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Introducing Sustainability into Japanese Corporate Governance

The Shift to “New Capitalism” or a Continued Gradual Transformation?

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I. INTRODUCTION

Sustainability is quickly making its way into Japanese corporate governance. It was in the 2017 revision of the Stewardship Code that the reference to ESG (environment, social and governance) risks appeared in a corporate governance instrument for the first time. In less than five years since that time, the Corporate Governance Code (as revised in 2021) requires that all listed companies disclose their activities concerning sustainability and that those listed in the Prime Section of the Stock Exchange make disclosures in accordance with the framework of the Taskforce on Climate-related Financial Disclosures (TCFD). Furthermore, the Council of Finance has concluded that the Financial Instruments and Exchanges Act (FIEA) is to be amended to introduce sustainability-related disclosure, in line with the TCFD framework. The concept of Sustainability Development Goals (SDGs) has also become widely known in the Japanese society. There is not a day on which one does not see the SDGs logo of seventeen colours in the newspaper or find someone wearing an SDGs badge on the street.

These developments need to be viewed in context. In Japan, corporate governance has constantly been on the policy agenda since the early 2000s. The focus was on transforming the employee-oriented “Japanese style” management of large companies – which was once highly credited as enabling the spectacular economic growth seen during the second half of the twentieth century – into a corporate governance regime responsive to the demands of the capital market. After the long-lasting economic downturn, policymakers in Japan concluded that the Japanese economy needed investments from global investors in the capital market and that traditional Japanese-style management was no longer appealing to them.

Despite the reluctance – and sometimes even the resistance – of the industry to accept corporate governance oriented to the capital market, the reform of corporate governance made gradual progress. Having an outside director on the board became mandatory for listed companies under the Companies Act in 2019. Earlier still, the Corporate Governance Code was introduced in 2015 and required that listed companies have two or more independent directors on the board or explain the reason why they are not in compliance with this condition. In 2021, reportedly two-thirds of the companies listed in the then First Section of the Tokyo Stock Exchange had a nomination committee and a remuneration committee to enhance corporate governance, though most of them are not legally required to do so. After two decades of reform, the model of corporate governance has apparently transitioned from the traditional, employee-oriented one to the model based on the primacy of shareholder interests, responsive to the demands of investors in the capital market.

Against such recent developments, the quick proliferation of the sustainability concept might appear to be a sudden turn in corporate governance. One might argue that the “new form of capitalism” that the recently organised Kishida Cabinet is advancing as its key policy has caused such a turn, as the policy aims at exerting discipline over the “old” capitalism narrowly focused on profit-seeking.¹ It may also be recalled that in his policy speech made in autumn of 2020, former Prime Minister SUGA launched the initiative of achieving a carbon-neutral society and realising a decarbonised society in 2050.² While the political leadership does have influence, the political economy of corporate governance reform is more complex. If this were not the case, the earlier transition to the shareholder-oriented corporate governance would have been much easier.

The aim of this paper is to analyse how the concept of sustainability is affecting corporate governance in Japan and to examine its relationship with the previous reforms. For this purpose, the next section (II.) describes three recent developments made under the auspices of the Financial Services Agency (FSA). It is followed by the exploration into the background of the recent developments and comparison with the approach and motivation of the transition to the shareholder-oriented model in the previous years (III.). The following section examines how the companies are responding to these developments, focusing on the sustainability committees that several listed companies have established to address the emerging demands (IV.). The concluding section offers an outlook for the coming years with regards to the acceptance of the sustainability concept in Japanese corporate governance (V.).

II. QUICK ADAPTATION TO SUSTAINABILITY DEMANDS

1. *Corporate Governance through Non-mandatory Codes*

The non-mandatory Stewardship Code and Corporate Governance Code, modelled after the Codes in Commonwealth countries, were introduced as “soft law” instruments designed to advance the reform of corporate governance. As opposed to the United Kingdom, the Stewardship Code was first published in Japan in 2014.³ In the course of transforming the traditional Japanese-style of corporate management, it was considered essential that

1 See Policy Speech by Prime Minister Fumio KISHIDA to the 207th session of the Diet, English translation available at https://japan.kantei.go.jp/101_kishida/statement/202112/_00002.html.

2 See Policy Speech by the Prime Minister to the 203rd Session of the Diet, English translation available at https://japan.kantei.go.jp/99_suga/statement/202010/_00006.html.

the institutional investors become aware of their role in advocating shareholders' interests as an exercise of their fiduciary duty towards asset owners. As of August 2022, 322 investors have become signatories to the Stewardship Code, now in its 2020 version.⁴ A year after the Stewardship Code's publication, the Corporate Governance Code was adopted by the committee co-chaired by the FSA and the Tokyo Stock Exchange (TSE). It has been implemented as part of the listing rules of all the stock exchanges in Japan since April 2015.

Because the two Codes are not legally binding, the implementation of the rules in the Codes takes the form of "comply or explain." The addressee does not have to "comply" with all the rules. However, when it chooses not to comply with certain rules, it must disclose the reason why it chooses not to do so. For the Corporate Governance Code, the TSE periodically publishes statistics about how many companies listed with them choose not to comply and to instead disclose the reason for each of the rules in the Code.⁵

In the revision of 2017, the Stewardship Code first mentioned "ESG", though only in a footnote to a risk factor. After a further revision in 2020, the current Stewardship Code elaborates that the investors are to have dialogues with the companies in which they invest, considering "medium- to long-term sustainability including ESG factors."⁶

On the side of listed companies, the Corporate Governance Code, after the last revision of 2021, urges listed companies to collaborate with "a range of stakeholders, including the employees, customers, business partners, creditors and local communities" for the sake of the sustainable growth of the company and mid- to long-term creation of corporate value, and it requires them to address issues of sustainability, such as social and environmental issues.⁷ In addition, in the context of disclosures, the Corporate Governance

3 B. ARONSON/S. KOZUKA/L. NOTTAGE, *Corporate Legislation in Japan*, in: Haghirian (ed.), *Routledge Handbook of Japanese Business and Management* (2016) at 111.

4 The list of signatories is published on the website of FSA, <https://www.fsa.go.jp/singi/stewardship/list/20171225.html> (accessed on 14 February 2022, available only in Japanese).

5 Tokyo Stock Exchange, Inc., [Reference] Response of Listed Companies regarding Revised Corporate Governance Code (As of December, 31 2021), available at <https://www.jpx.co.jp/english/equities/listing/cg/tvdivq0000008jdy-att/b5b4pj000004obku.pdf> (2022).

6 See Principles for Responsible Institutional Investors «Japan's Stewardship Code» — To promote sustainable growth of companies through investment and dialogue, Guidance 1.1, available at <https://www.fsa.go.jp/en/refer/councils/stewardship/20200324/01.pdf> (2020).

7 General Principle 2 of the Corporate Governance Code, as revised in 2021, provides that "[c]ompanies should fully recognize that their sustainable growth and the crea-

Code specifically requires that companies listed in the Prime Section of the stock exchange disclose risks and opportunities concerning climate change, pursuant to the TCFD framework or an equivalent framework.⁸

The Prime Section was launched in 2022 as a result of the restructuring of listing categories of the Tokyo Stock Exchange (TSE).⁹ The intention was to create a market for a handful of globally active companies that attract investors from abroad, whereas most of the 2,000 companies currently listed in the First Section of TSE were expected to choose the Standard Section. Given that the disclosure pursuant to the TCFD framework is costly, limiting its application to companies listed in the Prime Section would have made sense if the originally planned channelling of companies to the Prime and Standard Sections had been accomplished. In reality, however, many of the companies previously listed in the First Section have chosen the Prime Section.¹⁰ While some of them may find climate-related disclosures to be burdensome, it may result in an unintended spread of climate-related disclosure pursuant to the TCFD framework.

2. Amendments to the Statutory Obligation of Disclosure

Debates over climate-related disclosures have gone beyond soft law regulation. The Council of Finance, with which the FSA consults when making amendments to FIEA, started a new round of deliberations of its Disclosure Working Group in September 2021. The latter concluded its deliberations in June 2022 with the publication of a Report.¹¹ The Working Group had

tion of mid- to long-term corporate value are brought about as a result of the provision of resources and contributions made by a range of stakeholders, including employees, customers, business partners, creditors and local communities. See Japan's Corporate Governance Code: Seeking Sustainable Corporate Growth and Increased Corporate Value over the Mid- to Long-Term, available at <https://www.jpx.co.jp/english/news/1020/b5b4pj0000046kxj-att/b5b4pj0000046l07.pdf> (2021).

8 Supplementary Principle 3.1.3 of the Corporate Governance Code provides that “companies listed on the Prime Market should collect and analyze the necessary data on the impact of climate change-related risks and earning opportunities on their business activities and profits, and enhance the quality and quantity of disclosure based on the TCFD recommendations, which are an internationally well-established disclosure framework, or an equivalent framework”. See JAPAN'S CORPORATE GOVERNANCE CODE, *supra* note 7.

9 JAPAN EXCHANGE GROUP, Overview of Market Restructuring, <https://www.jpx.co.jp/english/equities/market-restructure/market-segments/index.html> (2021).

10 See ‘Number of listed companies as of April 4, 2022’ on JAPAN EXCHANGE GROUP, *supra* note 13.

11 Report of the Disclosure Working Group of the Council of Finance, available at https://www.fsa.go.jp/singi/singi_kinyu/tosin/20220613/01.pdf (in Japanese).

three main items on its agenda: disclosure relating to sustainability (climate change and human resources), corporate governance and other matters.¹²

Introducing climate-related disclosures into the existing framework of financial disclosures under the securities regulation raises several difficulties. One of the difficulties is that a large part of the information to be disclosed will be qualitative information. Given that the FIEA provides for penal sanction in cases where the company fails to disclose or discloses incorrect information, the disclosure of descriptive (non-financial) information could raise a sensitive issue for companies. Another problem is that the disclosure duty under the FIEA is applicable to over 4,000 companies, a number even broader than the total of companies listed in the First Section.¹³ It implies that the costs associated with the introduction of the new type of disclosure may be too burdensome to some of the companies affected by it. In light of these challenges, the Working Group suggests in its Report that the mandatory disclosure in the annual report be limited to core information related to sustainability and allow references to detailed information as supplemented in non-mandatory documents, where necessary. Furthermore, among the four elements of the TCFD framework, the Working Group suggests that only the disclosure of “governance” and “risk management” be mandatory for all the companies to which FIEA applies and that the disclosure of “strategies” and “targets and goals” be made when the company finds it appropriate to do so, considering materiality.

Prior to the launch of the Working Group’s new round, the FSA had already commenced annual publication of “Good Practices in Disclosures of Descriptive Information” since 2018. ESG-related information has been added in the 2020 version, published in November 2020.¹⁴ Thus, the FSA seems to be taking careful steps, ranging from encouraging good practices to introducing the statutory obligations. As a result, the no opposition was – remarkably – heard, even from the industry representatives, in the Working Group.¹⁵ The result was that after less than one year’s deliberation, the Working Group concluded that the introduction of sustainability-related disclosure be made.

12 See the Material prepared by the Secretariat of the Disclosure Working Group, available at https://www.fsa.go.jp/singi/singi_kinyu/disclose_wg/siryoku/20210902/03.pdf (only in Japanese).

13 See Minutes of the second meeting of the Disclosure Working Group, held on 1 October 2021, available at https://www.fsa.go.jp/singi/singi_kinyu/disclose_wg/gijiroku/20211001.html (only in Japanese).

14 記述情報の開示の好事例集 2020 [Good Practices in disclosures of descriptive information 2020], downloadable from <https://www.fsa.go.jp/news/r2/singi/20201106-3.html> (only in Japanese).

15 See Minutes of the second meeting of the Disclosure Working Group, *supra* note 13.

3. *Improving Sustainability Finance*

The FSA as the market regulator is concerned not only with corporate disclosures but also financial products. According to the Green Finance Portal set up by the Ministry of Environment (MEV),¹⁶ the issuance of ESG bonds in the Japanese market rose to 99 cases, reaching 1,865 billion yen in amount in 2021. This record figure is remarkable as compared with that of 2016, when there were only 4 issuances and the total amount was 75 billion yen. Sustainability-linked loans are also mushrooming, 54 loans with a total amount of 352 billion yen.

In 2020, the FSA set up the Expert Panel on Sustainable Finance to examine issues arising from these practices. On the one hand, the FSA apparently intends to promote sustainable finance in the Japanese market, as can be observed in the language in the Report of the Expert Panel calling for the establishment of a “Green International Finance Center” capable of attracting investments from domestic and foreign investors.¹⁷ On the other hand, the Report notes the problem whereby the labelling of investment trusts marketed to individual investors as “related to ESG or SDGs” is left unregulated.¹⁸ The criteria for the evaluation and scoring of companies’ ESG-related activities is not always disclosed.

The Report further emphasises the importance of ESG ratings and data providers.¹⁹ Reference is made to the work on this subject as done by the International Organization of Securities Commissions (IOSCO), co-chaired by the European Securities Markets Authority (ESMA) and Japan’s FSA.²⁰ While the issue is not unique to Japan, the Report also notes that Japanese companies need to disclose necessary information in English and in a manner easily accessible. Language often creates a disadvantage for Japanese companies in comparison to competitors from other economies in the global market.

To address the issues raised in the Report, the FSA established the Technical Committee for ESG Rating and Data Providers in 2022.²¹ The Technical Committee published a report at the conclusion of its half-year exam-

¹⁶ GREEN FINANCE PORTAL, <http://greenfinanceportal.env.go.jp/en/>.

¹⁷ Report by the Expert Panel on Sustainable Finance: Building a Financial System that Supports a Sustainable Society 12 (2021), downloadable from <https://www.fsa.go.jp/news/r2/singi/20210618-2.html>.

¹⁸ Report by the Expert Panel on Sustainable Finance, *supra* note 17, at 14.

¹⁹ Report by the Expert Panel on Sustainable Finance, *supra* note 17, at 15–17.

²⁰ Report by the Expert Panel on Sustainable Finance, *supra* note 17, at 17.

²¹ FSA, Establishment of “Technical Committee for ESG Rating and Data Providers, etc.”, at <https://www.fsa.go.jp/en/news/2022/20220217.html>.

ination in July 2022.²² In the report, the Technical Committee proposes a “code of conduct” consisting of five principles for ESG ratings and data providers to ensure that ESG ratings are made in a transparent and fair manner, without conflicts of interest resulting from, among other reasons, the provision of rating and consulting services by a single entity.

III. DIFFERENCES AND CONTINUITY IN THE APPROACH OF THE REFORM

1. *Shift in the Focus of Corporate Governance Reform*

a) *From shareholder primacy to stakeholder interests?*

The developments reviewed in the last section might give the impression that corporate governance reform in Japan has made a sudden turn in the last few years. While past reform focused on a departure from stakeholder-oriented “Japanese style management” and a shift towards the shareholder primacy model of corporate governance, the recent adaptation to the sustainability concept creates the impression that the primacy of shareholder interests is being rejected in favour of stakeholder interests.

In fact, Japanese commentators often mention that the sustainability considerations are not unknown in the tradition of commerce in Japan. They claim that the ideal of “good for three parties” (*sanpō yoshi*) as held by merchants in Ōmi (now Shiga Prefecture, adjacent to Kyōto and traditionally known as the source of merchants) reflects the importance of sustainability.²³ The “good for three parties” (*sanpō yoshi*) principle means that business must be good for the seller, for the buyer and for society, which thus cautions a merchant against an exclusive pursuit of profit at the expense of the other party – and still more of public interests. It is no wonder that some corporate managers who had been discontent with the corporate governance based on the shareholder’s primacy welcomed the recent emergence of sustainability as a revival of the stakeholder model that they had been familiar with.

It is, however, more than likely that such a view is flawed. On the one hand, it is doubtful that the interests of the general public under the classic notion of “good for three parties” (*sanpō yoshi*) is equivalent to the considerations for sustainability as being discussed currently. Whereas the sus-

22 Report of the Technical Committee for ESG Evaluation and Data Providers, at https://www.fsa.go.jp/news/r4/singi/20220712/20220712_2.pdf.

23 See T. BANNO/Y. ISOGAI, 「SDGs ? 日本は昔から三方よし」論に欠けた視点 [The point lacking in an argument saying ‘SDGs? Japan has for a long time been pursuing *sanpō yoshi*’], Tōyō Keizai Online, 9 April 2021, <https://toyokeizai.net/articles/-/420536> (only in Japanese).

tainability of the environment is literally a global issue, urging us to be conscious of the problems taking place at some remote location on the globe, the pre-modern merchants of Ōmi may have simply considered the community in which they lived. It is true that the Corporate Governance Code explicitly includes “communities” as one of the categories of stakeholders when it urges management to collaborate with a range of stakeholders, but apparently the current focus on sustainability goes far beyond what Ōmi merchants cared about.

On the other hand, whether the Corporate Governance Code has departed from an orientation on shareholders’ interests is not so clear as it may seem at first sight. The Code consistently emphasises “mid- to long-term corporate value” even when it requires collaboration with “a range of stakeholders”.²⁴ The approach sounds close to what BEBCHUCK and TARALLITA call “instrumental stakeholderism”. BEBCHUCK and TARALLITA distinguish “instrumental stakeholderism” and “pluralistic stakeholderism”: the former considers that the relationship between a corporation and its stakeholders is mutually beneficial and that paying attention to the stakeholders’ interests is required in order to maximise the long-term interests of shareholders, while the latter regard stakeholder welfare as an end.²⁵ Japan’s Corporate Governance Code seems to exclude pluralistic stakeholderism, as it emphasises (mid- to long-term) corporate value as the goal of corporate governance and carefully avoids any expression whereby stakeholders’ interests are an ultimate goal in themselves.

A further twist makes the difference between the reform in the previous decades and the current adaptation to sustainability even more blurred. “Risks arising from social and environmental matters” was already mentioned in the initial version of the Stewardship Code, published in 2014, in the context of risk management of the company. The initial version of the Corporate Governance Code, adopted in the next year, explicitly mentioned that “taking positive and proactive measures toward ESG (environmental, social and governance) matters may also be included as part of [the] cooperation” with the stakeholders.²⁶ In other words, the final stage of the reform that was oriented to shareholders’ interests and the beginning of the adaptation to emerging ESG issues (later to be developed into sustainabil-

24 See *supra* note 7.

25 L. A. BEBCHUCK/R. TARALLITA, The Illusory Promise of Stakeholder Governance, *Cornell Law Review* 106 (2020), 91, 108–123.

26 See Notes to General Principle 2 of Japan’s Corporate Governance Code: Seeking Sustainable Corporate Growth and Increased Corporate Value over the Mid- to Long-Term, available at <https://www.jpx.co.jp/english/equities/listing/cg/tvdivq0000008jdy-att/b5b4pj0000046p7l.pdf> (2015).

ity) overlapped. This being said, it seems appropriate that the primary focus of corporate governance reform has shifted, if not entirely changed.

b) Speed of the reform

There seems to be another, though less prominent, new feature in the reform process. It is the speed of the process. In the past, corporate governance reform needed a long period of time, which one author has called “gradual transformation.”²⁷ Typical here was the introduction of an outsider on the board of directors, which was the primary issue of the reform in early 2000s. The first of such attempts was the 2004 amendment of corporate law (as part of the Commercial Code at that time) to add an optional corporate governance structure that featured three committees (nomination, audit and remuneration committees) operating under the board to be dominated by outside directors.²⁸ It took 15 years since that time to achieve an amendment to the (current) Companies Act, making it mandatory for listed companies to appoint at least one outside member to the board.²⁹ The resistance of business organisations was very strong and the issue became highly controversial.³⁰

By contrast, the adaptation to sustainability is taking place in an impressively swift manner. It was in the middle of 2010s that sustainability became a serious agenda item for global business. The General Assembly of the United Nations adopted the SDGs in 2015. The TCFD published the Recommendations on climate-related financial disclosures in 2017.³¹ As described above, the Japanese Stewardship Code mentioned “ESG” already in 2017. In less than five years since that time, amendments to the FIEA are being discussed that would make climate-related disclosures mandatory.

27 L. NOTTAGE, Perspectives and Approaches: A Framework for Comparing Japanese Corporate Governance, in: Nottage/Wolff/Anderson (eds.), *Corporate Governance in the 21st Century: Japan’s Gradual Transformation* (2008) 21.

28 In 2014, a third option for the corporate governance structure was introduced. It is a hybrid of the traditional dual-board structure and the board with three committees and requires only one single audit and supervision committee under the board. The majority of the audit and supervision committee must be outside directors (Art. 331-2 (2) Companies Act).

29 Art. 327-2 Companies Act.

30 G. GOTÔ/K. MATSUNAKA/S. KOZUKA, Japan’s Gradual Reception of Independent Directors: An Empirical and Political-Economic Analysis, in: Puchniak/Baum/Nottage (eds.), *Independent Directors in Asia: A Historical, Contextual and Comparative Approach* (2017) 135, 164–165.

31 Task Force on Climate-related Financial Disclosures, *Final Report: Recommendations of the Task Force on Climate-related Financial Disclosures* (2017), downloadable from <https://www.fsb-tcfd.org/recommendations/>.

What is more striking is that such rapid developments do not appear to be giving rise to any resistance from the industry and are instead meeting with the industry's understanding, as noted above.

2. *Continuity in the Approach to the Reform*

a) *The initiatives of institutional investors*

A closer look at the ongoing adaptation to sustainability reveals continuity from the corporate governance reform during the previous decades, rather than change from the latter. First, both instances of reform have been responses to the demands of the capital market. The acceptance of responsibility as regards corporate performance was, in fact, facilitated by the increasing presence of institutional and foreign investors in the Japanese capital market.³² Likewise, the recent orientation to sustainability reflects the emerging demands from investors in the market.

The Government Pension Investment Fund (GPIF), the largest institutional investor in Japan, has played a significant role in the previous reform so as to urge Japanese companies to shift to shareholder-oriented corporate governance.³³ The GPIF signed up to the United Nations Principles for Responsible Investment (UN PRI) in September 2015, which aroused interests in ESG investment among Japanese investors. The next year, the GPIF called for indices reflecting ESG factors to be used for investments in the Japanese market and adopted two ESG indices of a general nature along with one index specifically reflecting the social risks in 2017.³⁴ Furthermore, the GPIF adopted two global environmental stock indices in September 2018.³⁵

GPIF justifies its commitment to ESG investment with reference to its position as a universal owner. With its broadly diversified portfolio, GPIF needs to take steps towards limiting any negative externalities associated with a certain company or industry sector and to pay attention to the long-term sustainability of the society and market.³⁶

32 G. GOTÔ, Legally "Strong" Shareholders of Japan, *Michigan Journal of Private Equity & Venture Capital Law* 3(2) (2013) 125.

33 See S. KOZUKA, Corporate Governance Reform, Social Norms and Sustainability in Japanese Companies, in: Sjøfjell/Bruner (eds.), *The Cambridge Handbook of Corporate Law, Corporate Governance and Sustainability* (2019) 446, at 456.

34 GPIF, GPIF selected ESG Indices (2017), at https://www.gpif.go.jp/en/investment/pdf/ESG_indices_selected.pdf.

35 GPIF, GPIF Selected Global Environmental Stock Indices (2018), at <https://www.gpif.go.jp/en/topics/GPIF%20Selected%20Global%20Environmental%20Stock%20Indices.pdf>.

36 See GPIF, Description for Investment Principles (2020) at 7–8, downloadable from <https://www.gpif.go.jp/en/about/philosophy.html>.

The initiatives of GPIF started in a somewhat accidental manner. In 2015, the Ministry of Welfare, Health and Labor (MWHL), as supervising authority of GPIF, appointed Hiromichi MIZUNO, who had been a partner of Collier Capital, a UK-based private equity fund, as the first Chief Investment Officer (CIO) of GPIF.³⁷ The position of CIO was introduced as a result of changes to GPIF's governance and a shift in the fund's investment policy that lifted restrictions on investing in equity. MIZUNO contacted asset managers of pension funds in the US and Europe in searching out the investment policy most suitable to GPIF. Through such efforts, MIZUNO came to recognise the significance of ESG investments.³⁸ It was no coincidence that GPIF signed up to UN PRI in 2015, less than a year after MIZUNO's appointment to CIO. The personal enthusiasm of MIZUNO as CIO may explain GPIF's positive commitment to sustainability.

Further, GPIF is taking the lead in raising awareness about sustainability, giving momentum, in particular, to the acceptance of the TCFD framework in Japan. GPIF announced its support of the TCFD framework in December 2018³⁹ and has been making disclosures pursuant to the TCFD framework since 2019. In 2020, GPIF published an interesting analysis on the climate-related risks of its portfolio by using the method of Climate Value at Risk (CVaR).⁴⁰ It concludes that Japanese stocks have positive value under the 2-degrees scenario as supported by the environment-related technologies held by Japanese companies.

b) Shareholder activism through proposals at the shareholders' general meeting

Investors' voices are also heard through the shareholder proposals submitted at the shareholders' general meetings. Under the Companies Act, with the exception of small companies, a shareholder or shareholders with voting rights of one per cent or more or 300 units for the period of six months or more have the right to submit a proposal about an agenda item at the shareholders' general meeting. If the proposal is made eight weeks in ad-

37 R. KOZLOWSKI, GPIF names Collier Capital partner as its first CIO, Pension & Investments, 19 November 2014, at <https://www.pionline.com/article/20141119/ONLINE/141119881/gpif-names-coller-capital-partner-as-its-first-cio>.

38 K. FUMA, ESG 思考 [Thinking like ESG] (2020) 171–172.

39 GPIF, GPIF Supports TCFD Recommendations (25 December 2018), https://www.gpif.go.jp/investment/e_TCFD_supportstatement.pdf.

40 GPIF, Analysis of Climate Change-Related Risks and Opportunities in the GPIF Portfolio (2021), downloadable from https://www.gpif.go.jp/en/investment/esg/gpif_publishes_the_analysis_of_climatechange-related_risks_and_opportunitiesin_the_gpif_portfolio2020.html.

vance of the meeting date, the shareholder may request that its proposal be included in the notice of the meeting sent by the company to the shareholders without any cost. In 2019, the provision was amended to limit the maximum number of proposals to 10 in order to prevent frivolous proposals from being made. Notwithstanding such an amendment, serious proposals are increasing in number. Among them are the proposals related to sustainability, in particular, to climate-related risks.

The first such proposal was made at the general shareholders' meeting of Mizuho Financial Group, Inc., one of Japan's largest banking holding companies, in June 2020. The proposal required that a new provision be added to the corporate charter that obligates the company to disclose in the company's annual report "the company's business strategy, including metrics and targets, to align its investments with the goal of the Paris Agreement".⁴¹ Despite the company's opposition, the proposal attracted support from 34 per cent of the shareholders in terms of voting rights.⁴² The proposing shareholder reports that 172 institutional investors supported the proposal, which included Nordea Investment Management (Nordic region's largest asset manager), AP7 (Swedish pension fund), AkademikerPension (Danish pension fund) and Allianz Global Investors, as well as some of the Japanese investors.⁴³ The two major proxy advisers, Institutional Shareholder Services Inc. (ISS) and Glass, Lewis & Co., recommended support.⁴⁴

In 2021, a similar proposal was made at the shareholders' general meeting of another large banking holding company, Mitsubishi UFJ Financial Group (MUFG). Some non-governmental organisations (NGOs) working on global environment issues proposed, as shareholders of the company, that a provision be added to the corporate charter such that the company adopt and disclose in its annual reporting a plan outlining its business strategy, including metrics and short-, medium- and long-term targets, to align

41 KIKO NETWORK, Kiko Network, as Mizuho Financial Group shareholder, files first ever climate resolution in Japan, at https://www.kiconet.org/eng/press-release-en/2020-03-16/mizuho_shareholder_proposal (2020).

42 MIZUHO FINANCIAL GROUP, INC., Filing of Extraordinary Report, at https://www.mizuhogroup.com/binaries/content/assets/pdf/mizuhoglobal/investors/financial-information/stock-information/extra_18_eng.pdf (2020).

43 KIKO NETWORK, Voting results of shareholder resolution for Mizuho Financial Group (2nd tally): 172 institutions supported Kiko Network's climate resolution, https://www.kiconet.org/eng/press-release-en/2021-01-21/Mizuho_resolution_report_2 (2021).

44 KIKO NETWORK, Voting results of shareholder resolution for Mizuho Financial Group (1st tally), at https://www.kiconet.org/eng/press-release-en/2020-09-24/Mizuho_resolution_report_20200924 (2020).

its financing and investments with the goals of the Paris Agreement.⁴⁵ This proposal attracted support from 22.71 per cent votes of the shareholders.⁴⁶

One of the NGOs that raised a proposal with MUFG submitted a similar proposal at the shareholders' general meeting of Sumitomo Corporation held in June 2021.⁴⁷ This is because Sumitomo Corporation, as a major trading company, finances and makes investments in coal-fired power plants, in a similar manner as banks. With the ISS advising support for the proposal, it attracted support from 20 per cent of shareholders.⁴⁸

It needs to be noted that the shareholder proposals were made notwithstanding the companies having already committed to the TCFD framework and having made other efforts towards sustainability, including the discontinuation of the financing of coal power plants in developing countries, over the long term. Still, the proposals had some impact on the companies, despite their ultimate rejection. In the case of the Mizuho Financial Group, the management opposed the proposal with reference to its already having an environmental policy, which stipulated provisions similar to those proposed as an amendment to the corporate charter. In the opinion, the management argued that the corporate charter is not an appropriate instrument for committing to specific goals as regards climate change.⁴⁹ However, the environmental policy was in fact introduced in April 2020, after the shareholder's proposal had been submitted.⁵⁰ The shareholder who submitted the proposal, Kiko Network, made a statement indicating that the bank's efforts, while welcome, were still insufficient in that exceptions to the policy of not financing or investing in coal-fired power plants remained, and thus it did

45 See the third agenda item in the Notice of Convocation of the 16th annual general meeting of shareholders issued by MUFG, available at https://www.mufg.jp/dam/ir/stock/meeting/pdf/convocation2106_en.pdf.

46 MUFG filing of the Results of Exercise of Voting Rights at the 16th annual general meeting of shareholders, available at https://www.mufg.jp/dam/ir/stock/meeting/pdf/exerciseofvotingrights2106_en.pdf.

47 See Proposition No. 5 in the Notice of Convocation of the 153rd ordinary general meeting of shareholders by Sumitomo Corporation, available at https://www.sumitomocorp.com/-/media/Files/hq/ir/stock/doc/ir/2020/153_e_shoshututi.pdf?la=en.

48 Sumitomo Corporation's Notice of the Results of Exercise of Voting Rights at the 153rd ordinary general meeting of shareholders, available at https://www.sumitomocorp.com/-/media/Files/hq/ir/stock/doc/ir/2020/153_Results.pdf?la=en.

49 MIZUHO FINANCIAL GROUP, Proposal 5 at the 18th Ordinary General Meeting of Shareholders, at https://www.mizuhogroup.com/binaries/content/assets/pdf/mizuho_global/investors/financial-information/stock-information/20200610.pdf (2020).

50 MIZUHO FINANCIAL GROUP, Environmental Policy, at https://www.mizuhogroup.com/binaries/content/assets/pdf/mizuhoglobal/news/2020/04/20200415release_eng_2.pdf (2020).

not withdraw the proposal.⁵¹ Similarly, both MUFG and Sumitomo Corporation announced enhanced efforts to address climate change risks after the shareholders submitted proposals to the companies.⁵² These facts indicate that the proposals at the shareholders' general meetings serve as an occasion for dialogue between the company and the NGOs as shareholders.

c) Coordination among the government and industry

There is also a similarity in the approach of the previous reform leading to shareholder orientation and the current one towards sustainability, namely the careful coordination between the government as regulator and the regulated industry. In Japan, law is generally amended after business practice has sufficiently evolved and the government is convinced that the industry will be able to comply with the new regulation without much difficulty. For this purpose, soft law instruments are often used as a precursor of statutory regulation.

Upon introducing independent directors to the board to change the employee-oriented culture of corporate management, the industry stubbornly resisted. In the beginning, it seemed extremely difficult to make the appointment of an independent director mandatory under corporate law, and still more difficult the appointment of a significant number of independent directors, even in listed companies. As a result, the amendments to the Companies Act in 2014 introduced a "comply or explain" type of rule and requested that just one outside director be appointed on the board or that a reason be given for not doing so. However, the Corporate Governance Code, first adopted in 2015, went a step further and demanded two or more independent directors on the board or an explanation for not doing so.⁵³ After some years of experience, almost all the listed companies have come

51 See KIKO NETWORK, Mizuho Financial Group's tightening of coal finance policy is welcome but further steps needed, at https://www.kikonet.org/eng/press-release-en/2020-04-15/Mizuho_policy_update (2020).

52 See MUFG, Supplementary Explanation of Our Position on the Third Item of Business to Be Submitted to the 16th Annual General Meeting of Shareholders (2021), available at https://www.mufg.jp/dam/ir/stock/meeting/pdf/supplementary2106_en.pdf; SUMITOMO CORPORATION, Notice Concerning the Opinion of the Company's Board of Directors on a Shareholder Proposal (2021), available at <https://www.sumitomocorp.com/-/media/Files/hq/news/release/2021/14770/0514.pdf?la=en>.

53 Principle 4.8 of Japan's Corporate Governance Code [Final Proposal]: Seeking Sustainable Corporate Growth and Increased Corporate Value over the Mid- to Long-Term (2015), available at https://www.fsa.go.jp/en/refer/councils/corporate_governance/20150306-1/01.pdf.

to appoint at least one independent director, if not two.⁵⁴ Finally, the Companies Act was amended again in 2019 and introduced the obligation that listed companies appoint at least one outside director. On this occasion, there was no strong opposition.

The staggered and gradual approach is likely to be reiterated with regards to sustainability. Climate-related disclosures pursuant to the TCFD framework are already required, albeit limited to companies listed with the Prime Section of the Stock Exchange, under the Corporate Governance Code. As part of the Corporate Governance Code, the rule is of the “comply or explain” variety.⁵⁵ Companies may choose not to make climate-related disclosures and present reasons for not having done so. Now, the introduction of mandatory disclosures under the FIEA is foreseen as a result of the Report by the Working Group of the Council of Finance. Still, the standard for the disclosure will not be the TCFD framework as such, allowing larger flexibility (as mentioned in II.2.).

In the meantime, the government and industry have coordinated their efforts to spread the practice of TCFD-based disclosures in Japan. The TCFD consortium was established in 2019, with the support of the METI, MEV and FSA.⁵⁶ The consortium has served as the platform for information exchange among institutional investors, financial institutions and industry. Its Working Groups have, at this point, published two Guidelines, on climate-related disclosures and on the use of climate-related information by investors, respectively.⁵⁷

TSE is also making efforts at coordination with the industry as the market regulator. Together with its holding company, Japan Exchange Group (JPX), it published the Handbook on ESG Disclosures in 2020 to give guidance on sustainability-related disclosures.⁵⁸ With the aim of providing

54 The most recent White Paper of Corporate Governance reports that 95.6 per cent of companies listed on the TSE appoint independent directors; 78.5 per cent appoint at least two. TOKYO STOCK EXCHANGE, INC., TSE-Listed Companies White Paper on Corporate Governance 2021, at 105–106, downloadable from <https://www.jpx.co.jp/english/equities/listing/cg/02.html> (2021).

55 Supplementary Principle 3.1.3 2 of Japan’s Corporate Governance Code, *supra* note 8).

56 See the website of TCFD Consortium, at <https://tcf-consortium.jp/en>.

57 TCFD CONSORTIUM, Guidance on Climate-related Financial Disclosures 2.0 (TCFD Guidance 2.0) (2020), available at https://tcf-consortium.jp/en/news_detail/20081201; TCFD CONSORTIUM, Guidance for Utilizing Climate-related Information to Promote Green Investment 2.0 (Green Investment Guidance 2.0) (2020), available at https://tcf-consortium.jp/en/news_detail/21100501.

58 JAPAN EXCHANGE GROUP, INC. & TOKYO STOCK EXCHANGE, INC, Practical Handbook for ESG Disclosure (2020), available at <https://www.jpx.co.jp/english/corporate/sustainability/esg-investment/handbook/index.html>.

further information in making ESG disclosures, the TSE and JPX also created the JPX ESG Knowledge Hub and collect useful information, such as recent developments, statistics, lists of ESG rating agencies and relevant organisations.⁵⁹ It is the fruit of these coordinated efforts that Japan now has the largest number of companies supporting the TCFD framework.⁶⁰ The speed of reform towards climate-related financial disclosures reflects the spread of the practice thanks to all these efforts.

d) Political initiatives for the reform

Finally, on the political sphere, when the outside director was introduced in 2014 the facilitator of the reform was the centre-right coalition of the Liberal Democratic Party (LDP) and Kōmeitō. They have remained in power until now and are currently leading the reform towards sustainability in corporate governance. It may appear curious, when compared with Europe, where the environment-focused party is often in coalition with the (centre-) left party. It is also different from the US, where the Democratic Party is more concerned about climate change and global sustainability than the Republican Party.

In Japan, corporate governance reform has constituted an element of the growth strategy at least since around 2000. In the case of introducing independent members on the board, political pressure was strong despite the reluctance of the industry. The abovementioned “comply or explain” regulation was added at the last minute on the occasion of the 2014 amendments to the Companies Act as a result of the strong pressure of politicians.⁶¹ MATSUNAKA finds such a political setup as contrary to the “paradox” that political scientists CIOFFI and HÖPNER identified whereby the centre-left government had been the main political powers to advance pro-shareholder reforms in many jurisdictions.⁶² MATSUNAKA argues that Japan’s deviation from the paradox observed elsewhere lies in the fact that the centre-right coalition in Japan was in a position similar to that of the centre-left government in other jurisdictions. According to MATSUNAKA, the centre-right coalition in Japan, especially after returning to power in 2012, committed to

59 JPX ESG Knowledge Hub (only in Japanese), at <https://www.jpx.co.jp/corporate/sustainability/esgknowledgehub/index.html>.

60 As of January 2021, the number of Japanese companies supporting the TCFD framework reached 687, by far the largest in the world. See the website of the TCFD Consortium, at <https://tcfd-consortium.jp/en/about>.

61 GOTŌ/MATSUNAKA/KOZUKA, *supra* note 30, 142.

62 J. W. CIOFFI/M. HÖPNER, The Political Paradox of Finance Capitalism: Interests, Preferences, and Center-Left Party Politics in Corporate Governance Reform, *Politics & Society* 34 (2006) 463.

economic growth to gain support from voters at a time when the government faced fiscal limitations and globalisation of the economy made the traditional industrial policy ineffective. These factors are identical to those that have driven the centre-left coalition to embrace pro-shareholder reform – with the support of the financial market – in other jurisdictions.⁶³

It appears that the same political motivation is now driving Japan's centre-right coalition to advance sustainability in corporate governance. The government considers corporate governance reform to be an important element of growth strategy. Given that the globalisation of the capital market never retreats, politicians expect the investments from abroad in Japanese businesses to promote economic growth and therefore aim to give incentives to corporate managers in Japan to adapt to global developments. It therefore made sense to the centre-right government to introduce sustainability demands into corporate governance reform as long as the former is the concern of the global investors, as MIZUGUCHI of GPIF noted.

IV. THE PERSISTENT COLOUR OF JAPANESE CORPORATE GOVERNANCE

1. *Limited Acceptance of the Monitoring Model*

The adaptation to the global concept does not necessarily mean that corporate governance is making a fundamental shift and losing its local flavour; rather, the local colour tends to be indelible and remains even after the new concept has, on its face, been accepted. This was the case with the reforms undertaken in the last decade.

As argued above, the aim of corporate governance reform in Japan since early 2000s was to urge Japanese public companies to transition to the shareholder-oriented model. In terms of corporate structure, the focus was on the introduction of independent directors, or at least outside directors, which is more loosely defined under the Japanese Companies Act, to the board of directors. As originally conceived, non-executive directors were expected to serve as monitors of the management.⁶⁴ Then the question is what should be monitored by them. If corporate governance reform is understood as part of the growth strategy of the Japanese economy, independent directors acting as monitors may, among other subjects, need to concen-

63 M. MATSUNAKA, Politics of Japanese Corporate Governance Reform: Politicians do Matter, *Berkeley Business Law Journal* 15 (2018) 154.

64 On the historical development of independent directors in corporate governance, see C. JORDAN, Cadbury Twenty Years On, *Villanova Law Review* 58 (2013) 1; H. BAUM, The Rise of the Independent Director in the West, in: Puchniak/Baum/Nottage, *supra* note 30, 21.

trate on the performance of the management.⁶⁵ However, in traditional Japanese companies that retain (if to a lesser degree than before) long-term employment, management leaders are mostly individuals who have spent their career as employees and are subsequently “promoted” to the position of management team member. In such a company, monitoring of the management’s performance by outsiders is hardly acceptable, as outsiders are regarded as being unfamiliar with intra-corporate affairs.

As a result, while it is now not uncommon that outside (independent) directors constitute a significant portion (such as one-third) of the board members, they are usually expected to be advisors to top management in Japanese companies – as opposed to monitors. The exception is the monitoring of compliance, which has long been considered as better left to outsiders for reasons of possible collusion. The scepticism towards outside monitoring may be the reason why the corporate structure of a board with three committees (nomination, audit and remuneration committees) that are dominated by outside directors – a structure which is available as an alternative to the traditional structure of having statutory auditors (*kansa-yaku*) – has remained extremely unpopular.⁶⁶ The number of companies that choose the three committees structure still remains at 76 companies, which is only 2.1 percent of all the companies listed on the Tokyo Stock Exchange.⁶⁷ If outside directors are treated as advisors, rather than monitors, of top management, it may be inappropriate to give them a leading role in the nomination of top management and in the determination of their remuneration as both tasks would require a monitoring and evaluation of the management’s performance. The same perception and scepticism may explain the apparent success of another alternative board structure introduced in 2014, one featuring a single audit and supervision committee. According to a 2021 TSE White Paper, as of 14 August 2020 there were 1,106 companies having a single committee.⁶⁸ If the outsiders’ role is limited mainly to compliance-related matters, the resulting friction will be much smaller. In the end, the shift to shareholder-oriented corporate governance has not resulted in an acceptance of the monitoring model in Japan.

65 On the concept of performance monitoring (as opposed to conflict monitoring), see J. N. GORDON, *The Rise of Independent Directors in the United States, 1950–2005: Of Shareholder Value and Stock Market Prices*, *Stanford Law Review* 59 (2007) 1465.

66 On the situation right after the reform introducing this structure, R. J. GILSON/C. J. MILHAUPT, *Choice as Regulatory Reform: The Case of Japanese Corporate Governance*, *American Journal of Comparative Law* 53 (2005) 343.

67 See TOKYO STOCK EXCHANGE, INC., *supra* note 54, 105.

68 TOKYO STOCK EXCHANGE, INC., *supra* note 54, at 105–106.

2. *Practice of Sustainability Committee*

In response to the emergence of sustainability issues, some companies have set up a *sustainability committee*. This is known in the US and Europe as a best practice in taking sustainability seriously. It appears that the Japanese companies in the forefront of sustainability-related practice have learned of these models and introduced them. Recently, a commercial consulting firm made a survey of about 400 listed companies, mostly those included in the JPX-Nikkei Index 400. Among 38 companies that responded, 23 answered that they had a sustainability committee.⁶⁹ With the caveat in mind that there may be a bias in the data, as the responding companies may be more conscious about sustainability governance, the outcome at least indicates that the practice of establishing sustainability committee is beginning to spread among Japan's listed companies.

In 2021, the International Finance Corporation (IFC), a member of the World Bank Group, published the report on sustainability committees in companies.⁷⁰ In this Report, the authors argue that there are two types of sustainability committees set up to advance sustainable development of companies. One is the *management sustainability committee*, which is established by the executive management or executive committee. This type of sustainability committee consists of management members. Its role is the development of sustainability policies and frameworks, as well as the operational oversight of the implementation of sustainability activities. The other is the *board sustainability committee*, established by the board and consisting of directors. The role of the board sustainability committee is the approval of sustainability policies and frameworks and the oversight of their implementation. The authors of the Report state that a company can have both committees, implying that the functions of the two types of sustainability committee are distinct from each other.⁷¹

Given that the practice of expecting independent directors to monitor management is not widely accepted in Japan, it is anticipated that sustainability committees, even if introduced, may not have the role of monitoring the company's activities towards sustainability. The abovementioned survey underscores this prediction. Only five respondents had established a

69 HR GOVERNANCE LEADERS, 2021 年サステナビリティ・ガバナンスサーベイ報告書 [Report on the Sustainability Governance Survey in 2021] (2022) at 6 (only in Japanese).

70 THE INTERNATIONAL FINANCE CORPORATION, Focus 15 Sustainability Committees: Structure and Practices (2021), downloadable from https://www.ifc.org/wps/wcm/connect/topics_ext_content/ifc_external_corporate_site/ifc+cg/resources/focus_case+studies/focus+15+sustainability+committees.

71 THE INTERNATIONAL FINANCE CORPORATION, *supra* note 70, at 6–7.

sustainability committee under the board of directors, which is what the IFC report calls a board sustainability committee. The remaining eighteen respondents have a management sustainability committee, monitored either by the board of directors or the committee in charge of (operational) monitoring. The mandate of the sustainability committee commonly found among the respondents includes: the examination of sustainability policy and strategies; monitoring the implementation of sustainability strategies; deciding on individual sustainability agenda; and deciding on materiality.⁷²

Even in a case where the sustainability committee is established under the board of directors, it is not always the case that the committee actually functions as a typical board sustainability committee. In light of the independent directors' role in Japanese companies, the opposite seems most likely in Japan. To know whether such a prediction is correct, it is necessary to examine the composition and mandate of the actual sustainability committees as case studies. Below is an examination of a few cases from the companies that have recently introduced a sustainability committee.

a) Kao

One such company is Kao. Kao is a manufacturer of toiletry products and has actively engaged the topic of sustainability. It has a strategy named "Kirei Lifestyle Plan", which emphasises a commitment to ESG. Its integrated report features the phrase "Sustainability as the only path".⁷³

Kao has an ESG committee and an ESG Advisory Board. The chair of the ESG committee is the chief executive officer (CEO), and its members include executive officers. Apparently, it is not the monitoring organ. The integrated report describes the mandate of the ESG Committee as determination of the policies under the company's ESG strategy.⁷⁴ Below the ESG Committee, there is an ESG Promotion Meeting, which is populated by leaders of various sections within the company.⁷⁵ It is suspected that the ESG Promotion Meeting is responsible for implementing the decisions made by the ESG Committee.

It is interesting to observe that outsiders are separated from these organs and explicitly treated as advisors. While it is applaudable that three of the four Advisory Board members are non-Japanese and two of them are fe-

⁷² HR GOVERNANCE LEADERS, *supra* note 69, at 6–7.

⁷³ Kao Integrated Report 2021 (2021), downloadable from <https://www.kao.com/global/en/investor-relations/library/reports/>.

⁷⁴ Kao Integrated Report 2021, *supra* note 73, 59.

⁷⁵ Kao Sustainability Data Book: Kirei Lifestyle Plan Progress Report 2021 (2021), at 18, downloadable from <https://www.kao.com/global/en/sustainability/pdf/#area-LocalNavBottom01>.

male, their mandate is to advise the ESG committee, not monitor the latter.⁷⁶ None of the Advisory Board members is an outside director. They meet once a year, while the ESG committee meets four times and the ESG Promotion Meeting meets eight to twelve times in a year.⁷⁷

b) Asahi Group Holdings

Asahi Group Holdings is the holding company of a conglomerate in the food and drink sector. Its geographical business scope has now expanded to Europe, Asia, Australia and New Zealand. It established a Global Sustainability Committee in 2020. The chair is the CEO of Asahi Group Holdings, and members include the officer responsible for sustainability, leaders of relevant sections, and CEOs and sustainability officers of regional headquarters. The Committee meets once a year and determines the group's policy and strategy on sustainability. It also reviews investment decisions with regards to sustainability.⁷⁸

Below the Global Sustainability Committee, the Sustainability Execution Conference is set up, which meets twice a year. The chair is the head of the sustainability section of Asahi Group Holdings, and members include leaders of the relevant sections of Asahi Group Holdings as well as of the regional headquarters. The mandate of the Sustainability Execution Conference is to translate the strategies decided by the Global Sustainability Committee into actions for implementation. The actions are further concretised by task forces in relevant sectors.⁷⁹

There seems to be no mechanism involving outsiders. The outside directors may have expertise in sustainability, but no specific organ for monitoring or advising the management with regards to sustainability is formed.

c) Mitsubishi Corporation

Mitsubishi Corporation is a major general trading company in Japan. It has a Sustainability and CSR Committee, but its character as an executive organ is even stronger than in the cases of Kao and Asahi Group Holdings.

The mandate of the Sustainability and CSR Committee is to advise the Executive Committee, which is itself an executive organ under the CEO.

76 Kao Integrated Report 2021, *supra* note 73, at 66; Kao Sustainability Data Book: Kirei Lifestyle Plan Progress Report 2021, *supra* note 75, at 18.

77 S. TAKEYASU/H. HATANAKA, サステナビリティ委員会の実務 [I] – 花王の取組み – [The practice of the sustainability committee (Part 1): The case of Kao], 商事法務 Shōji Hōmu 2270 (2021) 38, 40.

78 See the website of Asahi Holdings, at <https://www.asahigroup-holdings.com/en/sustainability/strategy/governance/>.

79 See *supra* note 31.

Members of the Executive Committee are the CEO, executive officers and other senior employees nominated by the CEO. The Sustainability and CSR Committee is chaired by the Sustainability & CSR Officer. Its members include the executive officers of Mitsubishi Corporation, leaders (“CEOs”) of all the business groups as well as the general manager of the Corporate Strategy and Planning Department. The Committee meets twice a year and drafts policies concerning sustainability, which are approved by the Executive Committee and then by the board of directors.⁸⁰

Mitsubishi Corporation has a Sustainability Advisory Committee, which has the role of advising the Sustainability & CSR Officer. The Advisory Committee consists of six experts and meets twice a year. The company’s staff says that the Advisory Committee gives input on the process of drafting policies for sustainability and that it reviews achievements in the preceding year.⁸¹ Given that the Sustainability and CSR Committee is responsible for drafting sustainability-related policies, the role of the Advisory Committee seems to be giving the second opinion as the internal reviewer. None of the members is an outside director. Nor does the Advisory Committee have direct access to board members.

d) Asset Management One

Asset Management One is a large asset management company whose shareholders are Mizuho Financial Group, Inc. and Dai-ichi Life Holdings. Its Sustainability Advisory Board, introduced in 2021, includes as its members its directors alongside outside advisors. Though the Sustainability Report only identifies two outside advisors and does not reveal the directors who are members of the Sustainability Advisory Board,⁸² there was a media report that it consists of nine directors, one senior advisor of the company (which usually implies an ex-director) and the two outside advisors.⁸³ Given that the company actually has nine board members,⁸⁴ this

80 See the sustainability website of Mitsubishi Corporation, at <https://mitsubishi-corp.disclosure.site/en/themes/109>. See also T. FUJIMURA, サステナビリティ委員会の実務 [II] – 三菱商事の取組み – [The practice of the sustainability committee (Part 2): The case of Mitsubishi Corporation], 商事法務 Shōji Hōmu 2271 (2021) 69.

81 FUJIMURA, *supra* note 80, at 70–71.

82 2021 Asset management One Sustainability Report 87 (2021), downloadable from <http://www.am-one.co.jp/english/information/sustainability/>.

83 S. HANZAWA, 取締役参加の「サステナビリティ委員会」続々 [Sustainability committees with director participation burgeoning], Nikkei ESG, at <https://project.nikkeibp.co.jp/ESG/atcl/column/00005/102000127/?P=2> (2021, in Japanese).

84 See the website of Asset Management One, at <http://www.am-one.co.jp/english/company/summary/>. The corporate governance structure of Asset Management One is the hybrid type (board with one committee).

means that the Sustainability Advisory Board is the forum at which the board members invite the participation of the outside advisors and ask them to provide the board with their expertise as regards sustainability. One of the outside advisors is a female academic researcher working in the field of sustainability while the other is a French business person.

e) Ajinomoto

Ajinomoto, a manufacturer of food and health products with a history of almost one hundred years, is much different from the companies examined above. It shifted to the form of a company with a board and three committees in 2021.⁸⁵ At the same time, it established two sustainability-related organs.⁸⁶ One is the Sustainability Advisory Council that reports to the board of directors, while the other is the Sustainability Committee reporting to the Executive Committee. Apparently, the company has followed the model of having both a Board Sustainability Committee and a Management Sustainability Committee.

The mandate of the Sustainability Advisory Council is to respond to consultations from the board with respect to: materiality from a long-term perspective and a multi-stakeholder perspective, the company's involvement in the creation of topics and social rules (which may mean the company's role to take initiative in society) in the near future, and sustainability-related goals.⁸⁷ Interestingly, the members of the Sustainability Advisory Council are not solely board members. Among the twelve members, only two are outside directors, while there are three members from management, two executive directors (the CEO and a senior vice president) and one executive officer (Chief Innovation Officer). The remaining seven members are outside experts who are not affiliated with the company at all, among whom is a professor of management who chairs the Council.⁸⁸

The Sustainability Committee has the responsibility of implementation. It identifies the risks and opportunities, ensures that they are reflected in the business strategies and carries out sustainability-related activities. It is also

85 Ajinomoto Group Integrated Report 2021 (2021) at 16–17, downloadable from <https://www.ajinomoto.co.jp/company/en/ir/library/annual.html>.

86 Ajinomoto Group Integrated Report 2021, *supra* note 85, at 21–22.

87 Ajinomoto Group Integrated Report 2021, *supra* note 85, at 21.

88 To be precise, two are university professors (one an Australian teaching in Japan and one a professor in Thailand), an NGO activist, a former officer of the governmental aid organisation (Japan International Cooperation Agency: JICA), one young CEO of a start-up and two female investors. See Ajinomoto's website on the Sustainability Advisory Council, at https://www.ajinomoto.com/sustainability/framework/advisory_council.php.

in charge of risk management, which the Risks & Crisis Subcommittee directly handles.⁸⁹

f) Summary of the case studies

Although the practice abroad of constituting a sustainability committee is known in Japan – and is followed by some companies – it is not common to have independent directors lead such a committee. In three among the five companies reviewed above (Kao, Asahi Group Holdings and Mitsubishi Corporation), the committee consists of executive directors and heads of corporate divisions. Its mandate is either to determine concrete policies or to decide on the implementation of the greater strategy adopted by the board, or both.

Two other cases (Ajinomoto and Asset Management One) are different in that the sustainability committee does not include senior employees. Their sustainability committees also include outside (independent) directors. However, they are still different from a board sustainability committee as described in the IFC Report in that the committee members are not monitors of the company's sustainability-related activities, at least not in the sense that the outside directors monitor the management pursuant to a monitoring model. The lack of monitoring by independent directors, which was observed as regards corporate governance focusing on shareholder interests, is found also in respect of sustainability-related corporate governance.

Outsiders may be invited as experts to advise the board about the company's policy towards, and activities concerning, sustainability. As a result, the sustainability committee in Japanese companies offers an occasion to the board members and/or senior executives to receive advice from outside experts. It may make sense that outsiders with expertise in sustainability are invited as special advisors to the committee, not appointing them as (outside) board members. Because sustainability is still a very specialised subject, those with expertise in the area may not have proficiency in those skills generally required of a member of the board. Still, one may see that the practice of treating independent directors as advisors to the top management, a practice found in many Japanese companies, underlies the practice of using outside experts as advisors in Japanese sustainability committees.

Otherwise, a Japanese company may establish a Management Sustainability Committee comprising a few executive officers and senior employees. Such a committee seems to be effective as part of the executive organ of the company's management. Having such committees may contribute to an

⁸⁹ See Ajinomoto's website at <https://www.ajinomoto.com/sustainability/framework/index.php>.

enhanced engagement in sustainability and is probably worth being recommended. Effective as it may be, it is a practice strongly marked by the local colour of Japanese corporate governance and is significantly different from the practice in other parts of the world.

V. CONCLUSIONS AND OUTLOOK FOR THE FUTURE

Given the rapid developments in recent years, it may not prove surprising to find in the near future that Japan has become one of the jurisdictions most advanced in adapting its corporate governance to sustainability issues. Japan already has the largest number of companies in the world having announced support for the TCFD framework.

It is quite likely that the developments will continue in the future, due to the restructuring of the Tokyo Stock Exchange.⁹⁰ As already mentioned, the reform creates the Prime Section, which emphasises the liquidity of shares in the market. The listing criteria for the new Prime Section require a high level of liquidity.⁹¹ Furthermore, the definition of tradable shares has become stricter than before, as shares held by financial institutions and insurance companies are now excluded from the definition. These developments mean that managers can no longer be safely entrenched through a practice of cross shareholding with friendly shareholders – as could have been done in the good and old days. There are incentives for companies listed in the Prime Section to advance corporate governance reform further and, among other actions, to take the sustainability agenda seriously, as long as investors are pursuing it. If the industry does not resist reforms related to sustainability, it is partly because corporate managers understand the benefit of these reforms notwithstanding their cost, inclusive of the cost of climate-related disclosures.

Still, the approach to the sustainability agenda will retain a Japanese colour in both the regulation and practice of corporate governance. The motivation for reform is mainly the pressure from the capital market, in particular from institutional investors. The political power behind the reform is the ruling centre-right coalition, convinced of the need for economic growth

90 On the restructuring of the TSE market, visit the special website of TSE at <https://jpx-market.jp/en/>.

91 To be accepted to the Prime Section, there must be 20,000 or more units of tradable shares, the market capitalisation in terms of tradable shares must be 10 billion yen or more and the amount of sales must be 25 billion yen or more in terms of market capitalisation. See TSE, Listing Criteria for the new market segments, available at <https://www.jpx.co.jp/english/equities/market-restructure/market-segments/index.html>. These criteria have already been revised once in November 2020 as the first part of the restructuring of the market.

through corporate governance reform appealing to institutional investors. Regulators prefer to employ a coordinated approach to the industry rather than to introduce a totally new regulation in a revolutionary manner. On the side of the industry, a monitoring mechanism is seldom adopted, whereas significant efforts are made in the implementation of the strategy for sustainability. Outside experts may be invited, but as advisors to the management and not as monitors of the latter. After all, most Japanese companies are still employee-dominated, with outsiders having an only limited, advisory role. Corporate governance in Japan does change, but changes take much longer when affecting the core structure, as compared with developments on the surface. This is a key feature of reform in Japan: gradual transformation.

SUMMARY

Japan's corporate governance practice is making rapid developments in its engagement with sustainability. Japan already has the largest number of companies in the world which have committed to the Climate-related Financial Disclosures (TCFD) framework. The Financial Instruments and Exchanges Act will be amended in the near future to introduce mandatory disclosure of sustainability-related information. The Tokyo Stock Exchange is also pushing developments through its demand that companies listed in its Prime Section implement the TCFD framework fully. The Code of Conduct for Environmental Social Governance (ESG) ratings and data providers will also be introduced soon. All these developments may appear to suggest that the focus of corporate governance in Japan has made a quick turn from shareholder primacy to sustainability. However, the approach to the sustainability agenda in fact retains a Japanese colour in terms of both the regulation and practice of corporate governance. The reform is driven by the pressure from the capital market and the initiatives of institutional investors. There is a continuity from the previous reforms urging Japanese managers to turn to the shareholders in that both the previous and current reforms are responses to demands from the capital market. The political power behind the reform is also common, i.e. the ruling centre-right coalition, convinced of the need for corporate governance reform appealing to institutional investors as drivers of economic growth. As regards the style of regulation, regulators prefer to employ a coordinated approach to the industry rather than to introduce totally new regulation. Finally even those companies that are advanced in adapting to sustainability seldom employ monitoring mechanisms while making significant efforts for implementation of their strategy for sustainability. In this respect, features of Japanese corporate governance have been retained. After all, corporate governance in Japan

changes only gradually, taking a longer time as compared with developments occurring on the surface.

ZUSAMMENFASSUNG

Die Praxis der Corporate Governance in Japan schreitet im Bereich der Nachhaltigkeit rasch voran. Heute hat Japan bereits die weltweit größte Anzahl von Unternehmen, die sich dem Climate-related Financial Disclosures (TCFD)-Ansatz verpflichtet fühlen. Das Finanzprodukte- und Börsengesetz wird in naher Zukunft novelliert werden, um zwingende Veröffentlichungspflichten zu nachhaltigkeitsbezogenen Informationen einzuführen. Die Börse Tōkyō (TSE) fördert diese Entwicklung ebenfalls, indem sie verlangt, dass die in der Prime Section der TSE notierten Unternehmen den TCFD-Ansatz vollumfänglich umsetzen. Ferner wird in Kürze ein Verhaltenskodex für Environmental Social Governance (ESG)-Bewertungen und Datenanbieter eingeführt. Diese Entwicklungen könnten die Annahme nahelegen, dass sich der Schwerpunkt der Corporate Governance in Japan innerhalb kurzer Zeit von dem Vorrang der Aktionärsinteressen hin zur Nachhaltigkeit verlagert hat. Tatsächlich weist die Hinwendung zur Nachhaltigkeit jedoch sowohl bezüglich der Regulierung als auch der Praxis der Corporate Governance japanische Charakteristika auf.

Die Reform erfolgte auf Druck der Kapitalmärkte und der Initiativen institutioneller Investoren. Insoweit besteht eine Parallele zu früheren Reformen, in denen japanische Unternehmenslenker gedrängt wurden, die Interessen der Aktionäre stärker zu berücksichtigen, und die ebenfalls auf Druck der Kapitalmärkte umgesetzt wurden. Der politische Akteur hinter beiden Reformen ist derselbe, nämlich die regierende rechts-liberale Koalition, die davon überzeugt ist, dass Wirtschaftswachstum durch Reformen der Corporate Governance gefördert wird, die den institutionellen Investoren zusagen. Bezüglich der Art der Regulierung ist zu beobachten, dass die Verantwortlichen einen mit der Industrie koordinierten Ansatz der Einführung vollständig neuer Regeln vorziehen.

Abschließend ist ferner festzustellen, dass diejenigen Unternehmen, die sich Nachhaltigkeit auf die Fahnen geschrieben haben und erhebliche Anstrengungen zur Umsetzung dieses Zieles unternehmen, gleichwohl selten Überwachungsmaßnahmen implementieren und damit zentrale Elemente der japanischen Corporate Governance beibehalten. Ungeachtet rascher Veränderungen an der Oberfläche ändert sich die Corporate Governance in Japan im Kern nur langsam.

(Die Redaktion)