

**ICGN**

International Corporate Governance Network

Inspiring good governance & stewardship

Mr. Tomoyuki Furusawa
Director-General and Head of the Policy & Markets Bureau
Financial Services Agency
3-2-1 Kasumigaseki Chiyoda-ku
Tokyo, 100-8967 Japan

Via email: tomoyuki.furusawa@fsa.go.jp

10th November 2021

Dear Mr. Furusawa,

Re: Minority shareholder protection in Japan

The International Corporate Governance Network (ICGN) is pleased to submit this letter to the Financial Services Agency (FSA) and the Ministry of Justice (MoJ) regarding minority shareholder protections in Japan, particularly in relation to mergers and acquisitions, corporate takeovers, and management buyouts (MBOs).

ICGN has a long history of engaging with regulators and other stakeholders in Japan to support measures that enhance corporate governance and stewardship practices. This reflects the importance of Japan as a primary equity market for ICGN Members, where over 30% of the market capitalisation of the Tokyo Stock Exchange (TSE) is held by overseas investors.

Led by investors responsible for assets under management of \$59 trillion, ICGN is a leading authority on global standards of corporate governance and investor stewardship. Our membership includes institutional investors and business leaders who have a shared interest - and thus a shared responsibility - to preserve and enhance long-term corporate value, contributing to economic growth, social prosperity, security, and a healthy environment.

Squeeze-out rules

A “squeeze-out” is defined as the compulsory sale of the shares of minority shareholders to the controlling shareholders of a company. The squeeze-out is triggered when a minimum threshold of shareholders agree to sell their shares. In Japan, the low threshold for management buyouts and takeover bids is set at 66.7%, requiring only two-thirds of shareholders to authorize the buyout.¹ In contrast, the global standard is generally 90%, a much higher standard for majority shareholders to attempt to “squeeze out” the minority investors and take full ownership of the company.² The lower Japanese threshold can serve to allow the majority shareholder(s) to lowball or misprice a buyout or takeover bid, which in turn, limits the ability of minority shareholders to receive just and fair compensation for their ownership interests.

¹ The Companies Act, Article 180(2) and Article 309. www.izvoznookno.si/Dokumenti/Drzave/japcompact

² Baker McKenzie, ‘A Global Guide to Take-Private Transactions: www.bakermckenzie.com/-/media/files/insight/publications/2020/08/global-take-private-guide_6aug2020, August 6, 2020.

ICGN therefore respectfully recommends coordination between the FSA and the MOJ to address this by establishing a special rule as an exception to the general rule of the Companies Act. This would require a 90% threshold for TSE Prime Market listed companies. The adoption of a higher threshold for takeovers and buyouts, in alignment with the 90% global standard, would provide Japanese boards with the ability to balance the rights of all its shareholders when mergers, acquisitions, buyouts or takeovers are on the horizon. It would serve to give minority shareholders a voice in the transaction at hand and still provide the board with the ability to generate sustainable shareholder value.

More generally, ICGN recognises that the Ministry for Economic Trade and Industry (METI) issued “Fair M&A Guidelines, Enhancing Corporate Value and Securing Shareholders’ Interests” in 2019, which are important guidelines clarifying that minority shareholders’ interest should be protected.³ More could be done to ensure the protection of minority shareholder interests either through fair compensation for their shares and the issuance of dividends, or through the opportunity to decide whether to support these corporate transactions.

Listed Subsidiaries

ICGN commends the Japanese government’s goal to end “parent-child” listings that can create corporate governance problems and cause the “child” company to trade at a significant discount to fair value. However, ICGN is aware of recent tender offers that have been made wherein a parent company has tendered its bid for the minority interests of a subsidiary at a price well below intrinsic value. Under the current requirements, a minimum tender offer can be made to acquire just enough shares to take the parent company to 66.7% ownership. Once this occurs, if other shareholders do not tender their shares, the parent company can then exercise a “squeeze-out” and take full control which could harm minority shareholders.

The ICGN Global Governance Principles (Revised 2021), Principle 1: Board role and responsibilities, 1.3 Director’s duties in company groups and subsidiaries, provides:

Director’s duties. In the case of business groups, boards of the parent company should recognise the independence of any subsidiary company’s board composition, governance structure, audit and reporting processes. **While taking account of the interest of the parent company or business group as a material stakeholder, directors serving on boards of subsidiary companies, owe their legal duties to the subsidiary as a separate legal entity.**⁴
(Emphasis added in bold)

³ [METI Newly Formulates Fair M&A Guidelines: Enhancing Corporate Value and Securing Shareholders’ Interests](#), 2019.

⁴ [ICGN Global Governance Principles 2021](#), p. 10.

ICGN's Global Governance Principles (2021) address the means to which a board must ensure that all shareholders are treated equally in these situations. Principle 9, Shareholder rights, 9.7, states:

Equality and redress. The board should ensure that shareholders of the same series or class are treated equally and afforded protection against misuse or misappropriation of the capital they provide due to conduct by the company's board, its management or controlling shareholder, including market manipulation, false or misleading information, material omissions and insider trading. **Minority shareholders should be protected from abusive actions by, or in the interest of, controlling shareholders acting either directly or indirectly, and should have effective means of redress.** Proper remedies and procedural rules should be put in place to make the protection effective and affordable. Where national legal remedies are not afforded the board is encouraged to ensure that sufficient shareholder protections are provided in the company's bylaws.⁵

ICGN is aware that METI has established merger and acquisition (M&A) guidelines which adopt the principle of "majority of minorities"; however, this is a voluntary practice. The latest revisions to the Code call on the listed subsidiaries of prime-listed companies to have a majority independent board. This might help the situation but only if the independent board sought independent advice and consulted with the "major" minority shareholders. ICGN recommends changing the "majority of minorities" principle to a compulsory clause, which would then force independent directors to review a takeover/buyout more carefully and to consult with the larger minority holders. ICGN is hopeful such a change in the guidelines could be implemented relatively quickly.

ICGN recommends that the "parent and child" relationship is effectively addressed so that minority shareholders can 1) be treated fairly and 2) be able to vote their interests according to the terms of the tender offer or buyout, after consideration by an independent board. A special rule related to Articles 180 and 235 of the Companies Act to restrict boards from using a special resolution to effectively limit minority shareholders, would then bring the corporate action in line with the global standard of 90%. In essence, the board would not be "squeezing out" minority shareholders, providing smaller equity holders with greater protection for their limited share ownership.

ICGN is pleased that Japan recognizes the need for equity and impartiality in such transactions. The Japan Corporate Governance Code, Supplementary Principle 1.5.1 provides the following:

In case of a tender offer, companies should clearly explain the position of the board, including any counteroffers, and **should not take measures that would frustrate shareholder rights to sell their shares in response to the tender offer.**⁶

⁵ [ICGN Global Governance Principles 2021](#), p. 35.

⁶ Japan Corporate Governance Code, www.fsa.go.jp/en/news/2021/20210611/06, p. 9.

In addition, the ICGN Global Governance Principles (Revised 2021), Shareholder Rights 9.2 Major decisions, provide that those major decisions that impact shareholders should be brought to the shareholders for a vote. The Principle states:

The board should ensure that shareholders have the right to vote on major decisions which may change the nature of the company in which they have invested.

Equitable treatment of shareholders

One of the most significant recent corporate governance reforms in Japan has been the revision to the Japan Corporate Governance Code. This expressly provides for a board to “fulfil its fiduciary responsibility and accountability to shareholders in order to promote sustainable corporate growth and the increase of corporate value over the mid- to long-term and enhance earnings power and capital efficiency” through the appointment of directors, including independent directors.⁷

Furthermore, under General Principle 1, a board is required to create an environment of equal treatment of shareholders. It states:

Given their sensitivities, adequate consideration should be given to the **issues and concerns of minority shareholders and foreign shareholders for the effective exercise of shareholder rights and effective equal treatment of shareholders.**⁸

In a similar style, ICGN’s Global Governance Principles, revised in 2021, require that a board consider shareholder rights, particularly those held by minority shareholders, when transactions impact their ownership stake, including company share repurchases (buybacks) and mergers and acquisitions. Under Principle 9:

Shareholder rights. Rights of all shareholders should be equal and must be protected. Fundamental to this protection is ensuring that a shareholder’s voting rights are directly linked to its economic stake, and that **minority shareholders have voting rights on key decisions or transactions which affect their interest in the company.**⁹

This consideration by a board of the rights of its minority shareholders is paramount because any unequal treatment could cause minority shareholders to receive less than they are entitled to or limit their voting rights and thus their ability to voice their support for or concerns with a pending transaction. In this regard, the current lower standards of minority shareholder protection in Japan are cause for concern and ICGN urges FSA and MOJ to review measures which may disproportionately favour majority shareholders at the expense of minority shareholder interests.

⁷ Japan’s Corporate Governance Code, Section 4. Responsibilities of the Board, Principle 4.7, Roles and Responsibilities of Independent Directors, www.fsa.go.jp/en/news/2021/20210611/06, p. 26.

⁸ Japan’s Corporate Governance Code, Section 1. Securing the Rights and Equal Treatment of Shareholders, www.fsa.go.jp/en/news/2021/20210611/06, p.14.

⁹ [ICGN Global Governance Principles 2021](https://www.icgn.org/publications/2021/06/11/ICGN-Global-Governance-Principles-2021), p. 33. Note: The Global Governance Principles (Revised 2021) have been translated into Japanese and may be accessed here: [ICGN Global Governance Principles JPN](https://www.icgn.org/publications/2021/06/11/ICGN-Global-Governance-Principles-JPN).

ICGN believes that Japan's Corporate Governance Code, its more recently adopted Stewardship Code, along with this suggested rule change, will continue to enhance the ability of minority shareholders to confidently invest in the Japanese capital market. It is in this spirit that we commend our recommendations and sincerely hope that the FSA and the MOJ will find our comments useful in the consideration of any necessary regulatory amendments.

If you have any questions about this letter, please contact ICGN Japan Advisor, Amane Fujimoto by email at amane.fujimoto@icgn.org or ICGN Policy Director, George Dallas at George.dallas@icgn.org.

Yours faithfully,



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Kerrie.waring@icgn.org

CC: Toshitake Inoue, Deputy Director-General, Financial Services Agency
(toshitake.inoue@fsa.go.jp)

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Genta Ando, Director, Ministry of Economy, Trade & Industry (ando-genta@meti.go.jp)

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Ministry of Justice
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Tokyo, 100-8977 Japan

Via email: n.wakabayashi.44p@i.moj.go.jp

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Yours faithfully,



Kerrie Waring
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Kerrie.waring@icgn.org

CC: Genta Ando, Director, Ministry of Economy, Trade & Industry (ando-genta@meti.go.jp)