

JAPAN MOVES TOWARDS TOUGHER CORPORATE COMPLIANCE

'Japan Inc' is now back on the front pages with many Japanese corporations increasingly pursuing significant M&A opportunities internationally given the mature market at home and high levels of cash reserves. The corporate landscape in Japan has also been changing in other ways in recent years.

As a consequence of a number of high-profile corporate scandals, Japanese legislators have been busy revising legislation to further improve corporate governance in the world's third largest economy. This article summaries three of the key changes.

More robust independent directors

Until recently, Japan's reputation for overall sound corporate governance was subject to criticism as the statutory requirements in relation to outside directors did not require a sufficient degree of independence from company management and there was historically a very low number of independent outside directors on most Japanese boards. These concerns in part drove responsive changes to Japan's Companies Act and the introduction of Japan's 'Corporate Governance Code'.

In 2015, the Companies Act was amended to create new eligibility requirements for outside directors which increased their independence from company management.

Further, an additional rule in the Corporate Governance Code came into force in June 2015 effectively requiring that listed companies should appoint at least two independent outside directors. Whilst this rule is not legally binding, listed companies who choose not to appoint such directors must publicly disclose their reasons.

Despite initial inertia from many Tokyo boards which were long dominated by internally appointed directors, the rule has led to over 80% of businesses listed on the Tokyo Stock Exchange now having at least two or more independent outside directors, a dramatic increase from only around 30% of listed enterprises having any outside directors as recently as 2015.

Global companies with listed subsidiaries in Japan should be aware of the growing importance of independent outside directors.

Key issues

- Japanese legislators have been working to improve corporate governance in Japan.
- Amendments to the Companies Act and a new Corporate Governance Code have led to a big increase in listed companies appointing independent outside directors.
- A new plea-bargaining regime will come into effect on 1 June 2018 creating a new compliance risk for corporations with operations in Japan.
- The Tokyo Stock Exchange's "Principles for Listed Companies Dealing with Corporate Malfeasance" sets out guidance that Japanese listed companies should follow when investigating suspected cases of corporate misconduct.

Plea-bargaining system

Japan's plea-bargaining regime will come into effect on 1 June 2018, creating a new compliance risk for corporations with Japan operations.

Prosecutors may dismiss or reduce criminal charges or agree a punishment outcome (although it is the court that ultimately decides any punishment) if the individual or company provides evidence in relation to certain offences, including bribery and bid-rigging. In contrast to the US system, such evidence must relate to the alleged offences of *other* individuals or companies.

As a consequence, a person or company may potentially seek to reduce or avoid their own criminal guilt by giving false evidence in relation to innocent third parties, although there are safeguards in place to reduce this risk. These include the compulsory involvement of lawyers in the plea bargain negotiation process and sanctions for providing false or misleading evidence.

Global companies with a Japan presence should be aware of the potential risk. For example, a junior staff member terminated and prosecuted for criminal misconduct may seek to implicate an innocent manager to reduce or escape their own culpability.

This potential new risk underlines the importance of a well-structured, active and senior management-led compliance culture and effective whistleblower procedures.

Investigating corporate misconduct

In 2016, the Japan Exchange Regulation authority (the JPX) of the Tokyo Stock Exchange released its "*Principles for Listed Companies Dealing with Corporate Malfeasance*" which set out overarching guidance that Japanese listed companies should follow when investigating suspected cases of corporate misconduct.

Whilst the Principles are not legally binding on listed companies, the JPX has said that it will consider the extent to which listed businesses have adopted the Principles when considering penalties or the potential delisting of corporations which are guilty of corporate wrongdoing.

The Principles encourage companies to establish a truly independent and expert third-party investigation committee with little or no oversight by or relationship with the company subject of the investigation.

The other main components of the Principles encourage companies to ascertain the fundamental, underlying cause of the malfeasance in question, promptly implement remedial measures and make prompt and appropriate information disclosures to the authorities and relevant stakeholders.

Global companies with a Japan presence may be well advised to consider the significance of the Principles in relation to not only their Japan operations but also potentially their businesses in other parts of the world.

Conclusion

Global corporates with Japan operations should take particular note of the fact that many of the aforementioned corporate scandals came to light due to employee whistleblowing which, until only around ten years ago, was rare. Whistleblowing will probably increase. This further underlines the importance of having properly structured and implemented compliance procedures on the ground in Japan.

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