Material 4

Provisional Translation

Reference Material for the Twenty-Fourth Council

(Enhancing Dialogue Between Companies and Investors/Managing Conflicts of Interest Between Corporate Pension Beneficiaries and Parent Companies)

February 15, 2021
Japan Financial Services Agency

(1) General Remarks

Overview of the Stewardship Code

Drafted on February 26, 2014
Revised on May 29, 2017
Revised for the second time on March 24, 2020

- Provides principles of conduct for **institutional investors, etc.** to fulfill their responsibility (stewardship responsibility) toward **achieving sustainable corporate growth** and **increasing medium- to long-term investment returns for clients and beneficiaries** through constructive dialogue with **investee companies**.

Framework

- Whether to accept the Code is **left to the discretion of institutional investors**. However, the FSA will encourage investors to accept the Code through a system entailing the **publication of a "List of Institutional Investors"** that have expressed their acceptance of the Code.
- Principle-based approach: entails **judging whether one's activities are truly appropriate in light of the purpose and spirit of a text rather than its letter**.
- Comply or explain: the Code requires companies to **either implement the principle or explain why they have not instead of imposing blanket obligations** as is the case with laws and ordinances.

Overview

Institutional investors should:

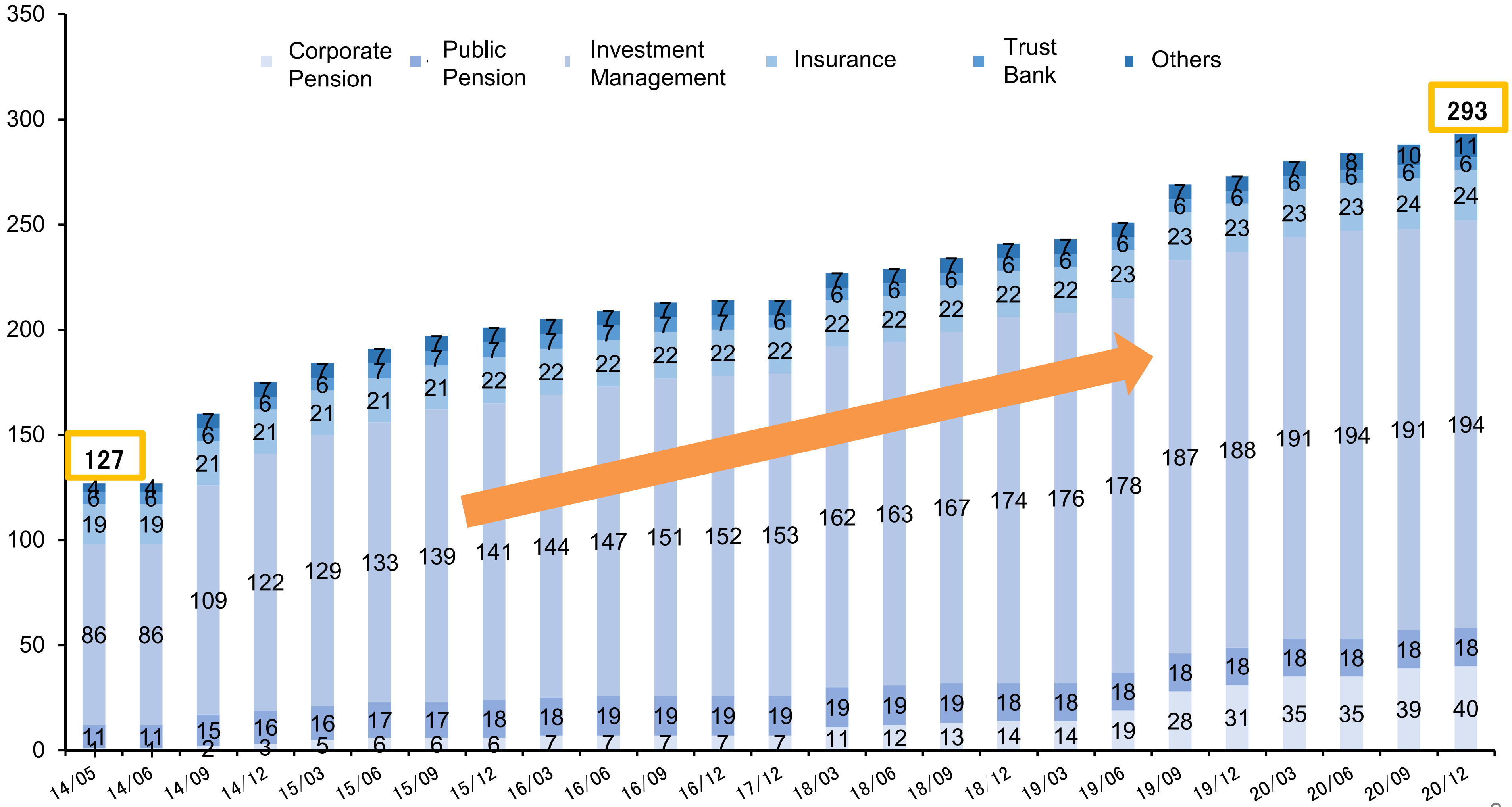
1. Formulate a **basic policy** for fulfilling stewardship duties and make it public.
2. Manage **conflicts of interest** appropriately in order to act with the **interests of customers and beneficiaries as the top priority.**
3. Develop an accurate **understanding** of the **governance, corporate strategy** and other aspects of investee companies.
4. **Share their understanding** with investee companies and endeavor to **address problems**.
5. **Publish** their **policy** on the **exercise of voting rights** along with the **results of voting**.
   - Publish the results of voting **for each investee company and agenda item**.
   - Exercise their voting rights on their own responsibility and judgment, without formally relying on the counsel of proxy advisors, etc.
6. Provide **regular reports** about their activities to customers and beneficiaries.
7. **Possess the ability** to engage in appropriate dialogue and take decisions based on **an in-depth understanding of investee companies**.

Providers of services to institutional investors should:

8. Endeavor to **provide the appropriate services to institutional investors as they fulfill their stewardship responsibilities.**

Trends in acceptance of the Stewardship Code

- Since the establishment of the Stewardship Code in February 2014, the number of signatory institutions has consistently increased, with **293 institutions** having announced their signatory status (as of December 31, 2020).
- As of December 31, 2020, **257 institutions** (204 asset managers and 53 corporate pension funds, etc.) had already complied with the revised Stewardship Code of March 2020.



Source: compiled by the Financial Services Agency (FSA)

(2) Sustainability Considerations

Sustainability in the Stewardship Code

- In March 2020, when the Stewardship Code was revised again, the definition of "stewardship responsibility" at the beginning of the preamble to the Code was changed, adding that **sustainability (over the medium to long term and including ESG factors) should be considered**.

Principles for Responsible Institutional Investors (Japanese version of the Stewardship Code)

In the Code, "Stewardship Responsibility" refers to the responsibility to grow the investment returns of clients and beneficiaries (including final beneficiaries; the same applies below) by boosting corporate value and promoting the sustainable growth of companies. Institutional investors should do so by engaging in "goal-oriented dialogue" (engagement) based on an in-depth understanding of investee companies and their business environment along with sustainability considerations (over the medium to long term and including ESG factors) to fit investment strategies.

The Code stipulates principles that institutional investors may find useful in fulfilling their stewardship responsibilities as "responsible institutional investors," taking into account both their clients/beneficiaries and investee companies. Appropriate fulfillment of stewardship responsibilities by institutional investors in line with the Code will also lead to the growth of the economy as a whole.

Sustainability Considerations

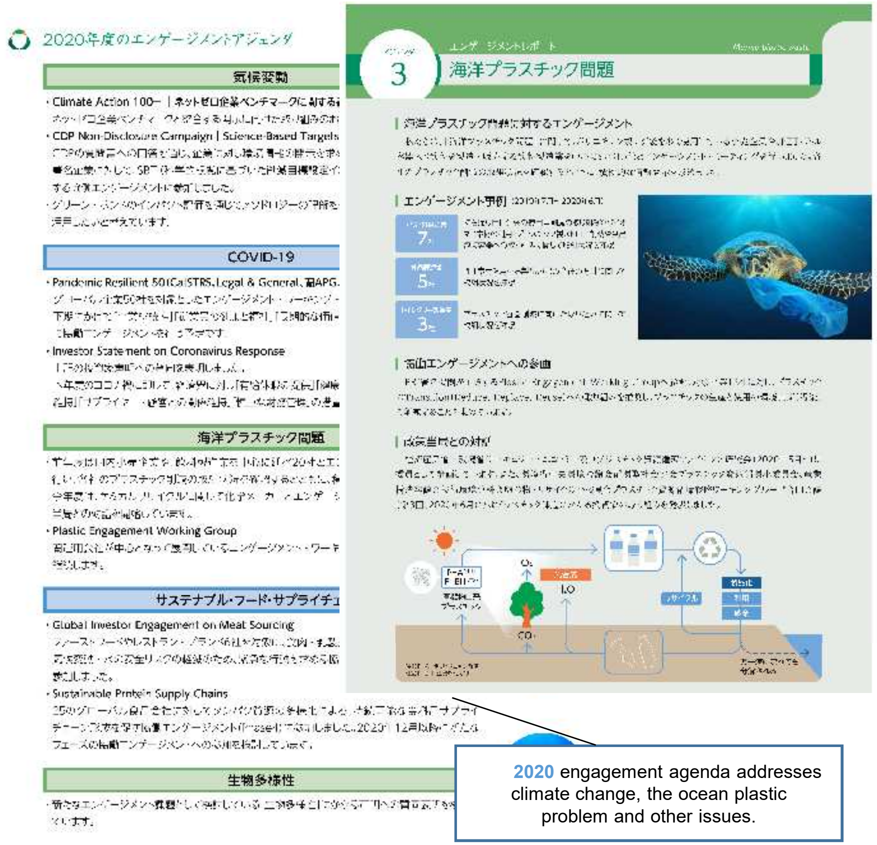
- Out of the companies that have complied with the second revision of the Stewardship Code, **about 70%** of the investment management institutions mentioned **sustainability considerations (over the medium to long term and including ESG factors) in some form in their stewardship activity policies or stewardship activity reports**.
- In many instances, they made reference to **engagement with ESG, etc.** and **ESG integration.**

Published examples of sustainability considerations

Dialogue based on ESG evaluation

As explained in Principle 3, **we will use our own ESG evaluation and other methods to understand the situation of the relevant companies in order to ensure their sustainable growth.** The **agenda for dialogue will be based on the challenges faced in ensuring medium- and long-term sustainability that are identified in this process**.
In order to enhance the effectiveness of dialogue based on ESG evaluation, we have been assigning a Corporate Governance Officer (a specialist in ESG and the exercise of voting rights) to our investment management division since September 2007. The Corporate Governance Officer advises investment managers who engage in dialogue with investee companies based on trends in global governance, ESG and CSR, and collaborates with investment managers as necessary.

In line with its Global Sustainability Strategy, the Group aims to ensure that all of its investment strategies adopt a sustainable investment approach and integrate ESG risks and opportunities into the investment process. The ESG integration process is designed to identify and assess areas of risk and opportunity. The process of integrating and incorporating ESG factors is based on the Group's ESG Integration Guidelines and is monitored by the ESG Verification Committee. The investment team monitors investment performance and risk on an ongoing basis. (...) In addition to regular ESG training by the Investment Team, the Sustainability Center, with its extensive resources for sustainability research and stewardship, supports the integration of ESG in line with investment strategies. (...)


2020年度のエンゲージメントアジェンダ

気候変動

・Climate Action 100+

・CDP Non-Disclosure Campaign | Science Based Targets

COVID-19

・Investor Statement on Coronavirus Response

海洋プラスチック問題

・Plastic Engagement Working Group

サステナブル・フード・サプライチェ

・Global Investor Engagement on Meat Sourcing

・Sustainable Protein Supply Chains

生物多様性

3 海洋プラスチック問題

2020 engagement agenda addresses climate change, the ocean plastic problem and other issues.

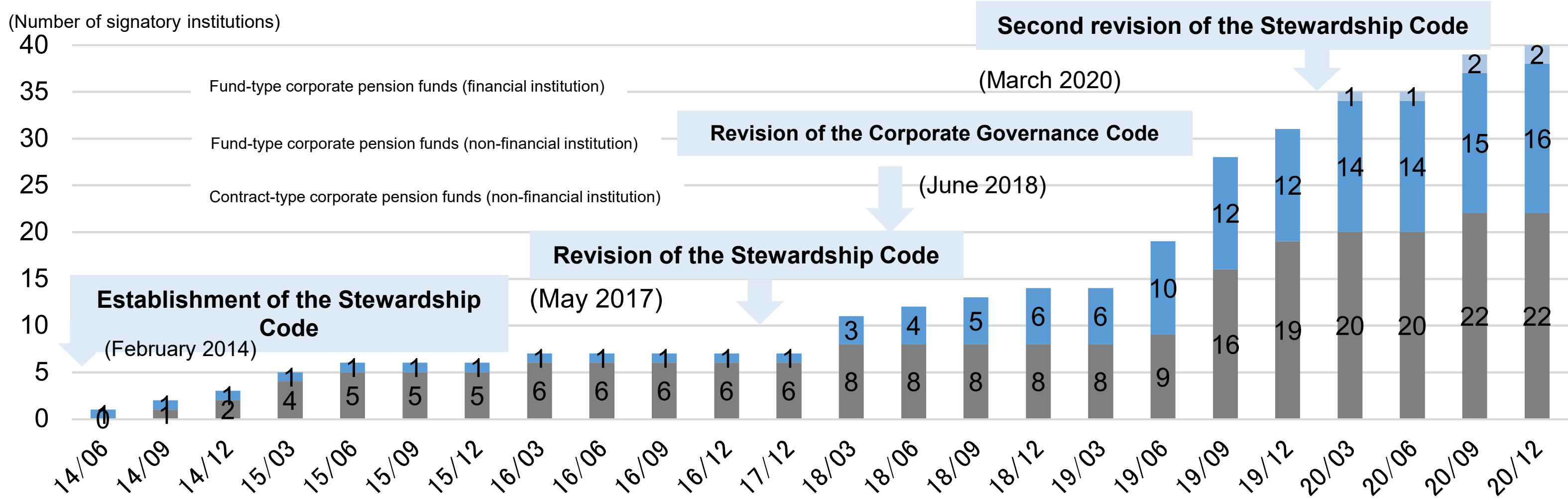
From: Reports on Stewardship Activities by Signatory Institutions to the Stewardship Code; surveyed by the Financial Services Agency

From: Resona Asset Management's "Stewardship Report 2020/2021"; compiled by the Financial Services Agency.

(3) Managing Conflicts of Interest Between Corporate Pension Beneficiaries and Parent Companies

Status of Acceptance of the Stewardship Code by Corporate Pension Funds and Other Asset Owners

- Of the 293 institutional investors that have signed the Stewardship Code, **40** are **corporate pension funds**. (Following the 2017 revision, **31 new fund-type and 2 contract-type corporate pension plans** have announced their acceptance as of December 31, 2020)



Source: compiled by the FSA

Fund-type corporate pension funds (financial institution)

2014	Mitsubishi UFJ Trust and Banking Corporation Pension Fund Mitsubishi UFJ Bank Pension Fund
2015	Sumitomo Mitsui Banking Corporation Pension Fund Mizuho Pension Fund, Resona Pension Fund
2016	Sumitomo Mitsui Trust Bank Pension Fund
2018	Aioi Nissay Dowa Pension Fund Mitsui Sumitomo Insurance Pension Fund
2019	Bank of Yokohama Pension Fund, The Hyakugo Bank, Ltd. Pension Fund Chiba Bank Pension Fund, Chugoku Bank Pension Fund The Daishi Bank Pension Fund, The Hokuetsu Bank Pension Fund The Iyo Bank Pension Fund, Toho Bank Pension Fund The Musashino Bank Pension Fund, The Higo Bank Pension Fund Kagoshima Bank Pension Fund
2020	Joyo Bank Pension Fund, Hokuriku Bank Pension Fund Hokkaido Bank Pension Fund

Fund-type corporate pension funds (non-financial institution)

2014	Secom Pension Fund
2018	Eisai Pension Fund, NTT Corporate Pension Fund National Construction Association Pension Fund, Mitsubishi Corporation Pension Fund
2019	Certified Public Accountants' Corporate Pension Fund, Otsuka Pharmaceutical Corporate Pension Fund (Casio Pension Fund, Itochu Pension Fund) Nihon IT Software Pension Fund, Omron Pension Fund
2020	Tourism Industry Pension Fund, Shiseido Pension Fund Advantest Corporate Pension Fund Nissin Foods Pension Fund Nippon Paint Pension Fund

Contract-type corporate pension funds (non-financial institution)

2020	Nomura Research Institute, Ltd. (contract-type pension plan) Panasonic Corporation (contract-type corporate pension plan)

Disclosed in Accordance with Principle 2-6 of the Corporate Governance Code

- Some companies **include detailed descriptions of measures taken to manage conflicts of interest between the parent company and the corporate pension plan in their Corporate Governance Reports (Principle 2-6)**.

Excerpts from Corporate Governance Reports on Principle 2-6 (Roles of Corporate Pension Funds as Asset Owner)

A Inc.

Due to the necessity of complementing the expertise of corporate pension plans, we have established basic investment policies and investment management regulations for pension assets. Furthermore, **in accordance with the Articles of Incorporation of the fund, important matters concerning the fund's operation are resolved by a meeting of representatives, half of which are representatives of the employees who are the beneficiaries of the fund; any conflicts of interest that may arise between the company and the beneficiaries are appropriately managed.**

B Inc.

The Company **respects the intent of the corporate pension fund** with regard to its investment portfolio and the stewardship activities of its asset management contractors**, and the fund's regulations prevent the asset manager from investing its reserves for the purpose of benefiting themselves or a third party. By regularly informing fund directors and representatives of the fund about conflicts of interest, etc., any conflicts of interest that may arise between the beneficiaries of the corporate pension plan and the company are managed appropriately**.

C Inc.

The selection of individual investments and the exercise of voting rights are **left to the asset manager to avoid conflicts of interest between corporate pension beneficiaries and the company.**

Reference: Principle 2-6 Roles of Corporate Pension Funds as Asset Owner

(C)ompanies (...) should take and disclose measures to improve human resources and operational practices, such as the recruitment or assignment of qualified persons, in order to increase the investment management expertise of corporate pension funds (including stewardship activities such as monitoring the asset managers of corporate pension funds), thus making sure that corporate pension funds perform their roles as asset owners. **Companies should ensure that conflicts of interest which could arise between pension fund beneficiaries and companies are appropriately managed**.

(4) Dialogue Between Outside Directors and Investors

Promoting Dialogue Between Companies and Investors

- The second revision of the Stewardship Code also mentions **the usefulness of dialogue between non-executive officers (independent outside directors, auditors, etc.) and investors in promoting dialogue between companies and investors**.

Second revision of the Stewardship Code (edition revised March 24)

Principle 4 Institutional investors should seek to arrive at an understanding in common with investee companies and work to solve problems through constructive engagement with them.

Guidance

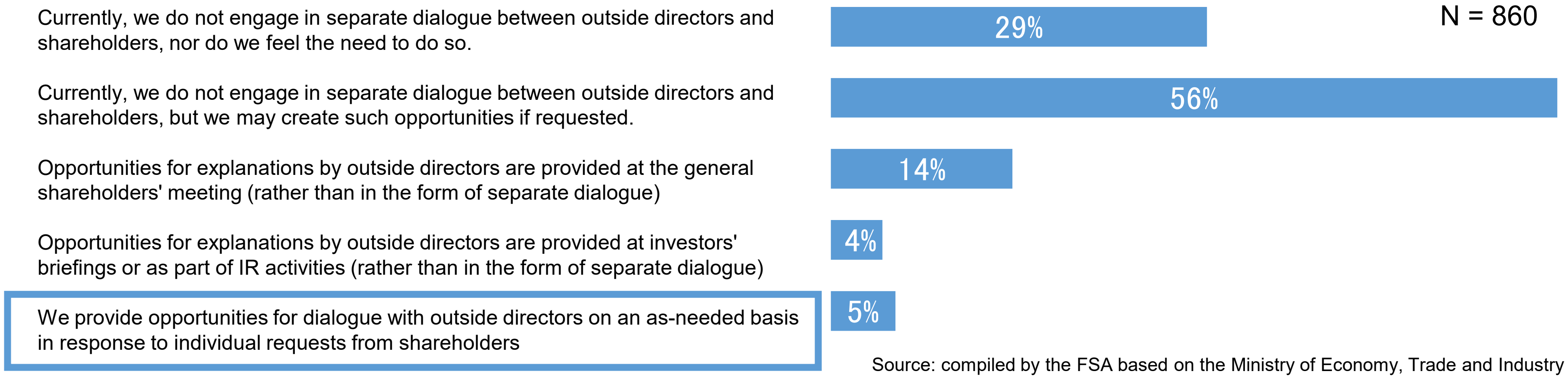
4-1. Institutional investors should endeavor to arrive at an understanding in common[17] with investee companies through constructive dialogue with the aim of enhancing the companies' medium- to long-term value and capital efficiency, and promoting their sustainable growth. In case a risk of possible loss in corporate value is identified through the monitoring of and dialogue with companies, institutional investors should endeavor to arrive at a more in-depth common understanding by requesting further explanation from the companies and to solve the problem.

17: For example, in order to reach a common understanding with investee companies with regard to the status of their governance systems (including the use of independent directors), business portfolio revisions and other management priorities, it may also be beneficial to hold dialogues with officers who are not involved in the execution of business (independent directors, *kansayaku* (Audit & Supervisory Board member), etc.).

Participation of Outside Directors, etc. in Engagement

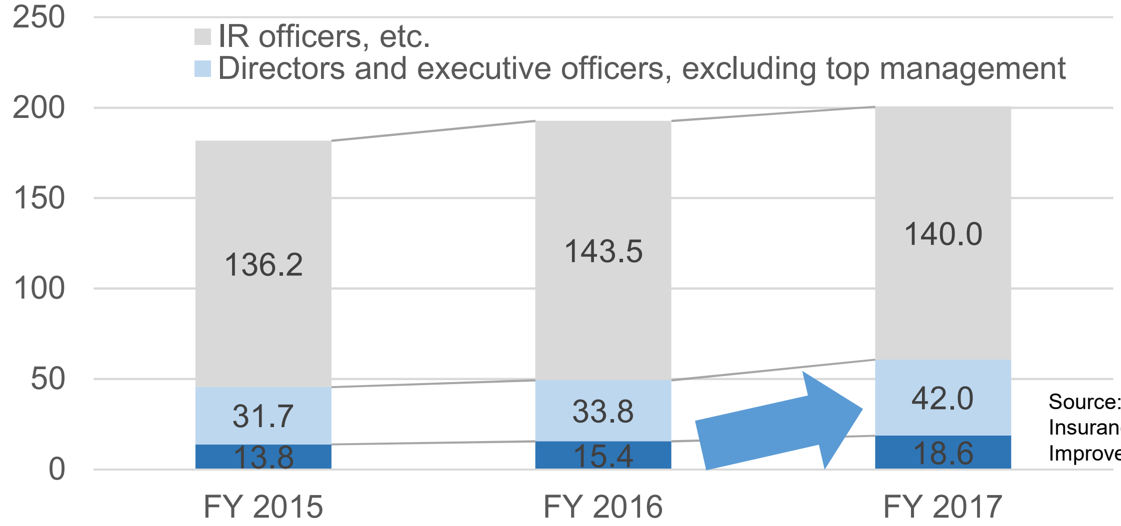
- **Only about 5% of companies create separate opportunities for dialogue** between outside directors and investors.
- It has been pointed out that although **the number of companies whose management and board members participate in dialogue with institutional investors** is on the rise, it is **still low**.

State of Dialogue Between Outside Directors and Investors



Source: compiled by the FSA based on the Ministry of Economy, Trade and Industry (METI)'s FY 2019 Survey of Corporate and Outside Directors

Average yearly frequency of dialogue (companies)



Source: Compiled by the FSA based on The Life Insurance Association of Japan's survey "Efforts to Improve Stock Value" for FY 2015, 2016 and 2017.