

Opinion Statement for the Council of Experts Concerning the Follow-up of
Japan's Stewardship Code and Japan's Corporate Governance Code
(for the 12th meeting)

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1. Overall discussion

As I'll be absent from today's meeting of the Council of Experts Concerning the Follow-up of Japan's Stewardship Code and Japan's Corporate Governance Code (the 12th meeting), I'd like to express my opinions as follows.

Firstly I'd like to discuss how to proceed with our future discussions. I understand that points at issue presented by the secretariat are based on discussions at the Follow-up Council to make further progress on the corporate governance reform, moving its focus from Formality to Substance. Each issue requires in-depth and wide discussions, and is presented taking into account the current state of Japan. Naturally, corporate governance issues are wide-ranging. However, to prepare and firmly establish guidance in the future, we need to have a perspective of offering specific and practically useful solutions, and I would like to focus our discussion on these points.

2. Division of CEO and Chairman ((3) CEO and the Board)

In the UK, since the release of the Cadbury Report (1992), and in the current UK's Corporate Governance Code (2016), as the best practice of corporate governance, it is stipulated that the roles of CEO being a leader responsible for business execution, and Chairman being a leader responsible for management oversight, should not be exercised by the same individual, and the division of responsibilities should be clearly established (A.2.1 of the Code). Furthermore, Chairman should be an outside director who meets the independence criteria. For the purpose of this principle, Chairman refers to "Chairman of the Board". In this background, there is a concern about adverse effects that if CEO or chief executive concurrently assumes the position of Chairman of the Board responsible for management oversight, the oversight function will not be fully performed. Similarly, in Japan, among all companies listed on TSE's First Section, 83.1% of the Boards are chaired by President/CEO ("TSE Listed Companies White Paper on Corporate Governance 2017").

In contrast, generally, Chairman in Japan is the position for retiring President/CEO. Such Chairman in Japan can be referred to as "Chairman of the Company", and does not necessarily coincide with the position of Chairman of the Board. According to the above-mentioned Corporate Governance White Paper, Boards chaired by "Chairman of the Company" account for 15.4%. In terms of corporate governance, the problem here is the existence of a person, who has strong power, other than the current top management. This would be similar to the issue of Senior Advisor/Corporate Advisor.

Nonetheless, in the previous discussion as well as the today's Material prepared by the secretariat, both "Chairman of the Company" and "Chairman of the Board" are referred to as Chairman in the English version, thus causing confusion. Furthermore, it may lead to sending such a message as "in Japan, a retiring President/CEO assumes the position of Chairman of the Board", which is not true. Accordingly, in the future discussion, I recommend to define terms, and discuss issues and initiatives concerning "the division of President/CEO and 'Chairman of the Board'".

3. Cross-shareholdings ((4) Cross-shareholdings)

Cross-shareholdings are stable shareholdings and also impede dialogue with other minority shareholders, including institutional investors. Moreover, in terms of efficient use of capital, in general, cross-shareholdings are not acceptable. On the other hand, since cross-shareholdings are deeply rooted in business practice in Japan, a sharp change may take time.

If the management considers that cross-shareholdings are truly necessary investments for increasing corporate value over mid- to long-term, after securing a high level of transparency and fulfilling accountability, this issue will be ultimately solved through dialogue between the companies and shareholders, including institutional investors. It is, however, difficult for outsiders to distinguish whether shares are held as cross-shareholdings or pure investments. Besides, sufficient information on performance of cross-shareholdings cannot be obtained.

Accordingly, I'd like to repeat my point which I mentioned last time. First of all, increased transparency is required. Engagement rests on appropriate and sufficient disclosures in quality and quantity, so I'd like the Council members to discuss disclosures of cross-shareholdings.

4. Stewardship activities by corporate pension funds ((5) Asset owners)

Asset owners, which pool diverging assets of ultimate beneficiaries in the form of funds, hold an important position in the investment chain. In Japan, most stewardship activities are currently conducted by asset managers, but I believe that asset owners' active engagement and monitoring will contribute to enhancing the quality of such activities throughout the investment chain.

However, the status report periodically released by the Financial Services Agency shows that an increasing number of public pension funds have signed up to the Stewardship Code in Japan, but very little corporate pension funds.

In case of corporate pension funds, due to constraints of human resources and expertise as well as relationships with parent companies, the pension funds themselves have difficulty in conducting such stewardship activities as engagement and proxy voting. On the other hand, among stewardship activities, monitoring or overseeing asset managers is an act for protecting benefits of the beneficiaries. Therefore, I believe that asset owners, including corporate pension funds, are required to undertake such activities as a part of their fiduciary duties. When investment performance or return is increased through adequate monitoring by corporate pension funds, it will lead to a favourable situation for their parent companies.

In the UK, a pioneer in implementing the Code, the situation surrounding corporate pension funds is the same except for some large funds. Some pension funds do not even have full-time staffs. For such funds, the Pensions and Lifetime Savings Association (PLSA) provides various support and services necessary for conducting stewardship activities. For example, the Association offers tools, which asset owners can use for monitoring asset managers' stewardship activities, including a list of questions which asset owners might ask to asset managers, and preparation and disclosure of self-evaluation sheets for asset managers' stewardship activities ("Stewardship Disclosure Framework"). Similarly, in Japan, if a certain system is established to support each fund, for example, through such organizations as the Pension Fund Association, it will be useful for asset owners, including corporate pension funds.

The Stewardship Code is based on the 'Comply or Explain' principle, allowing each investor's flexible response according their specific circumstances. The establishment of such a support system by external organizations will encourage corporate pension funds to sign up to the Code.