

Stewardship Practices in Japan

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金融庁

Financial Services Agency, the Japanese Government

* The cases in this document have been processed based on information collected through interviews, so they do not necessarily represent specific cases.

Background

Action Program for Corporate Governance Reform 2024: Principles into Practice (published on 7 June, 2024) (excerpt)

[Future initiatives]

Based on the recommendations in the reports of the Financial System Council, in order to make engagement more effective, the Stewardship Code should be reviewed with the aim of promoting collective/collaborative engagements that contribute to constructive and purposeful dialogues and ensure the transparency of beneficial shareholders. The review should also take into account the viewpoint that it is important to recognize that dialogues and the exercise of voting rights are interrelated, and consideration should be given to how dialogues prior to the exercise of voting rights should be conducted. It is also important to be aware of and assess the outcomes of engagement.

In addition, in order to resolve the above issues, **it is useful to share specific cases and certain viewpoints on desirable and undesirable engagements, taking into account the opinions of stakeholders, such as investors and companies.**

In light of these viewpoints, the Financial Services Agency [...] should **assess compliance with the Stewardship Code** by asset managers, asset owners, and proxy advisors, in cooperation with related parties.

[About this document]

- ❑ Building on the conclusion mentioned above in the Action Program 2024, the Financial Services Agency have conducted interviews on the stewardship activities with asset managers, asset owners (including pension funds and insurance companies), and proxy advisors.
- ❑ This document is based on the premise that there are various approaches and initiatives for stewardship activities, and shows some good practices for the effective implementation of stewardship activities. The Financial Services Agency does not request all the signatories of the Stewardship Code to uniformly follow the activities described in this document.
- ❑ This document is to be updated and evolved by establishing a forum for discussion between companies and investors and improving the quality of cases collected. In order to promote the effective implementation of stewardship activities, the Financial Services Agency will continue to collect and share the good practices of stewardship activities by asset managers, asset owners, and proxy advisors, in coordination with relevant parties.

List of interviewed investors on stewardship activities

- With the aim of identifying investors' good practices and promoting the effective implementation of stewardship activities, the Financial Services Agency interviewed from September 2024 to January 2025 the following 26 institutions who are signatories to Japan's Stewardship Code.

Interviewed institutions (in Japanese syllabary order)

- | | |
|---|--|
| 1. ISS Inc. | 14. Nippon Life Insurance Company |
| 2. Asset Management One Co., Ltd. | 15. Neuberger Berman East Asia Limited |
| 3. Kaname Capital | 16. Government Pension Investment Fund (GPIF) |
| 4. CalPERS | 17. Norinchukin Value Investments Co.,Ltd. |
| 5. Pension Fund Association | 18. Nomura Asset Management Co., Ltd. |
| 6. Glass Lewis | 19. Norges Bank Investment Management |
| 7. Federation of National Public Personnel Mutual Aid Associations | 20. FIL Investments (Japan) Limited |
| 8. SPARX Asset Management Co., Ltd. | 21. BlackRock Japan Co., Ltd. |
| 9. The Dai-ichi Life Insurance Company, Limited | 22. Misaki Capital Inc. |
| 10. Taiyo Pacific Partners L.P. | 23. Sumitomo Mitsui Trust Asset Management Co., Ltd. |
| 11. Daiwa Asset Management Co.Ltd. | 24. Mitsubishi UFJ Trust and Banking Corporation |
| 12. Pension Fund Association for Local Government Officials | 25. Lazard Japan Asset Management K.K. |
| 13. Promotion and Mutual Aid Corporation for Private Schools of Japan | 26. Resona Asset Management Co., Ltd. |

We would like to express our gratitude to all the institutional investors who cooperated with us.

List of interviewed companies on engagement

- ❑ In order to understand practices of engagement by institutional investors from the perspective of companies to promote the effective implementation of stewardship activities, from September 2024 to January 2025, the Financial Services Agency interviewed companies that are proactively working on corporate governance reform.
- ❑ The interviewed companies include the following 18 companies listed on the Tokyo Stock Exchange Prime Market or Standard Market.

Interviewed companies (in Japanese syllabary order)

- | | |
|---------------------------------------|---------------------------------------|
| 1. ID Holdings Corporation | 10. DAIICHI SANKYO COMPANY, LIMITED |
| 2. Astellas Pharma Inc. | 11. DAIHATSU INFINEARTH MFG.CO.,LTD.* |
| 3. AS ONE CORPORATION | 12. Tokyo Electron Ltd. |
| 4. ANA HOLDINGS INC. | 13. NEC Corporation |
| 5. SWCC Corporation | 14. Hitachi, Ltd. |
| 6. J. FRONT RETAILING Co., Ltd. | 15. HOYA CORPORATION |
| 7. SHIKOKU KASEI HOLDINGS CORPORATION | 16. Mitsubishi Shokuhin Co., Ltd. |
| 8. Shin-Etsu Chemical Co., Ltd. | 17. Murata Manufacturing Co., Ltd. |
| 9. Daito Pharmaceutical Co., Ltd. | 18. THE YAMANASHI CHUO BANK, LTD. |

* Company name was changed from “DAIHATSU DIESEL MFG.CO.,LTD.” on May 2, 2025.

We would like to express our gratitude to the companies that cooperated with us.

Practices on stewardship activities: At a glance

- ❑ Asset owners were interviewed on monitoring and incentivising asset managers in relation to Principle 1 of Japan's Stewardship Code.
- ❑ Asset managers were interviewed on the entire process of dialogue leading up to the exercise of voting rights in relation to Principles 3, 4, and 5 of the Stewardship Code.
- ❑ The Financial Services Agency also examined and evaluated compliance with Principle 8 by proxy advisors.

Asset owners	Monitoring	■ Asset owners use a standardised form, with each requesting asset managers to submit additional documents for specific topics for which detailed explanation is necessary. Asset owners also recognise the need to reduce the reporting burden on asset managers.
	Incentivising	■ Asset owners give feedback to individual asset managers with the results of monitoring evaluation, while it is not a common practice to pay additional fees for effective engagement.
Asset managers	Accurate understanding of business conditions	■ Many asset managers keep records on the progress of dialogues at appropriate times and manage and share them in a centralised manner. ■ Some asset managers research investee companies using their own tools. In addition, it is important to engage with investee companies by carefully analysing investee companies and providing information to contribute to consideration by the companies themselves.
	Engagement	■ There is successful and constructive engagement when asset managers identify the growth stage of the investee company and present examples from other companies as reference. ■ Some long-term active engagement funds carefully select companies to invest in, build strong trust relationships with companies, and have tense dialogue. ■ From the perspective of companies, engagement that is less meaningful includes cases where investors ask questions only about short-term financial indicators and where dialogue focuses entirely on shareholder returns, such as stock repurchase. ■ From the perspective of investors, engagement that is less meaningful includes cases where companies consult only on how to improve the appearance of disclosures or want voting for specific resolutions of the AGM.
	Voting	■ Many asset managers have developed systems to conduct dialogue and the exercise of voting in an integrated manner by close coordination and information sharing between the engagement team and people in charge of voting. ■ Approaches to voting policies and actual voting vary among asset managers
Proxy advisors	Compliance with Principle 8	■ There is still a perception gap regarding communication between proxy advisors and companies. Devising ways to increase the frequency of communication is an ongoing issue. ■ There has been an increase in services that provide advice and data in line with voting policies for each asset manager as a client. Proxy advisors increasingly need to establish logics and to secure personnel to address this recent trend.

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(i) Monitoring practices

- ❑ We conducted interviews regarding asset owner's fulfilment of stewardship responsibilities, focusing mainly on (i) monitoring practices, (ii) the provision of incentives for stewardship activities, and (iii) awareness of issues, on asset managers.
- ❑ As for monitoring, while using a standardised form, asset owners also request additional documents for specific topics for which detailed explanation is necessary. On the other hand, some institutions place importance on the quality of communication and initiatives with asset managers, seeking efficient and substantive methods.

Monitoring practices

- ✓ Each fiscal year, we receive reports on stewardship activities from mandated asset managers and conduct interviews in order to confirm whether their stewardship activities are aligned with our policies. We place emphasis not only on formal aspects such as implementation structures, but also on the **quality of initiatives**, such as confirming the mandated asset managers' views on their understanding of investee companies and the extent to which sustainability factors are taken into account. In evaluating the quality of mandated asset managers' engagement, we confirm case-based examples such as how they analyse the challenges of individual companies and what kind of dialogue they conduct.
- ✓ Asset management companies are asked to respond to a standardised questionnaire consisting of approximately 50 common questions. Although we update part of the questionnaire each year, considering the burden on asset management companies, we allow them to only provide updated responses to items which their response has been changed from their previous answers. In addition, asset management companies are requested to prepare presentation materials as optional material where necessary. Some overseas asset management companies have noted that translating responses to the questionnaire into Japanese **poses a significant burden**, so we now provide the questions in both Japanese and English and allow responses to be submitted in English. We are also working to reduce the number of questions by consolidating or reducing them.
- ✓ Since some items are **not sufficiently covered by the "Smart Format" (*)**, we request additional responses or materials using a similar format. For changes over the past year that require particular explanation, we ask that PowerPoint materials be prepared. We recognise that this process is burdensome for managers. On our side as well, we review multiple materials during the interview process. **We have been trying various approaches to reduce the burden.** In the past, we have considered whether it would be possible to reduce the burden by utilizing stewardship reports prepared by managers.

(*) A standardised reporting format from asset managers to asset owners, developed under the leadership of the Japan Stewardship Initiative, which is primarily composed of domestic asset managers.

- ✓ Although we do not contact the investee companies on specific matters, we confirm the content of dialogue, with asset management companies that engage in dialogue with investee companies. When individual misconduct incidents occur, we conduct interviews to confirm how each asset manager responded, taking into consideration the severity of the case.
- ✓ The active management we have outsourced is focused on the generation of excess returns (alpha). Investments are made in carefully selected companies, and engagement and proxy voting are conducted for a limited number of companies. Another group (within our organization) holds meetings regularly and as necessary to review the investment status. We meet with the asset management companies regarding stewardship activities a few times a year. We are careful to conduct these meetings in a way that does not affect their investment style.

(ii) Incentivisation

- ❑ As to incentivisation, several institutions provide feedback on the monitoring and evaluation results of stewardship activities individually. On the other hand, acknowledging the effects of engagement and providing additional fees for such activities has not yet become standard practice.

Incentivisation

- ✓ We evaluate stewardship activities each year based on what we have identified through monitoring and incorporate this into the comprehensive evaluation of the fund. Evaluation results of stewardship activities are **provided as individual feedback to the mandated asset managers**. In addition, we aim to enhance the effectiveness of the activities conducted by each mandated asset manager by sharing best practices and introducing cases identified through monitoring in reports.
- ✓ For passive management, we have used **enhanced engagement-type passive management** under a different fee structure from that of conventional passive management. The reason for adopting a different fee structure is that it is considered a compensation for the benefit received. Asset managers are asked to commit to setting the medium- to long-term engagement goals, annual plans to achieve those goals, engagement structures and methods, and to report regularly on the achievement status. Some asset management companies evaluate the effects of engagement in collaboration with internal or external parties.
- ✓ Recently contracted asset managers seem to have incorporated fees related to stewardship activities into their fee tables. For asset managers with existing contracts, fees have not increased after the enactment of the Stewardship Code, potentially placing a financial burden on these asset managers. While praising excellent engagement could serve as an incentive, there is often uncertainty about the extent to which asset managers' engagement activities should be anonymised, and therefore we describe them in stewardship activities reports to the extent that anonymity can be maintained to the extent possible.
- ✓ In meetings, we provide positive feedbacks for positive initiatives. Asset management companies that provide well-considered explanations based on our prior questions, rather than presenting voluminous materials, are perceived that they are taking necessary measures after careful consideration. These asset management companies are perceived to have well-integrated proxy voting and engagement in their investment policies.
- ✓ For active investment, the results of stewardship activities are ultimately realised in investment returns and, therefore, incentive for stewardship activities alone is not necessary. (Expected) excess returns for risks resulting from company research that includes stewardship activities are evaluated, and fees are paid accordingly.

(iii) Awareness of issues

- ❑ As for awareness of issues, several asset owners expressed concerns about the burden of stewardship activities and emphasised the importance of dialogue with asset managers. Some institutions implement collaborative monitoring and work to efficiently and effectively monitor stewardship activities.

Awareness of issues

- ✓ There is ambiguity at the national level regarding the scope and content of engagement that mandated asset managers should undertake, resulting in a heavy burden on them. Discussion from a holistic perspective should be held regarding the roles and scope of activities that asset owners and mandated asset managers should fulfil, including considerations of corporate governance structures. We monitor the stewardship activities of mandated asset managers annually and, **based on exchanges of views with them, work to reduce burdens by using “smart formats” and carefully selecting the items we request in reports.**
- ✓ We believe that **having each asset owner bear costs proportionate to the benefits** is essential for improving market sustainability through increased corporate value of companies subject to engagement.
- ✓ With the enactment of the Stewardship Code and quality engagements by asset managers with companies, **it is not desirable for asset owners’ monitoring and incentive structures toward asset managers to remain superficial.** It is recognised that it is an urgent task for asset owners to establish a framework that enables effective dialogue with asset managers.
- ✓ Companies are undertaking many initiatives to enhance corporate value, and it is believed that encouragement from investors can further support these efforts. While there are many critical issues that can serve as decision-making perspectives for management, rather than breaking them down into smaller components, the focus is on **asking, at a high-level perspective, whether such initiatives contribute to better management from the perspective of enhancing corporate value**, and this is believed to lead to the substantive implementation of stewardship activities.
- ✓ Among asset owners, the proportion of stocks held by corporate pension funds is extremely low. Although the proportion of shareholding is not considered in stewardship activities, the expected impact is very limited while the associated costs are enormous. Thus, it is not realistic for corporate pension funds to conduct these activities. Therefore, a collaborative monitoring framework has been launched and is scheduled to operate from this summer. Collaborative monitoring is an initiative to enhance the substance of stewardship activities, and it is hoped that the Stewardship Code will explicitly state the role of such collaborative monitoring.

Specific examples of asset owners monitoring and incentivising the asset managers

GPIF “Enhanced Engagement-type Passive”

- ❑ With the aim of lifting the market overall through stewardship activities and diversifying and strengthening the approaches of stewardship activities, GPIF has adopted a passive investment model that places emphasis on stewardship (“**Enhanced Engagement-type Passive**”), which is based on a fee scheme different from ordinary passive investments.
- ❑ Each selected firm conducts engagement suited to its situation, including filtering companies with significant index impact to efficiently increase β and active involvement by top management.

Characteristics of engagement under the “Enhanced Engagement-type Passive” funds

Asset Management One Started in 2018	✓ In April 2024, research and engagement functions were integrated, combining the expertise of sector analysts and ESG analysts. ✓ ESG analysts and proxy voting staff with over 20 years of practical investment experience collaborate with fund managers and analysts to engage on 18 ESG issues. ✓ This brings to light corporate awareness of issues and contributes to enhancing the corporate value of investee companies.
FIL Investments (Japan) Started in 2018	✓ It aims to efficiently increase β by leveraging insights from analysts of active investments and drive transformation in companies with significant index impact. ✓ Engagement topics are identified from the perspective of corporate value creation, aiming to improve profitability and growth by strengthening corporate competitiveness.
Sumitomo Mitsui Trust Asset Management Started in 2021	✓ A multi-engagement model in which top management (e.g., chairpersons and presidents) actively participate in engagement. ✓ A fusion of a top-down approach based on ESG materiality and a bottom-up approach from a business perspective. ✓ Additionally, by leveraging policy engagement, it seeks to maximise engagement effectiveness and lead to an increase in corporate value.
Resona Asset Management Started in 2021	✓ Engagement based on integrated reporting analysis using AI. ✓ Aims to enhance the corporate value of investee companies by promoting disclosure and improving the quality of integrated reports as an intermediate goal and trigger. ✓ Currently, the analysis scope has expanded to include securities reports, and has developed into TCFD analysis.

Specific examples of asset owners monitoring and incentivising the asset managers

GPIF “Evaluation Project on the effects of engagement”

- Using records of 26,792 engagement sessions covering a total of 48,077 topics conducted by 21 domestic equity investment funds entrusted by GPIF from FY2017 to FY2022 (for FY2022, up to the end of December; hereinafter the same) and a variety of indicators (including financial and stock price indicators, ESG scores, and specific ESG indicators such as GHG emissions and the ratio of female officers), an empirical analysis was conducted using statistical causal inference methods to examine what kind of changes in various indicators (KPIs) have been brought about by engagement.



Purpose of “Evaluation Project on the effects of engagement” - Verification of β Improvement -

Illustration of engagement effects

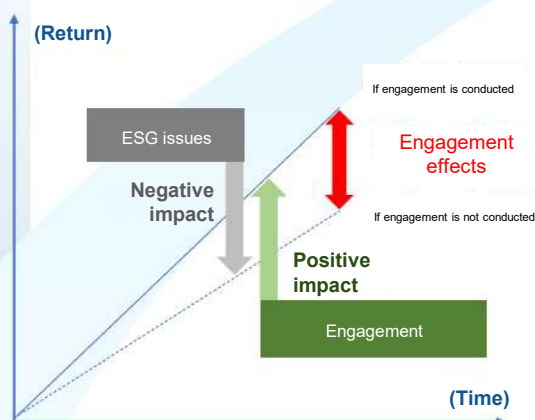
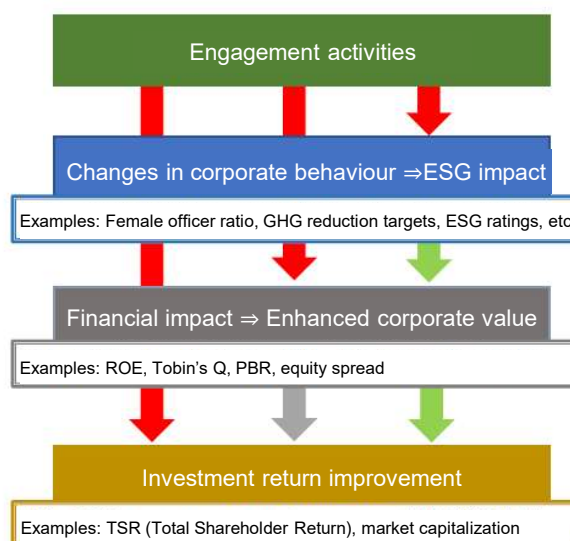
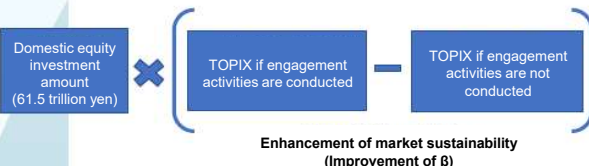


Illustration of how engagement leads to improved investment returns



[Results of the initiative]

- ✓ In dialogue on climate change, improvements were observed in corporate value indicators such as PBR and Tobin's Q, along with an increase in setting decarbonization targets directly linked to engagement content.
- ✓ In dialogue concerning board composition and evaluation, improvements were observed in investment return indicators such as market capitalization and returns including dividends, alongside an increase in the number of independent directors, demonstrating that engagement contributes to the sustainable growth of the market.



(Source) Prepared by the Financial Services Agency from GPIF presentation materials at the 1st meeting of the Expert Panel on the Stewardship Code

The effects of engagement are being communicated from the asset owner side, leading to increased motivation for action by asset managers.

Specific examples of asset owners monitoring and incentivising the asset managers

Corporate Pension Funds Stewardship Initiative “Collaborative Monitoring”

- ❑ Collaborative monitoring is an initiative where corporate pensions jointly monitor the stewardship activities of asset managers, as required to asset owners under the Stewardship Code. It requires acting responsibly as responsible institutional investors to support the sustainable growth of investee companies and aims to **implement efficient and effective monitoring** of such activities.
- ❑ The Corporate Pension Funds Stewardship Initiative asks all asset managers entrusted with domestic equity investments by corporate pensions to participate and cooperate in collaborative monitoring and clarifies that participation and cooperation in collaborative monitoring implemented by the Initiative do not exempt asset managers from providing individual reports or explanations to their client corporate pensions.

Objectives

Specific aims

Efficiency and substantive implementation

- ✓ The aim is to efficiently and effectively conduct the monitoring of stewardship activities by asset managers, as required to asset owners under the Stewardship Code, and to enhance the substance of such stewardship activities.

Minimization of agency costs

- ✓ Corporate managers must improve corporate value and achieve sustainable growth to reward investors (shareholders), and to do so, it is important to establish systems and mechanisms that ensure managers act in the best interests of investors (shareholders) (establishment of governance system), which minimises agency costs.
- ✓ By collaboratively monitoring the stewardship activities of asset managers, a healthy tension can be maintained with asset managers as the trustees, which is expected to help minimise agency costs.

Prevention of free-riders

- ✓ If free-riders are left unchecked, asset managers who incur costs to conduct stewardship activities may disappear, and this would make it impossible for corporate pensions to fulfil their stewardship responsibilities.
- ✓ To prevent free-riding, collaborative monitoring is implemented for all asset managers entrusted with domestic equity investments by corporate pension funds.

Engagement between asset owners and asset managers (1/2)

Opinions from both sides

- ❑ Many asset managers particularly referred to the fee levels for passive funds and the burden of reporting stewardship activities.
- ❑ On the other hand, while asset owners recognise this burden, they expressed cautious views about reflecting it into fees.
- ❑ There is a need to continue constructive dialogue between asset owners and asset managers, and to explore the effective and efficient monitoring methods that also take into account the burden on asset managers in preparing materials for asset owners.

Opinions from asset managers toward asset owners

- **Many asset managers commented on the paperwork burden and the discussion surrounding fees for stewardship activities.**
- ✓ Fundamentally, this stems from the difficulty in measuring the outcomes of stewardship efforts.
- ✓ Attention on low fee rates for passive investments has increased since engagement activities began, resulting in a cost-first structure.
- ✓ It is hoped the clients will understand this in terms of fees.
- ✓ It is hoped that awareness of cost sharing will grow.
- ✓ An increase in questions from asset owners outside of standard formats is hindering genuine stewardship activities.



Opinions from asset owners towards asset managers

- **While asset owners recognise the burden on asset managers, they hesitate to immediately offer incentives in terms of fees.**
- ✓ We are aware of the increasing burden on each firm, but requests for immediate fee increases have not been made.
- ✓ There remains ambiguity about the content and scope of engagement expected, which may be leading to an increasing burden on mandated asset managers each year.
- ✓ Going forward, this may be something to keep in mind when contracting with new asset management companies.
- ✓ As discussions around the substance progress, it is not desirable for asset owners' monitoring and incentive structures toward asset managers to remain superficial.

Opinions from asset managers toward asset owners (details)

Reporting

- Reporting now includes content of **questions beyond standard formats**, and responding to these requests has become extremely costly, requiring some form of ingenuity or measures.
- **The reporting formats have become more specific and detailed**, with requests for **explanations on individual topics** such as human capital and human rights, and this has led to a checkbox-style response. This likely **stems from the fundamental challenge of difficulty in measuring the outcomes of stewardship activities**. However, if too much emphasis is placed on results, there is a risk that only short-term outcomes will be pursued, which is problematic.

Cost burden of stewardship activities

- At our firm, we accommodate all engagement that we can within our capacity and are making considerable efforts with corresponding costs, but for passive funds with a low fee rate, there are limits to what we can handle. Attention on low fee rates for passive investments has increased since engagement activities began, resulting in a cost-first structure. Even in passive investment, client expectations for engagement are increasing, and there is a rise in dialogue requests from companies, and we hope clients will **understand the need for appropriate fees**.
- In the case of enhanced engagement-type passive activities, the volume of activity has increased in response to growing requirements from asset owners, so we have encouraged other asset owners to provide similar compensation. However, except for GPIF, while engagement activities have been appreciated, it has not been possible to receive compensation commensurate with the engagement efforts. We hope that going forward, asset owners will come to **recognise the need to compensate asset managers for the engagement activities they undertake**.
- The number of dialogues in Japan has also grown from 500 to 1,600 cases. Requests for disclosure from clients have increased accordingly, and we handle these individually; however, even though these tasks have increased, fees have remained unchanged. Clearly, this has become a situation where asset managers are bearing the cost, and while the Asset Owner Principles now include wording about bearing costs in accordance with added value, **we hope awareness of cost-sharing will grow**.

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III Compliance with Japan's Stewardship Code by proxy advisors (Principle 8)

IV Opinions on policies of the FSA and TSE

- Many large institutional investors keep track of the progress of engagement in a timely manner and centrally manage and share engagement stages. While utilising proprietary tools, they often conduct in-depth research and analysis of target companies and reflect them in discussion papers for engagement meetings.

Stage management

- Stage management** for companies subject to engagement **is centrally handled**. Records of engagements are kept, with Stage 1 marked when an issue is identified, Stage 2 when the issue is presented to the company, and Stage 3 when the issue is shared with the responsible person. If company action progresses, it leads to implementation of measures and resolution of the issue. If our set goals cannot be confirmed through the company's disclosures, we consider it the investor's role to express our concerns as investor and encourage the company to move toward transformation.

Enhancing the content of discussion papers

- Engagement is conducted while showing the company the content of the tool. We prepare it with our proprietary "**Cost of Capital GAP Model**," which is used by our quantitative investment team to calculate theoretical stock prices. This model was researched and developed in collaboration with MTEC, our subsidiary investment engineering research institute. In addition to calculating theoretical stock prices, the model analyses the causes for discrepancies with market prices by categorizing the causes into financial, non-financial, and growth factors.
- We **analyse integrated reports using AI**. When integrated reports are quantified, a normal distribution can be drawn. To make the numerical information easily understandable for companies, we provide companies with an overall evaluation in the form of deviation values. Our system is a proprietary analysis system that performs evaluation from an investor's perspective, not a commercially available integrated report analysis system.
- As tools to enhance the effectiveness of engagement, we believe **discussion papers are essential**. Although last-minute preparations sometimes occur, we still convey discussion themes in advance and arrange meetings with the appropriate personnel according to the themes. One of our key practices with discussion papers is documenting past engagement content and reviewing the progress since the previous engagement every time.
- Engagement tools are shared with companies in advance. Specifically, we send a **discussion paper summarizing the issues and action plans** and use it as the basis for discussions.

Investors

Companies

Engagement in practice

■ Engagement from the investor's perspective ... p.18

■ Examples where dialogue developed into constructive engagement

- (i) Dialogue with global top companies ... p.19
- (ii) Disclosure of business portfolio management ... p.20
- (iii) Utilisation of global investor networks ... p.21
- (iv) Practice of dialogue by long-term active funds ... p.22
- (v) Response to corporate culture transformation ... p.23

■ Cases where dialogue did not develop into constructive engagement ... p.24

- The purpose of the dialogue is limited to improving disclosure or confirming voting standards.
- Poor coordination between the company's SR and IR personnel results in overlapping content.
- Dialogue itself has become the goal.

■ Engagement from the company's perspective ... p.25

■ Cases where dialogue developed into constructive engagement ... p.26, 27

- Based on thorough research on the company, precise proposals and advice on potential improvements are provided from the medium- to long-term perspective.
- During dialogue, investors provide their extensive analytical results.

■ Cases where dialogue did not develop into constructive engagement ... p.28, 29

- Only interested in short-term figures.
- Pursues only the short-term profits of their own fund.
- Attempts to extract undisclosable information.
- Focuses only on asking detailed questions about immediate performance to the CEO or CFO.
- Asks questions out of a sense of obligation for reporting to asset owners.

Individual topics

■ Dialogue with independent directors from the investor's perspective ... p.33

- Although requests for dialogue are numerous, some have pointed out that setting an appropriate agenda is crucial.

■ Efforts by small and mid-cap companies ... p.35

- Although potential is recognised, there are concerns about cost balance and the difficulty of discovering.

■ Collaborative engagement ... p.37, 38

- While recognising the advantages, the importance of agenda setting, to ensure meaningful dialogue is pointed out.
- While pointing out avoidance of free-riding and superficial themes, there are opinions that this should be considered as an option.

■ Need for enhanced disclosure by investors ... p.39

■ Dialogue with independent directors from the company's perspective ... p.32

- While there are signs of positive consideration, there are concerns about excessive expectations.

■ Efforts by small and mid-cap companies ... p.34

- Voices from small and mid-cap companies emphasise the importance of enhanced disclosure and active outreach to investors.

■ Collaborative engagement ... p.36

- While efficiency is expected, concerns and the importance of agendas are pointed out.

**Engagement considered meaningful and engagement considered less meaningful
from the investor's perspective**

- ❑ Many asset managers aim for the medium- to long-term partnership-based engagement rooted in trust with companies, assuming that companies themselves are striving for transformation. However, continuing such substantive engagement requires considerable resources and cost.
- ❑ Formalistic engagement occurs not necessarily due only to the investor's circumstances; sometimes it arises from the company's side, such as when dialogue is held solely to meet short-term voting standards.
- ❑ In sustainability-related dialogue, it is also important for investors to sufficiently analyse the connectivity between a company's related initiatives and its enhancement of corporate value.

Engagement from the investor's perspective

**Dialogue
that is
deemed
meaningful**

- When a company is strongly motivated to transform itself, engaging in deep dialogue often leads to more meaningful engagement.
- While presenting various examples of other companies, we receive requests for feedback or more details on particularly relevant cases, and an increasing number of companies are demonstrating a very proactive and forward-looking attitude.
- Unless discussions reach a significant depth, companies cannot transform themselves or have a meaningful impact on corporate value, and for such deep engagement, a strong foundation of "trust" and access to information is essential. It is unrealistic to expect all investors to uniformly conduct deep dialogue that directly impacts corporate value.
- It is important to approach engagement after analysing the connectivity that if a company conducts sustainability-related initiatives, the return will increase in the medium to long term.

**Dialogue
that is
deemed
less
meaningful**

- Engagements that are still conducted as checkbox exercises are acknowledged by investors to exist. However, this is not unique to Japan and is considered a global trend.
- There are investors for whom meeting an independent director becomes the purpose of engagement itself. Multiple companies have reported that investors have demanded meetings with independent directors without any agenda, which has caused confusion.
- At times, investee companies request dialogue solely to understand "how to meet the voting criteria," which does not constitute constructive dialogue.
- For ESG engagements, discussions sometimes focus only on formalities, such as current GHG emissions and target levels by 2050. Unless a hypothesis is communicated as to how overcoming this hurdle will lead to corporate value creation, companies may find it unconvincing.

Having a common understanding and solving problems through constructive dialogue (Principle 4)

Case study (i): Dialogue is conducted with a global top-tier company by presenting a comparison with a U.S. company serving as a role model, focusing on carefully selected themes.

Status of the target company and engagement topics

- Company E was a major investee, with clear managerial challenges, and it was necessary to proactively encourage improvement in management. With changes in the top management, it was determined that engagement would serve as a catalyst for addressing the issues.
- As for the external environment, the enactment of the Corporate Governance Code in 2015 and other initiatives were gaining momentum, and there was a rising trend in the rate of votes against the appointment of Company E's top management.
- Considering these specific issues and changes in both the company and external environment, the decision was made to actively engage with Company E.



Details and outcomes of engagement

- A comparison with a global company was presented. Company E is considered an excellent company and was reportedly working to improve its management by **modelling itself after XX, a U.S. company**; therefore, instead of general discussions, **a comparison with that company was presented**. The engagement began by showing comparative data such as ROE, financial leverage, and ESG-related disclosure to help the company recognise the issues.
- Dialogue is conducted **with the responsible executives and senior management on selected topics such as intellectual property, R&D, and human capital, to convey the perspectives of shareholders and investors**.
- As the **investor perspective was not sufficiently reflected** in the company's recognition of its management foundation, we requested that **Company E communicate its strengths and their sources to stakeholders**. Regarding human capital, discussions were held on **desirable disclosure content that reflects the perspectives of shareholders and investors**.
- ✓ The company began reducing excess cash and significantly improved ESG disclosures.

- Company H is a comprehensive materials manufacturer with strengths in infrastructure-related businesses in certain business field and high-value-added products.
- In a certain year, the company began managing with a focus on improving Return on Invested Capital (ROIC), which led to better performance; however, the company presented an **optimistic management plan implying growth in all business segments** which raised concerns in the market about the sustainability of ROIC improvement, and Price-to-Book Ratio (PBR) remained below 1.
- In light of the Tokyo Stock Exchange's request for "action to implement management that is conscious of cost of capital and stock price," we determined that engagement on **business portfolio management issues** could lead to significant improvement.

- To address the issue, we communicated the need for appropriate business portfolio management, including **clarifying the strategic positioning of each business**, especially showing specific investment and return (contribution to profit) outlooks for growth segments.
- **We provided analytical materials that categorised businesses** based on profitability and market growth potential, such as positioning the decarbonization business as a "growth-driving business" with high profitability and significant expected market growth.
- ✓ The analytical materials on business portfolio management proposed during the engagement were **adopted in Company H's disclosure documents** related to "management that is conscious of cost of capital and stock price." In the disclosure material, the company illustrated how new investments in growth-driving businesses and products would contribute to profits in stages and showed a proactive stance in allocating cash generated from operating cash flows and sale of cross-shareholdings toward growth investment and shareholder returns. This led to increased investor appreciation.
- ✓ The case was **included in the Tokyo Stock Exchange's case studies** related to the aforementioned request published in February 2024. The company has been recognised for its steady transformation, as evidenced by its longstanding promotion of ROIC-focused management, the upward revision of the targets in its medium-term management plan based on progress, and company-wide efforts to instil ROIC management, including internal communications through the company newsletter.

- Company W is a regional company and a **listed subsidiary** that holds a dominant market share in its local area. It was incorporated jointly by a top-tier national company and a local operating company, providing regionally specialised services.
- Local loyalty toward the company is very high, supporting its strong market share, and the company has established a structure to maintain profitability in high-cost areas due to its extremely low cancellation rate. While this also contributes to its cash-generating capability, how to utilise the **surplus cash was an issue**.
- From a long-term investor perspective, surplus cash should be allocated to growth investments or shareholder returns and the need for engagement on this point with top management, was recognised over the past several years.



- As a result of engagement efforts that led to a certain level of mutual understanding regarding the use of cash, Company W conducted its first-ever share buyback in a given year.
- Following continued engagement with Company W, an escalation was undertaken. Specifically, we sent a letter to the company's board of directors, made a presentation outlining our views, and shared our approach to exercising voting rights.
- **We also sought cooperation from our global equity team based overseas, which conducted engagement with Company W's parent company.** Since one of the background issues was the CMS (Cash Management System), we determined that it was necessary to persuade the parent company as well and conducted engagement with both companies in a transparent manner.
- During the engagement, we advised the company to use the cash allocated to the CMS for growth investment or shareholder returns in order to improve ROE, and to disclose such plans to the market if implemented.
- In addition, to realise sustainability-oriented management, we proposed setting goals for securing and developing human resources as the foundation of DX business and suggested expanding disclosures on new DX initiatives and human capital through employee reskilling.
- ✓ The share buyback, implemented with the aim of improving shareholder returns and capital efficiency, partially resolved the deposits to the CMS. Subsequently, the medium-term management plan was disclosed, indicating that cash would be used for flexible share buybacks within the scope of capital allocation to enhance capital efficiency.
- ✓ As the growth story (a storyline leading to improved profitability), including the sustainability strategy, became clearly articulated along with expected improvements in asset efficiency, this led to a continued rise in stock price.

Having a common understanding and solving problems through constructive dialogue (Principle 4)

Case study (iv): As a long-term active engagement fund, building strong trust and realizing dialogue with healthy tension

- Company Z is a **small- to mid-cap trading company** based in the Kansai region, with a history of over 90 years. Before our investment, although the company had a certain earning power, it showed only modest sales growth, and a complacent atmosphere prevailed internally, with a **sense that such low growth was acceptable**.
- We pointed out that at that time (about ten years ago), the share price was around 1,000 yen, the market capitalization was slightly below 50 billion yen, the PBR of 1.0x, PER of approximately 12x, and the company held significant cash reserves, and it was at the level at which the company could be acquired at a relatively low price compared to its market capitalization. We also pointed out that unless the company increased its corporate value, it would become an easy target for short-term-minded activists and potential acquisition.
- At the time, the president had just taken the office of president over from the effective founder and was still exploring his management style, and our engagement came at the same time, and through repeated dialogue, **the company realised the need to gain a deeper understanding on enhancing corporate value**, which led to our investment.

- There were three phases of transformation. During Phase 1, over approximately one year, starting in a certain year, we engaged in intensive discussions. During Phase 2, the company incorporated those discussions into its medium-term management plan, disclosed the plan, and proceeded with its implementation. During Phase 3, after five years, a new medium-term management plan has been formulated and is under execution.
- In Phase 1, we conducted offsite training at our overseas office. The management team visited us several times and held intensive sessions in a closed environment. Initially, the president came alone and learned about **corporate finance** and the **investor's perspective**. At that time, the president was in his early forties and it had been approximately four years since he had succeeded the previous president.
- In Phase 2, the company drafted its first external-facing medium-term management plan, and considered rebuilding the business model (expanding market share in existing businesses), focusing on growth drivers (e-commerce and global expansion), capital policy (raising the dividend payout ratio from 30% to 50%), and designing employee incentive schemes.
- In Phase 3, we supported the formulation of the second medium-term management plan for the company, and as the president reached his 50s, he began to consider **succession** planning and Company Z sent a next-generation executive candidate to our overseas office for training. The candidate created a roadmap for tripling current sales and presented it to the president.
- ✓ Through this series of engagements, **corporate value has steadily improved over the long term**. The PBR has exceeded 3x, and PER has surpassed 25x, with significantly improved performance, and based on the trust built over time, we continue to engage in constructive dialogue with healthy tension.

- Company C was originally inward-looking, but due to a significant shift in the market environment that led to managerial deadlock, its management team decided to break away from this inward-looking orientation out of a sense of urgency.
- The current CEO, since taking office, has declared breaking away from the inward-looking orientation as his mission and has been working on “transformation away from a top-down culture.” This included promoting dialogue with stakeholders.
- When we invested in 2022, the company was undervalued with a PBR of approximately 0.1x.



- Company C was receptive to our engagement from the time of our investment and **actively sought our input**. Generally, during the first year following an investment, we had discussions with IR representatives and identified the right people to participate in engagement and facilitated interviews on issues of the company; however, **due to the company's proactive attitude towards engagement, this process was expediated and we were able to compile a proposal promptly**.
- Company C had formulated a medium-term management plan, but its KPIs and roadmap were unclear. We advised that without simultaneous improvement of both the PL and BS, the stock price might rise temporarily but could decline back to prior levels without being able to sustain the increase.
- We introduced past engagement examples and demonstrated what had worked to enhance corporate value at other companies. As a general tendency, Company C's sector has a strong sense of uniformity, and companies in the sector are highly conscious of their peers; therefore, we shared an example of engagement with peer Company N.
- Company C had an extremely high equity ratio, and we advised gradually lowering this ratio and investing in other areas. The company's disclosures did not disclose its high market share in the targeted area, so we recommended enhancing disclosure on this point and clarifying the growth roadmap.
- ✓ Through a series of engagements from the latter half of 2022 to spring 2023, Company C's stock price rose significantly after information disclosure in June 2023.
- ✓ The disclosure, which was particularly well received, presented Key Goal Indicators (KGI) as the long-term vision of the “desired future state,” set Key Performance Indicators (KPI) as intermediate milestones, and outlined specific initiatives toward achieving these goals in a way that clearly conveyed the overall picture.

Having a common understanding and solving problems through constructive dialogue (Principle 4)

Cases where dialogue did not develop into constructive engagement from the investor's perspective

<<Voices from investors>>

- There are voices that when the purpose of dialogue of the company is superficial, investors find it difficult to see meaningful value in engagement.

Did not develop

[Key points]

- The purpose of the dialogue is limited to improving disclosure or confirming voting standards.
- Poor coordination between the company's SR and IR personnel results in overlapping content.
- Dialogue itself has become the goal.

[Examples of requests from companies during engagement]

- ✓ Companies request for only a review of their integrated report.
- ✓ Companies seek support for the proposal and have a dialogue only on that matter.
- ✓ Companies just want to create a record of having conducted dialogue.

Examples of dialogue requested by companies that are superficial in nature

- Such engagement, limited to reviewing integrated reports or **focused solely on a specific issue** for the purpose of gaining support for a proposal, is perceived as formalistic and unproductive, unlikely to contribute to the enhancement of corporate value. Even if the goal is to improve evaluations of integrated reports or increase rates of voting for company proposals, if there are other themes for discussion and dialogue is expected to be meaningful, we may choose to engage in such dialogue.
- Corporate stances are becoming polarised. **Dialogue solely aimed at determining how to meet the standards for exercising voting rights is not constructive.** On the other hand, more companies are showing a highly proactive and forward-looking stance, for example, by providing feedback on useful examples or requesting more detailed explanations, while we present various examples of other companies.

There are cases where companies seem to be making the **act of dialogue itself the goal**, such as the number of dialogues with independent directors. Even if there is no dialogue with independent directors, if the company has presented a response plan, we may consider that outcomes have been achieved without dialogue. If corporate awareness changes, it may become possible to focus on issues where dialogue is truly necessary.

- If investors do not share information sufficiently between fund managers and those responsible for exercising voting rights, there is a risk of investors visiting companies for duplicate interviews, and similarly, on the corporate side, it is unfortunate that **there is insufficient coordination between departments and individuals**, such as that **IR personnel are unaware of the contents of meetings held by SR personnel**.
- Rather than genuine dialogue, companies sometimes seem to take a stance focused on responding to questions from investors and persuading them. It appears that some companies forget that the purpose of engagement is to hold dialogue. In recent years, although the number of engagement requests from companies has increased, in reality, many of them are **one-sided dialogue focusing on company explanations, persuasion, or confirming the content of voting criteria**.

- ❑ Companies view engagement as meaningful when investors do not seek only short-term financial indicators but engage in continuous, two-way dialogue based on a shared goal of medium- to long-term growth and value creation, reflecting deep understanding and insights into the company and clarifying expectations to the company. However, it was also pointed out that only a few investors are capable of genuine engagement.
- ❑ On the other hand, when investors do not show initiative such as asking mechanical questions based on checklists, and when the link between the question and corporate value is unclear, companies find little value in the dialogue.
- ❑ Multiple companies noted that disclosure is the starting point for dialogue with investors and the subsequent improvement of corporate value, emphasizing the need to enhance disclosure.

Dialogue perceived as meaningful

- Medium- to long-term perspectives and expectations as investors are clearly and directly communicated to management.
- Specific discussion topics are communicated in advance.
- Investor input reflects and evolves appropriately based on the company's growth stage.
- Enhanced and improved disclosure aligned with investors' perspectives facilitates two-way dialogue between companies and investors.
- By including KPIs such as cost of capital and ROIC in disclosures, companies are able to explain the causes of underperformance and future improvement prospects using common indicators with investors, making constructive dialogue possible.

Dialogue perceived as less meaningful

- In dialogue with top management, questions from investors focus solely on short-term perspectives, such as ROE for a single fiscal year or milestones for the next three months.
- Some investors treat ESG as a set of simple figures, and the engagement ends up being limited to checking numbers or whether KPIs are set, focusing on scoring or box-ticking.
- Feedback is limited to formalistic aspects, such as wording or presentation of the integrated report.
- Since questions are not submitted in advance, company representatives cannot adequately prepare, resulting in insufficient responses during the dialogue.
- Some engagement is conducted merely out of a sense of obligation to asset owners, lacking prior research and resulting in irrelevant questions that do not reflect the company's actual circumstances.

- In cases where investors made proposals from a “medium- to long-term perspective,” companies reported that they were able to engage in in-depth discussions about their growth strategies, which they found beneficial.

Constructive

[Key points]

- Precise proposals and advice on potential improvements are provided from a medium- to long-term perspective, based on thorough research of the company.

[Image of actual engagement]

- ✓ Given your current situation, wouldn't it be appropriate to engage in deeper discussion to this extent?

Examples of medium- to long-term dialogue

- The **quality of engagement** is perceived to vary depending (not on the investor but) on the company's stage. During the stage when the company was perceived to be undergoing portfolio reform, even if ROIC was introduced as a KPI, there were few questions from investors regarding capital efficiency. Once the capital market recognised that the company was entering a growth phase, investor questions diversified, leading to improvement in the quality of discussions.
- When the management plan illustrating the company's 2030 vision was announced, a long-term investor asked, “How much input have you received from the management talent expected to be active in 2030?” In response to this question, the president launched a project to gather employees in their 20s and 30s from each division, and their discussions were reflected in the 2030 management plan announced this spring.
- One long-term investor repeatedly raised questions about the company's **equity story**, its views on industry consolidation, expressed a desire for the company to take a leading role in the industry, and urged the company to **utilise equity in ways that contribute to medium- to long-term growth**, and discussions often revolve around the equity story. Such input is recognised as valuable.

- In cases where “input” is well prepared from an investor’s perspective, including preparation of materials, there is feedback that such engagement leads to two-way dialogue between the company and the investor and is valuable.

Constructive

[Key points]

- The materials provided by investors during the dialogue are rich in input information.

[Image of actual engagement]

- ✓ We have brought analysis and simulations of your company for this discussion.

Example of dialogue with substantial input from the investor's perspective

- Meaningful engagement is **two-way**, and it is extremely beneficial when detailed input based on our company’s situation is provided. One investor prepares a PPT material of about 30 slides in advance of engagement discussions.

This material includes scores and feedback on our ESG disclosures and impressions of our integrated report, providing input based on such materials. Investors capable of two-way communication, including IR interactions, tend to conduct **detailed prior research** on our company, making the **discussions highly substantive**.

- One investor stands out for their logistical approach. Specifically, they send a discussion paper around two days or one day before the engagement meeting with us. The document is about 5–6 pages long and the **scope of the discussion is clearly defined and limited**, such as “Progress of the X business in the U.S.”

Because the discussion themes are clearly defined, we are able to prepare in depth ahead of time. We find this investor’s approach to engagement highly meaningful. **Among roughly 600 institutional investors, only one or two** send such discussion papers in advance in our experience.

- One investor regularly visits our company and actively offers various proposals regarding our business strategies. In addition, the investor holds **study sessions on corporate finance**, during which we have meaningful discussions that serve as valuable input for developing our business strategies.

Cases where dialogue did not develop into constructive engagement from the company's perspective (1/2)

- There are cases where engagement is dominated by questions based on a “short-term mindset” from investors, who ask only what they want to know and attempt to conclude the meeting quickly; such cases are viewed by companies as not leading to constructive dialogue.

Did not develop

[Key points]

- Only interested in short-term figures.
- Pursues only the short-term profits of their own fund.
- Attempts to extract undisclosed information.

[Examples of actual engagement]

- ✓ Are you planning a share buyback or dividend increase?
- ✓ Are your recent business results in line with forecasts? Is there an upside?

Examples of dialogue that consist entirely of questions based on short-term mindset

- Engagement with relatively short-term-oriented investors tends to result **only in proposals and discussions focused on short-term gains**, and we feel that discussions aimed at enhancing our medium- to long-term corporate value are not being conducted. Therefore, we do not consider such engagement to be desirable for us.

Recently, **more investors have become conscious of long-term macro trends** such as the energy transition and increased demand for data centres, and questions from such investors are long-term in nature, offering insights with a view to the next 5 to 10 years, which we find highly valuable. While we occasionally receive suggestions from a short-term perspective, it is difficult for us to reflect such input in our management, given that an increasing proportion of our businesses are long-term in nature.

- Engagement where investors take a short-term approach, **asking only the questions they want answered and attempting to conclude the meeting quickly**. Despite setting aside about an hour for such meetings, we have experienced cases where the discussion ended in only around 15 minutes. Although such dialogue is presented as fundamental inquiries, in reality, it tends to revolve exclusively around questions such as the current earnings status, whether results are in line with guidance or if there is any upside, and whether a dividend increase is planned.

Engagement with hedge funds tends to be characterised by short-term-focused questions, and we feel **they show little interest in our capital efficiency**.

Cases where dialogue did not develop into constructive engagement from the company's perspective (2/2)

- There are opinions that, where an agenda is not tailored to the specific “dialogue counterpart,” such as CEO, independent directors, or IR representatives, constructive dialogue is not achieved. In addition, when questions are asked merely out of a sense of obligation to report to asset owners, and lack continuity, they come across as abrupt and disconnected to the company.

Did not develop

[Key points]

- The CEO or CFO is asked only detailed questions about short-term performance.
- Questions are asked merely out of a sense of obligation to report to asset owners.

[Examples of actual engagement]

- ✓ Please explain annual ROE or ROIC, or the details of milestones three months ahead (even though such information is already disclosed or explained in earnings briefings)
- ✓ Sudden requests, such as please tell us about your human rights policy.

Examples of questions that could be improved

- We want investors to tailor their questions to the dialogue counterpart. For **management members, we hope to receive questions that bring out discussion on medium- to long-term strategies**, rather than short-term indicators that could be answered by IR personnel. We would like investors to avoid asking the same types of questions to both management and IR personnel.

With investors who tailor their conversations to the counterpart, we have been able to engage in truly constructive discussions and believe both sides benefit greatly. **If investors communicate their requests to top management, those voices can be recognised as investor feedback by top management**, and rather than asking about the timing of disclosure of short-term milestones (something IR could answer), we believe that offering perspectives on our business or management from the capital market viewpoint would lead to more constructive discussions.

In Japan, **we have recently seen an increase in investors who are able to engage in constructive discussions tailored to the dialogue counterpart**, such as CEO and CFO. On the other hand, when foreign investors meet with our management, they tend to focus solely on questions regarding indicators.

- Engagements that are conducted **merely out of a sense of obligation** to the providers of capital, so-called **asset owners**, and are purely formalistic in nature are not desirable. Such engagement often **lacks sufficient prior research on our company**, leading to off-the-mark questions that **do not reflect our actual circumstances**.

- ❑ Given the continued presence of some engagements that remain merely at the level of information gathering, many companies commonly express the view that they wish institutional investors would engage in more meaningful dialogue from a medium- to long-term perspective, contributing to the enhancement of corporate value.
- ❑ Some companies expressed the view that dialogue should be two-way, and that companies themselves should not hesitate to ask questions or raise objections. Advanced companies are proactively utilizing opportunities for engagement, not only ensuring a certain volume of dialogue to maintain overall quality, but also selectively contacting investors who are particularly beneficial to them.
- ❑ Many companies pointed out that enhancing disclosure is a prerequisite for creating opportunities for dialogue and improving its quality.

Toward improving engagement

Efforts by company

- Some companies are listing domestic and international investors who provide valuable input, along with their characteristics, and approaching investors appropriate for each topic when they seek opinions on specific issues.
- If dialogue is infrequent, there is a risk that the biased opinions of certain investors will be perceived as the primary voice. By increasing the dialogue, this risk is reduced, and the quality of opinions is ensured.
- Companies are focusing on how to effectively communicate both financial and non-financial information in relation to corporate value.
- When investors say that disclosure materials are difficult to understand, we make efforts to improve them by asking what specifically is unclear, requesting examples from other companies, and then holding internal discussions.

Advice to other companies

- Disclosure should be enhanced. Unless a company is attractive as an investee company to begin with, investors will not engage even if approached by the company.
- By understanding how investors think, companies can gain valuable insights, and companies should make efforts to understand what investors are thinking.
- Companies should also ask questions to investors, making the dialogue more interactive and deepening the engagement and the relationship.
- Companies should meet with institutional investors especially when performance is poor. Investors are looking for a recovery story when performance is down.

Requests to investors

- Most engagements with institutional investors tend to serve as interviews or information-gathering opportunities to fill in each investor's revenue model or spreadsheet.
- We feel that there are not many instances where the dialogue is truly aimed at enhancing corporate value or shareholder value. Companies should return to the original philosophy of the capital markets and increase engagement that focuses on how companies can enhance their corporate value over the medium- to long-term.
- When investors offer criticism of a company, they should clearly explain the specific points they would like to see improved. Without specific reasons as to, for example, how disclosure is difficult to understand compared to other companies, it is not possible for the company to take action for improvement.

Having a common understanding and solving problems through constructive dialogue (Principle 4)

Specific discussions: For independent directors, small and mid-cap companies, and collaborative engagement

- ❑ Engagement with independent directors is being positively considered by companies. On the other hand, there are concerns that the act of engaging with independent directors is becoming an end in itself, and it is crucial to set agenda that is appropriate for discussion with independent directors, rather than administrative matters such as for IR representatives.
- ❑ Small and mid-cap companies need to build ongoing relationships primarily between top management and investors, with disclosure as a starting point.
- ❑ Collaborative engagement is one option for engagement, but careful consideration must be given to matters such as the selection of themes.

Toward enhancing the quality of engagement	Opinions from companies	Independent directors	● If requested by investors, we may consider meetings with independent directors, but whether such meetings are held depends on the content of the agenda. ● In meetings, common questions include succession planning for the CEO and how the effectiveness of the company's board of directors is evaluated.
		For small and mid-cap companies	● Hiring people from the investment industry who understand how investors think may make it easier to facilitate dialogue. ● While it is common to go through intermediaries, contacting institutional investors directly can sometimes be effective.
		Collaborative engagement	● If an appropriate mutual understanding of the engagement theme can be established among investors participating in collaborative engagement, efficient engagement may be possible. ● Facing multiple investors at once can raise concerns about whether a unified discussion can be achieved.
	Opinions from institutional investors	Independent directors	● Few companies disclose in detail the roles played by their independent directors. Even during dialogue with independent directors, it is often difficult to align perspectives with institutional investors. ● In times of corporate scandals or other crises, the effectiveness of independent directors' monitoring functions is a key factor in determining their real value.
		For small and mid-cap companies	● An investor believes that focusing on small and mid-cap companies offers the potential for α, but identifying high-quality companies requires significant cost, and it is not feasible to cover all listed companies. There are many excellent companies, and it is difficult to determine how best to bring them into the spotlight.
		Collaborative engagement	● There are differences in the level of information held by each investor participating in collaborative engagement. When investment time horizons differ, it is difficult to consolidate the opinions of diverse investors. ● Setting the theme is the most important factor. Some themes are more suitable for collaborative engagement than others.

Dialogue with independent directors from the company's perspective

- An increasing number of companies are positively considering engagement with independent directors. On the other hand, some voices suggest that investors may have excessive expectations for dialogue with independent directors.

Dialogue with independent directors

- Efforts are being made on engagement between investors and independent directors. It is considered desirable to appoint **independent directors with IR experience**. Mr. A, who previously served as one of our independent directors and had experience as an executive officer as well as manager of public relations, IR, and sustainability promotion departments at a general trading company listed on the Prime Market, engaged with investors after gaining a deep understanding of our business and challenges. We even had Mr. A hold one-on-one meetings with active funds invested in our company, and we believe he was truly well-suited for the role of independent director.

- **When there is a lack of engagement or misalignment of expectations between companies and investors, investors may feel compelled to ask directly whether the independent directors are truly functioning.** As we are a listed subsidiary, we understand that investors may want to directly ask whether independent directors are functioning as representatives of minority shareholders. However, this fiscal year, our IR team made efforts to follow up with investors on their questions, and we included an article in our integrated report detailing how our independent directors view the parent-subsidary listing structure. These actions seemed to provide a certain level of satisfaction to investors, and no investors requested meetings with independent directors. Accordingly, we have not had any actual engagement between independent directors and investors, but we are open to considering it if requested, depending on the agenda and scheduling.

At the same time, there is concern that **investor expectations for independent directors may be excessive**. Even when the supervisory and executive functions are separated, in reality, the supervisory side might not be provided with sufficient information or might not be able to gather necessary information (because they often lack the time and are unable to act proactively); however, it sometimes feels as though investors take it for granted that independent directors have a deep understanding of the company, just like the executive side.

- One institutional investor **asked questions directly to an independent director as a shareholder at a general shareholders' meeting**. Specifically, with respect to involvement and monitoring by independent directors in appointment of the representative director and formulation of the medium-term management plan, the investor asked when discussions began in the Nomination and Compensation Advisory Committee, as well as what kind of advice the independent directors had provided. Before then, most of the attendees had been local shareholders who were former employees, and they tended to quietly observe the meeting, so questions were rarely raised.

The investor may have believed that, because the general shareholders' meeting included internal directors, executive officers, staff, and employee shareholders, **this would exert more pressure on the independent directors** than in a prior dialogue setting. When discussions take place in a closed setting, there is a possibility that, even if a report is provided afterward, the stakeholders may not take it seriously. Furthermore, we believe it also had the effect of making those around them more aware of the role of independent directors.

Dialogue with independent directors from the investor's perspective

- There are many voices from investors expressing a desire for independent directors to engage in dialogue. At the same time, both companies and investors have pointed out that setting appropriate agenda for such discussions is crucial.

Dialogue with independent directors

- Since independent directors also represent investors, it is desirable that they speak as investors' proxies at board meetings. However, we believe that there are still too few companies that describe the **effectiveness of such roles of independent directors** in the governance sections of their integrated reports, and even during dialogue between independent directors and us investors, it is often difficult to align perspectives. We believe this is an **issue where mutual understanding should be deepened through disclosure and dialogue**.

In one case involving an investee company that had received a shareholder proposal from an investor, we held a one-on-one dialogue with an independent director to discuss whether the monitoring of the management strategy was functioning properly. They gave a clear explanation that effective monitoring was being carried out. We believe it is especially important to have **mechanisms for monitoring and information gathering during times of crisis, such as when misconduct is revealed**.

- We would like independent directors to actively participate in dialogue. In the past, at one company, when we requested a meeting with an independent director, we were told that it would be difficult to treat a specific institutional investor as a special case, and the meeting with an independent director never occurred.

Regarding dialogue with independent directors, we believe there are cases where the **boards' secretariat feels reluctance** (including psychological resistance to letting independent directors speak), and this mindset of companies needs to change. Although occasions of small meetings attended by independent directors are increasing, such resistance still seems stronger at smaller companies.

- One concern we often hear from Japanese executives is **"let us meet with your independent director"** issue. Asset owners have started to care about how often asset managers meet with independent directors. This may be partly because we, the asset managers, convey to asset owners the benefits of engaging with independent directors and recommend doing so, but we have heard from multiple companies that they are troubled by being asked to arrange meetings with independent directors even when there is no agenda.

If the **investor is trustworthy, has an appropriate agenda, and expresses a desire to meet with independent directors, then companies should proactively accommodate such requests**; however, if there is no agenda and the investor merely delivers one-sided and rigid criticism from a condescending position (such as stating that "diversity is lacking") the engagement benefits no one.

For example, we sometimes observe the Q&A sessions of other investors in small meetings with independent directors, and we often see situations where investors unilaterally point out issues, such as company performance or scandals, based on their own proxy voting criteria, **without being receptive to the explanations provided by the independent directors**. If such dialogue does not lead to constructive discussions or is not used for voting decisions, companies may be reluctant to arrange dialogue with independent directors.

Voices from companies: Efforts by small and mid-cap companies

- Regarding engagement with small and mid-cap companies, companies of similar size have pointed out the importance of enhanced disclosure and proactive communication from companies to investors.

Efforts by small and mid-cap companies

- It is especially important for small and mid-cap companies to ensure thorough **disclosure**.
- We are committed to **disclosing information** that deepens investor understanding and **makes IR meetings more productive**.
- There are opportunities such as investor matching events**, and when we encounter investors who are on the same wavelength with, we proactively reach out to them. We also consider leveraging referrals from people in the industry as a potential approach. Even if it requires paying a slight premium in compensation, **hiring individuals who understand how investors think** may be beneficial for companies.
- When we were listed on JASDAQ in the past, our market capitalization and liquidity were low, so securities firms did not act as intermediaries to connect us with institutional investors. As a result, we began directly visiting institutional investors without appointments. Our relationships with institutional investors were built through a chain of referrals. We believe that even in today's environment, **direct visits to institutional investors** can still be effective.

The first priority is to **get institutional investors interested in us**. To that end, speaking about the broader Japanese industry to which we belong can be highly valuable to overseas investors. Rather than providing information institutional investors already have (i.e., publicly available data), offering information regarding the industry from an insider's perspective and how we think about it is very well received by them.

We made an effort to **meet institutional investors especially when our performance was poor**. We heard that institutional investors want to hear the story of how a company plans to recover when its performance is down. As a small-cap company, we believe it is important for top management to respond sincerely to investors. Top management should respond especially when tough questions are asked by investors.

Institutional investors are generally reluctant to invest in small and mid-cap stocks, citing liquidity and market capitalization as obstacles, but we believe they will invest in us if we can demonstrate three things: (i) that we are a company with which they can engage in proper dialogue; (ii) that we have potential for future growth; and (iii) that **we are seriously working to deliver on our growth story** with a demonstrable track record.

Voices from investors: Efforts by small and mid-cap companies

- Regarding engagement with small and mid-cap companies, investors acknowledged its effectiveness but also pointed out the difficulty of engaging with all companies included in a stock index considering the cost, and the difficulty in identifying companies that are capable of constructive dialogue.

Opinions from investors on small and mid-cap companies

- Perhaps due in part to the Tokyo Stock Exchange's push for PBRs, we have been receiving more requests for dialogue from small and mid-cap companies. As a result, the number of engagements with small and mid-cap companies has increased. However, due to limited resources, we cannot accept every request, and it **is also difficult to have meaningful dialogue with companies outside the TOPIX 300 or 500.**

Clients in Europe and the U.S. consider it sufficient to engage with large-cap companies, whereas Japanese clients expect engagement for both large- and small- to mid-cap stocks. Our engagement coverage includes **the top 300 companies, which account for 80% of Japan's market capitalization**, but in Japan there seems to be a strong emphasis on covering companies by headcount and **raising the overall standard of all companies.**

- Engagement with small and mid-cap companies can be highly effective. **If successful, we can identify companies with a strong awareness of the need for transformation** and in that sense, Japan's equity market still has a lot of potential. That said, it is also true that small and mid-cap companies are often left behind in engagement activities. They believe that focusing on small and mid-cap companies offers the potential for α , but **identifying them requires significant cost**, and it is impossible to cover them all. Finding the right balance is difficult, but this is an area worth pursuing.

Providing capital to small and mid-cap stocks requires a certain level of capacity, but currently there is no buffer to allow such capital to circulate. Small companies tend to remain small. It is important to focus on how to increase **liquidity**, how to promote **capital increases**, and how to provide them with the foundation for future growth. On the other hand, it is also important to set a fixed time frame for progress and, if targets are not met, exit in order to **encourage renewal and turnover.**

- There is a situation where small and mid-cap companies are taking appropriate steps to enhance corporate value, yet are not being recognised by the market or institutional investors. This is because few investors are engaging with small and mid-cap companies, and although it may take time, **steady engagement and escalation with small and mid-cap companies is necessary; otherwise, no positive outcomes will emerge for Japanese companies as a whole.**

Voices from companies: Collaborative engagement

- With respect to collaborative engagement, companies noted that while it is useful in enabling them to efficiently understand investors' perspectives, they also expressed concerns about the participation of a large number of investors and pointed out the importance of ensuring that the engagement is two-way in nature, in order for it to contribute to constructive dialogue.

Opinions from companies on collaborative engagement

- Our company has never received collaborative engagement before, but we would welcome having collaborative engagement as a way to **efficiently understand investor expectations**. However, we cannot deny some concerns about **engaging with a large number of investors in the same room**.

We are uncertain **whether unified discussions can be held regarding perspectives and the setting of themes**. While it is difficult to specify concrete topics that would enable effective engagement, we believe that collaborative engagement could be implemented efficiently if the investors involved have properly authorised their theme selection in advance.

- We had one experience with collaborative engagement three years ago. The topic at the time was **policies regarding listed subsidiaries**. Our impression was that the **engagement felt more like an unrelenting cross-examination**. Even in collaborative engagement, we believe it would be a better opportunity for dialogue if it were structured as a two-way engagement.

In the collaborative engagement we experienced, **the topic of discussion may not have been appropriate**, but when it comes to discussing policies on listed subsidiaries, companies often have to respond cautiously due to insider trading regulations. Therefore, appropriate theme setting is important in collaborative engagement.

To be frank, **we did not find much benefit** in participating in collaborative engagement. This is because our purpose in engagement is to receive input on the company and improve our disclosure and governance based on such input.

Voices from investors: Key considerations when conducting collaborative engagement

- ❑ From the perspective of investors, the advantages of collaborative engagement generally include: (i) when multiple investors share the same dialogue objective, collaboration can help supplement resources for stewardship activities and reduce costs, and (ii) when several investors share the same concerns, it may be more efficient for companies to have a single collaborative engagement rather than respond to repetitive questions from individual investors.
- ❑ Investors have noted that theme setting is crucial for effective and efficient collaborative engagement, and that conducting collaborative engagement with overseas investors can provide companies with a global perspective.

Key considerations when conducting collaborative engagement

- Theme selection is critical. Some themes are more suitable for collaborative engagement than others. The importance of stable shareholder returns is a common concern in our industry and is an accessible theme for collaborative engagement. Integrated disclosure and climate change are also appropriate themes. On the other hand, we have previously discussed internally whether to pursue collaborative engagement with companies that have low ROE; however, since investors have differing analytical perspectives and there are various views on what low ROE means, the discussion did not reach consensus.

We believe that unless the theme is one on which investors have a certain degree of consensus in terms of analytical perspectives, **it is likely that the effectiveness of collaborative engagement will not be realised**. Therefore, rather than simply requesting improvements in ROE itself, it may be possible to engage more effectively through collaborative engagement with companies where the causes of low ROE can be categorised to some extent - for example, companies in which a large amount of cross shareholdings is the reason for low ROE.

- Our characteristic top-down engagement approach involves researching and analysing what constitutes a material issue for “Japan stock companies” or, from the perspective of being shareholders of “global stock companies”, identifying what is material issue, and based on that, we encourage companies to address those material issues.

From this perspective, we believe that dialogue with stakeholders is extremely important, and we believe that we have a competitive advantage over other companies in terms of information networks and building relationships in gathering insights from stakeholders and the international community, such as **by engaging in collaborative engagement with global investors, we are able to view Japan’s challenges from a global perspective**, and we can work together with other investors to raise issues related to global challenges with companies.

We believe that the above information is also important for companies, and that **we are able to provide companies with insights obtained through collaborative engagements** that take a leading role in rule-making, regarding **developments in global rule-making and material issues**.

Voices from investors: Concerns regarding collaborative engagement

- ❑ Some investors have raised concerns about collaborative engagement, pointing out issues such as free-riding, the fact that it does not necessarily reduce costs, and the risk of engagement being limited to superficial themes.
- ❑ Whether to pursue collaborative engagement should be considered by institutional investors as one of several options, depending on their investment objectives and strategies.

Concerns about collaborative engagement

- We are sceptical about collaborative engagement. There tend to be many free riders, and even when someone takes the lead, **if the engagement goes well, disputes may arise as to who should take the credit**. Even when there is consensus on the problem, proposed solutions vary widely, making it difficult to consolidate opinions. Based on past experience, we feel that the cost of coordinating opinions often outweighs the benefits. For those who already have influence as a single investor, there is little value in pursuing collaborative engagement.

A further issue is the **difference in the level of information held by investors** participating in collaborative engagement. Each firm has **different investment time horizons**, so **aligning diverse investor views is difficult**. The extent to which each investor engages with a company also varies, and aligning those positions involves high costs.

- We are concerned that collaborative engagement **does not necessarily lead to cost reduction**. While it is one method of engagement, we are uncertain about the value of pursuing it proactively. There is a risk that only **one-size-fits-all questions** can be asked, **resulting in engagements that are merely procedural**.
- Collaborative engagement tends to be limited to superficial themes and discussions. There are also topics and issues that are difficult to discuss in the presence of other investors. **Themes that relate to corporate strategy may not be appropriate for collaborative engagement**.

Collaborative engagement may **only be effective when dealing with clearly defined social issues**. Because other investors are present, we often cannot delve into the topics we truly want to discuss. It can end up with companies being pressured simply by the weight of numbers.

Voices from investors: Toward enhanced investor disclosure

- ❑ There is an increasing number of cases in which investors seek to enhance their own disclosures and help investee companies understand their thinking.
- ❑ In particular, index investors recognise that they cannot always secure sufficient opportunities for dialogue with all investee companies, and it is important that they communicate their expectations and views to companies with transparency through their own disclosures.

Toward enhanced investor disclosure

- We have **published a roadmap for our stewardship activities based on a medium- to long-term perspective**. From the company's standpoint, this makes it possible to visualise future issues that need to be addressed, thereby increasing predictability and contributing to constructive dialogue.

- (Regarding the primary purpose of disclosing in-depth information such as stewardship reports)
As an institutional investor providing long-term capital, we aim to contribute to the realization of a sound capital market and a sustainable society by conducting stewardship activities based on the idea of being a universal owner, and we also have a sense of purpose in **communicating our initiatives and views to society**. The report has been fundamentally revised this time, taking into account the opinions of outside members of the Stewardship Advisory Committee. We feel that continuous improvement and ingenuity will be necessary in the future.

(Regarding our evaluation of other institutional investors' disclosure practices) **It is beneficial for companies to have a certain level of understanding of institutional investors' thinking, as this also contributes to constructive dialogue**, so it would be better to express views. That said, it ultimately comes down to each investor's decision as to how much cost they are willing to incur for their stewardship activities, including such disclosures. When we engage in dialogue, we provide the company with our "Stewardship Activities Report" and explain our approach, and have received feedback from companies indicating that the report is highly informative.

Exercising voting rights with coordination between teams in charge of engagement and voting (Principle 5)

- Many asset managers have developed systems to conduct dialogue and the exercise of voting in an integrated manner by close coordination and information sharing between the engagement team and people in charge of voting.

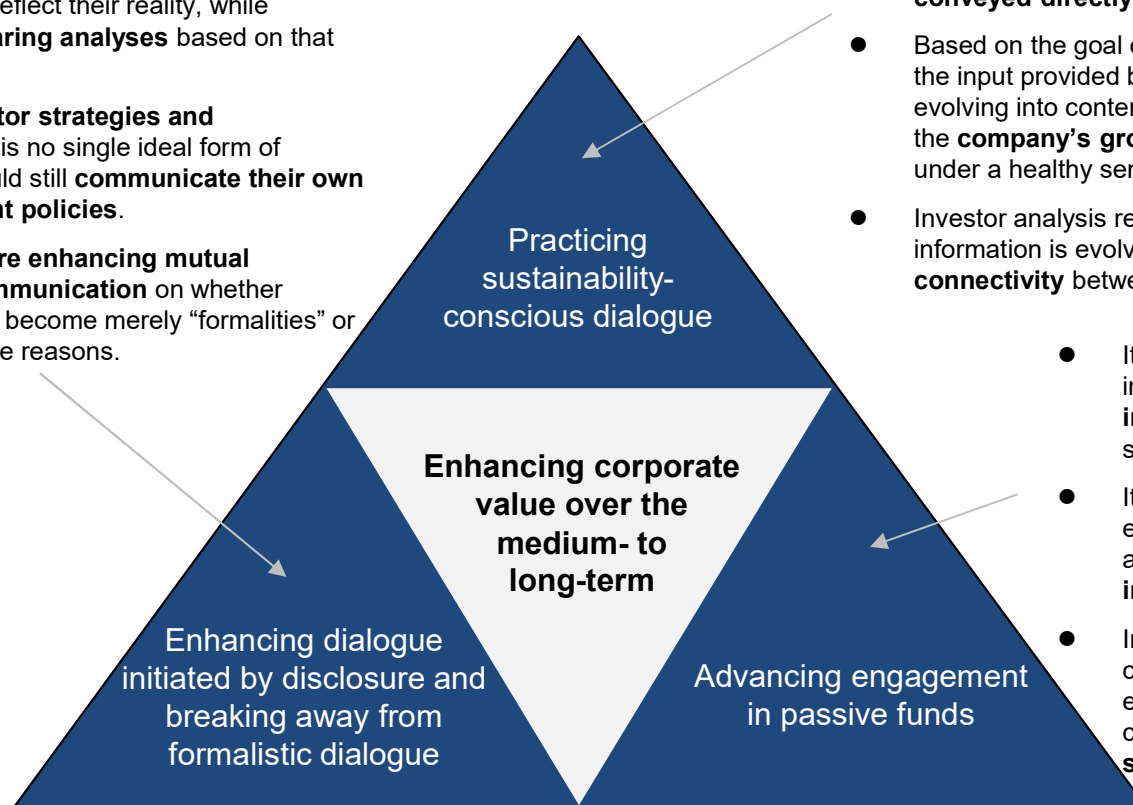
- A dedicated responsible investment department handles both engagement and proxy voting, enabling an integrated approach. Furthermore, since dialogue with independent directors during escalation ties into proxy voting, we coordinate with the department that promotes engagement company-wide. We believe the most important aspect is to reflect information gained through engagement in our proxy voting decisions.
- We refer to our primary investee companies as covered stocks. For covered stocks, corporate research analysts also serve as the main contact point for SR. These corporate research analysts actively collaborate with the responsible investment department to consistently form opinions on proxy voting. For non-covered stocks, the responsible investment department handles SR, but input from corporate research analysts is presented and incorporated for specific agenda items. Thus, we place importance on **forming integrated opinions from those with a comprehensive understanding of each company**.
- Since the beginning, we have managed engagement and proxy voting within a single department. We had already established such a framework even before the Stewardship Code was introduced in 2014. When the Stewardship Code required robust stewardship activities for passive investments in 2017, asset management companies took different approaches. Some asset management companies, unlike our structure, reassigned or newly established separate engagement departments differently from departments to which analysts belong, enhancing their staffing. As **analysts and proxy voting officers have always been in the same department** from the start, we maintained our organizational structure despite such changes.
- We hold “**Engagement Promotion Meetings**” attended by both the engagement and proxy voting teams. The main objectives are (i) information exchange and (ii) skill enhancement. In (i), two-way information sharing is conducted; for example, in the case of a company where a scandal has occurred, the proxy voting team may provide advice such as, given the circumstances we should proactively communicate our views and requests through engagement activities throughout the year, while the engagement team may propose how the content of the dialogue should be reflected in proxy voting decisions. In (ii), information sharing and exchange of opinions are conducted through study sessions with efforts made to improve the quality of engagement.
- Some investors **adopt extremely lenient voting standards** and consistently vote in favour of proposals, but does this truly benefit the companies? There should be discipline, and voting against proposals should be done firmly when necessary. On the other hand, institutional investors with **overly strict voting standards** who frequently oppose proposals should also consider whether rejecting director appointments at well-functioning companies is truly reasonable. If a director is not appointed at a sound company, it could impair the company's value, and this is something we, as an investor in that company, cannot overlook.

Toward enhancing the quality of engagement

Summary

- ❑ The existence of investors with diverse views on investment policies and time horizons is a prerequisite for securing a deep market composed of a wide range of investors. To promote corporate value enhancement and sustainable growth through constructive, “purpose-driven dialogue,” “engagement grounded in trust relationships with tension” is essential.
- ❑ In building trust, it is sometimes useful to employ various approaches unconstrained by traditional formats, and constructive dialogue is founded upon high-resolution corporate disclosures by companies and in-depth corporate analysis by investors based on those disclosures.
- ❑ Going forward, with greater awareness of sustainability, it will become important for diverse investors to deepen their dialogue with companies at different growth stages, centring on the sources of corporate value.

- Companies are aiming to provide **high-resolution disclosures** that accurately reflect their reality, while investors are **carefully preparing analyses** based on that information.
- Given **the diversity of investor strategies and engagement policies**, there is no single ideal form of behaviour, but investors should still **communicate their own investment and engagement policies**.
- **Investors and companies are enhancing mutual understanding through communication** on whether engagement and voting have become merely “formalities” or whether there are unavoidable reasons.



- Dialogue **topics are communicated by investors in advance**, and investors' medium- to long-term perspectives and **expectations are being conveyed directly and clearly to management teams**.
- Based on the goal of medium- to long-term corporate value enhancement, the input provided by investors incorporating global perspectives is evolving into content appropriate to the next stage of growth according to the **company's growth stages**, with the company **earnestly** responding under a healthy sense of tension.
- Investor analysis regarding corporate disclosures and the disclosed information is evolving in a way that increasingly **emphasises the connectivity** between financial and non-financial information.

- It is necessary to share awareness across the entire investment chain regarding the **importance of engagement in passive investment**, and to consider effective incentive structures.
- It is important to identify investee companies requiring engagement among a large number of investee companies, and to carry out **engagements with varying degrees of intensity on a medium- to long-term basis**.
- In considering efficient methods of engagement, collaborative engagement is one option. However, when evaluating the approach to engagement, it should be considered **whether the dialogue contributes to the sustainable growth of the investee companies**.

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Status of Stewardship Code compliance by proxy advisors (1/3)

- ❑ Regarding the status of compliance with the Stewardship Code by proxy advisors, interviews were conducted on (i) the development of personnel and organizational systems, (ii) the actual status of exchanges of opinions and advice with companies, and (iii) the handling of opinions submitted by companies.
- ❑ Guidance 8-3 of the Stewardship Code states that “In providing proxy recommendations, proxy advisors should rely upon corporate disclosure and actively exchange views with companies upon necessity”; however, there is a gap in perception with companies regarding communication. Ingenuity on the frequency of opinion exchange remains an ongoing issue.
- ❑ While Guidance 8-2 of the Stewardship Code states that “provide with proxy recommendations based on accurate information on specific companies,” reflecting the increase in requests for data aligned with the proxy voting standards of each client, the need to establish logic and secure adequate personnel is growing.

[Stewardship Code (Revised in March 2020) (Excerpt)]

Principle 8 Service providers for institutional investors should endeavour to contribute to the enhancement of the functions of the entire investment chain by appropriately providing services for institutional investors to fulfil their stewardship responsibilities.

Guidance

8-1. Service providers for institutional investors including proxy advisors and investment consultants for pensions should identify specific circumstances that may give rise to conflicts of interest, put in place a clear policy as to how to manage them effectively, develop structures for conflicts of interest management, and disclose such measures.

8-2. Proxy advisors should develop appropriate and sufficient human and operational resources, including setting up a business establishment in Japan, in order to provide asset managers with proxy recommendations based on accurate information on specific companies. They should also disclose with specificity the voting recommendation process, including the above measures to assure transparency.

8-3. In providing proxy recommendations, proxy advisors should rely upon corporate disclosure, and actively exchange views with companies upon necessity.

Upon request from a company that is the subject of a proxy recommendation, it is considered to contribute to secure accuracy of the information that is the basis for the recommendation and transparency if the proxy advisors provide the company with an opportunity to confirm whether such information is accurate, etc., and provide the submitted opinion of the company to their clients together with the recommendation.

Proxy advisor A

(i) Personnel and organizational system (including the advice formulation process)

- ✓ Analysts who observe the Japanese market year-round, the necessary personnel, are primarily stationed at the Tokyo office. During peak periods, a considerable number of temporary staff are hired, and we believe that we have a sufficient number of staff members.
- ✓ A proprietary program is provided which extracts data prior to issuance of reports and discloses it to issuing companies.
- ✓ In addition to advisory services, we collect data, set logic based on that data, and provide it under customised policies (configured to align with each client's desired voting practices).

(ii) Actual situation of opinion exchange

- ✓ **We respond to engagement requests as much as possible.** Upon receiving an offer, **efforts are made to address companies' concerns.** Webinars are held free of charge approximately two or three times a year to explain our proxy voting policy and provide results of season review.
- ✓ **Engagement is considered to contribute most to market understanding.** It is also viewed as **a good opportunity to reflect the opinions of companies.**
- ✓ Before we finalise policies, we conduct surveys with investors and companies, and reflect the responses to a certain extent.

(iii) Handling of opinions

- ✓ We have in place a proprietary program whereby, after issuing a proxy voting advisory report, we reissue the voting advisory report attaching original texts of the opinions of the company or the shareholder proponent regarding the analysis and voting recommendations and notify our clients accordingly.

Status of Stewardship Code compliance by proxy advisors (3/3)

Proxy advisor B

(i) Personnel and organizational system (Including the advice formulation process)

- ✓ According to Proxy Advisor B, **“The primary sources of information for report and recommendation formulation are the notice of convocation of the general meeting of shareholders, the securities report disclosed in the previous year, and timely disclosure materials.”** A robust data collection process ensures the quality of reports and forms the basis of accurate proposal recommendations. In addition to internal processes, data regarding issuers based on public information is also obtained from data providers. This allows for cross-checking and ensures the accuracy of collected information.”
- ✓ From the corporate side, there have been concerns that B’s human and organizational structure in Japan is inadequate, leading to issues such as insufficient opportunities for opinion exchange, as (ii) below. On the other hand, according to B, “Currently, there are seven Japan-dedicated analysts (with an average years of service of 14 years), most of whom are stationed in Tokyo, and about ten expert analysts from B’s overseas offices specializing in M&A and ESG that participate in research as needed. The June shareholders' meeting season is the busiest period of the year, during which approximately 50 temporary staff are hired to support tasks such as data entry and data collection.” **This indicates a discrepancy in perception regarding the personnel and organizational systems.**

(ii) Actual situation of opinion exchange

- ✓ In its statement of acceptance of the Stewardship Code, Company B states with respect to Guidance 8-3 that it **“engages in dialogue with issuers as necessary** to better understand the disclosure information of companies, including proposals and their background.” However, companies have pointed out that “Company B is never available for dialogue no matter when we reach out. There is an imbalance between Company B's level of influence and its organizational system.” “We are rarely given time for dialogue, so we have no choice but to refer to the guidelines issued by Company B and respond accordingly on our end.” “If dialogue were possible, we would like to hear their honest views regarding opposition or support.” According to Company B, “As a service provider to institutional investors, it is against our policy to provide companies with the kind of advice that the Stewardship Code expects institutional investors to offer through engagement. For us, engagement is conducted for the purpose of clarifying ambiguities in publicly available information or obtaining deeper insights. We engage **whenever we determine that doing so would contribute to the creation of high-quality reports or voting recommendations for our clients.**” **This indicates a divergence in recognition regarding when dialogue with companies is necessary.**
- ✓ According to Company B, “Recommendations are determined solely based on the proxy voting standards specified by our clients, and what our clients seek for their decision-making is purely data and facts. **A company’s explanation is not usually a determining factor under the proxy voting standards.** Our proxy voting guideline, which is published on our website, stipulates that **recommendations are to be made based on the contents set forth in the guideline, not on a company’s explanation. In cases such as M&A, shareholder proposals, or so-called corporate scandals where case-by-case judgment is required under the standards with consideration of the company’s explanation, or when a company is in a special situation, we actively initiate engagement.**”

(iii) Handling of opinions

- ✓ According to Company B, “All rebuttals from companies published by the stock exchange for public inspection are posted in our system alongside our reports and are made available to our clients. Our clients are institutional investors. What our clients seek above all is the accuracy of the information that serves as the basis for the research and recommendations regarding proxy voting. Therefore, our engagement is also conducted from that perspective.”

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Opinions toward the Financial Services Agency and the Tokyo Stock Exchange

<<Voices from companies>>

- ❑ Companies have generally expressed a certain level of appreciation for the Financial Services Agency and the Tokyo Stock Exchange's initiatives to promote corporate governance reform.
- ❑ On the other hand, there have been requests to create opportunities for interaction with each company's IR and SR departments, and to reduce the burden of disclosure requirements.

- The message from the Financial Services Agency and the Tokyo Stock Exchange regarding corporate governance reform is being received positively by investors. Even if an individual company tries to tout its corporate governance reforms, it does not immediately attract investor attention. However, when the Financial Services Agency and the Tokyo Stock Exchange **demonstrate a nationwide commitment to reform**, it sends a strong signal to investors that Japan is seriously attempting to change, and we hope they will continue to take the lead.
- **External voices calling for the substantive implementation** of corporate governance are appreciated, as they provide **momentum for our company to move beyond merely formalistic compliance with each code**. However, after several revisions, the volume of the Corporate Governance Code has increased. If the overall content could be streamlined, such as by integrating overlapping sections, it could lead each company to consider and decide on its own, thereby contributing to substantive implementation.
- Currently, many Japanese companies appoint independent directors through introductions from business partners, and **this may not necessarily lead to contributions from independent and objective perspectives** as required of independent directors.
- We feel the initiatives for corporate governance reforms and improved capital efficiency have had a positive impact. In fact, we have received favourable responses from overseas institutional investors. However, some overseas institutional investors remain sceptical, suspecting that **the initiatives may be only superficial**. We hope the Tokyo Stock Exchange and the Financial Services Agency will continue ongoing communication.
- There are currently no opportunities to learn about the IR and SR practices of other companies across different sectors, and we request that **opportunities for interaction with IR and SR from different companies be considered to share their practical concerns**. Many companies share similar challenges, and developing horizontal networks would enable more concrete and advanced action.
- We would like **multiple disclosure documents to be consolidated**. We understand that there are discussions about postponing the annual general meeting to autumn, integrating the business report with the securities report, and disclosing the securities report before the shareholders meeting. We believe discussions are heading in the right direction. We will continue to monitor developments.
- Compared to the United States, where shareholder rights are quite restricted, shareholders in Japan possess relatively strong shareholder rights. Activist investors and funds from the U.S. and Europe have realised this and are currently taking various approaches toward Japanese companies. While activists are shareholders, we believe that **there needs to be a movement in Japan to rectify the differences in shareholder rights compared to those in Europe and the United States**.

Opinions toward the Financial Services Agency and the Tokyo Stock Exchange

- Investors expressed a variety of requests to the Financial Services Agency and the Tokyo Stock Exchange, including the enhancement of case studies related to disclosure, the alignment of soft law and hard law, and the strengthening of conflict-of-interest management by asset managers.

- The collections of good disclosure practices regularly published by the Tokyo Stock Exchange and the Financial Services Agency are seen as valuable initiatives. It was also suggested that the publication of **unfavourable examples** should be considered.
- Even at present, there are a certain number of companies with insufficient disclosure, and while the method of disclosing unfavourable examples would require careful consideration, it may be acceptable to do so in a way that does not allow for the identification of the issuer. If both favourable and unfavourable disclosure examples were made available, it could promote initiatives that enhance corporate disclosure.
- There are cases where, when we point out issues to a company, they give a superficially agreeable response but take no actual action, with the IR representatives merely deflecting our inquiries with lip service. In addition, **there are still many companies that refuse to hold meetings with IR or management-level representatives**. Recently, a list of companies wishing to meet with institutional investors was published by the Tokyo Stock Exchange, but in contrast, there are companies that claim to engage with shareholders in their corporate governance reports but still reject meetings with institutional investors, and it was proposed that a list of such companies should also be disclosed.
- The structure in Japan may place too much emphasis on shareholders' meetings, and there is a need to reform this through legal design. **Japan is perceived as being overly reliant on soft law**. The **revision of hard laws**, such as the Companies Act, Financial Instruments and Exchange Act, and the Tokyo Stock Exchange listing rules, is considered **too slow**.
- It was suggested that the Financial Services Agency should **reconsider the definition of engagement**. **Dialogue that does not contribute to the sustainable improvement of corporate value should be excluded from the scope of engagement**.
- The **concept of stewardship** is unclear. While stewardship fundamentally involves enhancing the value of entrusted assets through appropriate exercise of authority, this essence seems to be lacking in the Stewardship Code. Since stewardship is a concept that should further extend beyond investors to include companies, its **definition should be clarified**.
- In countries like the U.S., stewardship codes emphasise strict **conflict-of-interest management**. While there is a growing trend toward requiring greater independence of asset managers, as Japan seeks to advance the sophistication of its asset management industry at the national level, it may be more in line with the current era to demand a higher standard of independence for asset managers.
- Given that this is an effort to improve the value of Japanese companies, the role of Japanese investors such as public pension funds should increase. However, there have been numerous instances where cooperation could not be achieved due to disagreements over fees with pension funds. It was suggested that if the Financial Services Agency were to address such issues publicly, it could lead to meaningful change.

❑ Investors voiced opinions on issues related to various players in the investment chain, with a focus on enhancing medium- to long-term corporate value.

- While maximizing investor returns is important, our philosophy is not to seek short-term shareholder profits, but rather to enhance long-term, intrinsic corporate value, which will ultimately lead to improved future returns. We would like Japanese asset owners to fully consider **the importance of the fact that enhancing the competitiveness of Japanese companies and the Japanese economy will ultimately result in greater returns.**
- Forcing companies to increase capital efficiency by paying higher dividends, conducting share buybacks, selling off low-ROIC businesses, or disposing of real estate might generate short-term profits, but it will not strengthen Japan's competitiveness, and we hope that **policies will be put forward that help enhance long-term, intrinsic corporate value**, even incrementally.
- In recent years, programs to support the establishment of funds have become active, but the requirements for obtaining licenses are stringent, and above all, it is said to be difficult to find the **first asset owner**. Although support from the Financial Services Agency and the Tokyo Stock Exchange has likely contributed to expanding the budgets of major financial institutions, there seems to be limited success in matching them with emerging funds.
- **The track record gained while contributing as an analyst or assistant portfolio manager at a fund is not easily recognised as an individual track record** and therefore, for independent asset managers founded by analysts or assistant PMs, it is difficult to deliver a convincing presentation based on their track records. Although each asset manager's investment philosophy and team should be evaluated, they have few opportunities to make presentations that showcase their logic and uniqueness, resulting in difficulties in winning over asset owners.
- It takes time to generate returns, and **Japanese institutional investors, including pension funds, are not providing capital**. In some cases, the fee structure could not be agreed upon, but it also seems that performance-based evaluation is prioritised, while qualitative evaluation is lacking. We believe we are doing something good for Japan but feel a dilemma about the lack of domestic funding.
- To enhance the investment chain as a whole, it is important to promote **full digitization of proxy voting** and to **develop a platform that consolidates information**.
- One of the biggest issues in the Japanese market is that **small-cap companies remain small-cap companies indefinitely**. There may be too few business leaders focused on increasing corporate value. Companies that cannot enhance their corporate value need to exit. When such companies exit, their talent and human resources can be reallocated to more competitive firms, which is critically important at the national level. We view the recent efforts by the Tokyo Stock Exchange to narrow down the companies included in the TOPIX index very positively.

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12	Asset owners	Specific examples of monitoring and incentivising	Corporate Pension Funds Stewardship Initiative “Collaborative Monitoring”	Summary
13	Asset owners	Engagement between asset owners and asset managers (1/2)	Opinions from both sides	Summary
14	Asset owners	Engagement between asset owners and asset managers (2/2)	Opinions from asset managers toward asset owners (details)	Summary
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16	Asset managers	Monitoring investee companies’ governance and strategy	(Principle 3 related) Progress management, corporate surveys, discussion papers	Summary
17	Asset managers & companies	Having a common understanding and solving problems through constructive dialogue	Overview of investor and company interviews on engagement	Summary
18	Investor	Engagement from the investor’s perspective	Engagement considered meaningful and engagement considered less meaningful from the investor’s perspective	Summary
19	Investors & companies	Engagement case study (i)	Dialogue is conducted with a global top-tier company by presenting a role model, focusing on carefully selected themes	Case study
20	Investors & companies	Engagement case study (ii)	Proposal for disclosure of business portfolio management	Case study
21	Investors & companies	Engagement case study (iii)	Dialogue utilizing the network of global investors	Case study
22	Investors & companies	Engagement case study (iv)	As a long-term active engagement fund, building strong trust and realizing dialogue with healthy tension	Case study
23	Investors & companies	Engagement case study (v)	Engagement responding to awareness of corporate culture transformation	Case study

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24	Investor	Cases where dialogue did not develop into constructive engagement	Some voices express difficulty in finding value in superficial dialogue.	Opinions
25	Companies	Engagement from the company's perspective	Dialogue perceived as meaningful and dialogue perceived as less meaningful from the company's perspective	Summary
26	Companies	Cases where dialogue developed into constructive engagement (1/2)	Proposal-based input from a "medium- to long-term perspective"	Opinions
27	Companies	Cases where dialogue developed into constructive engagement (2/2)	Well prepared "Input" from the investor's perspective	Opinions
28	Companies	Cases where dialogue did not develop into constructive engagement (1/2)	Discussions focused solely on short-term mindset	Opinions
29	Companies	Cases where dialogue did not develop into constructive engagement (2/2)	Set agenda tailored to the dialogue counterpart	Opinions
30	Companies	Toward improving engagement	Own initiatives, advice to other companies, and request to investors	Opinions
31	Investors & companies	Specific discussions	For independent directors, small and mid-cap companies, and collaborative engagement	Summary
32	Companies	Dialogue with independent directors from the company's perspective	While there are signs of positive consideration, there are concerns about excessive expectations.	Opinions
33	Investor	Dialogue with independent directors from the investor's perspective	Although requests for dialogue are numerous, some have pointed out that setting an appropriate agenda is crucial.	Opinions
34	Companies	Efforts by small and mid-cap companies	Voice of the importance of enhanced disclosure and proactive communication	Opinions
35	Investor	Efforts by small and mid-cap companies	Although potential is recognised, there are concerns about cost balance and the difficulty of in identifying companies that are capable of constructive dialogue.	Opinions
36	Companies	Collaborative engagement	While efficiency is expected, there are some concerns, and the importance of agenda is pointed out.	Opinions
37	Investor	Key considerations when conducting collaborative engagement	While recognising the advantages, the importance of agenda setting is pointed out.	Opinions
38	Investor	Concerns about collaborative engagement	Some points out the need for avoiding free-riding and superficial themes, but collaborative engagement is appropriate as one option.	Opinions
39	Investor	Toward enhanced investor disclosure	Advanced perspectives on the importance of disclosure by investors	Opinions
40	Asset managers	Exercising voting rights with coordination between teams in charge of engagement and voting	(Principle 5 related) Establishing systems to integrate engagement and voting	Opinions
41	Asset managers & companies	Towards enhancing the quality of engagement	Summary: Interrelation between dialogue and the exercise of voting rights	Summary
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