

Principles for Responsible Institutional Investors

《Japan’s Stewardship Code》

Summary of Public Comments (in English) and Replies

No	Summary of Comments	Replies
● Preamble		
▼ Concern over “explain” mechanism losing substance		
37	<p>The proposal also relies heavily on “comply or explain” mechanism which is new to Japan. This could potentially result in an excessive use of boilerplate in the disclosure of the application of the code’s principles, especially when dealing with the “explain” part. Such a development would make the disclosure meaningless to investors, stakeholders and regulators.</p>	<p>We believe that it is important to request institutional investors and their industry groups to avoid preparation and use of boilerplate for the disclosure items required by the Code.</p> <p>Furthermore, the “comply or explain” approach has not been widely known in Japan yet. Therefore, we also believe that it is important to publicize the significance of the “comply or explain” approach.</p>
▼ Costs associated with engagement		
38	<p>There is an administrative cost associated with adherence to the stewardship code. It is important to note that large institutional investors could have the resources and the administrative capacity to apply the code. However, small institutional investors may not have the administrative tools or the resources to implement active stewardship and it could be prohibitively expensive...</p> <p>FSA could possibly consider a different approach to small institutional investors who have small amounts under management. To make adherence to the code cost effective, FSA could possibly consider different forms of participation for different kinds of players (i.e. active – long only asset managers versus passive; equities versus bonds; activist asset managers; Hedge funds; asset owners versus asset managers, etc.)</p>	<p>Effective and appropriate stewardship activities by institutional investors ultimately aim at the enhancement of the medium- to long-term returns for their clients and beneficiaries. Thus, the preamble to the Code (Paragraph 7) clearly indicates that institutional investors and their clients/beneficiaries should both recognize that costs associated with stewardship activities are an indispensable element in asset management, which we believe is in line with your point.</p> <p>Additionally, the preamble to the Code (Paragraph 9) makes clear that the manner in which the Code is implemented may differ, depending on such factors as the investor’s size and investment policies (e.g., whether the policies are oriented toward long-term or short-term returns, or active or passive strategies), which we also believe is in line with your point.</p>

		We will publicize the above points thoroughly and carefully to avoid misunderstanding.
▼ Scope of institutional investors		
39	We encourage the FSA to extend the responsibility of stewardship beyond listed equities and into private equities, bonds, etc. while recognizing that the practices of stewardship in these markets are less established and more difficult.	The Code is primarily targeted at institutional investors investing in Japanese listed shares, but this does not mean that those investing in unlisted shares, bonds, etc., are excluded from accepting and signing up to the Code.
● Principle 2 (Appropriate management of conflicts of interest)		
40	It is important to emphasize the need for clear policies on how to manage conflicts of interest. We suggest that this principle may be strengthened by adding reference to the fact that investors should also ‘understand such conflicts and strive to minimize them.’	<p>We believe that it is extremely important for institutional investors to manage conflicts of interest appropriately in fulfilling their stewardship responsibilities. In order to do so, it is necessary to fully understand and endeavor to minimize conflicts of interest.</p> <p>Considering the above, Guidance 2-1 includes the statement that “in conducting stewardship activities, they [institutional investors] inevitably face the issue of conflicts of interest from time to time, for example when voting on matters affecting both the business group the institutional investor belongs to and a client or beneficiary.”</p>
● Principle 3 (Appropriate monitoring of investee companies)		
41	We encourage institutional investors to actively monitor companies. We would suggest a reconsideration of the drafting in this principle with regards to the words ‘and support the sustainable growth of companies.’ When monitoring a company, the role of an investor is to ‘assess the individual circumstances, performance and long-term potential of companies in order to make an informed investment decisions.’ This is different from the reference to ‘supporting the sustainable growth of companies’ which may infer a degree of influence more relevant to management.	As you indicated, the English version of the exposure draft reads that “(i) nstitutional investors should monitor investee companies so that... they can support the sustainable growth of the companies.” Therefore, the draft has been revised to state that “(i) nstitutional investors should monitor investee companies so that they can appropriately fulfill their stewardship responsibilities with an orientation towards the sustainable growth of the companies.”
42	Principle 3, Guidance 3.3, allows leeway for investors to choose the focus of their monitoring. It is important, however, that they are	Based on the comment, Guidance 3-3 of the Code has been revised to clarify that monitoring also involves non-financial factors.

	encouraged to monitor a broad range of factors, not just financial ones. Risk arises from non-financial issues.	
●Principle 4 (Common understanding with investee companies and solving problems through constructive engagement)		
43	We note that principle 4 is carefully worded to ‘achieve common understanding’ with investee companies. Although we recognise that it is extremely important to do this, and we practice this every day, there will always be cases where a ‘common understanding’ cannot be reached. In this case, there should be a defined procedure to escalate the issue, in order to resolve it more effectively.	It is true that common understanding cannot always be reached through engagement. Thus, footnote 6 was added in relation to Guidance 4-1, stating that “(t)he effort to arrive at an understanding in common may result in an agreement to disagree, but may provide a better understanding on why they disagree.” In addition, as stated in Guidance 4-2, institutional investors should have a clear policy in advance on how they design dialogue with investee companies in various possible situations.
44	Principle 4, Guidance 4.3, allows investors discretion in disclosing details of their dialogue with companies. It is right that corporate engagement should generally take place on a confidential basis if trust is to be established between investors and companies. Investors should therefore not routinely disclose the content of such engagement, but it should also be clear that the purpose of engagement is not to enable investors to obtain private information that gives them a market advantage.	Based on the comment, a new sentence has been added to the beginning of Guidance 4-3 stating that “institutional investors can well have constructive dialogues with investee companies based on public information, without receiving information on undisclosed material facts.”
●Principle 5 (Disclosure of voting policy and voting activity)		
45	We are concerned that there is not stronger requirement in the Code for Japanese investment firms to fully disclose its voting records. We do not find voting records being aggregated by resolution type to be helpful disclosure. (Three other similar comments)	It was pointed out during the Council meetings that a full and individual disclosure of voting activities might deter institutional investors from actively exercising their voting rights. The Code hence states that institutional investors should aggregate the voting records into each major kind of proposal. However institutional investors should disclose their voting activities individually if they consider such approach is most suitable to fulfill their stewardship responsibilities. Upon the preparation of the Code, we also referred to the fact that the UK

		Stewardship Code does not necessarily recommend an individual disclosure as the particularly-suitable approach for disclosing voting activities.
●Principle 6 (Reporting to clients and beneficiaries)		
46	It is our hope that the reporting requirement will be broadened to include the public rather than being limited to clients and beneficiaries. (One other similar comment)	With regard to expanding the target of the reporting requirement in Principle 6 beyond clients and beneficiaries (i.e., the public), we believe it is necessary to consider the agreements between institutional investors and its clients and beneficiaries, and whether the relevant information is suitable for public disclosure (i.e., whether the disclosure of such information would harm the interests of the clients and beneficiaries).
●Others		
▼ Need for collective engagement		
47	The principle of ‘collective engagement’ has not been incorporated into the suggested code. We are cognisant that companies and investors are wary of joining together to actively engage on common issues. This is not unique to Japan; we have observed this in markets such as the US, which has treaded carefully on the potential issue of consortiums.	<p>The Council discussed that collective engagement may not fit into the current Japanese practice and that the approach is not commonly taken by institutional investors in Japan, which we believe is in line with your point.</p> <p>The Code does not incorporate the principle of collective engagement specifically but indicates that exchanging views with other investors and having a forum as necessary may help institutional investors conduct better engagement with investee companies and make better judgments (Guidance 7-3).</p>
▼ Legal issues		
48	<ul style="list-style-type: none"> ▪ Many investors are concerned about unintentionally being considered by the company or regulators to have formed a concert party by discussing views on a company with one another whilst engaging independently. It would be appreciated if the Financial Services Agency (FSA) would in due course publish guidance which would provide clarification in Japan on the issue. ▪ In November 2013, the European Securities and Markets Authority (ESMA) has published a statement on practices governed by the Takeover Bid Directive, focusing on shareholder cooperation relating 	<p>Based on the comment, in order to facilitate smooth dialogues between institutional investors and investee companies, the FSA will further clarify the legal interpretation in the Q&A eliminating uncertainty as to specific cases to which the Joint Holder concept under the large shareholding reporting rule will apply.</p> <p>While it is necessary to make judgment on a case-by-case basis, even if an institutional investor exchanged views with other investors based on the Code, the Joint Holder concept will not apply if such exchange of views does not involve “agreement” regarding “jointly exercising voting rights and other</p>

	<p>to acting in concert and the appointment of board members...</p> <p>We think that it would also be helpful if the FSA, liaising with other regulators and legislators in Japan, could consider developing and providing such kind of clarification to address concerns of institutional investors and to help facilitate effective engagement collaboration.</p> <p>(Two other similar comments)</p>	<p>shareholder rights (restricted to legal rights for shareholders).” (Please refer to the Q&A for detailed information.)</p> <p>Additionally, the FSA published a paper titled “Clarification of Legal Issues Related to the Development of the Japan’s Stewardship Code” to clarify issues associated with the existing legal system in Japan by outlining the legal interpretation in an easy to understand format including the contents of the above Q&A. The paper is referred to in the Code in the footnote to the preamble with the URL of the FSA’s website so that readers can refer to this paper easily (http://www.fsa.go.jp/en/refer/councils/stewardship/material/legalissue.pdf).</p>
▼ Stewardship responsibilities of investee companies		
49	<ul style="list-style-type: none"> • It is important to recognize that companies, even more than investors, should accept primary responsibility for seeking common ground with investors and initiating constructive engagement. • ...the draft does not specifically mention that company boards also have responsibility for stewardship. We would suggest that it would be helpful to make this clear. This would strengthen the position of investors in instances where they wish to engage with a board that is perhaps reluctant to have a meaningful dialogue. • It is perhaps beyond the strict scope of this consultation but we consider that the existing “Principles of Corporate Governance for Listed Companies” published by the Tokyo Stock Exchange in 2004 need to be reviewed and reinforced.” 	<p>Your comment is highly appreciated.</p> <p>The Code defines principles considered to be helpful for institutional investors in fulfilling their stewardship responsibilities, not those as to the behavior of investee companies. However, in order to conduct “purposeful dialogue [engagement],” investee companies are expected to cooperate with institutional investors sincerely in their attempt to achieve constructive and purposeful engagement.</p>
▼ Others		
50	<p>The FSA should report annually on progress with the code. It would also encourage investors to adhere to the code if they were obliged by the FSA to state publicly whether or not they apply it as is the case with asset managers in the UK. Asset owners who might not be subject to such a declaration could be required to state their expectations with</p>	<p>We believe that it is meaningful to publish in some form, the progress of institutional investors’ efforts to practice the principles of the Code and will consider implementing such publication.</p>

	regard to the code when issuing mandates to asset managers.	
51	<p>We believe that investors should make informed voting decisions at investee companies, applying due care, intelligence and independent judgment. Investors should seek to vote all shares held, however, the ability to vote all shares in Japan can be challenging given the high number of companies that have their annual meetings within a similar time frame.</p> <p>(One other similar comment)</p>	As pointed out, it is important to establish an environment to facilitate the exercise of voting rights by shareholders. We acknowledge that various efforts are being made by investee companies in this regard and expect such effort to continue for further improvement.
52	<p>We expect the FSA collaborates with the Ministry of Justice and the Ministry of Economy, Trade and Industry to remove the barriers to achieve Japan's long-term growth. The Corporate Act Committee in the Ministry of Justice discusses the reform of corporate laws including board structure and independent directors. The Competitiveness and Incentives for Sustainable Growth: Building Favorable Relationship between Companies and Investors Project in the Ministry of Economy, Trade and Industry discusses policies for competitiveness of companies for sustainable growth. The top-down governance would clearly be a strong incentive to change activities of companies and investors towards the long-term and integrated thinking.</p>	<p>The FSA participated as an observer in the Corporate Act Committee in the Ministry of Justice and have also been participating as an observer in the "Competitiveness and Incentives for Sustainable Growth: Building Favorable Relationship between Companies and Investors Project" in the Ministry of Economy, Trade and Industry. The FSA will continue to closely cooperate with related ministries and agencies in order to work towards the implementation of the "Japan Revitalization Strategy", the third arrow of <i>Abenomics</i>.</p>