

Material 2

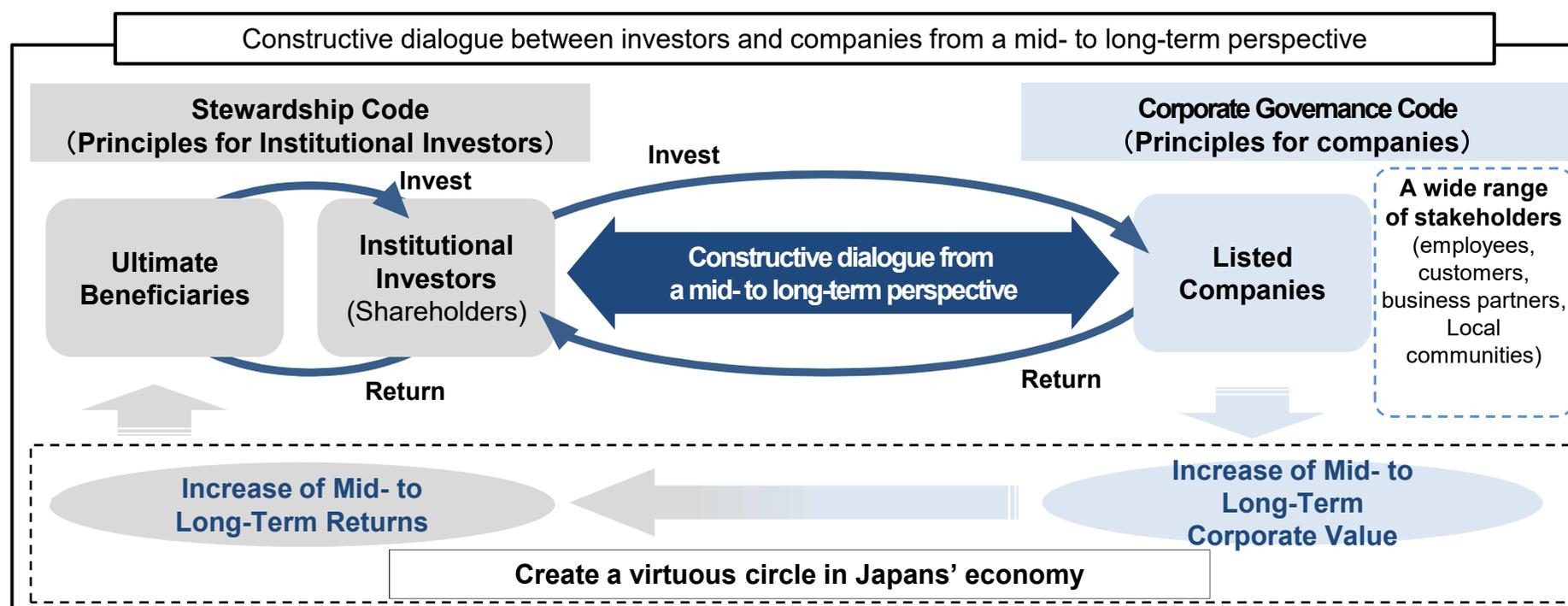
Provisional
Translation

**Enhancement of the dialogue between companies and
investors / Managing conflicts of interest between
corporate pension beneficiaries and sponsor companies**

February 15, 2021
Japan Financial Services Agency

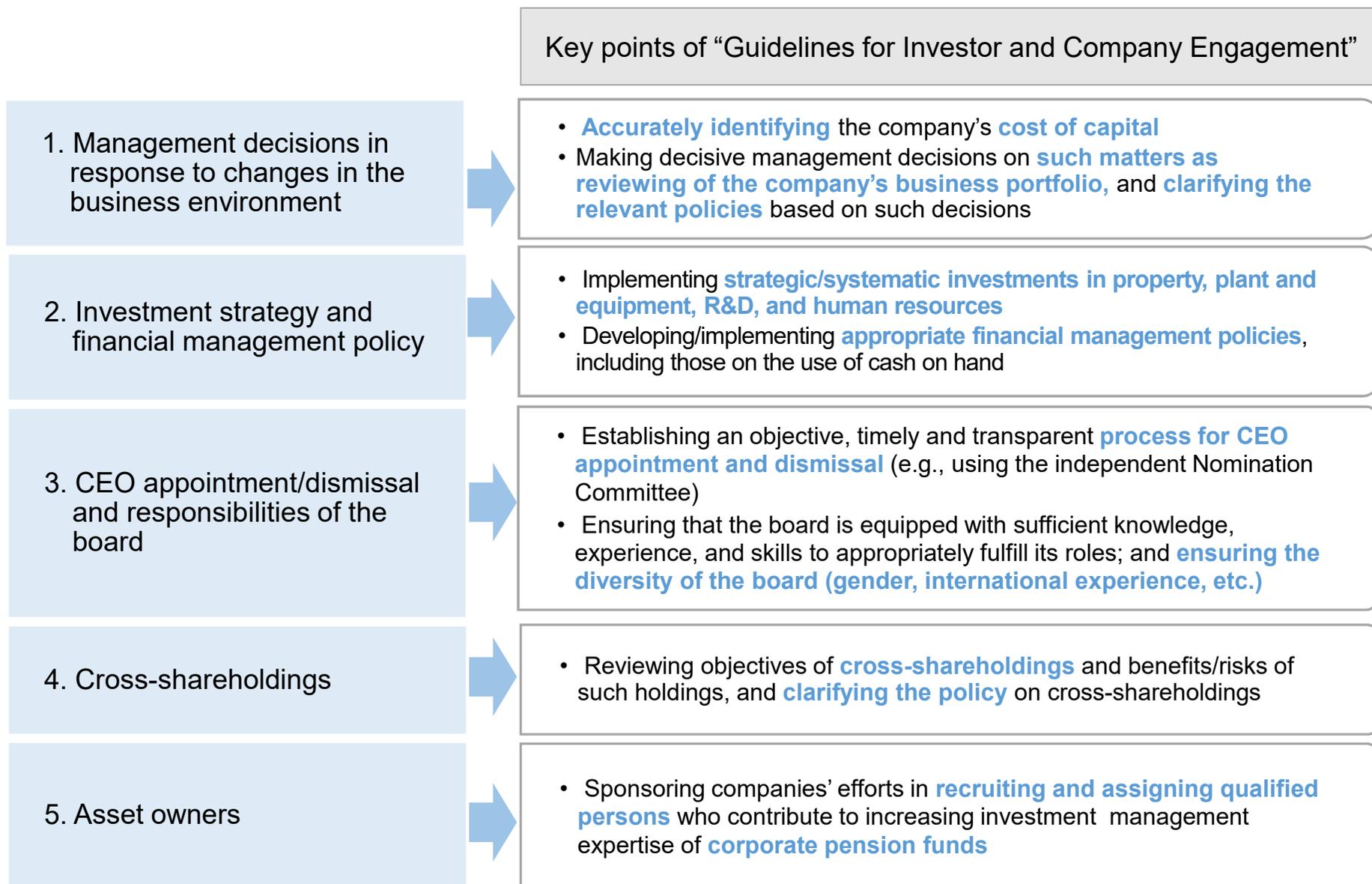
(1) Efforts to Deepen Corporate Governance Reform

- ❑ As part of Japan Revitalization Strategy, efforts for corporate governance reform have been strengthened with the Stewardship Code and the Corporate Governance Code working in tandem for long-term growth in corporate value
- ❑ **In June 2018, the Guidelines for Investor and Company Engagement was established** as a supplemental document to the Stewardship Code and the Corporate Governance Code to enhance the effectiveness of dialogue between investors and companies, .



(1) Outline of “Guidelines for Investor and Company Engagement” (June 2018)

- The outline of “Guidelines for Investor and Company Engagement” is as follows.



(1) Opinions about enhancing dialogue

- Opinions regarding **the importance of enhancing dialogue** on the items listed in the Guidelines for Dialogue on Capital Efficiency has been pointed out.

Opinions about enhancing dialogues

【Management decisions in response to changes in the business environment】

- The board of directors of a holding company should consider optimizing group management, and for this purpose, dialogue between investors and the board of directors (outside directors, not management) is important. For this purpose, dialogue between investors and the board of directors (outside directors, not the management team) is important. It is important to work persistently to create an environment that promotes dialogue.
- In terms of how to improve capital efficiency, it will be more important to have dialogue based on individual circumstances.
- The issue of capital efficiency is a matter that should be resolved through dialogue with investors rather than codes, and it would be better to be included in the Guidelines for Investor and Company Engagement.
- More in-depth dialogue is needed on medium- to long-term corporate strategy, risk strategy, and risk allocation strategy.

【Investment strategy and financial management policy】

- What should be the material for dialogue as a major framework for the post-COVID19 outlook are green, digital, and healthcare topics. Since resources are finite, it is important to find ways to increase efficiency, and it is important to promote constructive dialogue between companies and investors.

【Appointment and dismissal of CEO/Board effectiveness】

- From an investor's point of view, for example, there is a need for dialogue on the pros and cons of independent directors who have been appointed to more than three companies, the issue of independence, and more specifically, whether they have the necessary skills. At the same time, their performance should be a subject of dialogue.
- I would like to see investors also train and develop female executives through dialogue. I also hope that they will voluntarily expose themselves to criticism and train themselves.

【Cross-shareholdings (Structure of shareholdings)】

- I am concerned that decisions on cross-shareholdings will not be based on economic rationality. I hope that investors will also use dialogue to encourage rigorous examination by independent outside directors at board meetings.
- Dialogue should explore what kind of logic companies have in owning listed subsidiaries.
- It would be desirable for investors to be able to directly confirm whether the company is responding to the concerns of minority shareholders through dialogue between independent directors and investors.
- Cross shareholding without criticism is also not an efficient use of capital. Cross shareholdings should also be considered as a subject of dialogue.

【Others】

(Counterparts of dialogue)

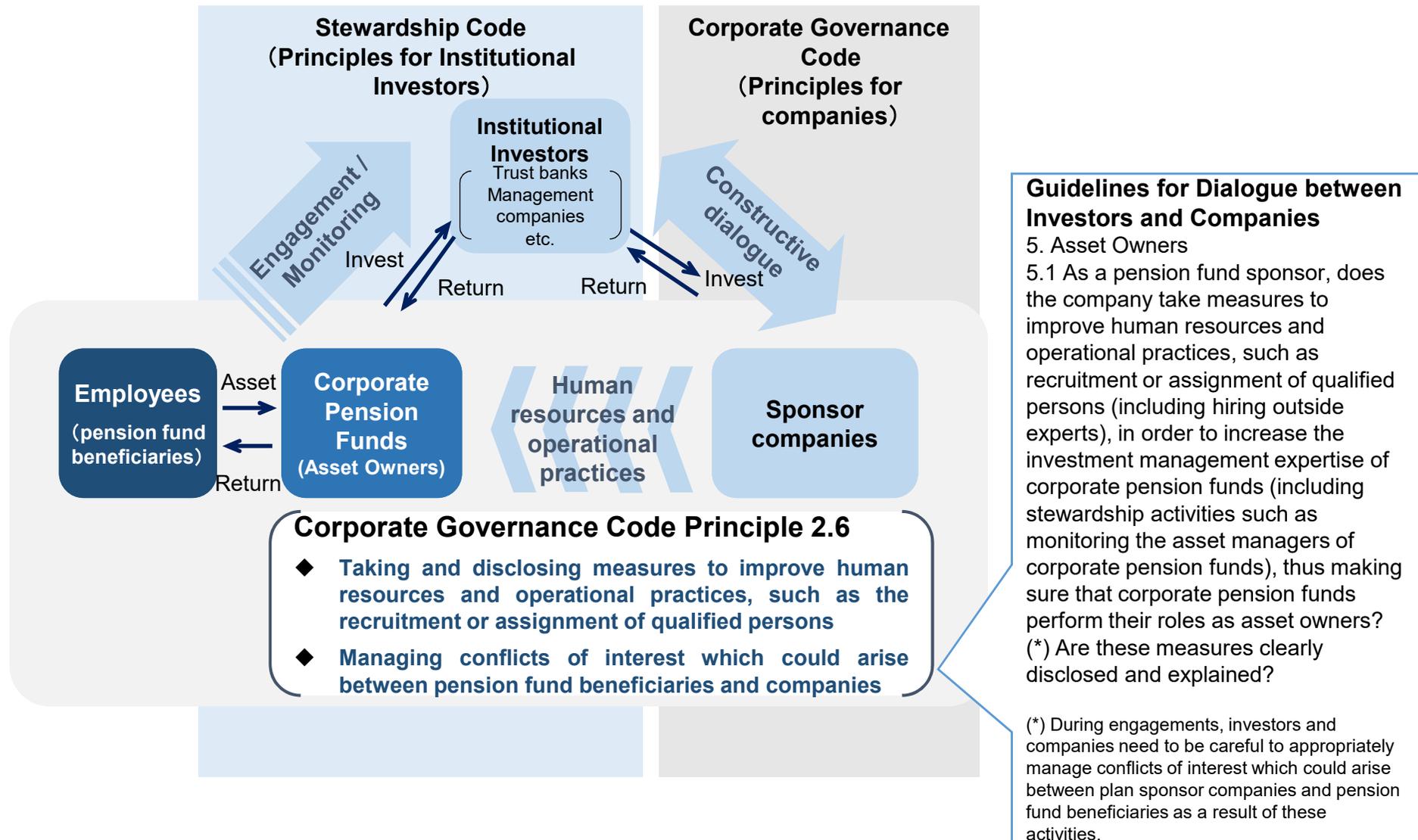
- Given the current situation in Japan, the dialogue between investors and independent directors should be expanded to include as many interactions as possible.
- Regarding dialogue with shareholders, in addition to outside directors, independent *Kansayaku* should also respond.
- Dialogue with shareholders, including independent directors, should be more explicit and frequent. Based on my experience as an independent director of a company that was in the midst of a crisis such as a scandal, I can say that by engaging in dialogue with shareholders as much as possible, including independent directors, execution will learn a great deal and gain more trust from other parties, including institutional investors, to a certain extent.

(Others)

- Dialogue is important as a way to improve the quality of independent directors. From the investor's point of view, there is a groping exchange at the beginning, but by the end of the one-hour meeting, there is a rapport, and the independent director has a clearer understanding of the expectations of shareholders and investors.
- As for directors with long terms of office, I think there is a direction to maintain a sense of tension in this regard through disclosure and dialogue.
- It is desirable for institutional investors' awareness of the issues to be extracted from the dialogue and discussed by the management.

(2) Description in the code about the roles of asset owners and parent companies

- The Corporate Governance Code Principle 2.6 and the Guidelines for Investor and Company Engagement mention the importance of efforts by sponsor companies, such as the recruitment or assignment of qualified persons, and managing conflicts of interest which could arise between pension fund beneficiaries and companies.



(2) The relationship between sponsor companies and corporate pension funds (managing interest conflicts)

- ❑ With regard to asset owners, it has been pointed out at the time of the second revision of the Stewardship Code, that it is important to strive for conflicts of interest management, especially with regard to the relationship between corporate pension funds and sponsor companies.

Indication in “Second Revision of the Stewardship Code” (March 24, 2020)

The following issues were also raised in the Public Consultation. **It is expected that relevant authorities, including the Financial Services Agency and the Follow-up Council, will have further discussions about them.**

...(omitted).....

To ensure effective stewardship activities of corporate pensions, **it is important to strive for conflicts of interest management in sponsor companies.**

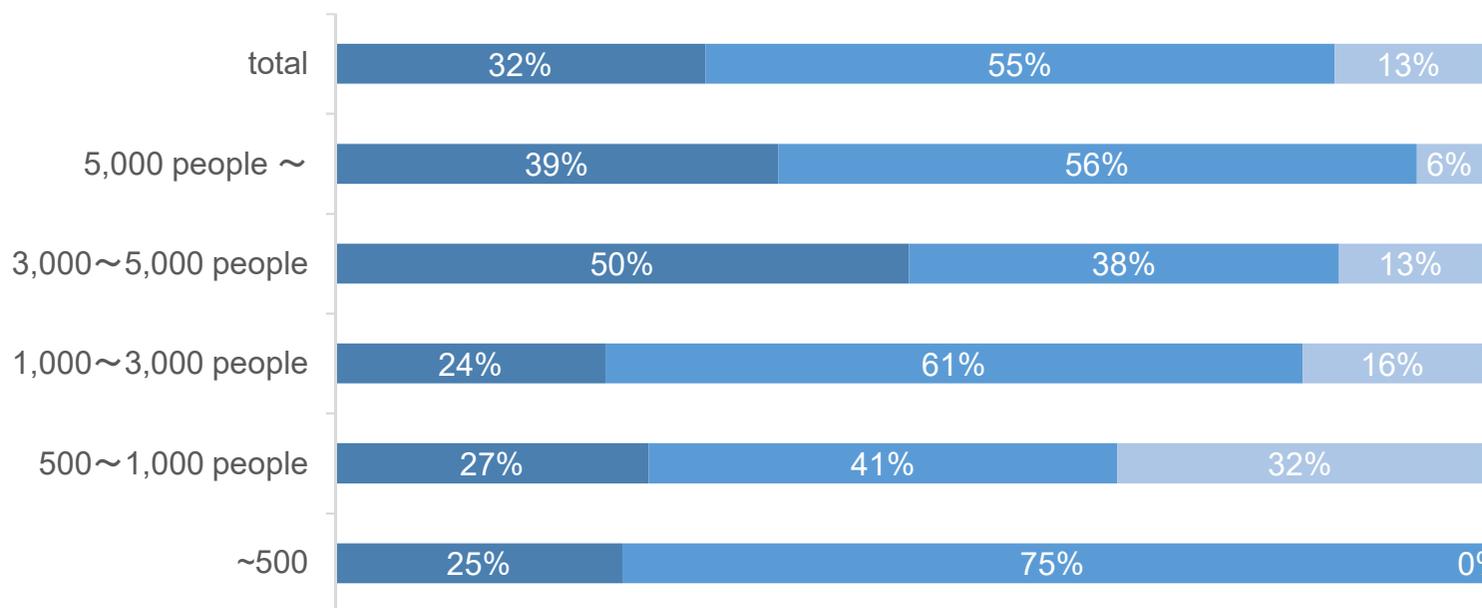
The main opinions heard related to this issue

- Many sponsor companies are concerned that the spread of stewardship activities will put pressure on them to strengthen their governance, and the corporate pension funds under them tend to agree. For corporate pension funds, which are part of the balance sheet of the sponsor company, the institutional and financial support of the sponsor company is essential. For corporate pension funds that are part of the balance sheet of the sponsor company, the institutional and financial support of the sponsor company is indispensable, and **many corporate pension officials are not sure whether they are "acting solely for the benefit of the pension."**
- The addition of provisions in the Stewardship Code that would make the **fund independent of the sponsor company** would probably promote stewardship activities.
- With regard to conflicts of interest, **30% of all companies decide on asset managers based on their operational capabilities alone**, while some companies focus on their business relationship with the sponsor company. The reality is that **there is little awareness of the issue.**

(2) Managing conflicts of interest

- Regarding the management of conflicts of interest between pension fund beneficiaries, **some companies decide on their asset managers mainly based on business relationships with the sponsor company.**

Managing conflicts of interest between pension fund beneficiaries



- Asset managers are decided based on their investment performance and capabilities, irrespective of their business relationships (loans, shareholdings, etc.) with the sponsor company.
- Asset managers are decided comprehensively, taking into account not only investment performance and capabilities but also business relationships with the sponsor company
- Asset managers are decided based on their business relationships with the sponsor company

(Note) Respondents were 155 persons in charge of corporate pension fund management.

Source: Prepared by JFSA from KPMG Japan "Survey on Pension Investment Governance 2020"

Subjects to be discussed at the 24th Council

- We have heard opinions on the importance of enhancing dialogue, including dialogue between companies and investors on issues such as capital efficiency. In this context, what do you think about the following points?
 - What measures are needed to make dialogue between companies and investors more effective in order to improve corporate governance?
 - What matters should be included in the "Guidelines for Investor and Company Engagement" in order to further enhance dialogue?
- Also, what do you think about the relationship between corporate pension funds as asset owners and their sponsor companies (management of conflicts of interest)?