

The Sixth Council of Experts Concerning the Follow-up of
Japan's Stewardship Code and Japan's Corporate Governance Code

February 18, 2016

[Ikeo, Chairman] Good morning. Although Mr. Toyama is not yet here, since it is already the scheduled opening time, I'd like to open the sixth Council of Experts Concerning the Follow-up of Japan's Stewardship Code and Japan's Corporate Governance Code.

Thank you very much for taking the time from your busy schedule.

Today the secretariat prepared the draft of this Council's Opinion Statement titled "Corporate Boards Seeking Sustainable Corporate Growth and Increased Corporate Value over the Mid- to Long-Term", which summarized our discussions. I'd like you to make a final confirmation of the draft.

I thought we might need to meet one more time to finalize the draft, but the secretariat has contacted each member to gain feedback, and judged that we are likely to be able to reach an agreement. So today I'd like to have your confirmation of the draft, hopefully without much debate or controversy. Your understanding would be appreciated.

After that, since we need to speed up our discussion, I'd like you discuss a new topic, "Constructive Dialogue between Companies and Institutional Investors" related to the Stewardship Code.

To learn an asset owner's view on this topic, today we invited Mr. Hiromichi Mizuno, Chief Investment Officer (CIO) of the Government Pension Investment Fund. Mr. Mizuno will come later, and make a presentation in the second half of this meeting.

Now I'd like to ask a representative of the Financial Services Agency to explain the draft Opinion Statement.

[Tahara, Director of the Corporate Accounting and Disclosure Division, FSA] Good morning. I'd like to explain the draft Opinion Statement in accordance with Material 1. We sorted out your discussions at the previous several meetings and summed up points of broad consensus in this Statement.

The Statement consists of the following parts: "Introduction" from page 1, "Changing

Business Environment and the State of the Board” from page 2, and “Closing Remarks” on the last page, or page 8.

First of all, “Introduction” summarized the progress since the implementation of the Corporate Governance Code. According to disclosures by listed companies, roughly 80% of the companies reported that they complied with more than 90% of the Code’s principles, with a high compliance ratio for each principle. In terms of the governance efforts related to boards, almost half of the companies listed on TSE First Section have appointed two or more independent directors, doubling from the preceding year. Furthermore, the boards of some companies have adopted the monitoring model, aiming at further strengthening their oversight. It can be seen that significant changes have been made.

On the other hand, in the areas such as the board’s evaluation, dialogue between investors and companies and actual contents of disclosures of the Corporate Governance Reports, efforts of listed companies and investors to enhance corporate governance are still underway.

This Opinion Statement offers perspectives which are considered important now for companies to achieve genuinely effective corporate governance.

Please turn to the next page. The Council has discussed what the boards should be. During such discussions, the members pointed out that, while the environment has been significantly changing due to globalization, the progress of technological innovation, population decline and rapid aging of the society, increased attention to sustainability issues like social and environmental matters, business environment surrounding the listed companies has been changing and management challenges facing companies have become increasingly complex. While the environment has been significantly changing in such a way, in order for the listed companies to achieve sustainable growth and increase their corporate value over the mid- to long-term, it was pointed out that the role of Chief Executive Officer (CEO) is very important.

It is important that management led by CEO constantly makes far-seeing and correct managerial decisions. In this sense, the appointment/dismissal of CEO is the most important strategic decision for the listed companies, and thus objectivity, timeliness and transparency are strongly desired to render appointment/dismissal procedures appropriate.

In addition to the appointment/dismissal of CEO, the board has important roles and responsibilities in establishing business principles, setting strategic decisions, establishing an

environment that supports appropriate risk-taking by senior management, and conducting effective oversight. It is pointed out that the board is expected to exercise leadership in the company or play an active role together with the management, as described in the book recommended by Mr. Tanaka. The Council discussed the fact that the expected effect by strengthening the board in this way would be achievement of sustainable corporate growth and increased corporate value over the mid- to long-term.

From such a perspective, we have categorized the discussions into 4 parts. Section 1 focuses on Appointment/Dismissal of Chief Executive Officer (CEO). Please take a look at page 3. The Council pointed out that what Japanese companies lack most are talented executives qualified for the position of CEO. The Council argued that, to cope with such a problem, it is essential for companies to work on CEO candidate talent development as well as the actual appointment of the CEO by investing sufficient time and resources. Furthermore, it is necessary to have in place appointment procedures to secure objectivity, timeliness and transparency.

The Council also pointed out that in cases where problems are found with the CEO after conducting appropriate evaluation of the company's performance – including corporate scandals, I assume –, it is necessary to set a mechanism that makes it possible to dismiss the CEO. In this regard, the Council discussed that it is important for the boards to sufficiently secure its independence from the management as well as objectivity.

As mentioned before, in the footnote on page 3, it is confirmed that although some examples of efforts are introduced in this Opinion Statement, such examples do not constitute new formal rules.

Section 2 discusses Board Composition. Please turn to the next page. In order to fulfill the roles of responsibilities, earlier-mentioned, it is important that the board has the necessary qualifications and diversity as well as independence and objectivity.

In this regard, as mentioned in item (2) for instance, the number of independent directors has seen steady growth. In more than 10% of companies listed on TSE First section, at least one-third of board members are independent directors. In terms of the number, we can see a steady progress. Nonetheless, stakeholders are increasingly shifting their focus from the number of independent directors to the qualifications and diversity of the board members. We

summarized your opinions in this way.

Please turn to the next page. In item (4), we summarized your opinions as follows: in order for the Audit Committee or Supervisory Committee to appropriately fulfill their important roles and responsibilities such as operational auditing and accounting auditing, Audit Committees need to secure their independence and objectivity; and appointing an independent director as the committee chairperson contributes to strengthening the independent and objective standpoint of the Audit Committees.

Furthermore, whether the independence and objectivity of the board and the Audit Committees can be secured and whether they can sufficiently exercise their functions often depends on CEOs – specifically, CEOs’ intention to make use of the characteristic of the board and Audit Committees, which is “the independent and objective standpoint”, for their managerial decisions. Here, we reaffirmed that from this perspective as well, the appointment/dismissal of CEO by the board is an important business challenge for listed companies.

Section 3 focuses on Board Operations. The Council discussed as follows: in order for Japanese companies across the full range of their corporate groups, not limited to the listed companies as pointed out by the members, to address changes in the business environment and increasingly complex business challenges, it is important that boards enhance their discussions on strategic directions and appropriate evaluation of corporate performance, etc. Therefore, it is necessary to conduct board meetings flexibly and creatively, for instance, by clarifying key points to be the focus of discussion, reducing the number of agenda items, and securing sufficient time for deliberation.

Please turn to the next page. It was also pointed out that internal directors must fully understand that their role is not limited to the execution of their own operational responsibilities and includes conducting oversight of the totality of a company’s business, including the oversight of the activities of other board members with operational roles.

I’m moving on to Item (6) on page 7. The council argued that whistleblowing is the final defense in preventing corporate scandals. In order to ensure that such a whistleblowing system works well, it is appropriate to establish a system where an act of whistleblowing is reported to a point of contact that is independent of the management, for example, outside directors and

outside *kansayaku*.

Section 4 discusses Evaluation of Board Effectiveness. The council pointed out that, to ensure that effective efforts are being made or further improved, it is essential to evaluate effectiveness of the board as a whole, and continuously reflect such results in the next steps of the board – in other words, to implement a PDCA (Plan-Do-Check-Action) cycle.

At the end of May, one year will have passed since the implementation of the Code. Accordingly, each listed company is expected to properly evaluate effectiveness of its board from that perspective. Upon making an evaluation, it is expected that companies will make various choices in their evaluation efforts, but primary importance should be placed on an honest evaluation of the board by each board member. We summarized your discussion in this way.

As written in Item (2), in conducting such an evaluation, it is first required to clarify the roles and responsibilities of boards.

Please turn to the next page. When the board implements a PDCA cycle, it is important to disclose and explain to stakeholders its efforts and evaluation results in an easy-to-understand manner.

We'd like to organize your opinions in this way. As written in the Closing Remarks, many listed companies are now working toward their general shareholders meetings in June by examining director candidates and preparing for the evaluation of the board effectiveness.

We hope this Opinion Statement will be used by them as a reference. We expect that each company will create a PDCA cycle toward enhancing effectiveness of the board through systematically cultivating and nominating directors with qualifications and leadership skills, securing the independence and objectivity of the board through its composition, and implementing a proper evaluation of the board.

And we closed the Statement by saying that we expect that the sincere efforts of Japanese companies to enhance their corporate governance will lead to the achievement of sustainable growth and increased corporate value over the mid-to long-term, thus generating a virtuous cycle for the Japanese economy.

That's all for my explanation about the Opinion Statement.

[Ikeo, Chairman] Thank you very much.

Now I'd like to invite your comments on the draft Opinion Statement which was just explained. Who would like to start?

Mr. Takei, I heard you would like to express your opinions.

[Takei, member] Thank you. I think this Statement paper is excellent, and appreciate the great job by the secretariat. At this Follow-up Council, we have exchanged various opinions. I believe that this paper will be useful for the companies when they evaluate their boards and carry out other activities in response to the Code. Besides, this paper is easy to read – just right in terms of both contents and volume. I hope that this version will be published at the earliest possible time.

I'd like to add a supplementary explanation. I don't mean to request a change in the current wording of this Statement, but just want to make a supplementary explanation. Mr. Tahara earlier referred to sustainability. In this Statement, the term "business challenges" and expressions "changing business environment" and "increasingly complex business challenges" are used several times and I believe that these points are very important. From the perspective of achieving genuinely effective corporate governance, which is the objective of this Follow-up Council, while formulating growth strategies, it is becoming important for the listed companies in Japan to address sustainability issues. In the Corporate Governance Code, Principle 2.3 and Supplementary Principle 2.3.1 stipulate that the board should address sustainability issues positively and proactively. In relation with the changing business environment and increasingly complex business challenges in this paper, I'd like to emphasize the importance of Principle 2.3 and Supplementary Principle 2.3.1.

Especially I think that many Japanese companies regard taking the growth of the global market as core business strategies in the midst of the fundamental changes of globalization. In addition, changing industrial market, typically characterized by the Fourth Industrial Revolution, including the recent development of IoT, supply chains. In such a structural change, various new sustainability issues most of which are complex challenges beyond the assumptions within Japan are evolving. When considering corporate growth strategies over the mid- to long-term, how to address such sustainable issues in such strategies as well as the governance system for enabling such efforts could be essential for Japanese companies. I hope the Japanese companies will address increasingly complex business challenges with full

awareness of the importance of Principle 2.3 of the Code.

As for the text of the paper itself, I think it is OK to publish as it is. Thank you in advance for your efforts.

[Ikeo, Chairman] Thank you.

Who else would like to share comments or opinions? Mr. Tanaka, please go ahead.

[Tanaka, member] Thank you. I think that the paper is well-written. The Closing Remarks state that many companies are now working toward their general shareholders meetings in June by examining director candidates and preparing for the evaluation of the board effectiveness. It is indeed so. In this connection, on page 7, there are descriptions of Evaluation of Board Effectiveness under Principle 4.11. As I have already told the secretariat, I consider that the evaluation of the board's effectiveness is a very new task for Japanese companies. In that sense, examples in other countries could be useful for them. Usually, it is considered that there are 3 steps in the evaluation of the board's effectiveness.

The first one is an evaluation of whether the board as a whole is working well. It corresponds to the description "to evaluate effectiveness of the board as a whole" in the first paragraph of Section 4 in this Statement.

The second one is typically applicable to Companies with Three Committees (Nomination, Remuneration and Audit). It's an evaluation of whether each committee is working well. There are companies which established advisory committees. Then they need to evaluate whether such advisory committees are really working. This is the second layer.

Finally, they need to evaluate whether each director is working well. I think that boards are mostly evaluated from these 3 viewpoints.

Especially when companies are adopting the organizational structure of Companies with Three Committees or other organizational structures with advisory committees, I believe that evaluations at the committee level are important. Indeed, in case of Companies with Three Committees, Nomination, Remuneration and Audit Committees have significant authority. The board as a whole delegates the authority to such committees, so it is very important that the board as a whole evaluates whether Nomination Committee and other committees are working well: especially, it is essential that how board members outside of such committees evaluate activities of such committees.

Finally, the evaluation of each director is also a very important process. It is necessary to decide whether or not to reselect each incumbent director as a director candidate, for instance, by considering for-rates for each incumbent director at the latest general shareholders meetings. Generally, it is said that for-rates at general shareholders meetings should reach approx. 95% at least. For instance, if there is a director whose for-rates reach only 70% it is necessary to reconsider the board composition by focusing on whether the board should reselect such director as a director candidate. Taking an example of a company with 50,000 shareholders, for-rates of 70% means that a large number of shareholders (15,000 shareholders) are against him or her. Therefore, taking it into account, the board should evaluate each director. I think that the evaluation should be made through these 3 steps, and wanted to make this comment for your reference.

That's all.

[Ikeo, Chairman] Thank you very much.

Who else would like to express opinions? Mr. Kawamura, please.

[Kawamura, member] This may not be a main role of the board, which this Council focuses on. It is about the prevention of corporate scandals. I think that it is great to mention "whistleblowing is the final defense" on page 7, but there is no doubt that the prevention of corporate scandals is one of the roles of the board. Before discussing whistleblowing, I think it would be better to mention that the *kansayaku* board and Audit committee should perform their relevant functions as a mechanism in the governance structure including the board. However, if you meant that this Opinion Statement does not cover the board's role of the prevention of corporate scandals but we will write about it in detail later in a separate Statement, it would be fine.

[Ikeo, Chairman] I consider that we need further discussion on auditing. This Statement mainly focuses on growth-oriented governance. We have discussed defensive governance as well, but not sufficiently. So I'd like to have in-depth discussions at a later date.

[Iwama, member] I'm quite satisfied with the Statement. It is well organized. While the board oversees the business execution by the management, it is important for the board to trust the management and work together toward a right direction. In that sense, this Statement is written in a way to communicate the essence of governance which contributes to the growth of

corporate value, so I think it is excellent.

Then whether or not the Stewardship Code can be truly effective depends on us [investors]. I felt a heavy responsibility, and would like to make efforts for it.

[Ikeo, Chairman] Thank you.

Is there anybody else who wants to speak? No more comments?

I consider that there were no objections or proposals for corrections, and you agreed with this draft Opinion Statement as it is.

Accordingly, we will remove the word “draft” from this document, and publish it in this form. After the release, I’d appreciate it if you could actively disseminate this Opinion Statement to the public.

Well, Mr. Mizuno has not arrived...

[Tahara] Let me explain the material.

[Ikeo, Chairman] Sure. Now I’d like to move on to discussions on “Constructive Dialogue (Engagement) Between Companies and Institutional Investors” related to the Stewardship Code.

First, I’d like to ask a representative from the Financial Services Agency to explain the material titled “Disclosure of policies/activities by institutional investors that accepted the Stewardship Code”.

I’m handing it over to you for the explanation of Material 2.

[Tahara] For your discussions on dialogue between companies and institutional investors, I’ll explain the latest situation based on “Disclosure of policies/activities by institutional investors that accepted the Stewardship Code”. We distributed Material 2 and the copy of the Stewardship Code on your table. Please refer to the Principles as needed during my explanation.

By the end of November 2015, 201 institutional investors had announced their acceptance of the Stewardship Code. This material illustrates the summary of disclosure of policies/activities by institutional investors that accepted the Stewardship Code based on their websites, although we have not yet conducted an in-depth analysis on the content of disclosure.

Page 2 shows the trend of the number of institutional investors who accepted the Code. Since the establishment of the Stewardship Code in 2014, we have updated the list of the

institutional investors who announced their acceptance of the Code on a quarterly basis. The latest number is 201. Although the increase rate had declined, the total number of the accepted institutions had shown a steady increase. In addition, major domestic investment managers and large institutional investors had already accepted the Code. So we regard it as good progress.

Page 3 shows the description of institutional investors who accepted the Code by their attributes. Investment managers occupied the large majority, with numbering in 141 and accounting for 70%. It was followed by 24 pension funds, 22 insurance companies, 7 trust banks, and 7 others. “Others” refers to proxy advisors and engagement investment firms like Mr. Oguchi’s company.

As for the percentages of domestic and foreign investors, 114 institutions were domestic investors, and 87 institutions were foreign investors, accounting for roughly 60% and 40%, respectively.

Page 4 shows the compliance/explanation rates that are based on disclosures by the institutional investors. Although we consider it is necessary to investigate the actual situations, the chart shows high compliance rates overall – mostly approx. 90%. The blue parts represent percentages of investors who complied with the Principles; the yellow parts represent percentages of investors who provided explanations; and the red parts represent percentages of investors who did not make any disclosure.

Looking at figures for each principle, the compliance rate was relatively low for the Principles concerning policies on voting and disclosure of voting activities. Specifically, the Principle concerning disclosure of voting activities marked the compliance rates of roughly 60%. The Principle concerning policies on voting recorded the compliance ratio of 82%, which was also relatively low.

Page 5 shows breakdown by attribute-based classification concerning disclosure of policies on voting. Pension funds marked the highest disclosure rate of 71%, followed by trust banks (67%) and investment managers (52%). Insurance companies marked the lowest rate of 39%.

Page 6 shows the status of disclosures of voting activities, which marked the lowest compliance rate, as I explained earlier. Trust banks took the most active stance toward disclosures of voting activities; 5 out of 7 or roughly 70% of trust banks made such disclosures. The second most active sector was investment managers, 64% of whom complied with the

Principle concerning the disclosure of voting activities. Investment managers who did not disclose voting activities were relatively small-sized ones – both domestic and foreign ones. It may be because of administrative burdens. Insurance companies again showed a very low compliance rate with this Principle, with roughly a half of them making the required disclosures. There were many insurance companies which merely introduced examples of the exercise of voting rights, without showing aggregate numbers of affirmative and negative votes. They just explained the examples of the exercise of voting rights without releasing any vote count.

Page 7 is about disclosures of conflicts of interest management policy. Specifically, this corresponds to Principle 2, which stipulates that institutional investors should have a clear policy on how they manage conflicts of interest in fulfilling their stewardship responsibilities and publicly disclose it. As for specific percentages of investors who disclosed their conflicts of interest management policy, 28% of investment managers and 61% of pension funds disclosed such policies. Insurance companies and trust banks marked very high disclosure rates. Actually, it could be difficult for them to explain how they manage conflicts of interest. Therefore, unless we examine contents of their policies in detail, it will be difficult to confirm whether they disclosed appropriate policies in line with the aim of the Principle.

Page 8 is related to Principle 6 concerning disclosures of stewardship activities. The Principle stipulates that “Institutional investors in principle should report periodically on how they fulfill their stewardship responsibilities, including their voting responsibilities, to their clients and beneficiaries.” Overall, the compliance rates with this Principle were low, marking 55% among insurance companies, and roughly 40% among trust banks and pension funds. Among investment managers, the disclosure rate is just 7%, which is very low. This situation means that only large institutional investors disclosed their stewardship activities. It can be understood that whether institutional investors can disclose their stewardship activities depends much on their organizational size or human resources regarding stewardship activities.

That’s all for my brief explanation of “Disclosure of policies/activities by institutional investors that accepted the Stewardship Code”.

[Ikeo, Chairman] Thank you very much.

If you have any opinions or questions regarding “Disclosure of policies/activities by

institutional investors that accepted the Stewardship Code” which were just explained, please do not hesitate to express them.

Mr. Iwama, please go ahead.

[Iwama, member] I’d like to confirm one thing. This material shows responses of the companies which signed for their acceptance of the Stewardship Code, right?

[Tahara] That’s right.

[Iwama, member] Actually, our organization, Japan Investment Advisers Association, has been conducting a more detailed survey on various aspects. We are now aggregating the data, and considering in what form we should publish the results, because there were many results in narrative form. Nonetheless, we’d like to make the best efforts for publishing the results in a manner that people can understand the actual situation of the Japan Investment Advisers Association.

[Ikeo, Chairman] I’m looking forward to seeing the results.

[Iwama, member] We’ll do our best.

[Ikeo, Chairman] Dr. Ueda, please.

[Ueda, member] Thank you. First, I’d like to refer to the number of institutional investors who announced their acceptance of the Stewardship Code. Last year, a representative of the FRC, which established the UK’s code, told me, “Amazingly many investors signed up!” In the UK, at first, only large investors with sufficient resources signed for their acceptance, and the FRC had a very hard time trying to increase the number of institutional investors who accept the code. Furthermore, in the UK, the asset managers are required by the rules to adopt the code or announce alternative measures if not. In Japan, there is no such rule. He said it is wonderful to have achieved that much under ‘Comply or Explain’ approach. I showed a smile of pride on behalf of the Financial Services Agency, so I reported the episode before making comments.

Now I will go into the main issue. I have 2 points to make. The first point is about the number of institutional investors who announced their acceptance. Today Mr. Mizuno will be participating in the meeting. In the future, I assume that private pension funds rather than public pension funds are expected to accept the Code, although it may not be so easy, considering the issues of resources or relationships with parent organizations. In the UK, while

an increase in the number of investors who accept the UK code has been slow, I hear that the regulating body and related organizations have been making efforts to increase the number. So I think it will become necessary to create an environment where such pension funds feel comfortable with accepting the Code, or raise their awareness in the future. At the Council of Experts Concerning the Stewardship Code, I don't think we had much discussion targeting corporate pension funds. For example, if there are matters not applicable to corporate pension funds, it should be clarified so. With such a support system, I think more pension funds will adopt the Code in the future. As a result, asset owners may also participate increasingly. Then the entire investment chain will work well. This is my first point.

My second point is related to disclosure ratios by attributes shown on pages 5 and 6 of today's material from the secretariat. First, I found the figures of investment managers are rather small. I talked with Mr. Iwama, and he said it may be because of differences in data collection and definitions and I'm convinced. Second, as for insurance companies, 39% of them disclosed details of their voting standards by agenda item, and 50% of them disclosed their voting activities. I think these percentages are rather low. There may be various reasons. Probably, in Japan, while stewardship responsibilities or fiduciary duties are not clear especially in case of general accounts of life insurance companies, they are required to assume stewardship responsibilities. Accordingly, each insurance company makes various efforts. That's why their efforts vary widely.

Actually, looking at stewardship activity reports and disclosed information of each insurance company, I feel there are a lot more variations across companies than the figures shown in the material. I'd like to introduce good examples of two large Japanese companies. One of them issued a detailed report of their efforts on more than 40 pages, which can be a good brochure. Another company issued an excellent report on their policies and efforts with detailed numerous data. The content is very rich. As for specific figures, for instance, one company clearly mentioned "affirmative votes xx%, and negative votes xx%", and another company used more vague expressions like "we investigated agenda items of xx companies", but overall they communicated specific efforts.

In contrast, I'd like to introduce actual examples of foreign insurance companies. Although the Financial Services Agency's website shows their website URLs to be used for disclosures,

the links were expired and people cannot get access to their websites. Furthermore, some websites merely quoted several lines from the Code. Overall, there are more variations in their efforts.

It may be a good aspect that individual companies will differentiate and clarify their efforts in the future.

These are the things I noticed while reviewing the material. Thank you.

[Ikeo, Chairman] Thank you very much.

Mr. Nishiyama, please.

[Nishiyama, member] First of all, I'd like to ask a question to the secretariat. It seems that awareness building activities have been carried out in various places in connection with the participation of corporate pension funds, which Dr. Ueda mentioned earlier, but the increase in acceptance has remained slow. What does the secretariat think about it? And while stewardship activities are under way, I have a concern, which may be linked with disclosures under the Corporate Governance Code. I think I talked about it before. When the Corporate Governance Code applies to a wide range of companies, institutional investors are expected to dedicate considerable efforts for stewardship activities. However, even if we make such efforts, the number of companies which an institutional investor can actually engage in may be 100 or a little more, where there are more than 2,000 companies that are expected to improve the quality of disclosures. To what extent can such engagement activities contribute to improving the quality of disclosures of more than 2,000 companies? I think it would be very difficult. Then I'm afraid that, after all, institutional investors are regarded not to have carried out engagement activities sufficiently.

Investors have actually made various engagement efforts. However, considering the large number of target companies and considerable variation in views of such companies, I think it would be necessary to consider how to look at this matter.

[Ikeo, Chairman] Thank you.

Mr. Mizuno has arrived. After his presentation, we'd like to resume the discussion. Could you please wait for a moment?

Mr. Mizuno, I'd like to hand it over to you.

[Mr. Mizuno, CIO, Government Pension Investment Fund (GPIF)] Thank you, Mr.

Chairman.

Good morning, everyone. I'm Mizuno, CIO of GPIF. Thank you very much for inviting me to the Council and giving me the opportunity to talk about our activities. Do I have 10 to 15 minutes today?

[Ikeo, Chairman] That's right.

[Mr. Mizuno, CIO, GPIF] Before I talk, I'd like to confirm that you have the material titled "Investment Chain Surrounding GPIF" and "Summary Report of GPIF's Stewardship Activities in 2015" which we have published recently.

First of all, you know that there have recently been discussions on GPIF's reform in terms of governance and asset management. As a party involved, I've been watching the progress of the discussions and thought about various things. Media reported that in-house investment or in-house management is unlikely to be allowed this time. In the midst of such discussions, I felt a strong doubt: is there an understanding or consensus in this country on 'fiduciary duties' of investors?

While listening to companies' arguments against our in-house investment, in short, I renewed my awareness that the companies – both employees and employers – have a strong sense of distrust of their shareholders. I thought about reasons for this situation, and felt that despite various discussions at various meetings including this Council, in practice, there is no consensus on a Win-Win relationship between these two parties.

Meanwhile, we reviewed how we, as an asset owner, should position ourselves in the value chain of the Corporate Governance Code and the Stewardship Code, and prepared this relationship chart. In this kind of graphics, including those prepared by the Financial Services Agency, we are always placed in the back of institutional investors. I have not been comfortable with such charts over the years, because GPIF is certainly a client for institutional investors in a way; and the institutional investors, including asset managers, investment managers, and trust banks, fulfill their stewardship responsibilities to us. Similarly, we have fiduciary responsibilities or stewardship responsibilities to the general public of Japan. In other words, we are in a position to have stewardship responsibilities equally for both employers and employees of the companies. In that sense, as for the value chain of the Stewardship Code and the Corporate Governance Code, I believe that it is completed only by putting asset owners in

the center.

In this sense, the recent discussion should not have focused merely on how GPIF should act as a shareholder. They should have discussed what roles GPIF should play for employees or companies in terms of fiduciary duties or stewardship responsibilities, but the discussion did not go deep into such an area.

In this regard, unfortunately, although the members of this Council have had intensive discussions, I don't think there were any comments which support the development of this area, and I'm disappointed with that.

That's why I talked about this issue. From this perspective, this year, we have drastically changed the structure of our stewardship report in a certain sense. Until last year, in this graphic, parties who have direct relationships with us were considered to be institutional investors, typically investment managers - Chairman Iwama [from Japan Investment Advisers Association] is here. Therefore, we used to issue annual reports by summarizing hearings from them until last year, but I had been thinking that such a way was problematic in several points.

First, there is no way to investigate comments from institutional investors. What I heard from most of asset managers was like this: "As a result of my advice, Company A did this and that." Is that true? The management of Company A may have already planned to do so, prior to receiving advice from the asset manager. Or Company A did so based on another shareholder's advice, but the institutional investor or asset manager in question reported that it was their contribution. We did not have any means to check the fact.

Can we take a responsibility for including such unverifiable matters in our summary report? Are we responsible? Therefore, we decided to reconsider this issue, but as I mentioned earlier, there is no consensus about our engagement with companies. Probably, the members of this Council encourage us to engage more with the companies. However, in the outside world, we are told not to do so. We cannot go for it one-sidedly without a consensus. So this time, we changed our practice. We now submit the report on stewardship activities or raise issues only to parties to whom we can certainly ask to fulfill their stewardship responsibilities to us - meaning asset managers. We made such a change.

Under such a circumstance, we have pointed out several problems, but this situation itself is also a problem, too. In addition, we have heard various opinions at meetings hosted by the

Ministry of Economy, Trade and Industry (METI). As I mentioned at the beginning, it seems that they [companies and institutional investors] do not trust each other and have doubts about a Win-Win relationship or constructive dialogue. Then what should be done to correct such a situation? One of the reasons for such distrust is obvious: while asset managers tell companies to improve governance, do the very asset managers have good governance? Needless to say, nobody listens to advice on governance from an entity with poor governance. In that sense, asset managers or institutional investors must straighten themselves. I won't refer to names of specific companies, but in general, I'd like institutional investors to reconfirm whether their governance is really functioning.

Second, while many asset managers are subsidiaries of financial institutions, there are some cases where they obviously have conflict of interests with their parent financial institutions. I don't mean to say that conflict of interests is impermissible in any and all circumstances. However, even though there is conflict of interests, some companies do not clearly explain how they address it. Therefore, we wrote in the report that they should take appropriate actions.

I have another long-time concern. As stated in the comment of President Mitani, GPIF expects asset managers to engage with companies - to have dialogue with companies. However, as soon as we say so, asset managers, in a rush, try to make appointments to have meetings with companies. They proudly report, "We've met with President xx times." That is not what we expect. We would rather say they should not visit companies just to have meaningless conversation.

We would like corporate managers to secure time for managing their companies as much as possible. In that sense, we need to assess whether such dialogue was meaningful. In addition to this need, we also cannot verify whether what asset managers reported is true, as I mentioned earlier. We are now facing these two problems. As a countermeasure, we are conducting a survey of JPX400 companies as an experiment.

As for contents of this survey ... did I attach the survey to the material? No? Anyway, in this survey, we asked JPX400 companies the following questions: "Among external asset managers to which we entrust investments, which one gave you useful comments?", "At meetings which we call 'engagement', what complaints do you have from the standpoint of

business companies?” or “How would you like external asset managers to use your Corporate Governance Report and other documents in the future?” We are conducting hearings at business companies.

This survey would bring about an effect similar to a 360-degree feedback to external asset managers. And as I mentioned earlier, in order for such a value chain to work, I believe that it is absolutely necessary to dispel mutual distrust. That’s why we have conducted such a survey. As of now, we have received responses from approx. 260 out of 400 companies. I’m not sure whether you think the number is large or small. I was afraid of a low response rate – responses from just 10 companies or so. So I feel relieved. Yesterday, I met with the corporate manager of a certain listed company, who is committed to this kind of activities. He said, “What are the remaining 150 companies thinking? When an asset owner offered such an opportunity for us to have dialogue and express our views, I cannot at all understand why some companies do not participate in the survey.” In that sense, the number of respondents may be small.

We have not yet finalized our report on the survey results, so I cannot report details today. However, I can give you some examples of their responses. Concerning topics of dialogue, some respondents reported that they do not merely focus on valuation, and have more dialogue leading to an evaluation of long-term corporate value. Some companies replied that they have received more participants to their facility tours or more requests for such tours. They have been asked questions about not only their businesses, but also the management and capital policies. While there are such extremely positive comments, we saw an increased number of stereotyped opinions about the purchase of cross-shareholdings, dividends to shareholders, share buy-back and so on. Or they stated that interviews are required for internal procedures [of external asset managers] for stewardship activities – this is the most unacceptable case as I mentioned at the beginning. Furthermore, although there are many interview questions, [external asset managers] seem satisfied with just obtaining responses. It seems they ask questions for the sake of asking questions.

There has been an increased demand for the improvement of ROE without relying on short-term return or profit increase. On the other hand, [external asset managers] do not really listen to explanations provided for better understanding on their capital investment, mission statement or business philosophies. In the future, we plan to incorporate requests for

improvements under such circumstances. Companies expect them not only to gather information, but also to provide advice or have dialogue on the market environment and trends of other industries. Companies would like them to have better understanding of the companies, and then have dialogue toward mid- to long-term growth. They also want to have discussions from the ESG (Environmental, Social and Governance) perspective. I understand that this Council focuses on G or governance, but in other countries, it is rare to discuss solely governance. We discuss governance as a part of ESG. Companies also would like to have such a discussion.

There is a bipolarization of disclosures of ESG information. And as mentioned earlier, there are 150 companies which have not responded to the survey. I'm not sure whether they don't understand the meaning of this survey or they are just too busy. Anyway, reactions of the companies are diverse, or polarized. Some companies stated that they would like institutional investors to engage more with investee companies and work with other investors.

Inspired by this survey, some companies have requested appointments with us, saying "We'd like you, as an asset owner, to listen to our opinions face to face." We have no intention to tell them how they should do their businesses. However, as mentioned earlier, we believe that we, as an asset owner, have a significant role to make this value chain work, and thus their opinions are more than welcome. If business companies would like to express their views directly to asset owners, we would like to listen to such opinions at any time.

Finally, I earlier referred to the relation between G (governance) and ESG. In overseas countries, they discuss G as a part of ESG. One of the biggest agenda items for CIOs of public pension funds, including myself, is how to address ESG. GPIF signed on to the UN Principles for Responsible Investment (UNPRI) last September. By doing so, we declared that we agree with the concept of ESG – its principles and rules.

On the other hand, we have not yet decided whether or not we go for ESG investments. At least, GPIF is very much interested in the trend of ESG investments in other countries. Actually, there have recently been arguments on ESG. Some argue that the concept of ESG originated from socially responsible investment. Accordingly, the emphasis is placed rather on philanthropy or social contribution, and they argue that it violates fiduciary duties of investors. Although the concept of ESG emerged, actually there has been a concern that UNPRI team has

gradually shifted the focus for discussion toward the environmentalist point of view. I assume they wanted to correct it by themselves. This time, UNPRI established the Asset Owners' Advisory Committee. This Advisory Committee was established for the re-clarification of the concept of ESG, which allows simultaneous pursuit of investors' fiduciary duties and social responsibilities. I also participate in this initiative as an Advisory Committee member, together with CEO or CIO of the California State Teachers' Retirement System (CalSTRS), University of California, Ontario Teachers' [Pension Plan], and AustralianSuper. I'd like to participate in discussion not only on G (governance) but on the entire framework of ESG, and consider what to do with Japan's G in the global context.

I took long time. That's all for my presentation. Thank you very much.

[Ikeo, Chairman] Thank you very much.

Now I'd like to resume the discussion, taking Mr. Mizuno's presentation into account. Mr. Oguchi, would you like to start?

[Oguchi, member] Thank you. I'm not sure whether the timing is good or not. It is tough to talk right after Mr. Mizuno's presentation, which was very encouraging, but at the same time, hit us where it hurts. Anyway, my first point is about the so-called investment chain, which he referred to at the beginning. The graphic shows fiduciary responsibilities at one side, and stewardship responsibilities at another side. In early February, a panel discussion on PRI was held, with the participation of foreign asset owners. A question was raised by the floor. Panelists were asked to express their views on a concern over GPIF's potential intervention in the management of companies. Frankly speaking, all foreign participants looked confused.

I talked with a foreign participant later. For him, it is naturally understood that asset owners have fiduciary responsibilities: in case of GPIF for instance, GPIF should look at beneficiaries, who are the public of Japan. He asked me what is wrong with activities for meeting expectations from the Japanese public to increase their assets. An asset owner may be the master of asset managers, but GPIF's master is the Japanese public. In such a structure, asking such a question is rather surprising [to foreigners]. Including the Corporate Governance Code, there has been a trend to incorporate the global viewpoint into various discussions. In that context, I assume that there is a need for discussing the investment chain, fiduciary responsibilities, and views on asset owners from the global perspective, and forming a

consensus. That's my first point upon hearing the presentation.

Next, this is what I wanted to discuss before Mr. Mizuno's presentation. It's about Material 2, specifically, disclosure of voting policies in the analysis of the Stewardship Code-related disclosures. Page 5 reminded me of a previous discussion. This is a huge advantage of the Follow-up Council, where we discuss both the Corporate Governance Code and the Stewardship Code here. As an extension of discussions on the Corporate Governance Code, we can now discuss the Stewardship Code. I think it was the third meeting when we discussed cross-shareholdings. Principle 1.4 [of the Corporate Governance Code] focusing on cross-shareholdings is divided into two parts: the first part refers to economic rationale, and the second part requires appropriate measures to be taken with regard to voting rights. I'm not sure whether other members agreed on what I said at that time. Economic rationale is needed, but in order to have economic rationale without causing any doubt about grant of illegal benefits, I believe that the most effective way to dispel any doubt about conflict of interests or grant of illegal benefits would be appropriate handling of voting rights. Therefore, I suggested that this Council could discuss how to handle voting rights for cross-shareholdings, or disclosure of voting results.

As Mr. Mizuno just mentioned, in this investment chain, asset owners or institutional investors have fiduciary duties. In addition, institutions which signed their acceptance of the Stewardship Code voluntarily declared that they would undertake stewardship responsibilities, even though they are not legal responsibilities. Then, what is the concept of stewardship responsibilities? I had an opportunity to ask this question to Professor Kansaku. He told me that they are not legal responsibilities, but close to fiduciary duties. If the duty of loyalty to beneficiaries underlies stewardship responsibilities, dispelling doubts about grant of illegal benefits or conflict of interests would be vital for assuming stewardship responsibilities. Therefore, the Stewardship Code has Principle 2 concerning conflict of interests. They disclose information on conflict of interests as their duty of loyalty to beneficiaries. I think this is the logical flow. Based on this assumption, as for the method to fulfill the accountability, disclosures of voting activities, as mentioned on page 6 of Material 2, would play a significant role in dispelling doubts about conflict of interests or grant of illegal benefits.

I reviewed the description of Principle 5 of the Stewardship Code. It reads, "Institutional

investors should have a clear policy on voting and disclosure of voting activity. The policy on voting should not be comprised only of a mechanical checklist: it should be designed to contribute to sustainable growth of investee companies.” This is the basic form.

However, because the Code adopted ‘Comply or Explain’ approach, it allows the adoption of alternative methods instead of disclosure of aggregated voting records. Including the earlier-mentioned cross-shareholdings issue, if there is a doubt about grant of illegal benefits or conflict of interests as Mr. Mizuno also mentioned, the most basic and effective way to get rid of the doubt should be disclosure of voting activities. If they go for alternative methods, what are such methods? Just providing an explanation is not sufficient. Such methods should be either equaling or surpassing disclosure of voting results. Otherwise, people will not be convinced.

Under the revised Companies Act, if a company does not appoint any outside directors, such a company is required to disclose “reasons why it is not appropriate for the company to appoint outside directors.” Because it is a law, it is stricter. To eliminate any conflict of interests or grant of illegal benefits upon exercising voting rights, if an institutional investor does not disclose aggregated voting results – if not individual results, they should provide a convincing explanation of reasons why it is appropriate for them not to do so. To prevent issues of conflict of interests or grant of illegal benefits, given that it would be the best especially for institutional investors to disclose aggregated voting results, the requirement for explaining reasons for non-disclosure will set the bar high for non-disclosure. That’s what I thought while looking at the chart on page 6.

I am sorry to have taken long time. That’s all.

[Ikeo, Chairman] Thank you.

Professor Kawakita, please.

[Kawakita, member] I also had opportunities to listen to Mr. Mizuno’s view on various matters at the Evaluation Committee for Incorporated Administrative Agencies. Continued from such meetings, I have several questions. Before that, I’d like to refer to the issue of conflict of interests. Asset managers’ conflict of interests especially with the parent company, and the quality of dialogue with companies – these are very important, but not sufficiently addressed. I agree with this view, and assume that we will discuss the topic later at this

Council.

Anyway, my first question to Mr. Mizuno is about active and passive management, as written on the top of page 2 of Material 3. I consider that the quality or quantity of engagement or dialogue would be different between active and passive management. I'd like to know how GPIF regards this point.

As I mentioned several times at the Evaluation Committee for Incorporated Administrative Agencies, there would be the following issues concerning passive management: whether passive managers have resources to have dialogue in terms of the cost, and how different is the dialogue led by passive managers from that led by active managers. I'd like to know how GPIF regards these issues. On page 2 of the Material, the third bullet point concerning the exercise of voting rights reads, "many external asset managers exercised voting rights under passive management simply based on the opinions of active investment managers". In a certain sense I think this is understandable. I'd like to know GPIF's evaluation of such a situation.

And this is not a question for Mr. Mizuno, but it is related to earlier-mentioned disclosure of voting policies and disclosure of voting activities. For example, an institutional investor exercised their voting rights to cast a negative vote, or made various suggestions during dialogue. However, the corporate manager did not properly respond to the said actions, and their response seemed unreasonable. In such a case, will the asset manager continue to hold shares of such a company? I don't think they need to own such shares. Even though the asset manager said "No" to the company's proposal, the company does not take a reasonable action. Then I think they should sell the shares. In this sense, concerning the exercise of voting rights, while Japan Investment Advisers Association is conducting a survey, I think it would be preferable if it also conducted hearings of asset managers or pension funds about this issue.

That's all.

[Ikeo, Chairman] Mr. Mizuno, could you answer the questions?

[Mr. Mizuno, CIO, GPIF] Thank you, Professor Kawakita. I think you raised several issues. First, concerning active and passive management, in the first place, the effectiveness of active management has been discussed as a significant issue on various occasions, including discussions on the reform of GPIF's asset management. In this regard, I believe that GPIF has a duty to carry out active management, especially investments in Japanese stocks.

The reason is as follows: the reason why passive management is efficient is because passive managers collect and analyze various active managers' opinions to make their asset management more efficient. To speak of extremes, if all asset managers became passive managers, passive management would become totally inefficient. Therefore, we should consider negative effects in case where such large-sized influential investors as GPIF decide to adopt only the passive management strategy. I believe we should thoroughly consider it as a part of GPIF's asset management responsibilities.

Next, in response to your question about the comparison of passive management and active management in our report, I totally agree with you. After all, if a company were not managed in a way an active manager expects, they could sell the shares. Which have stronger needs for increasing corporate value over the long-term through engagement, active managers or passive managers? The answer is obvious. Passive managers do not have a choice to sell the shares, so desperately need to increase the long-term corporate value. Unfortunately, in many cases, active management and passive management are carried out by different teams in the same company. If these are carried out by different companies, it should be passive managers that need to seriously consider the engagement as well as sustainable corporate growth over the long-term.

In such an environment, I have read Professor Kawakita's criticism of GPIF in the Minutes of this Council, which argued that the current situation may have been caused by the fact that GPIF lowered fees excessively. I'd like to make a counter-argument. Honestly speaking, until 2 years ago, asset owners had requested passive managers just to manage assets at a low cost and low ratio of tracking errors. In the past couple of years, they have increasingly requested for engagement, etc. Both asset managers and asset owners have had a hard time keeping up with such a trend. I think this is the reality.

In this report, we clearly told passive managers that stewardship activities relating to passive management are included as an evaluation item of the comprehensive evaluation, and thus their stewardship activities influence the evaluation results. In the past, tracking errors was the significant evaluation item, but there should not be many tracking errors with regard to Japanese stocks in the first place. So we clearly stated that from now on, stewardship activities would be an important item in our evaluation of passive managers.

How do we reward managers who properly carried out such activities? The easy way is increasing the balance. In addition, you mentioned whether we are in a position to increase the cost. This is a common misunderstanding. In selecting asset managers, GPIF does not adopt such a method as selecting an asset manager with the lowest cost. It is a competition seeking proposals in a public offering process for a public institution. Therefore, I would like asset managers to clearly mention in the proposals what their passive management teams are doing, how many staff members they have, and how much they need for such activities in terms of fees. Honestly, I'm disappointed by the absence of such proposals. If asset managers are carrying out passive management with meaningful teams by bearing that much cost, of course, we will recognize such managers.

Professor Kawakita, you asked one more question. What was the last question?

[Kawakita, member] It is related to the third bullet point concerning the exercise of voting rights on page 2. I'd like to know GPIF's evaluation of the fact that passive managers exercise their voting rights based on active managers' opinions.

[Mr. Mizuno, CIO, GPIF] I see. As a result of intensive discussions during our hearings, even though passive managers had stated that they engaged with companies and actively exercised their voting rights, we found the fact that they made the same voting decisions as those of their active management team upon exercising their voting rights in the same investee companies. In other words, it is like lending their voting rights or their shareholdings to their active management team. I think this is the reality.

Our report used the term "many [external asset managers]", because actually some passive managers were not like that. Active managers have an option to sell their shares, as mentioned earlier. For instance, if an active management team plans to sell certain shares within a year, it will be better for the team to make the company use all the cash to pay dividends. However, from the long-term perspective, it will lead to a reduction in capital investment or R&D, and thus may harm sustainability of the company over the long-term. In that sense, I don't think the current situation where passive management teams follow decisions made by active management teams is appropriate.

Here as well, in that sense, we just raise issues, and watch asset managers' future efforts with great interest.

[Ikeo, Chairman] Thank you very much.

Mr. Toyama, please go ahead.

[Toyama, member] Thank you very much. I also read it in the newspaper. While reading the current discussion on the direct shareholding and voting rights by GPIF, including the logic of the opponents – although I'm not sure whether it is true or not, I got worried. Assuming that the media report is true, I'm worried about the future of this country. As Mr. Mizuno mentioned, the ultimate beneficial owner of GPIF is the general public of Japan – all Japanese people. Naturally, GPIF has responsibilities to all Japanese people. In a certain sense, GPIF has fiduciary responsibilities or fiduciary duties. It is a matter of course that GPIF exercises voting rights, in order to maximize the assets of the general public over the long term. Then if they bring into question the state intervention in the exercise of voting rights, they should argue that something is wrong with GPIF's governance in the first place, and focus on discussion for the correction.

Furthermore, if the state intervenes despite the independence of GPIF's governance structure, it will mean that GPIF is not viable in the first place. It's better to terminate it. If they make opposition due to such reasons, they should rather demand the dissolution of GPIF. According to media reports, both employers and employees make opposition because of the state intervention. I don't mean to be offensive, but if they do not understand this simple, extremely simple logic, we will have to consider that they are dumb despite higher education, or the true reason is something else. It seems to me that the true reason is something else, if they are not dumb.

Assuming they are not dumb, if there is another reason, it will be the sense of distrust, which Mr. Mizuno referred to earlier. Then they should say so frankly. I believe they should honestly say that they do not trust shareholders' exercise of voting rights. Indeed, there are reasons for it. There is a historical background. I argue like this, believing that it eventually leads to discussion of the Stewardship Code. After all, in the picture of corporate governance in Japan... what to say... the shareholders' position reminds me of national governance in or before the 17th century, which was based on the perception that there was no need to grant the institutionalized power to ordinary citizens to allow them to participate in political power. Probably companies could achieve greater growth that way, and such a view to the

shareholders' position was rather accurate, I think.

Then, even though capitalist democracy was formally introduced, the role of shareholders before that was like that of an opposition party. Like a perpetual opposition party, they just talk out loud, instead of being involved as a responsible ruling party. Ruling party-like shareholders play the role of quietly supporting the management of the companies. The rest are like irresponsible ruling party and irresponsible opposition party members. We have such a long history. Japan has experienced such a situation for a long time. Then recently, for the first time, shareholders were told to perform a responsible role like a ruling party. So they are at a loss - confused by a sudden change. They used to talk out loud. They say only two things: "increase dividends" and "increase treasury shares". Almost nothing else. In fact, shareholders' comments made to the companies are mostly categorized into these two. I have seen many comments from shareholders as a director of Omron. Most of them are either of these two demands.

If all they have to say is only these two things, even monkeys could do that. Nonetheless, it had worked that way, because we did not have the Corporate Governance Code or the Stewardship Code those days. Virtually, there was no ground for citizens or general shareholders to seriously participate in corporate governance. It was just recently that they were required to address this issue. Therefore, I feel a little sympathy. It's a sudden change in a long-standing practice. It's like chaos after people's revolution, which the history saw many times. When people are suddenly granted voting rights and told to exercise such voting rights responsibly, they get confused because they have never experienced it before. I think that would be the case.

In the future, constructive dialogue will become increasingly important. They are still wobbling and toddling. It could be said that various companies have finally become modern civil states. Then, for the development of such civil states, it is important to learn from each other. In the future, we cannot blame corporate managers any longer for not supporting shareholders' views, because we now have the Codes. It is shareholders' fault for not making valid points. I believe we should look at the issue in a straightforward manner, and institutional investors should reflect on their past conduct with sincerity. If they cannot exercise their voting rights properly, what is the use of granting voting rights?

Speaking of the recent discussion on GPIF from such a perspective, I have exactly the same opinion as Mr. Mizuno. If passive managers cannot effectively engage with investee companies, it will be a natural consequence that GPIF itself has a “mirror” portfolio which is closer to that of passive managers, and conducts engagement activities. In other words, the scale matters. Unless they are large, they cannot maintain sufficient staff members in charge of engagement. In this regard, since it is GPIF that has the largest scale, I think it is justifiable that GPIF directly holds shares and exercises voting rights.

The governance reform was carried out, and there is no longer risk of state intervention. Therefore, although the decision was made that way [not to allow in-house investment] probably for various political reasons, I personally think that this Council should bring up the issue once again to make a turnabout. Otherwise, as I said before, looking at the structure of the discussion, at least the one reported by media, although I assume the panel consists of intelligent people in Japan, I have a doubt about their IQ level or, what to say, – it sounds like discussions by people who do not at all understand the basic elements of investments and trusts including fiduciary responsibilities, fiduciary duties and beneficial owners.

As I said before, if they argued that the very existence of GPIF is unacceptable, I would understand it. However, while approving the existence of GPIF, they say it is unacceptable that GPIF directly holds shares and directly exercises their voting rights because that is considered the state intervention. Such an argument is implicitly based on the assumption that GPIF does not operate on the principle of fiduciary duties to the ultimate beneficial owners, but basically acts with fiduciary duties to the state, the present political power, or incumbent power. Therefore, if they argued that way, the opposition forces should have frankly called for the dissolution of GPIF. I’m really concerned about that, and feel relieved if media reports in English have not covered this point. I do hope that the issue will be discussed once again in a proper way.

That’s all.

[Ikeo, Chairman] Mr. Iwama, please.

[Iwama, member] Thank you. I’d like to refer to the graphic in the reference material. Basically, I agree that it is important that this structure works well, but institutional investors include both asset owners and asset managers. And I assume it is generally understood that

asset managers act as agents of asset owners.

Then, speaking of disclosure of voting activities for instance, it works like this: responding to requests for what kind of information asset owners would like to be disclosed, asset managers, on behalf of asset owners, make the disclosures regarding voting activities. In general, it is commonly understood that disclosures are indeed necessary. However, there also are some cases where asset owners will get into trouble, if individual voting activities are disclosed. In that case, as asset managers have a duty of confidentiality as their agents, they cannot make such disclosures. I hope everyone understands this structure.

The Japan Investment Advisers Association established guidelines for exercising voting rights, and requested member companies to submit their policies in accordance with the guidelines. We are looking at their activities accordingly.

We are considering how we fulfill our stewardship responsibilities. Some members referred to “passive management vs. active management”. As a global trend, it is increasingly considered that the engagement by passive managers is actually meaningful and effective. Considering that an asset owner is the starting point as mentioned earlier, we appreciate that GPIF announced such a policy, which facilitates the proper functioning of the entire [investment chain]. The question at stake is to what extent we could respond to it.

Let me return to the topic of active and passive management. Passive managers also need to conduct engagement activities. There must be an argument that active managers could sell shares, if they are not worth investing in. However, this would be an issue of time horizon of investment mandates. How long is an investment period? Depending on the duration, there may be room for growth. In other words, effective engagement may result in a significant value increase. Holding shares for a certain period and having dialogue with investee companies – these are not the things which active managers always must do, or passive managers do not have to do, and vice versa. It’s not that kind of argument.

In response to the implementation of the Stewardship Code, we expect that the quality of such activities will be improved, thus triggering an upward spiral of this investment chain.

I also participated in the discussion on GPIF’s governance. Although I was not involved in the discussion on its investment management and do not know the progress in that sphere, I think they made a good step forward.

As Mr. Toyama mentioned, there are things which, I must admit, are incomprehensible. Nonetheless, they made a step forward. Although we are in the asset management industry with little influential power, we'd like to make our best efforts. Thank you very much.

[Ikeo, Chairman] You mentioned there are cases where asset owners do not want certain information to be disclosed. Could you be more specific?

[Iwama, member] I mean disclosures of individual agenda items of the companies. Of course, there are asset owners which approve such disclosures. Yet unless the entire the asset owners approve such disclosures, we cannot do so. Disclosures should be limited to some extent.

[Mr. Mizuno, CIO, GPIF] Thank you, Chairman Iwama. You mentioned the graphic in the reference material. We are not familiar with creating an illustration as well with the Financial Services Agency (FSA). Therefore, we just copied and pasted the illustration of institutional investors created by the FSA. As you mentioned, we are also an institutional investor. So in this graphic, maybe this part should have been described as an asset manager or fund manager.

You used the term "agents". As Mr. Toyama mentioned earlier, what I felt from discussions this time is that they have a vague understanding of agents and other governance-related concepts. The submission of the governance bill should mean that such an influence was removed by governance, but there remains the concern, while governance is promoted. This situation implies the absence of clear understanding of those concepts.

Under such circumstances, Chairman [Iwama] asserted that since asset managers are our agents, we need to provide instructions. I read his similar comment in the previous meeting minutes. I'd like you to understand that GPIF has various constraints in the current environment. Nonetheless, I'd like to tell you that there is one thing we can do with regard to the discussion of active and passive management. We used to select external asset managers every year for a fixed term of 3 to 4 years. In contrast, we are going to introduce the manager entry system, which allows us to select managers at any time. Once the system is introduced, we plan to decide the period for evaluating each manager's performance according to their asset management policies. We may review a certain manager's investment performance over several years, and another manager's performance in one year. We will decide the evaluation period case by case. By doing so, I think the concern pointed out by Chairman Iwama can be

dispelled to a certain extent.

[Ikeo, Chairman] Professor Kansaku, please.

[Kansaku, member] Thank you very much. As other members mentioned, in order to make the investment chain work properly, asset owners and asset managers have significant roles. It is based on the idea that especially asset owners need to fulfill their stewardship responsibilities to ultimate investors or “clients and beneficiaries” as in Japan’s Stewardship Code.

To discuss this issue, we need to be aware of the difference between legal responsibility and such social norms as stewardship responsibility which is not a legal one, and discuss them separately.

Under the concept of the investment chain, there are major limitations in a legal discussion. Typically, for instance, proxy advisers do not have contractual relationships with ultimate investors. In such a case, what legal relations or legal responsibilities are involved? That’s the issue. However, as mentioned earlier, because it is necessary to make the entire investment chain work, if there are various intermediaries between ultimate investors and investee companies, unless all the players fulfill their stewardship responsibilities, the entire chain will not work well. The Stewardship Code was, therefore, designed as a soft law, which is a norm, in a way to incorporate the entire investment chain, in my understanding.

Under such circumstances, for instance, some assert that if institutional investors cannot expect much from investee companies, they can sell their shares. Such an assertion vis-à-vis corporate governance discussion will make sense, if they sell such shares, and someone acquires such shares for takeover, thus leading to change in control in order to address poor corporate governance – in other words, the hostile buyout properly works. That’s how good corporate governance can be achieved in the context of the sale of shares. However, I understand that in Japan as well as other many countries, it seems still difficult to achieve good governance through hostile buyouts. Conversely, in my understanding, on the ground that they own shares, shareholders are expected to increase corporate value and improve governance through engagement.

In this connection, I’d like to ask a question. In the Stewardship Code, the fourth paragraph of Item 7 on page 3 stipulates as follows: The asset managers should aim to know the intention

of the asset owners so that they can provide services as expected, and the asset owners should aim to assess the asset managers in line with the Code, not placing undue emphasis on short-term performance.

On the premise that GPIF is an asset owner, I'd like to ask a question. The Stewardship Code expects asset owners to evaluate asset managers, not just from the short-term perspective, in accordance with the intention of the Code. Concerning specific methods for evaluation, in today's presentation, you mentioned such examples as looking at governance of investee companies or disclosures on conflict of interests. As an answer to Mr. Iwama's question, you said you adopted the manager entry system, and are considering how the performance evaluation should be. That way, you already answered most of the questions I had. So I'd like to know what you do for or think about the evaluation of asset managers without placing a disproportionate emphasis on short-term performance. Thank you.

[Ikeo, Chairman] Could you?

[Mr. Mizuno, CIO, GPIF] May I? Thank you for an excellent question. My expression is always extreme, and tends to cause misunderstanding. I said active managers could sell shares, but I did not mean that they, therefore, do not have to conduct engagement activities, etc. I said active managers have an option to sell shares, and their fiduciary duties to us could be explained like this: if the sale of shares is the most reasonable way to protect our assets, which we entrusted to them, within the agreed investment horizon, they have a duty to sell such shares.

Concerning whether it should be called short-termism, if we call it short-termism, I'm afraid that the efficiency of the stock market itself will be destroyed. Therefore, I admit and recognize it as one of their duties. In case of passive managers, since they do not have an option to sell their shares, they have to engage with companies even if it takes 2 or 3 years. In contrast, if companies do not change in 6 months or 1 year despite the similar engagement activities, active managers will sell their shares: this is a message to the companies that [the failure to change] may result in a decrease in their stock price. Suppose all asset managers adopt passive and long-term management strategy. Then, as soon as we say we also conduct only the long-term evaluation, we will be asked how long we need to wait. In that sense, active managers are more impatient with individual companies than passive managers, and I believe

that such impatience will positively contribute to overall efficiency.

Then what evaluation is made? As Professor Kawakita pointed out, in case of passive managers, while the low tracking error and low cost were considered important in the past, we rather evaluate whether they can carry out things I just mentioned. I don't say we have done everything, but we are determined to conduct comprehensive evaluations of passive and active management by employing a new method or using newly defined weighting criteria every year. Through such activities, the requirements of the Stewardship Code, which you pointed out, are actually being met. I think that efforts of all the participants, including myself, are still under way. I'd like to improve the situation over time.

I failed to answer a question from Mr. Toyama earlier. Yesterday an article in the Wall Street Journal quoted a foreign investor's comment, stating that this discussion on GPIF "could discourage investors who are looking for signals of improvement in Japan's approach to corporate governance." I think we should keep in mind such a perception abroad, while operating in the future.

[Ikeo, Chairman] Dr. Ueda, please.

[Ueda, member] Thank you. Mr. Mizuno, thank you very much for the excellent presentation. I also really agree with Mr. Toyama. I do not have courage to argue that way, but I am impressed.

Provided that the Corporate Governance Code and the Stewardship Code aim at raising the level of the whole market and improving Japan's economy as the national wealth, taking advantage of the large scale of GPIF's passive management would be one of the efforts for sustainable growth. Therefore, I believe it is very important. However, what to say, the fund is essentially for pension payments to us, so GPIF should look at the general public who are the beneficiaries, as Mr. Oguchi mentioned. Nonetheless, for no special reason, it has been regarded as money which can be used for politics – there has been a perception that the government could use money from there. It seems to me that, while such a perception has not completely disappeared, how to manage huge amount of funds has been currently discussed. It does not sound like an independent discussion of the pension fund management. Sometimes, it even sounds like a part of discussions of the sovereign wealth fund, which is owned by the state. That is completely wrong. As a premise of discussions, there needs to be greater

awareness that the fund constitutes pensions for the public.

If so, considering that [GPIF] is such a large scale national pension fund, it is a global trend that they are encouraged to proactively carry out their activities instead of being reserved, and enhance the transparency: transparency of the decision-making process and voting activities, if any, should be enhanced. I think that is the global trend. In doing so, they can demonstrate that they are conducting their investment activities or stewardship activities, while ensuring effective corporate governance. They enhance transparency and get evaluated by the public or politicians. Such a global trend is especially applicable to large public asset owners, but it seems that is not the case in Japan. Listening to on-going discussions, I got confused whether GPIF is not the national pension fund for the public, but something like a sovereign wealth fund.

Having said that, speaking from the perspective of stewardship, as Professor Kansaku also mentioned, in order to enhance stewardship by involving the entire investment chain, the concept of stewardship which covers directors, shareholders – especially institutional investors, asset managers and asset owners – and the general public as the ultimate beneficiaries, seems to have taken root globally.

When I was invited to the Council of Experts Concerning the Japanese Version of the Stewardship Code to make a presentation as a resource person, the relation between fiduciary duty and stewardship was still vague in terms of concepts. This point was discussed a lot in the UK as well. The concept of stewardship was vague, but exactly because of that, it was used to cover all players, aiming at raising the level of the entire market.

Then what is the most important key? As I referred to insurance companies earlier, the ultimate beneficiaries are individuals, and it is the asset owner who incorporates all of them in one fund. Therefore, asset owners are the key. As shown in Mr. Mizuno's material as well, as for the relation between asset owners and companies, it constitutes a chain of fiduciary duties. Or the scope of stewardship responsibilities may cover all players broadly from investee companies to asset owners. In either way, I believe that it is worthwhile for asset owners to take initiatives.

Looking at moves of other Japanese pension funds or mutual aid associations, I can see they have problem awareness. However, when there is a giant fund in this systematic Japanese

society, it seems that other organizations are hesitating to take initiative. GPIF brought up issues in its report released at the end of January, and signed on to the PRI. I believe that it encouraged other public pension funds to act accordingly – it opened a new window. You talked about judgment on mandates earlier. Through an overall move in this way, I assume that their relation with asset managers will gradually change.

Let me introduce a case example. Several years ago, ICGN, an international organization of investors, announced the Model Mandate Initiative. It discusses how to share the cost burden between asset managers and asset owners, while the latter require the former to consider ESG elements upon investments and conduct engagement activities. This kind of discussion inevitably involves the cost issue. If asset owners do not bear the cost, excellent asset managers will run away from the asset management industry. In such an environment, the business will not be viable, so some investment companies will go out of business, causing deterioration in the quality of the asset management industry. Therefore, cost-awareness is important. That is the background of this Initiative. I heard that foreign players have increasingly been taking this Initiative into account when they conclude new mandate contracts. Since the UK implemented the Stewardship Code 5 years earlier than Japan, discussions on this issue started in the world in advance of Japan. Yet, while listening to GPIF's presentation today, I got an impression that Japan has been sufficiently catching up with the world, looking in the same direction. Especially, GPIF's move may accelerate such development.

I'm sorry for taking a long time. Thank you very much.

[Ikeo, Chairman] Could you?

[Mr. Mizuno, CIO, GPIF] Sure, thank you. You pointed out several issues. First, concerning transparency, as Chairman Iwama pointed out, we disclose our voting activities in the form of such a chart in the report which I submitted today or other ways as in the past disclosures. Some argue that this is not enough, so we are wondering to what extent we should disclose information.

However, we are now considering that we will at least disclose what kind of companies' shares and how many shares we have all in all, including those through asset managers for the following reason. In the recent discussions, GPIF has been criticized for owning 7% of Japanese stocks. The said percentage represents the percentage of floating shares. If you look

at our share on a voting rights basis, the percentage is not that large. We realized the lack of their understanding, and so plan to disclose our shareholding ratios in aggregation.

As for our roles as an asset owner, we are told by various people – not only about this, but also the use of derivatives, etc. – that they would like GPIF to do this and that. However, whenever we try to do so, we are heavily attacked from various directions. So I'd like to request the members of this Council to say, on various occasions, that GPIF should do that, and actually has a duty to do that, instead of just saying "I hope GPIF will do that." That will help establish an enabling environment.

You mentioned ICGN. Although we are not a member, we have been invited as a guest on various occasions, so I have a plan for the participation. UNPRI's Asset Owners Advisory Committee, which I mentioned earlier, has set up several task forces. I'm going to participate in a work group which focuses on what kind of instructions asset owners should provide passive managers from the ESG perspective. Although this forum is another venue, I assume similar discussions will be had there.

[Ikeo, Chairman] Thank you.

We have only some 10 minutes left. Mr. Iwama, please make your comment brief.

[Iwama, member] You earlier raised a pointed question: what about asset managers' governance? I think I should answer the question. Needless to say, asset managers must ensure that their interests are aligned with those of their clients and investors. That is the most important value. Then in the event of conflict of interests, how do they manage it? Conflict of interests may occur on any occasion. It happens not because a certain shareholder holds 100% of the shares, or President was appointed from a parent company. I think it is important to examine whether there actually is any conflict of interests under specific circumstances, and consider how to solve such a problem.

Since the implementation of the Corporate Governance Code and the Stewardship Code, such discussions have taken place, and accordingly, the top management of asset managers has become very sensitive on the issue. They increasingly consider this issue seriously. I believe it is moving in the right direction.

Generally speaking, such structures can also be seen in Europe and the US. Of course, there are asset management companies, which are fully owned by life insurance companies and

manage the third parties' funds. They also invest in shares. It is possible that a parent company owns shares of the same investee companies, and the parent company and its subsidiary asset manager have different views. Then, does a parent company force its view on the subsidiary? No, there is a common solution to completely shut it out. There is a growing trend which requires asset managers to declare such things as much as possible to win investors' trust. It is still under way, but the management increasingly has such problem consciousness. Accordingly, shareholders also need to give this issue some consideration. I think there is such a move. We'd like to continue our efforts.

[Ikeo, Chairman] Mr. Oguchi, please.

[Oguchi, member] I'll make a quick comment. I think that one of distinctive characteristics of the Stewardship Code, which are different from the Corporate Governance Code, is the declaration of voluntary announcement of their [institutional investors'] acceptance of the Code. In response to the invitation, approx. 200 institutional investors announced their intention to undertake stewardship responsibilities. First of all, they have an option with regard to whether or not to accept the Stewardship Code. Furthermore, after the acceptance of the Code, as stated in No. 9 of the Preamble of the Stewardship Code, each institutional investor may implement the Code in various manners depending on their specific circumstances – for instance, using either active or passive strategies, which we discussed earlier today. There is no pre-fixed manner. However, from the viewpoint of fiduciary responsibilities, they are prohibited to take into account irrelevant matters, and expected to consider solely interests of beneficiaries. I think this is a common requirement.

While there are various investment policies or philosophies serving the common purpose, that is interests of beneficiaries, they undertake stewardship responsibilities. Then I think it is desirable that disclosures under the Stewardship Code will be more diversified. There should not be the only one right way. There are various ways of implementation, and each participant advocates their way through disclosures. I feel that is better.

However, in that case, I have a concern: if GPIF announces that it will evaluate the status of asset managers' acceptance of the Stewardship Code, all the asset managers may make disclosures in a uniform manner, similarly to companies' reports of compliance with the Corporate Governance Code. I think there will be such a risk. I'd like to know GPIF's view

with regard to individual asset managers' fulfillment of fiduciary responsibilities while their taking diverse investment approaches, as well as their commitment to the Stewardship Code.

[Mr. Mizuno, CIO, GPIF] May I?

[Ikeo, Chairman] Sure.

[Mr. Mizuno, CIO, GPIF] Thank you. This is applicable not only to asset management companies, but also to business companies. With regard to differences between the Corporate Governance Code and the Stewardship Code, you pointed out differences from the legal perspective. The Codes adopted 'Comply or Explain' approach, and do not expect everyone to do the same things. We have no intention to require such things. Instead, we'd like individual asset managers to call attention to how they create value.

As for business companies, honestly speaking, I did not expect that so many companies would obediently comply with the principles, even though the Code adopted 'Comply or Explain' approach. Many companies used to have no outside directors, but as soon as the Code was established, they secured outside directors. Actually, many business companies said to us, "When we are told to do this and that by asset owners and others, we have no choice but to comply." We replied, "That's not true. The Code adopted 'Comply or Explain' approach." Even if many companies say "Who cares about the Code?" and assert the validity of their corporate management, there will be no problem, in my opinion. Rather, I think that's how the Code should be. I have a similar attitude to asset managers.

[Ikeo, Chairman] Professor Kawakita, please.

[Kawakita, member] I'd like to ask just one question concerning passive management. As described in Material 3, while the number of listed companies is very large, in case asset managers adopt passive strategies and must conduct engagement activities, it takes tremendous efforts. As a solution, they become creative about the index composition. I also heard that many of them are now shifting their index to JPX400. I'd like to know in which direction GPIF's passive strategy is heading.

[Ikeo, Chairman] Mr. Mizuno, please.

[Mr. Mizuno, CIO, GPIF] Thank you. Currently, we are reconsidering what passive management is in the first place. It is not directly related with stocks, but due to the negative interest rate, government bond yields also turn negative under passive management. So it's

time for us to reconsider what the passive strategy is in the first place.

Under the passive strategy, we'd like to expand the target by including not only JPX400 but also Smart Beta. However, we were told by the supervisory authority that Smart Beta falls under the category of active management. Then it is no longer passive management. We need to consider such a framework in its entirety.

Professor Kawakita raised a question whether it is feasible to engage with all 1,700 listed companies. In the long term, I think there is a possibility that passive management will become like a process industry and only those companies with such resources can be passive managers. However, in the near term, I think asset managers will differentiate their screening processes for selecting investees from 1,700 listed companies as well as what they do with such investees, and try to draw attention of their clients, including us. Of course, we have no intention to criticize them for not engaging with all 1,700 companies. Instead, we'd like to evaluate the said efforts.

[Ikeo, Chairman] Time is running out. Mr. Tanaka, you are the last commenter.

[Tanaka, member] I'll make just one comment. Our Group [Mitsubishi UFJ Financial Group] also includes an institutional investor. For this kind of occasion, I have talked with them to find out what they do on the front line. They talk a lot about passive investment. They often say that for the very reason that they are passive managers, engagement is rather important. However, when they actually try to conduct engagement activities, they find that now many companies do not have any intention to have dialogue with investors in the first place. For instance, such companies do not even have IR departments or the equivalent. Passive managers often have hard time finding contact persons.

According to them, strong companies or large companies tend to ignore dialogue with institutional investors. Furthermore, attitudes vary across industries: some industries have great enthusiasm, and some do not. Front line teams actually have such a headache, but they say the number of engagement opportunities has been obviously increasing. Having mentioned such front line efforts, I'd like to ask a question. Mr. Mizuno, you referred to the sense of distrust, which is a very serious problem. In order to dissolve it, what measures can be considered? What do you think would be necessary? I just want to know these points.

[Ikeo, Chairman] Could you answer the last question?

[Mr. Mizuno, CIO, GPIF] Mr. Tanaka, thank you very much. We have conducted a survey of JPX400 companies. To grasp a perception of the current situation, we should seriously take the fact that we have not received responses from all of JPX400 companies. If the target is expanded to cover all listed companies, their reactions would be polarized into three or four categories, not just two. I assume that front line personnel of passive management companies have such worries. In that sense as well, it would be asset owners who can listen to concerns of both business companies and asset managers/asset management companies. Based on such a perception, we have conducted this survey. We'd like asset managers to express their concerns. On the other hand, we'd like to take in opinions of business companies.

As for the sense of distrust, I think it takes time to dispel it. This is linked with what Mr. Toyama said earlier. It is important at least to be perceived as having good governance. To erase such groundless fears as so-called state intervention or shareholders' influence, good governance - at least the formal appearance - is important. In addition, meetings are also important. After a company had meetings with 10 institutional investors, if the company found that an investor was useless, but 9 investors were useful and responded with understanding, distrust would be dispelled. At the moment, I got an impression that the number of such useful investors is 1 or 2 out of 10. If the number increases to 3, 4, or 5, eventually distrust will be eliminated. Therefore, we'd like everyone to make efforts to dispel distrust in terms of the formal appearance, and really improve the quality at the front line level. I think there is no other option than implementing these 2 approaches in parallel.

Did I answer your question?

[Tanaka, member] Thank you.

[Ikeo, Chairman] Thank you very much.

We still have plenty to say, but as I mention every time, this is not the end of our discussions. We will continue our discussions at the next meetings. So I'd like to close today's discussion.

Mr. Mizuno, thank you very much for coming despite your busy schedule.

[Mr. Mizuno, CIO, GPIF] Thank you very much.

[Ikeo, Chairman] The secretariat will sort out and summarize today's discussion. Taking the summary into account, we'd like to further discuss the matters.

Now I'd like to hand it over to the secretariat for an administrative announcement, if any.

[Tahara] I could not answer some of your questions for the convenience of conducting the meeting, but I'll answer the questions in the next meetings.

As for the date of the next meeting, we will fix the date which is convenient for you, and let you know later.

That's all from me.

[Ikeo, Chairman] Thank you. Now I'd like to declare the meeting adjourned. Thank you very much for your participation.

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