Provisional translation

Material 1

Preceding Discussions on "Conflicts of Interest regarding Engagement" at the Follow-up Council Meeting

Major comments at the preceding Follow-up Council meetings, mainly at the 7th meeting (on 26 April) were as follows.

1. Conflicts of interest in general

- Institutional investors are required to fulfill their fiduciary duty for the ultimate beneficiaries.
- The concept of fiduciary duty is important for the whole investment chain. From this perspective, it is necessary to discuss "conflicts of interest" as a phenomenon which actually takes place in the investment chain.

  [Comments received at the Follow-up Council]

  - Unlike the extended debate on appropriate governance structures and practices of listed companies, less attention has been devoted so far to the organizational implications for institutional investors of their stewardship responsibilities. There needs to be more discussion on this in due course, including the issue of conflicts of interest and how this affects responsible investment.
  - We feel doubtful as to whether institutional investors who accepted the Stewardship Code sincerely complied with the principles. For example, the issuance of different classes of shares of some companies has been approved at a shareholder meeting. We cannot understand why many institutional shareholders with stewardship responsibility voted for the agenda

2. Conflicts of interest relating to asset managers

- There seem to be some cases where asset managers do not have good governance. In particular, some asset managers have not clearly explained how they manage conflicts of interest, if any, with their parent financial institutions
- The issue of conflicts of interest among institutional investors in financial groups is not only a problem for Japan, as a similar issue has been discussed in the United Kingdom. This type of conflicts of interest is inevitable. It is important to discuss what kind of procedures are necessary to effectively eliminate the influence of conflicts of interest based on this assumption.

- It is necessary to strengthen the governance of asset managers or improve independence in cases where asset managers are subsidiaries of financial institutions.
- It is extremely important to select top managers who have experience as a buy-side analyst or CIO, and understand fiduciary duty and stewardship responsibility.

[Comments received at the Follow-up Council]

- Most domestic assets are held by asset managers who belong to powerful banks and insurance companies, whose business interests are not necessarily aligned with that of the underlying beneficiaries of assets.
- Most domestic assets are held by asset managers who are employed by powerful banks and insurance companies, whose business interests are not necessarily aligned with that of the underlying beneficiaries of assets.
- We believe the Council could take a close look at the robustness of the so-called Chinese Wall. In reality, this ‘wall’ could function extremely weakly.
- It is important that their responsibility to act in the best interests of all stakeholders is respected

When an asset manager of a corporate pension fund votes on the agenda of a parent company, the issue of conflicts of interest comes up. How should such conflicts be managed?

3. The case where there are business relations between asset managers and investee companies

- Aside from conflicts of interest between an asset manager and its parent, could there be conflicts of interest in an individual entity that has both an asset management department and a corporate business department, as we typically see at trust banks?
- We would like to ask insurance companies to fulfil their responsibilities as asset managers breaking off relations with companies although they may have difficulty in voting purely from an asset manager perspective due to their business relations with companies.
- It is difficult for shareholders who have conflicts of interest in essence to vote purely on behalf of the ultimate beneficiaries, and it is questionable as to whether insurance companies, for example, can vote against their client companies.

[Comments received at the Follow-up Council]

- The current proxy voting disclosure of insurance companies is not satisfactory since they do not disclose proxy voting records.

4. Corporate Pension Funds

- Corporate pension funds are expected to accept the Stewardship Code, although they may not find it easy to do so since they lack resources for engagement and relations with parent companies

5. Countermeasures to the issue of conflicts of interest

- It is important for institutional investors to establish a clear policy for managing conflicts of interest and disclose it in order to eliminate concerns over conflicts of interest. They are requested to show their policy in a satisfactory way to outsiders.
- It is not sufficient to simply outsource the proxy voting of a company with possible conflicts of interest to a third party.
- One effective way to dispel doubts about conflicts of interest would be to disclose voting results. In the insurance industry, a small number of companies have disclosed specific policies for exercising voting rights, and voting results by agenda.