 companies have adopted this structure as of January 31, 2020.

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.

3. **What are the sources of corporate governance requirements?**

The primary sources of corporate governance requirements 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, whether or not they are listed.

Meanwhile, on December 4, 2019, the Diet passed a law to amend the current CA (the **2019 CA Amendment**). The 2019 CA Amendment will come into effect by June 11, 2021, but the exact date will be specified by a Cabinet Order. We briefly refer to the content of the 2019 CA Amendment as necessary in the following.

(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) disclose material information in a timely manner 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 7).

(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) 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) (Japan's Stewardship Code or SSC), provide criteria for proxy voting that influence the corporate governance of listed companies.

4. **What is the purpose of a company?**

The primary purpose of a company is to obtain profits through external economic activities and to distribute the profits obtained to its shareholders. Shareholders cannot be deprived of at least one of the right to receive dividends from surplus or the right to receive distribution of residual assets. As to corporate social responsibility, see question 28.

5. **Is the typical governing body a single board or comprised of more than one board?**

The governing body is the board of directors, the members of which are appointed by the shareholders' meeting. The board supervises the execution of the 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.

6. **How are members of the governing body appointed and removed from service?**

Directors are elected by an ordinary resolution (see question 20) at a shareholders' meeting. Generally, the board of directors nominates director candidates, but 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 (see question 20) at a shareholders' meeting. Directors can seek damages for dismissal from the company if they are dismissed without justifiable grounds.

7. **Who typically serves on the governing body and are there requirements that govern board composition or impose qualifications for directors 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. Regarding the board composition, all listed companies are required to elect and disclose the name of at least one independent officer pursuant to 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.

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

Meanwhile, the 2019 CA Amendment will introduce a mandatory obligation under which the listed companies as well as some large non-listed companies must appoint at least one outside director.

8. **What are the common approaches to the leadership of the governing body?**

The leadership of the governing body 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). 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.

9. **What is the typical committee structure of the governing body?**

In the case of a company with an audit and supervisory committee, the company has an audit and supervisory committee, which mainly audits the management of the company by each director and the board of directors. The audit and supervisory committee must have three or more members, and all of them must be non-executive directors. The majority of audit and supervisory committee members must be outside directors.

In the case of a company with three committees, the company has three committees, (a) the audit committee, (b) the nominating committee and (c) the compensation committee. Each committee must have three or more members who concurrently serve as directors, and all members of the audit committee must be non-executive directors. The majority of each committee's members must be outside directors.

Meanwhile, in the case of a company with statutory auditors, there are no statutory committees, and in the case of a company with an audit and supervisory committee, there are no statutory committees specifically established for nomination of and determination of compensation for directors. The CGC, however, encourages these companies to establish voluntary advisory committees for the nomination and compensation of directors. Recently it is becoming more popular to establish these kinds of advisory committees in order to ensure transparency and objectivity of proposals made by the board of directors meeting.

10. **How are members of the governing body compensated?**

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. **Are fiduciary duties owed by members of the governing body and to whom are they owed?**

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) in a loyal manner. 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 of shareholders. There is no legally binding concept of fiduciary duty owed by majority shareholders to minority shareholders in Japan.

12. **Do members of the governing body have potential personal liability? If so, what are the key means for protecting against such potential liability?**

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.

However, if directors can demonstrate that they did not fail to exercise their duty of care in the performance of their duties, they generally will not be held liable.

In addition, some directors' liabilities may be discharged to a limited extent by shareholders resolution or, if the articles of incorporation so provide, board resolution. Approval of all shareholders is required to discharge the directors' liability in full. Also, a company may, if allowed by the articles of incorporation, enter into contracts with its directors who are not executive directors or employees, and with its statutory auditors, limiting their liability under such contracts. Directors, statutory auditors, and executive officers are also permitted to take out liability insurance at the company's expense.

Also, the 2019 CA Amendment will provide some explicit language concerning indemnification agreements, allowing companies to indemnify directors and executive officers against third-party claims under certain conditions.

13. **How are managers typically compensated?**

In Japan, directors (in the case of a company with statutory auditors or a company with an audit and supervisory committee) or executive officers (in the case of a company with three committees) generally serve as managers of the company. For details of their compensation, please see question 10.

14. **How are members of management typically overseen and evaluated?**

Members of management are evaluated by their performance, and if it is not satisfactory, they will not be nominated by the board of directors (as directors in the cases of a company with statutory auditors and a company with an audit and supervisory committee), or re-elected by the board of directors (as executive officers in the case of a company with three committees).

However, there has been a criticism that there is no specific criteria for the evaluation of management 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.

15. **Do members of management typically serve on the governing body?**

In the cases of a company with statutory auditors and a company with an audit and supervisory committee, typically all members of management serve as directors.

In the case of a company with three committees, some executive officers (typically at least one and less than half of all executive officers) serve as directors as well.

16. **What are the required corporate disclosures, and how are they communicated?**

Corporate disclosures for listed companies are mainly required by the CA, the FIEA, and TSE regulations.

(i) CA

Under the CA, a company must keep various documents at its head and branch offices including, articles of incorporation, shareholders registry, minutes of its meetings, financial statements and business reports.

Shareholders can generally inspect or copy these documents, while court permission is required for minutes of board meetings or committee meetings.

In addition, the company must provide shareholders with financial statements and business reports approved by the board when giving notice of an annual shareholders’ meeting (see question 25).

(ii) FIEA

Listed companies have periodic reporting requirements and must submit annual and quarterly securities reports to the authorities. These companies also have to file, without delay, extraordinary reports on the occurrence of certain major actions or events.

(iii) TSE regulations

Listed companies must promptly disclose certain material events, and also disclose summary reports on financial results on a quarterly basis. Furthermore, listed companies need to submit a corporate governance report setting forth, among other things, an outline of the corporate governance system and the basic policy regarding the internal control system.

17. **How do the governing body and the equity holders of the company communicate or otherwise engage with one another?**

Companies are required to disclose various information pursuant to CA, the FIEA, and TSE regulations (see question 16). 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.

18. **Are dual or multi-class capital structures permitted and how common are they?**

Dual or multi-class capital structures have been permitted at the TSE since 2008, and 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.

19. **What percentage of public equity is held by institutional investors versus retail investors?**

According to the TSE, the shareholding percentage at market value by retail investors is 17.2%. While the shareholding percentage by institutional investors itself is not available, the aggregate percentage held by trust banks and foreigners, which could be deemed to be approximately the same as the shareholding ratio of institutional investors, is 50.6%.

20. **What matters are subject to approval by the shareholders and what are the typical quorum requirements and approval standards? How do shareholders approve matters (e.g., voted at a meeting, written consent)?**

The operation and management of the company is the responsibility of directors or executive officers, and only material issues must be approved by a shareholders' meeting. Most items (*e.g.*, appointment and dismissal of directors, payment of dividends) can be resolved by a majority of the voting rights of shareholders present at the meeting (ordinary resolution); however, some material issues (*e.g.*, amendments to the articles of incorporation, mergers) must be resolved by a greater proportion of voting rights, such as two-thirds or more of the voting rights of shareholders present at the meeting (extraordinary resolution).

21. **Are shareholder proposals permitted and what requirements must be met for shareholders to make a proposal?**

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, and 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 will limit the number of proposals that a shareholder can make at a shareholders meeting to ten.

22. **May shareholders call special meetings or act by written consent?**

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 permission is obtained, the shareholder can call the special meeting for the company.

23. **Is shareholder activism common and what are the recent trends?**

Shareholder activism has become more common in Japan in recent years, and there have been several movements which 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.

24. **What is the role of shareholders in electing the governing body?**

Generally, shareholders may exercise voting rights to elect the governing body of the company as they wish.

Regarding institutional investors, however, based on the SSC, they are expected to exercise their voting rights with the aim of promoting sustainable growth of investee companies.

25. **Are shareholder meetings required to be held annually or otherwise, and what information needs to be presented?**

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. In this meeting, shareholders vote on items such as the appointment of directors/statutory auditors and the distribution of dividends (see question 20). 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.

26. **Do any organizations provide voting recommendations or otherwise advise or counsel shareholders on whether to approve matters?**

Several proxy voting advisory institutions cover the Japanese market. They provide proxy voting policies regarding exercise of voting rights and advising whether to agree or disagree based on agenda items of individual companies.

27. **What role do other stakeholders, including debt holders, employees, suppliers, customers, the government and communities, typically play in the corporate governance of a company?**

No laws provide a specific role for stakeholders such as creditors or employees in the context of corporate governance. 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 in a sustainable manner.

28. **What consideration is given to ESG (environmental, social and governance) issues, including climate change, sustainability and product safety issues, and are there any legal disclosure obligations regarding the same?**

There are no legally binding requirements for a company to deal with environmental and social issues. However, the CGC encourages companies to take appropriate measures to address these issues. Some listed companies voluntarily publish periodical CSR reports regarding social, environmental and ethical issues, or add descriptions in their securities reports or corporate governance reports regarding these matters.

29. **How are the interests of shareholders and other stakeholders factored into decisions of the governing body?**

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 in a sustainable manner pursuant to the CGC (see question 27).

30. **Do public companies typically provide earnings guidance on either a quarterly or annual basis?**

While it is not mandatory, most listed companies in Japan provide earnings guidance on a quarterly basis. As to the scope of earnings guidance, recently, some listed companies have ceased providing half-year forecasts of earnings ending up with full-year forecasts only, and this trend is slowly expanding.

31. **May public companies engage in share buybacks and under what circumstances?**

Listed companies may generally engage in share buybacks. While the CA provides several situations under which a company can buy back its shares, if a listed company desires to engage in share buybacks through the market, it can conduct them based on agreement with the shareholders who are willing to tender shares. To do so, the company is required to obtain an approval of its shareholders' meeting, or, where the articles of incorporation so provide, the board of directors' approval. Also, the amount of money to be used for share buybacks cannot exceed the distributable amount under the CA at the time of share buyback.

32. **What do you believe will be the three most significant issues influencing corporate governance trends over the next two years?**

First, as mentioned above, the 2019 CA Amendment will come into effect by June 11, 2021. Not only the amended provisions themselves, but we also anticipate seeing significant updates on the corporate governance environment in connection with the 2019 CA Amendment, such as the requirement that there be at least one independent officer for a listed company (see question 7), and discussions regarding potential future revisions of the

CGC, 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 material 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.