

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

April 26, 2016

[Ikeo, Chairman] It is the scheduled opening time, so I'd like to open the seventh 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. I'd like to apologize for the fact that it took such a long time since the last meeting. Due to various reasons – partly because everyone was busy at the end of the fiscal year, we eventually skipped a meeting in March. And we could not provide the notice of this meeting well in advance. We are sorry for your inconvenience.

Today, continued from the last meeting, we are going to discuss constructive dialogue between companies and institutional investors. As I just mentioned, it has been a long time since the last meeting, but the secretariat has had a thorough preparation all that time, and organized points to be discussed today concerning the significance of constructive dialogue between companies and institutional investors. First, the secretariat will explain those points, and then representatives from the Tokyo Stock Exchange and the Japan Investment Advisers Association will provide presentations. Then we will have a free discussion.

Now I'd like to ask a representative of the Financial Services Agency (FSA) to explain points to be discussed today.

[Tahara, Director of the Corporate Accounting and Disclosure Division, FSA] I'll explain in accordance with Material 1. In previous meetings, various points were raised for further discussion. We have summarized such points in the past two months, and would like you to discuss them today, although it does not mean today's discussion should be focused only on these points.

First of all, we reviewed your discussions so far and summarized problem awareness as follows: through the implementation of the Corporate Governance Code and the Stewardship Code, as well as the publication of the Follow-Up Council's opinion statement concerning

corporate boards, we consider that the basic framework for companies' governance reforms has already been established; however, the future challenge would be acceleration of their governance reforms in an effective sense, fueled by investors' efforts to enhance 'constructive dialogue' with the companies. It is important to create such a flow. We summarized the problem awareness this way.

The members raised various points concerning the challenges in realizing such governance reforms, and we consider that they could be classified into the following seven categories. First, institutional investors are expected to have effective dialogues with companies in a way to raise the companies' 'awareness.' On the other hand, dialogues just for the sake of formality have been increasing in number, and some institutional investors do not have sufficient understanding of business principles, etc. Furthermore, there are cases where companies do not show positive attitudes toward dialogue. The first challenge would be making dialogue more in-depth, and ensuring opportunities of such dialogue to be effective.

Second, there seem to be some cases where asset managers do not have good governance. Especially, it was pointed out that some asset managers have not clearly explained how they manage conflicts of interest, if any, with their parent financial institutions. At the last meeting, Mr. Mizuno, CIO of GPIF, also referred to this issue, and we consider that this issue is of high interest.

Third, one of effective ways to dispel doubts about conflicts of interest would be disclosures of voting results. This is incorporated in the Stewardship Code, but in the insurance industry, a low percentage of the companies has disclosed specific policies for exercising voting rights, and voting results by agenda. We understand that the necessity for increasing transparency in this area was pointed out.

Fourth, in case of passive managers, unlike active managers, there is no such alternative as selling off their shares. Therefore, it is more necessary for passive managers to increase corporate value over the mid- to long-term through their engagement. On the other hand, since it is difficult to have dialogue with all investee companies, passive managers need to be creative about how they engage with the companies. We understand that how stewardship should be in case of passive management – how to fulfill stewardship responsibilities – was a significant point at issue.

Fifth, asset owners are expected to evaluate asset managers in accordance with the intention of the Stewardship Code, not placing a disproportionate emphasis on short-term perspectives. At the last meeting, Mr. Mizuno, CIO of GPIF explained its initiatives in this area. Attention is drawn to what measures other asset owners have been taking.

Sixth, in this connection, it was pointed out that there are few corporate pension funds which declared their acceptance of the Stewardship Code, so it is necessary to create an environment which facilitates their acceptance.

Seventh, the commenter stated that proxy advisors should strive for making effective judgments, ensuring that they do not consequently encourage companies to make mere formal responses. We understand the commenter pointed out that institutional investors should not rely formally on advice from proxy advisors, but need to make their own effective judgments, for instance, by specifically examining the expertise of advisors, etc. prior to the use of advisory services.

Taking into account previous discussions, our reports in the last meeting concerning the status of compliance with the Stewardship Code as well as disclosures of measures to facilitate dialogue in Corporate Governance Reports, etc., and results of the Japan Investment Advisers Association's survey, which will be shared today, we'd like you to discuss what you think about constructive dialogue between companies and institutional investors, by focusing on the said points or raising other points, if any.

As you know, the Follow-Up Council invites public comments widely. Among comments we received, I'd like to introduce some comments which are directly related to today's topic. We have received public comments from nine organizations, institutional investors, and individuals. The first comment is from an international organization related to corporate governance. They pointed out that there have not yet been sufficient disclosures in the English language, and suggested that companies should create an enabling environment for dialogue by disclosing their Corporate Governance Reports and Annual Securities Reports in English.

The second comment is from another international organization related to corporate governance. They suggested that [the Council] should discuss the issue of conflicts of interest with institutional investor more extensively, and how such conflicts affect the fulfillment of stewardship responsibilities. Furthermore, they argued that just like companies should disclose

their long-term corporate governance policies and business strategies, institutional investors should also disclose their long-term policies and measures for their stewardship responsibilities.

The third comment is from an institutional investor in the U.K. While most of Japanese asset managers are affiliated with leading banks or life insurance companies, the commenter wonders if interests of a parent company may not always match with interests of an entruster of assets under management. There is a possibility that the “Chinese Wall” between an asset manager and its parent company is, in reality, extremely fragile, and, therefore, the Follow-Up Council should pay attention to this point. They state that it is important to respect a responsibility of asset managers to act in the best interest of stakeholders.

The fourth comment is from an organization of financial experts in the U.S. They argue that companies should make efforts to have constructive dialogue with shareholders in addition to general shareholders meetings. In order to facilitate effective dialogue between companies and shareholders, asset owners should bear appropriate costs for asset managers’ stewardship activities. They expressed their view on cost sharing with asset owners.

The fifth comment is from an overseas pension fund in the UK. With regard to the Stewardship Code, there is no standard reporting format like Corporate Governance Reports. Furthermore, while asset managers in Japan have already started dialogues, asset owners fall behind in taking such actions. They expect the Follow-Up Council to provide investors with guidance concerning dialogues and reporting on such dialogues, considering the fact that Japanese institutional investors are relatively not familiar with such activities.

They also stated that some companies are reluctant to meet with institutional investors. There are not enough opportunities to meet directors. They consider that meetings with independent outside directors are especially beneficial.

The sixth comment is from a governance-related organization in Japan. It is important that Japanese pension funds, as asset owners, play their full part in carrying out measures for stewardship responsibilities. They stated that it is necessary to conduct research on how stewardship responsibilities are fulfilled between asset holders/asset owners and asset managers.

The seventh comment is from an individual – personal comment from an executive of a public

pension fund. Many Japanese asset managers are affiliated with financial institutions, and therefore, there is doubt about whether their management of conflicts of interest is valid.

Furthermore, current disclosures by insurance companies are not sufficient due to the lack of disclosures of their voting results, etc.

The eighth comment is from a representative of a Japanese investment fund. The commenter suggested that all the listed companies should be obligated to ensure that senior management/directors meet with investors to a reasonable extent.

The commenter also questioned whether institutional investors, which accepted the Stewardship Code, put it into execution in a serious manner. For instance, last year, a proposal for issuing class shares was approved by the general shareholders meeting of a company. The commenter stated that he cannot understand why many institutional investors/shareholders who have stewardship responsibilities supported such a proposal.

The last comment is also from a Japanese individual. In addition to the government-led initiatives, it is important to make such efforts where disclosures of the Securities Reports include “equity story” as in the U.S. 10-K, and the top management speaks in his/her own words in IR activities.

These are the comments we have received. That’s all.

[Ikeo, Chairman] Thank you very much.

Next, I’d like to ask a representative of the Tokyo Stock Exchange to explain disclosures concerning corporate policies and measures to facilitate dialogue, in connection with today’s topics.

[Watanabe, Head of Listing Department, the Tokyo Stock Exchange] I’ll explain in accordance with Material 2. Please turn to page 2. The Corporate Governance Code consists of five sections, and Section 5 stipulates ‘Dialogue with Shareholders’ with two principles concerning ‘Policy for Constructive Dialogue with Shareholders,’ and ‘Establishing and Disclosing Business Strategy and Business Plan.’ I’ll briefly report what companies disclosed regarding these Principles.

Page 3 shows Principle 5.1 concerning Policy for Constructive Dialogue. With regard to this Principle, Supplementary Principle 5.1.2, shown below, listed items to be included in such policies. Let me introduce examples of disclosures for each of these items sequentially, as

shown on the following pages.

Page 4 shows disclosures regarding the appointment of members of the management or directors who are responsible for overseeing such dialogue. Many companies have appointed directors/officers in charge of IR, finance (CFO), general administration, or corporate planning to play such a role. As shown at the bottom of the page, some companies appointed President or CEO for the role.

Page 5 shows examples of measures to ensure positive cooperation between internal departments. In the examples in the upper half of the page, companies specified the names of departments in charge, but provided no more than a simple declaration that they will ensure positive cooperation with related departments. Meanwhile, the examples in the bottom half of the page describe specific measures for cooperation. For instance, some companies have taken such measures as cross-departmental staffing, regular information sharing, or the corporate disclosure committee composed of members from various departments.

Page 6 shows examples of measures to promote opportunities for dialogue aside from individual meetings. Such examples include the provision of operation update reports at general shareholder meetings, earnings release presentation, live broadcast, and disclosures in the English language. In addition, some companies issue the Integrated Annual Reports as shown in the example of Company K, or hold plant tours for shareholders and institutional investors as shown in the example of Company L.

Page 7 shows examples of measures to relay shareholders' views and concerns. While the first group of the companies merely stated that such feedback is provided as necessary or regularly, the second group shares such information not only with the management, but also with outside directors, or across the company. As shown at the bottom, there also are companies which have analyzed their exercise of voting rights, and reported results to the board of directors.

Finally, page 8 shows examples of measures to control insider information. As specific measures, companies stated that they manage the information in accordance with internal rules, and implement a silent period; they regularly conduct education; or multiple persons meet or deal with concerned parties for the purpose of mutual monitoring. There is a company which clearly stated that they never communicate any insider information in dialogues. Another company stated that if they provide such information, they will conclude a non-disclosure

agreement.

Lastly, page 9 with the title “Other” quoted an example where a company has a different department in charge of dialogues depending on attributes of counterparties, specifically whether they are institutional investors or individual shareholders. In case of this company, the Investor Relations division is in charge of measures for dialogue with institutional investors, and the President and the management participate to the extent possible. As for dialogue with individual shareholders, the shareholder relations division is in charge, and members of the management participate to the extent possible.

Then, from page 10, we compiled examples of disclosures based on Principle 5.2. This Principle stipulates that when establishing and disclosing business strategies and business plans, companies should articulate their basic capital policies, and present targets for profitability and capital efficiency and provide explanations to shareholders regarding specifically what they will do to achieve such targets. I’d like to introduce what companies described as their basic capital policies or targets for profitability and capital efficiencies.

First, as basic capital policies, Company Y’s example was introduced at the bottom of page 10. Company Y adopted return on equity (ROE) as their management performance indicator, and described their policy where they aim at constantly securing ROE of 10% or more by such means as profit growth and effective utilization of shareholders’ equity. Furthermore, as a policy for the return of profits to shareholders, they aim at achieving a consolidated payout ratio of 30%, based on stable dividend payments; and use the remaining profits, after deducting dividends, to acquire treasury shares, taking into account the amount of funds on hand, performance trends, or investment opportunities, if any.

Two more examples were quoted on page 11. Company Z described that they implement management practices by taking into consideration the adequate target levels for return on invested capital (ROIC) and return on equity (ROE); and also set the equity ratio target at a level sufficient for maintaining a corporate credit rating to prepare for sudden changes in the economic climate. In addition, they also stated that with respect to capital policy which results in significant dilution, the Board of Directors will make a rational decision by fully taking into consideration its effects; and as for a fund raising program which may result in significant dilution, the use of the fund and its collection plan will be fully deliberated at board meetings,

and sufficient explanation will be given to investors and shareholders.

In case of Company AA below, they first mentioned that their capital policy is formulated in accordance with the business principles, and then described that the policy centers around mid- to long-term return on equity (ROE) management, sustainable and stable shareholder returns, and growth-oriented investment criteria. Specifically, the company stated that they aim to attain a high ROE level exceeding capital cost over mid- to long-term; return profits to shareholders, taking into account balance sheets and free cash flow, as well as the signaling effect; and invest selectively to create corporate value by using the so-called discount cash flow method or internal rate of return (IRR) spread.

Page 12 shows 3 examples of disclosures regarding targets for profitability and capital efficiency. The first company presented target levels of sales, ordinary income, ROE, etc.

From a different perspective, the second company aims at sustainable growth as well as an increase in shareholder returns, and refers to the growth rate of operating income as their target, together with the target of shareholder returns.

In case of Company DD at the bottom, it considers that the profit margin on sales is the most important index, and set a numeric target.

At the bottom of page 12, as a reference, we quoted an example where no targets for profitability and capital efficiency are provided. This company does not disclose specific targets due to rapid changes in business models, technologies, and customer needs in their industry. In addition, the company may drastically change their business structure. That's why they have not disclosed specific targets.

From page 13, as a reference, we attached the status of compliance with the Corporate Governance Code as of March 31, 2016. Although there was no major change from the data as of December 31, 2015, additional 160 companies have disclosed information. Although the overall trend remains unchanged, we attached the updated status. Furthermore, in relation with dialogue, we included examples of explanations regarding information disclosure in English. Please refer to the data as necessary.

That's all from me.

[Ikeo, Chairman] Thank you very much.

Now I'd like to move on to the discussion session to hear the members' opinions. With

reference to today's topic, I'd like to ask Mr. Iwama to present results of the survey, which was conducted by the Japan Investment Advisers Association to analyze responses to Japan's Stewardship Code. In close connection with Mr. Iwama's presentation, the secretariat distributed results of the survey on stewardship activities of institutional investors, which were recently published by the Government Pension Investment Fund (GPIF) for listed companies.

Now I'd like to hand it over to Mr. Iwama.

[Iwama, member] Today, based on the survey on responses to Japan's Stewardship Code conducted by our Association, I'm going to report the situation of acceptance of the Code by asset managers who are the members of our Association, and improvement of the relevant structures by using an excerpt from the reference material. The detailed version was also distributed as a reference material. Please take a look at it when you have time.

Since 2002, our Association has conducted an annual survey on instructions for the exercise of voting rights under discretionary investment contracts, for the purpose of understanding the status of the members' exercise of voting rights. Later, in response to Japan's Stewardship Code established in February 2014, we changed, in 2014, the title to the "Survey on Responses to Japan's Stewardship Code." We conducted the survey under the new name for the past 2 years. Briefly speaking, although there are still many challenges, we perceive that there has been steady progress. On April 7, as mentioned earlier, the Government Pension Investment Fund (GPIF) published "Results of the Survey of Listed Companies concerning Stewardship Activities of Institutional Investors." GPIF, the world's largest asset owner, conducted the survey of JPX-Nikkei Index 400 companies for the purpose of evaluating stewardship activities of asset managers who manage GPIF's assets, and finding out the reality of purposeful dialogue or engagement. GPIF reported that they received responses from 260 companies. As is often pointed out, we consider it is important that asset owners (such as GPIF) and asset managers (such as our Association) make a concerted effort to enhance effectiveness of corporate governance in Japan. If all concerned parties in the investment chain, including companies, asset managers, and asset owners, keep in mind the objectives of both Codes [i.e. the Corporate Governance Code and the Stewardship Code], and work on making them take root more firmly, it will help create an environment which facilitates sustainable corporate growth and increase in corporate value. I hope you will listen to this report on our

survey results from such a perspective.

Please turn to page 1. Today I'll explain the results, focusing on these 4 areas.

Page 2 shows the outline of the survey. In FY2015, we conducted a survey of 206 member companies, and obtained responses from 184 companies. The content of the survey is written at the bottom of the page. 108 out of 184 companies or approx. 59% of the respondents replied that they had already formulated or were currently formulating their policies concerning the Code, marking an increase of approx. 7 percentage points from the previous year. Companies, which had already formulated or were currently formulating their policies, accounted for nearly 60% of the respondents. As shown in the chart on the right side of page 3, in terms of exposure of Japanese equities, they accounted for approx. 98%. It would be right to consider that almost all member companies which invest in Japanese equities have already formulated their policies. The member companies, which replied that they had no plan to accept the Code, do not invest in Japanese equities in the first place: that is the main reason for non-acceptance, and thus they consider it unnecessary to formulate such policies. We confirmed it. Therefore, almost all the members have established the policies: at least they delivered a message that they would respond to the Code in that way.

Page 4 shows the number of institutional investors, including pension funds, who declared their acceptance of the Stewardship Code, and the percentage of our members among them. As the Financial Services Agency also reported, there are 205 institutional investors who announced their acceptance of the Code, and 109 of them are our members, accounting for more than half. As of the end of August 2015, which is the base date of our survey, the total number of institutional investors who accepted the Code was 197, including 108 members of our Association.

Page 5 shows what our members place an emphasis on in their dialogues with companies as a part of engagement activities. Each member selected 3 agenda items on which they focus in their dialogues, and the chart in the left side shows the results. They most commonly focus on corporate strategy, governance structure, and policy on shareholder returns. The chart on the right side shows what they actually discussed with the companies, and the trend is similar to the left one. Generally, it could be said that the members conduct engagement activities for the purpose of facilitating sustainable corporate growth. Based on these results, we naturally

consider that it could be said that [institutional investors] have been taking actions in accordance with the objectives of the Stewardship Code – facilitating mid- to long-term corporate growth.

Please turn to page 6. Here are some good examples where companies' responses are considered to be very beneficial and effective while our members are conducting engagement activities. Although this summary may seem rather abstract, not specific, our members regarded them as good examples, because these companies have disclosed specific policies for addressing the Corporate Governance Code; appointed outside directors and established governance structures; shown proactive stance toward constructive dialogue with investors; and prepared organically combined disclosure materials including the Integrated Report in an easy-to-understand manner. These practices are perceived as good examples by investors. Actually, these practices are matters of course. In other words, it could be said that two wheels of a cart are finally working together. On the other hand, unfortunately, there are examples which are problematic and require further improvements. Continuous efforts are required.

Then, page 7 to page 10 show what efforts the member companies have been making in order to secure skills and resources required in Principle 7 of the Code, as well as what kind of self-evaluation they make concerning dialogue with investee companies. Approx. 40% of our members replied that they have been making efforts for increasing the effectiveness of their engagement activities since the establishment of the Code. Specific efforts are quoted on page 8. The members have been aggressively working on the improvement of internal process, and implementing training programs and organizing internal study sessions to enhance skills needed for dialogue. It could be said that members adopting a serious stance have been investing significant resources and energy. We also consider that it is desirable to enhance their ability to communicate results of such efforts.

The members' self-evaluation of their engagement is shown on page 9. There are members whose evaluation was that as a result of engagement, an investee company established a specific policy for enhancing its capital efficiency, or actually implemented its capital policy. Meanwhile, as shown on page 10, there are some members who consider that they still have challenges with regard to investee companies' stance for dialogue, as I mentioned earlier, or content of dialogue. With regard to securing skills and resources, both sides need to make

further efforts. We will continue to make efforts patiently.

Please take a look at page 11. These are areas, in which our members, through dialogue or engagement, requested investee companies to make improvements. In response to the establishment of the Corporate Governance Code, we understand that companies are making improved efforts. However, our members still have demands for their investee companies, such as the involvement of the management in engagement, awareness of engagement, enhancement of information disclosure.

Next, page 12 shows whether or not our members have established their own guidelines with regard to the exercise of voting rights. Among the members who announced their acceptance of the Code, 86% of them have already set their own guidelines with regard to the exercise of voting rights, clarified a relevant decision-making process, and established a framework for providing voting instructions. Other members have valid reasons for non-establishment of their own guidelines: for instance, because their exposure of Japanese equities are negligible, or because the investee companies are not listed. The members who should establish their own guidelines have already established their own guidelines. That's the situation.

I'll move on to page 13. This page shows whether they disclose aggregate results of instructions for exercising voting rights on their websites, etc. Among the members who announced their acceptance of the Code, 75% of them have made such disclosures or explained reasons for non-disclosure. The remaining members have valid reasons, - for instance, because they have no exposure of Japanese equities, as mentioned earlier.

Page 15 shows whether they voted for or against proposals at general shareholder meetings. This page shows the trend of voting for or against companies' proposals. Page 16 shows the trend of voting for or against shareholders' proposals. Generally, whether they voted for or against individual proposals of each issuer is not currently disclosed, because asset managers act as agents of asset owners who are their clients under discretionary investment contracts, in accordance with the latter's views on disclosures. Nonetheless, as an overall trend, you can get a sense of voting activities for different types of proposals from the data provided here.

Page 17 shows what and to whom our members provide explanations concerning their policies for responding to the Code, as well as their voting activities. The term "clients" here refers to asset owners, including pension funds. How do our members report to them? As shown in the

left chart regarding explanations on policies for responding to the Code to their clients or asset owners, approx. 60% of the members provide explanations only to clients who requested such information. Similarly, as shown in the right chart regarding explanations on voting activities to clients, 62% of the members provide explanations to clients, only if requested. In both cases, there are a certain number of investment management companies, which provide explanations to all clients, but they account for less than 10%. Let me explain the background of this situation. One reason would be a constraint in costs for engagement activities, another would be the fact that degrees of awareness and interest vary among their clients or asset owners. As a future challenge, we'd like to find out to what extent clients who made requests take these matters into consideration, and enhance the quality of reporting on stewardship activities.

Next, page 18 shows data on inquiries from investment management consultants. Generally speaking, consultants have not actively made inquiries, and what they submitted seemed to be general inquiries. We consider that it would be better, if investment management consultants made more active and effective evaluation in this area.

On page 19, the chart on the left shows products which involve engagement activities. While [the secretariat] referred to passive management earlier, more than half of investment management companies conduct engagement activities for all or part of active products. Yet there are 16 investment management companies, which reflect their findings from engagement activities in all products including index investment products, in other words, for passive management as well, although the number of such companies is rather small. Concerning whether they should engage in investee companies in case of passive management, as shown in GPIF's survey results, as well as an overseas trend where such large asset managers as BlackRock or Standard Life, or asset owners including Norges Bank, have taken a direction to engagement from passive managers, we understand that an increasing number [of institutional investors] is moving toward such a direction. Accordingly, we consider it is necessary for both asset managers and asset owners to positively consider such an engagement in the future.

Finally, I'd like to conclude that the members of our Association have been positively working on Japan's Stewardship Code, although the members' efforts are still in an early stage and there may be various shortcomings. Furthermore, as we have found further challenges concerning the Code in the course of making efforts, we'd like to share the survey results not only with our

members, but also with other asset managers and asset owners, and cooperate with concerned parties including regulatory bodies, so that we can overcome the challenges and realize effective corporate governance in Japan. We'd appreciate your continued support.

That's all from me.

[Ikeo, Chairman] Thank you very much.

Now, taking into account Mr. Iwama's presentation as well, let's start a free discussion. Mr. Tsukuda, would you like to speak?

[Tsukuda, member] Thank you. I'm Tsukuda.

At the beginning of the meeting, we were asked what we consider constructive dialogue between companies and institutional investors. Since I was absent from the last meeting for an unavoidable reason, I have thoroughly read the last meeting minutes, and got an impression that the members had a very meaningful discussion. Today, I'd like to raise 3 points, which are fundamental when considering constructive dialogue.

First, I assume that there would be distrust of the investment chain itself among the general public who are the ultimate beneficiaries. The members discussed distrust between companies and investors at the last meeting. Before we discuss measures to dispel it, I think it would be important to be aware of the entire picture where we, the ultimate beneficiaries, have the sense of distrust in the investment chain itself. A typical example is the public concern about Japan's pension system. Let's look at retail business. In the investment management industry in Japan, such sales companies as banks and security companies have more power, and thus, the business used to be overly inclined to develop products which generate higher earnings of sales companies. Monthly-dividend payout, double-decker fund, and churning of investment funds are also problematic. Recently, FSA Commissioner Mori raised the alarm in an article of a magazine by citing an example where banks and securities companies take 6-7% commission on their sales of single-premium insurance products in Australian dollars offered by insurers. When looking at the entire investment chain, there is a question whether the general public, who are the ultimate beneficiaries, can get adequate returns.

From this perspective, during the last meeting, the members argued that it is necessary to enhance the governance of asset managers, and increase the independence of subsidiaries of financial institutions, and the secretariat included such measures in the points to be discussed

today. I agree 100% with these measures. However, these would be necessary conditions, but not sufficient conditions. To secure sufficient conditions, I believe it is very important that asset management companies enhance their ability of investment management.

For example, a sales company should not appoint a person who has no experience in investment management to President of an asset management company in the same financial group. I believe it is crucial to develop human resources who have a solid investment philosophy as well as experience as a buy-side analyst or CIO, and appoint those who deeply understand fiduciary duties and the spirit of stewardship as the top management. Suppose the situation where an asset management company appointed multiple outside directors for the purpose of enhancing governance. I don't think such appointment alone will solve the fundamental problem. I believe it is essential that an asset manager establishes a structure for adding value to the investment chain by using its investment management ability, and secures its independence.

So I have a request to the FSA. In order to ensure that the entire investment chain works well, I'd like the FSA to place an importance on strengthening asset management companies' ability of investment management in the first place, and oversee the governance of asset management companies. Personally, I believe that the investment management industry has a strategic importance for Japan. Because it is a very important industry, I expect the FSA to support the healthy growth of the investment management industry. This is my first point.

Secondly, I'd like to raise an issue whether it really is necessary for passive managers to promote engagement activities, while the members expressed various views at the last meeting. I have read the meeting minutes, and found one thing I cannot be convinced by. Is it really possible for passive managers to engage with investee companies? Mr. Mizuno argued that it should be passive managers that need to seriously consider the engagement as well as sustainable corporate growth over the long-term. I agree with him. However, I have a doubt about whether passive managers, who are supposed not to pursue alpha, can have quality dialogue with the top management of companies in a way to raise their awareness. We should not ignore the fact that the ability required for passive managers and the ability required for engagement are significantly different. During the last meeting, there was the following argument: after meeting with ten institutional investors, a company may find that the number

of useful meetings was only one or two at the moment; but if they find that meetings with nine out of ten institutional investors were useful, distrust between companies and investors will be dispelled. That is true, but idealistic. When the gap between the said two abilities is huge, we need to thoroughly consider whether it is strategically right for passive managers to pursue such dialogue.

In the first place, in the investment management industry not only in Japan, but globally, active management does not necessarily outperform index management. There is a fundamental issue that many of active investments do not outperform passive investments. In its asset allocation, I believe that GPIF entrusted a significant portion of investments to passive managers. Then it would be necessary to consider whether it is better for GPIF to encourage passive managers to engage with companies, or to increase the use of active managers who regard engagement activities as their core competency and achieve strong performance in active value investing in the first place.

Ultimately, as mentioned in connection with my first point, the ultimate beneficiaries – the general public – do not want to bear additional costs incurred by passive managers' engagement activities, unless we can expect a proportional increase in returns. As Mr. Mizuno mentioned at the last meeting, the very existence of active management allows value investing to generate profits. Considering such a structure, I think it would be better to strengthen engagement activities of active managers as the top priority issue, and only after doing so, passive managers will follow a similar course.

It is a common tendency of Japanese companies that a company takes care of everything by itself, but it would be better to avoid it, when the current asset management industry is highly fragmented. Then what should they do? Concerning GPIF's in-house investment, Mr. Toyama made an important point the last time. In order to minimize a cost increase within the entire investment chain, I consider that GPIF should take initiative, by cooperating with asset managers, to strengthen engagement activities in a way that the entire investment chain absorbs engagement costs. Last time, the GPIF's representative mentioned that GPIF would like to pursue in-house active investments in Japanese equities. I believe that is the top priority issue. Only after having pursued it, as for [engagement of] passive managers, the whole mechanism centered around GPIF should be considered.

Finally, as my third point, I'd like to briefly talk about the exercise of voting rights. As I just mentioned, it would be difficult for passive managers to accelerate their engagement activities, but I'd like them at least to exercise their voting rights for the ultimate beneficiaries. I'll give you an example of a certain company, although I won't name the name. A salaried President, who is not the founder of the company, has held the position of President for more than 30 years, and business performance has been poor, marking ROE of less than 3%. Nevertheless, the President has enjoyed extremely high remuneration. I believe that institutional investors should take action so that this President is dismissed. This situation resulted from poor governance of the corporate board. Under such a circumstance, I expect institutional investors to adequately exercise their voting rights.

Life insurance companies have various transactions with corporate customers, so I can understand that they often cannot make genuine voting decisions. Yet I do hope that they break from such a practice, and fulfill their responsibilities as institutional investors.

I wanted to share these 3 points. I'm sorry for taking a long time.

[Ikeo, Chairman] Thank you very much.

Mr. Nishiyama, please go ahead.

[Nishiyama, member] I have several points to make, but I'll try to make it as short as possible. First, I'd like to raise a question. Actually, I asked this question when Mr. Mizuno, CIO [of GPIF], participated in the Council last time, but it remained unanswered. What do you think about the acceptance of the Stewardship Code by corporate pension funds? Recently, there have been new developments: for instance, there are some funds which entrust the Pension Fund Association with stewardship activities. Taking such development into account, I'd like to hear other members' views.

The next point. Concerning dialogue, I also submitted a one-page reference material for this meeting. Our company [Nomura Securities] holds an annual investment seminar for investors during New Year's holidays. At that time, we conducted a questionnaire survey among institutional investors. As it has been quite some time since we conducted this survey in January, I wondered whether I should present this data, but I think the overall trend remains unchanged. So let me share the survey result. You can see four options shown on the left. In response to the fact that companies have made disclosures under the Corporate Governance

Code by end-December, we asked the participants how they found such disclosures. We asked them to select one from four options. There were 169 respondents. The result revealed some distinctive characteristics. First of all, at that point, nearly 90% of the respondents replied that they had not yet read the disclosures. Considering the fact that the disclosures were provided in the year-end, and we asked this question in early January, it is understandable that the respondents had not completed reading them. However, the striking fact is that the largest group of the respondents [46%] replied that they had not read the disclosures, and also considered such information might not be so useful. Second, among the respondents who had already read the disclosures, the percentage of those who found such information not so useful was much larger than those who found such information useful.

Personally, I consider that there are two factors behind this result. The first factor lies at companies' side. Partly because it was the first year for making disclosures under the Corporate Governance Code, the disclosures have not necessarily incorporated individual companies' unique responses. They just tried to comply with the Code. I got an impression that the companies just followed the Code, rather than communicating their own way of thinking [about governance]. I suppose that such a stance caused the situation where the large percentage of respondents considers the disclosures are not useful.

The second factor is an issue on investors' side. Although the participants of this seminar do include people in charge of governance or exercise of voting rights, the majority of participants are portfolio managers or analysts. The result implies that such people have not yet been aware of the concepts of these two Codes. Therefore, regarding things which seem matters of fact to people in charge of governance or exercise of voting rights, portfolio managers or analysts do not have that much awareness yet. In that sense, while talking about the enhancement of dialogue, the gap between companies and investors is still big: I got such an impression from the survey results.

In this connection, although passive managers' engagement was referred to, in terms of dialogue, several times today, as I have mentioned several times, there would be a limitation in carrying out engagement activities by institutional investors. Therefore, if it is decided that passive managers should conduct engagement activities when many of them adopt TOPIX (Tokyo Price Index) for index investing, the list of targets for engagement will include approx.

1,800 companies. They are supposed to select and engage with some companies on the list. Conversely, when a company's issues are adopted in a TOPIX index fund, GPIF and other pension funds invest in them. Then, it does not matter whether or not the company works hard on disclosures required under the Corporate Governance [Code]. Thus, after the completion of the disclosures, companies might think about their responses. Yet, even if the companies have not had many dialogues, it seems they are not aware what disadvantages they might have. Therefore, personally, I feel that it would be necessary to establish a certain reward mechanism: for instance, the fact that a company has actively had dialogues with investors will lead to the inclusion of the company's issues in index investing, and thus the company can receive investments from pension funds and investors in index funds.

I have one more point to make. This is rather related to the discussion at the last meeting. Recently, there have been various discussions on the appointment of CEO. I raised this issue at the first meeting: since it is beyond the capacity of our company, I hope that research will be done to find out how many advisors are operating in Japan, and what roles they are playing. There should be various roles, so I think it is very important to understand what roles they are playing. Furthermore, in case there are advisors involved in such personnel matters as the procedures for appointing CEO, which are subject to disclosure under the Corporate Governance Code, it would be preferable if they disclosed such a fact.

Sorry for my long talk. That's all.

[Ikeo, Chairman] Are you replying to Mr. Nishiyama's question?

[Iwama, member] No, it's related to Mr. Tsukuda's comment.

[Ikeo, Chairman] Mr. Tsukuda's comment. Please go ahead.

[Iwama, member] I feel that his advice hit our sore spot. Speaking of distrust in the investment chain, for those who are on the buy-side, including ourselves, the key question is whether buy-side investors can fulfill fiduciary [duties]. This question has already been raised, and there will be a fundamental discussion on what to do in the future, so we'd like to actively participate in the discussion. Our industry is operating purely on the buy-side. In that sense as well, I consider that we should play the core role in the discussion.

necessarily engage every stock. However, selective engagement should be efficient. Despite being index managers, large-scale investment managers can do so. Therefore, I understand

such managers have been conducting engagement activities from such a perspective, and I consider it makes sense.

That's all.

[Ikeo, Chairman] Mr. Era, please.

[Era, member] Thank you.

Actually, this is the first time for me to express my view on this topic, so I'd like to briefly share my view on dialogue between investors and companies, and then talk about passive investment, which other members have referred to.

dialogue between investors and companies as very important. We expect companies to be managed from a mid- to long-term perspective, and communicate such expectations to the top management or the representative of the companies, to support such stance as an investor. Furthermore, we believe dialogue can also be utilized to confirm whether companies are actually managed in such a way.

Meanwhile, the term "dialogue" is not necessarily defined clearly. As Mr. Iwama mentioned in his presentation, topics discussed in actual dialogues are diverse. And depending on circumstances, topics and approaches of dialogues may significantly change. Currently, institutional investors are consulted by companies on various topics, such as corporate governance, capital policy, or mid-term business management; and provide feedback to them from the standpoint of investors – in other words, play the role of a sounding board. On the other hand, in cases which there are significant issues, an increasing number of investors are proactively requesting disclosure or responses from the companies.

And in such cases, investors check the companies' mid-term management plans, specifically, whether the companies has properly taken various steps including investments for the purpose of securing future growth. In terms of approach, there are many cases where investors support and encourage the top management and their business strategies. While there are also some cases where investors ask basic questions or present a different views during discussions to raise awareness on certain topics.

Of course, I believe the final decisions should be left in the hands of the management. Investors may express various opinions and the management may refer to some of the opinions, however the management and board should eventually make the decision on the approach in

managing the company. Nonetheless, I think it is still worthwhile for investors to express their views, as it may offer the companies with different perspectives, as long as the underlying motive is to contribute to the company's success.

Actually I believe refraining from dialogues which does not add value as stated in the first bullet point of today's paper is very important. I personally call it "dialogue with love" which is a dialogue where an investor thinks of what is best for investee companies, and is willing to help the company achieve sustainable growth and enhance corporate value. In other words, it is important for investors to engage in the dialogue as a partner to support investee companies' sustainable growth. Such a stance and approach is very important. Therefore, I'd like the Council to endorse the promotion of an environment to encourage such a stance for dialogue.

Furthermore, in order to make dialogues meaningful, needless to say, cooperation from companies is essential. While many companies have been increasingly become proactive towards dialogue, I also have an impression that there still are companies and management who are not. There still are companies which misguidedly treat investors in a reluctant manner like in the old days. Having said that, again, there are also increasing number of companies and management teams who regard shareholders as valuable partners to achieve sustainable growth, and skillfully use constructive feedbacks. I hope that the Council will further promote awareness-raising in this area in such a way as to encourage the latter case. Speaking in terms of the actual number of dialogues we had, the situation has been changing. Actually, we receive a lot more requests for dialogue from companies. As a result, more dialogues have been initiated by the companies' requests compared to those initiated by us. We'd like to create an atmosphere to facilitate this trend.

As for passive investment, our stewardship program is applied towards all our investment strategy – both passive and active investment strategies. However the size of our passive management is quite large, and that is why we often mention that we do not have an option to sell the shares, and hence dialogues are very effective. On the other hand, as Mr. Tsukuda pointed out, I also think the compatibility of stewardship activities, including dialogues, with the investment strategy is important. The characteristic of passive investing or broader investment offered by 'mainstream' institutional investors (asset managers) could be described as diversification and low costs. However such characteristic may not always be well matched

with the activities such as intensively engaging with companies. Therefore, while we consider stewardship as an important activity and believe we have the responsibility to actively engage with companies, it is also understandable if other investment managers may not consider similarly.

Lastly ‘dialogue with Love’ comes with a cost. As one of the members pointed out, how to fund such costs within the entire investment chain is an important issue.

Sorry for taking a long time. That’s all.

[Ikeo, Chairman] Thank you very much.

Mr. Oguchi, please go ahead.

[Oguchi, member] Thank you.

The term “fiduciary duty” was used several times today. As I said at the last meeting, Professor Kansaku, who is absent today, told me that stewardship responsibilities stipulated in the Stewardship Code are not legal responsibilities, but rather close to fiduciary duties. So I’d like to express my view within such a framework. Institutions which accepted the Stewardship Code made their own decision to undertake stewardship responsibilities in the first place. They declared the acceptance voluntarily. Then what are stewardship responsibilities? The secretariat distributed a copy of the Stewardship Code today. In the Code, the definition of “stewardship responsibilities” is provided in the first box. It refers to “the responsibilities [of institutional investors] to enhance the medium- to long-term investment return for their clients and beneficiaries, including ultimate beneficiaries,” clarifying the objective. This is exactly what the fiduciary duties are. There may be various views in legal debates, but at least, institutional investors who accepted the Stewardship Code declared that they would assume such responsibilities. So although “the Announcement of Commitment to Fiduciary Duties” is relevant to investment trust funds, the fact that institutional investors accepted the Stewardship Code would be, in some aspects, similar to “the Announcement of Commitment to Fiduciary Duties.”

The importance of fiduciary duties was already pointed out today. As Mr. Mizuno, CIO of GPIF, mentioned at the last meeting, when institutional investors manage not their own money, but others’ money, ‘fiduciary duties’ are like the Constitution, which is so extremely important that no one can ignore it. However, specifically what ‘fiduciary duties’ are, might be rather

ambiguous, so I'd like to refer to two points. Traditionally, it was said that there are two types of duties: one is duty of loyalty, and another is duty of care. The duty of loyalty is governed by 'no-conflict rule,' where investors are required to place the top priority on interest of beneficiary, not others, in other words, they should avoid conflicts of interest; and also by 'no-profit rule,' where investors are prohibited to gain profits behind beneficiary: these two are said to be the core of the duty of loyalty.

Guidance 2-1 refers to the duty of loyalty, which is a part of fiduciary responsibilities, by stating, "...institutional investors should put the interest of their client and beneficiary first." Then it continues "in conducting stewardship activities, they inevitably face the issue of conflicts of interest from time to time, for example when voting on matters affecting both the business group the institutional investor belongs to and a client or beneficiary" – this is a description of the real world. Other members have referred to conflicts of interest, especially the case of companies which belong to financial groups. In order to be free from any conflict of interest, they really must be independent companies – such cases would be very limited. Therefore, I consider that potential conflicts of interest actually exist. Unfortunately, because many Japanese companies take such a form [belonging to a financial group], as in the cases the secretariat shared earlier, foreign investors see a distinctive characteristic of conflicts of interest with Japanese institutional investors, and have concerns about how the companies manage such conflicts. Frankly speaking, that's an undeniable fact.

Then what will they do? Guidance 2-2 stipulates, "Institutional investors should put in place and publicly disclose a clear policy on how they manage key categories of possible conflicts of interest," meaning that providing explanations is more important and of effective significance. Ideally, they should shut out any conflicts of interest. To put it extremely, all of them need to become independent investment management companies, but it is impossible. Then what should they do? As a solution, I'd like to share an overseas example. It's about avoiding the appearance of evil: in case an institutional investor is perceived by others to have conflicts of interest with an investee company, they outsource the exercise of voting rights or stewardship activities for such a company to an independent third party. In doing so, they manage conflicts of interest in a preventive manner. Although there are arguments for and against whether this is necessary and sufficient, this is a measure actually taken.

Naturally, the issue of conflicts of interest is also important for the companies. Then how is it managed under the Corporate Governance Code? In Principle 4.7 iii), independent directors are expected to assume their roles and responsibilities in monitoring of conflicts of interest. Accordingly, under the Corporate Governance Code, while the companies naturally have conflicts of interest, independent directors play a leading role in monitoring such conflicts.

On the other hand, the Stewardship Code takes a stance that conflicts of interest are unavoidable, but does not provide any principles to cope with the issue. Therefore, discussion on conflicts of interest will continue in the future. Then, unless institutional investors provide outsiders with convincing explanations as in the case of explaining the role of independent directors under the Corporate Governance Code, concern over conflicts of interest will not be dispelled.

Then can they leave everything to an independent third party as in the example I just shared? I don't think so. This may be the same as what Mr. Nishiyama pointed out; the investment chain can fulfill its fiduciary responsibilities only when the entire chain is firmly connected even if a part of tasks is outsourced to someone else. At the bottom of the material prepared by the secretariat, it is stated, "Institutional investors should not rely formally on advice from proxy advisors, but need to make their own effective judgments, for instance, by specifically examining the quality of advisors, etc. prior to the use of advisory services." This attitude is applicable to not only when they use proxy advisors, but also when asset owners entrust investments to asset managers, or outsource something to other service providers. The duty of care, another aspect of fiduciary responsibilities, is important here. The duty of care is a responsibility to follow the best process as a professional. If they go for outsourcing, they have to choose experts through the best process with careful and sufficient consideration, and properly monitor the experts. Even if it is inevitable to outsource some tasks, in reality, due to various reasons including conflicts of interest, they have to ensure that the investment chain will not be discontinued there: while ensuring that the investment chain is not interrupted, the entruster will undertake effective supervision and fulfill such responsibilities. The creation of such a mechanism to cover the entire investment chain would be a substantive measure for asset managers and asset owners in Japan to fulfill their fiduciary responsibilities.

That's all.

[Ikeo, Chairman] Ms. Takayama, please.

[Takayama, member] I'd like to share companies' views on dialogue between investors and companies, especially on governance, by introducing some examples.

I'll talk about cases overseas and in Japan separately. In case of overseas investors, as it is clear from public comments from those investors, which the secretariat read out earlier, corporate governance of Japanese companies has attracted, and still attracts, a great deal of interest from foreign institutional investors. Under such a circumstance, the number of Japanese companies which conduct governance roadshows for foreign investors has been increasing recently. Japanese companies have held ordinary IR roadshows or IR meetings abroad for the past 10 to 20 years. While IR meetings focus mainly on business strategies or financial performance, governance roadshows or governance meetings focus on the companies' views of corporate governance and the oversight function of their boards, as well as how such views are connected with the creation of mid- to long-term corporate value.

Institutional investors who participate in such governance meetings are mainstream investors, who adopt mid- to long-term approaches and also targeted institutions in ordinary IR events. The participants of the meetings are mainly those who are in charge of governance. Sometimes, those who are in charge of investment management also attend the meetings. Our company also attended such meetings several times. The companies which held such meetings had already disclosed a lot of information on their corporate governance in the English language, and investors had thoroughly read such disclosures prior to the meetings. As a result, they had substantive discussions on the current state of their boards with many foreign investors from the US, Europe and the UK. These are examples of overseas communication

Now I'd like to talk about the current situation in Japan – dialogue between Japanese investors and Japanese companies. Triggered by the Corporate Governance Code, in companies which have seriously worked on improving the effectiveness of governance, their boards have had intensive discussions on how the board should be. Based on such internal discussions, they are willing to talk with Japanese institutional investors, and actually had many meetings. However, the companies found that the quality of dialogues varies depending on investors. With some investors, they can have fruitful dialogue. Yet there are disappointing cases as well.

Let me share some disappointing examples. The top management of a certain company

explained their response to the Corporate Governance Code and their view on the board composition in a well-organized manner, and asked an investor, “Do you have any questions?” The investor did not make any comment on the presentation itself, and just said, “Do you have any questions about our policy of the exercise of voting rights?” The top management was very much disappointed.

The issue of outside directors is also a common topic in dialogue with investors. In a certain sense, this may be understandable, but dialogues tend to focus on rather formal matters – typically, the number or independence of outside directors. Although such matters are also important, they can rarely have substantive discussion.

Similarly, while discussing outside directors, a certain investor said that what they expect from outside directors is nothing but the ability to dismiss CEO. The meeting with that investor focused solely on emergency situations. Of course, the appointment/dismissal of CEO is extremely important in terms of governance. Nonetheless, while being aware of importance of discussing emergency situations, the company wanted to discuss more of such matters in ordinary times as how independent directors contribute to increasing the corporate value through discussion at the board. They were disappointed by the biased discussion.

Another example is related to the standards of exercising voting rights. Such standards vary from investor to investor, but many investors require the companies to have a certain number of independent directors. However, some investors have the standards, which do not necessarily require independent directors if the companies achieve a certain level of ROE. From the perspective of the companies, it sounds like the old idea where if a company achieved good financial results, they do not care much about governance, and is, thus, confusing for the companies.

Those are disappointing cases. I, however, would like to emphasize that before the establishment of the Corporate Governance Code and the Stewardship Code, even such discussions had not occurred between investors and companies. It is true that we have seen rapid progress in discussions on governance and corporate boards in the past two - three years, although they may not yet be sufficient. It can be said that the speed of this change is very fast. As Mr. Iwama also mentioned earlier, the improvement of governance or dialogue depends on continuous efforts. I hope that the companies and investors will be able to have more fruitful

dialogues in the future, as a result of efforts of both sides.

[Ikeo, Chairman] Mr. Toyama, please go ahead.

[Toyama, member] I'd like to comment on Mr. Iwama's report. Page 5 shows agenda items on which investors place an emphasis, and agenda items which they actually discussed. Comparing these two categories, I found an interesting fact: there are some items which investors may have thought it is rude to include in the agenda, but actually discussed. All of such items are personnel matters. The number of investors who actually discussed personnel matters is larger than the number of those who included them in the original agenda. I think it reveals the nature of investors' honest feeling. A company depends on people. This is a long lasting issue. Without discussing CEO and succession planning, as well as the appointment and removal of directors, investors cannot truly engage with the companies. Therefore, this survey result reflected honest feeling of investors – in that sense, I think the respondents replied honestly.

Concerning the recent incident [*note: CEO to quit over failed personnel shake-up*], I wrote my opinion on the Nikkei yesterday [April 25, 2016], so I won't repeat it here. However, applying this case to the discussion on engagement based on the newspaper reports, I bitterly wonder why Japanese institutional investors did not raise a question about the problem – why it was a foreign institutional investor who raised the question. Probably, the Japanese institutional investors knew what was going on in that company. The company's press conference was covered on TV, the Nikkei Channel, for one hour. As far as I watched the 1-hour press conference, I think Professor Kunio Ito's judgment was right. The TV coverage was so surprising – I wondered if this management team is OK. You should watch the archive. In a certain sense, the reality of corporate governance in Japan as it is, was broadcast live on TV. To put it short, I felt regret.

This is linked with what Mr. Tsukuda said. I think people are not completely satisfied with the investment chain. People feel bad about why the problem had to be questioned by a foreign investor. In terms of phenomena, the Japanese equity market significantly fluctuates in response to trading by foreign investors. In the meantime, Japan is a country which receives notably less foreign direct investment (FDI) compared to other advanced economies. While the FDI is extremely small, the equity market is swayed by foreign investors' trading: it is a

distorted situation in a certain sense. If Japan received a lot of FDI and the Japanese equity market was swayed by foreign investors, it would be understandable. In other words, the problem is that foreign investors are interested in Japan as a speculative gambling venue, but not interested in Japan as a serious investment destination. Conversely, we have such a problem that an abnormally large portion of the household financial assets in Japan is allocated to deposits. As you know, essentially, the equity market has more domestic nature than the bond market in every country. Bonds are products close to commodities, and thus easier to be internationalized, but the equity market essentially has domestic nature, and should naturally be supported by domestic household financial assets or domestic asset owners. Then why has the money not flowed into the equity market? There have been various arguments. One of the causes would be, as Mr. Tsukuda mentioned, the traditional perception that investing in equities is very risky like gambling and should not be encouraged. Such a perception does exist. After all, asset owners and institutional investors – the investor side – have not gained the confidence of ordinary households, average salaried workers – what to say – average people. I believe that we cannot deny this aspect.

I assume that the FSA Commissioner Mori raised an issue with such problem awareness the other day. I believe that investment managers should seriously examine themselves, and consider how they can change the main flow of Japanese household financial assets from deposits [to the equity market]. Was the catch-phrase “Goodbye, Banks. Hello, Securities”? Mr. Atsushi Saito said, “When I was looking for a job, that catch-phrase made me decide to work for the Nomura Securities.” This is a story around 1965, so it has been 50-60 years. The fundamental point at issue would be how they can realize this long-cherished wish.

In this context, I’d like to discuss asset management companies. To tell you the conclusion first, it would be time to abandon the model where a subsidiary of a company with salaried employees serves as an asset manager. This model has two problems. One is, of course, the issue of conflicts of interest. Another problem is common for all asset managers in the investment management industry, ranging from venture capitalists to so-called institutional investors. This is the world of professionals. It is not a game for “salaried generalists” who are full-time employees under so-called “Japanese-style permanent employment system.” The model fits well into the manufacturing industry, etc., but among such industry, cases of

Information-Technology (IT) and Artificial Intelligence (AI) would be exceptional, and this area should be similar to professional sports. Unfortunately, it is not a game for so-called “salaried generalists” who may seem to be able to do anything, but actually cannot do anything. Therefore, I believe that it is time to undergo a fundamental shift from the current basic structure of the industry. In that sense, I feel that it is time for the FSA to facilitate such a shift through various regulations or reform.

In this connection, I’d like to make another point. Judging from today’s reference material, GPIF is quite decent. It is a decent organization on all accounts. I doubt the common sense of people who are against in-house investment in equities by such a decent organization. They are ridiculous. If they refer to the state power as justification, all public-private funds will need to be wiped out. Since the establishment of the Industrial Revitalization Corporation of Japan, where I used to work, such funds are owned by the state. And the state has and exercises its voting rights. If they are against it, they should demand the termination of all public-private funds. Those who are against [GPIF’s in-house investment] should immediately give such a voice. Frankly speaking, their logic is inconsistent. Therefore, they should discontinue such a childish argument. Therefore, discussion on GPIF should be restarted, and GPIF should be allowed to directly hold shares, and to exercise its voting rights. Today’s reference material renewed my belief.

I have another point in this context. It is about proxy advisors, which nobody has yet discussed today, related to passive management. If passive managers cannot [engage with companies] in practice, the role of proxy advisors will be important. They also seem to have signed the Stewardship Code. However, as I mentioned previously, some advisors adopted mere formal standards. They must become more serious about that. Today’s “defendants” are asset management companies. Next time, proxy advisors should be named as “defendants.” Every player should reflect on their past conduct. Companies were defendants in the last meeting; asset management companies today; and finally proxy advisors. Without the reflection of each player in turn, we cannot move forward. So we cannot skip it.

Finally, I have another point developed out of this context. It’s about “side effects” of discussion on engagement. What I mean by the “side effects” is the inevitable mixture of good and bad ones. Active managers include so-called greenmailers, who do no good and a lot of

harm. They try to take advantage of this trend. I assume that would be the biggest concern for the business community. Conversely speaking, the business community itself is self-contradictory. I believe that the legal doctrine of fiduciary duty should be established in Japan, similarly to the US, so that controlling shareholders are required to secure common interests of shareholders. I heard that the business community was against it for some reason. That is strange. I also belong to the business community, and I'm not against it. My point is that in the history of enhancing corporate governance in Japan, since they were reluctant to strengthen the board, the general shareholders' meeting has been gaining more power. Probably, the power of the general shareholders' meeting is the strongest in the world – the strongest among the advanced countries. There is a certain background. Therefore, shareholders' rights are strong. In Japan, shareholders' rights, including shareholders' proposal right, are actually very strong. On the other hand, when controlling shareholders, holding a certain percentage of outstanding shares, exercise their voting rights, Japan has no such legal doctrine that the controlling shareholders have a fiduciary duty to secure other minority shareholders' benefits, or common interests of shareholders. Although there is a legal doctrine concerning abuse of shareholders' rights, it is very limited. It is said that the business community has been against it, but I don't understand their reasons for the objection. That creates an environment conducive to activities of greenmailers. Accordingly, Japan will be a target of greenmailers. They can play the game most safely in Japan. I'm not sure whether it is true or false, but I heard that the reason for the business community's objection is as follows: in Japan, there are many cases where both a parent company and its subsidiaries are listed, so the parent company does not want to be sued under such a legal doctrine, when they exercise their voting rights at their listed subsidiaries. That's what I heard from a famous jurist.

That's ridiculous. Their subsidiaries got listed, so the subsidiaries are also public institutions. When the subsidiaries, being public institutions, have general shareholders, if voting decisions are made for the benefit of the parent company at their general shareholders' meetings, it will not be acceptable. If that is the case, they should cancel the parent-subsidiary listing. I don't think that can be a right reason for the opposition. One of today's keywords is "fiduciary duty." It is a very important point from all standpoints, so I'd like to assert that the FSA - or the Ministry of Justice? – should discuss the issue once again. The environment has been changing,

so there should be a renewed discussion under the current environment. The point is that we need to support investors who seriously conduct engagement activities, have sincere attitude, and are really responsible for fulfilling fiduciary duties. At the same time, we need to get rid of damned greenmailers. Taking these points into account, I hope the Council has discussion on this topic one more time.

That's all.

[Ikeo, Chairman] Mr. Kawamura, as you will be leaving early today, I'd like to ask you to share your opinions now.

[Kawamura, member] Thank you.

I'd like to make some brief comments on the exercise of voting rights. With regard to the exercise of voting rights, Mr. Tsukuda referred to an example of a company, which has marked ROE of less than 3% for consecutive 3 years, and asserted that the President should be dismissed: voting rights should be exercised in that way. While we have not seen a major increase in productivity in Japan, it seems that various opinions have not been properly delivered to the companies. Under the current circumstance, voting rights have not been exercised to that extent. Historically, the exercise of voting rights has remained at the level of merely voting for or against a director candidate who is also recommended as a candidate of a company, with which the company has conflict of interests. However, if they take a strict stance, for example, by asserting that the President is not fulfilling his responsibilities, given the current level of profits of the company, it will contribute to improving Japan's productivity, which is inferior to that of other countries, specifically in terms of amounts or ratios of profits. Therefore, I'd like them to actively influence the companies in that way. That will benefit the entire Japan.

Another point. As Mr. Toyama just mentioned, further efforts should be necessary to ensure that institutional investors are really fulfilling their responsibilities, or properly performing fiduciary duties. Therefore, if the exercise of voting rights goes into depth, instead of being just for the formality, and is utilized for revitalizing the entire Japanese economy or dispelling public distrust toward institutional investors, it will be the real thing.

That's what I thought.

[Ikeo, Chairman] Thank you very much.

Mr. Callon, please.

[Callon, member] I found Mr. Nishiyama's survey results very interesting, and with your permission, I'd like to give my interpretation of these figures. Most importantly, please don't worry. With respect to the January investor survey, the fact that a large number of the investors have not read companies' Corporate Governance (CG) Reports should not necessarily be interpreted as an absence of progress in Japan's corporate governance. The objective of the CG Reports is not to generate materials to be read by investors. Rather, the CG Reports are intended to be written by companies to convey their commitment to strong corporate governance, thus raising the companies' CG awareness and supporting their CG activities. The GPIF's survey results also showed changes in institutional investors' behavior in terms of their stewardship activities. The biggest effect of the two Codes is awareness-raising via the announcement of companies' and investor's commitments. As for companies, the key question is whether the CG Code is triggering new CG activities. My sense is that we will all be able to verify the presence of these new CG activities in survey results going forward, but for the moment I do believe that the CG Code has manifestly led to positive reforms.

While Japan's CG reform has made steady progress, there still remain challenges, as other members have pointed out. I'd like to discuss one of these challenges in the context of the third bullet point of today's Material 1 Opinions expressed in the past meetings of the Follow-up Council. As Mr. Tsukuda and Mr. Toyama mentioned, the adverse effects of conflicts of interest in the exercise of voting rights is an extremely important issue and one which all market participants are aware of. Shareholders fall into two categories: "Investment-Purpose Shareholders" and "Related-Party Shareholders." While Investment-Purpose Shareholders own shares for investment purposes and make voting decisions based on their views of business management, Related-Party Shareholders have fundamental conflicts of interest due to their relationship with companies, and thus it is impossible for them to exercise their voting rights truly as shareholders like Investment-Purpose Shareholders. For example, can an insurance company genuinely vote against the AGM proposals of a company which is its client? Shareholder voting rights should be exercised for the benefit of the ultimate beneficiaries and the citizens of Japan. This structural problem in conflict-of-interest voting will not be solved unless the relevant regulatory bodies establish guidelines or impose regulations. Only when

voting rights are properly exercised can investors support appropriate corporate governance. I would thus like to request that the FSA and other regulatory bodies consider an appropriate solution.

[Ikeo, Chairman] Dr. Ueda, please.

[Ueda, member] Thank you.

It may be like a trial in absentia, since I'd like to refer to a non-member who is not here today. On page 17 or 18 of Mr. Iwama's presentation material, I believe that the term "clients" refers to asset owners. The material also addresses investment consultants. I believe these pages would be more important than we think. In my opinion, it is asset owners who are the core of, or the most important actors in the investment chain. They are in a position to connect with beneficiaries, have large amount of funds, and are able to hire professional asset managers. So I think they are virtually the key to get the investment chain to work.

Last time, I frankly asked a question to Mr. Mizuno, and he replied in a straight-forward manner. So I'm encouraged to further discuss the matter. The point is that asset owners' involvement is essential, as written in Material 1. Especially, it is important for asset owners to encourage private funds, specifically corporate pension funds, to participate along with public pension funds. For example, reviewing survey results for corporate pension funds, I found that roughly 30% of corporate pension funds are interested in the Stewardship Code; and 60% of them, or 18% (60% times 30%) of corporate pension funds, have received reports from asset managers concerning their voting activities. This would be the result from the viewpoint of pension funds, whereas page 17 of Mr. Iwama's presentation material focuses on explanations from the asset managers to their clients. Furthermore, as written in the third bullet point from the bottom of Material 1, [asset owners] are expected to evaluate asset managers in accordance with the Stewardship Code, and encourage long-term investments. With this regard, out of 30% of corporate pension funds which are interested in stewardship, roughly 40% are now responding, or will respond [to the Stewardship Code]. In other words, roughly 10% of all corporate pension funds respond [to the Code]. It would be controversial whether one finds the percentage large or small, but roughly 10-20% of corporate pension funds are interested in stewardship activities, and plan to launch such activities in the near future. I hope we could promote such developments.

For that purpose, we need to reflect on our past conduct. For example, the media sensationally reported the news that GPIF had lost 5 trillion yen. Although it was a high-impact story, the fact that GPIF, with total assets of more than 100 trillion yen, lost 5 trillion yen in such a short period, should be evaluated from the long-term perspective. We say we aim at long-term investments. In the meantime, such a news story was reported. This is a tough situation. I wonder if the general public, as the ultimate beneficiaries, are aware of this point, and if they are yield-conscious. In managing assets, there is nothing special about making a short-term loss. It is impossible to keep on generating profits all the time. Then we should regret that we did not look at the issue from the long-term perspective, and criticized the short-term result. To secure yield return of the investment over the long term, it is necessary to take risks in investment decisions. Unless we change our perception, I'm afraid that we cannot do so.

This is not necessarily a problem of only asset managers and asset owners. It is a problem of general public, being beneficiaries, as well. We have no choice but to expect the government bodies, including FSA, or media companies to change the situation. There is a need for the change.

Now I'd like to talk about specifics. I believe that conflict of interests is the important point at issue this time. Concerning conflict of interests, as stated in the second and third bullet points of Material 1, one of the main problems would be conflict of interests with a parent financial institution within its group. Though stipulated in Principle 2 of Japan's Stewardship Code, this issue is not Japan-specific. In the UK in the early 1990s, a scholarly paper treated exactly the same problem. Therefore, the issue of conflict of interests facing institutional investors, which belong to financial groups, does exist and is inevitable. Having recognized such reality, how can they manage the conflict? What procedures are required in order to prevent virtual impact of conflict of interests? I believe such discussions are needed.

I heard that the FSA will place an emphasis on fiduciary duty in the future. I think that "customer-oriented operation management" is a good expression, being vague in a certain sense, and comprehensive. Nowadays, the concept of fiduciary duty is widespread. Where the concept of fiduciary duty connects players within the entire investment chain like a chain reaction, not limited to those who have legal relationships, the entire investment chain will be comprehensively covered. In this context, conflict of interests, as an actual phenomenon, needs

to be discussed.

The second bullet point of Material 1 merely refers to conflict of interests with a parent financial institution. Globally, this may be sufficient. However, in Japan, there may be conflict of interests between the investment division and the corporate division within the same entity. A typical example is trust banks: the cases where they establish the Chinese Wall within the entity in order to manage conflict of interests according to the Stewardship Code. This is a Japan-specific form, and it may be difficult to find similar cases overseas. If there are many cases where GPIF or other asset owners actually entrust investments to institutional investors in this form, I think we need to examine this type of conflict of interests as one of examples.

Finally, I'd like to ask a question to FSA – it's rather a request. Do you have a plan to publish our opinion statement intended for investors? I hope you do. The opinion statement concerning the board was published for the companies, and I believe that it will serve as guidance for the companies on individual issues. Therefore, I hope that issues surrounding investors will be sorted out, or something like an opinion statement will be issued as operational guidelines.

Let me tell you the reason for this request. The FSA has provided foreign investors with explanations on various points at issue, but we still receive inquiries from them concerning a practical difficulty, specifically, collective engagement. Japan's Stewardship Code does not refer to collective engagement. Although it is not stipulated, I personally believe that it is not prohibited. There is evidence: in practice, investors collectively send a letter, or collectively meet with the management of the companies. However, the UK investors and investors' associations with a lot of experience in such activities often tell us about their concerns: if they take part in collective engagement in Japan, it will be regarded as "acting in concert," and they will become subject to regulations on large volume holding of shares. Personally, I think it's like Japan is suffering from Galapagos Syndrome based on misunderstanding. Even though the FSA has already sorted out and published legal issues related to the Stewardship Code, such doubts have not been easily cleared up. Then we many need to consider other methods. For instance, aside from measures against greenmailers, I don't think that the Japanese laws and regulations prohibit collective actions which mid- to long-term investors abroad usually perform as a part of their engagement activities. If so, I hope it will be clearly stated in the opinion statement or something in order to remove the doubts, although it may be too user-

friendly.

I took a long time. That's my view. Thank you.

[Ikeo, Chairman] We hope to compile in a certain form and publish the current discussion on constructive dialogue between companies and institutional investors.

Please keep it in mind that we have less than 15 minutes left. Mr. Tanaka, please go ahead.

[Tanaka, member] I'll keep it in mind.

As other members have already pointed out what I wanted to say, I won't talk much. Today's topic is constructive dialogue. Where is this concept from in the first place? I brought the Ito Report here. The Ito Report provides a detailed explanation on what dialogue is. I think that we need to go back to basics in order to consider dialogue. This concept was originally developed to "create and maintain national wealth, while the Japanese economy is facing a serious population decline in the society," and it "aims at optimizing the entire investment chain." In this context, he stated that dialogue has aspects of both tension and cooperation, although such an expression as "love" was not used. A hurdle was set here, with regard to the stance toward dialogue and relevant skills required of institutional investors. Professor Ito was interviewed by the Harvard Business Review in March, and provided further details in the interview. He argues that conversation and dialogue are different. The reason why dialogue is required now is because "dialogue is a process through which people, who have different sets of values, explore the best course of action together, while feeling a sense of tension." It is the process to figure out what the differences between them are, where such differences stemmed from, and how they can bridge the differences. Furthermore, he wrote "such investors' actions as intensively analyzing the company and providing recommendations or suggestions from a different perspective, are called engagement." Therefore, I think we need to evaluate dialogue from the perspective of checking whether such a process has been really established. However, in this interview, Professor Ito also mentioned that the Japanese people are good at having conversation, but bad at having dialogue. I think this is a harsh criticism.

Having said that, I found Mr. Iwama's reference package is very useful. It serves as a basis for our discussion. Let's take page 5, which Mr. Toyama referred to earlier, for example. The Stewardship Code and the Corporate Governance Code intersect at some points stated on page 5: specifically, around five categories of agenda items written next to "governance structure,"

including leadership of chairperson/CEO, qualifications of directors/board, director remunerations, appointment and roles of outside directors, appointment/establishment and roles of *Kansayaku* and *Kansayaku* board. These are the topics which this Council has discussed. Nonetheless, the report shows that in reality, these were not usually included in the agenda of discussion between asset managers and companies. Why is that? It may be related with the issue of conflict of interests, or independence. I think we need to go into depth there. Since the investment chain is a chain, we need to detect a broken part of the chain, if any, and discuss the finding.

As I have recently talked with representatives from the US pension funds, they said that the position of asset owners is very important. Behind an asset owner, there are many individuals. Such individuals are the last in the investment chain. The most important point is whether the asset owner, who exists for such people, is fulfilling their fiduciary duties. I'll give you an example of how they do it in the US. A pension fund, being an asset owner, selects some 35 asset managers. Upon the selection, the asset owner carefully checks the independence of each asset manager first. Then, the asset owner asks questions to the asset managers - they used the term "algorithm" to describe a standard set of questions, including the leadership of Chairperson/CEO and the board composition. In other words, the asset owner, at the start, provides the asset managers with instructions to clarify what the asset managers are expected to do. Then the asset owner monitors whether they really do so. Accordingly, in order to confirm how asset owners behave, especially how they carry out their fiduciary duties for individuals behind them, I think it would be very important to focus on asset owners as Dr. Ueda mentioned earlier - or if I use Mr. Toyama's expression, let asset owners sit on the defendant's seat.

In the meantime, as someone mentioned earlier, it is necessary to sort out inputs from foreign investors, which were shared by Mr. Tahara earlier, and discuss them. When our opinion statement is prepared, I believe that it is important to reflect foreign investors' views in the statement.

That's it.

[Ikeo, Chairman] Time is really running out. Mr. Takei, please.

[Takei, member] I'll make it short.

My first point is related to today's topic, substantive dialogue. The listed companies are currently conducting the board evaluation. The board evaluation is very useful for the listed companies. Board evaluations have brought meaningful findings, which often present important agenda for of constructive dialogue between shareholders and the company. Surprisingly, in the past, the Japanese listed companies did not have many opportunities to review how their boards are functioning. The board evaluation will bring various findings to the companies. Therefore, in addition to the disclosures in the form of the Corporate Governance Report, their findings from the evaluation would be one of the key issues which may contribute to making dialogue meaningful. This is my first point.

with respect to the entire investment chain, on which other members have already expressed various opinions, each company has communicated their mid- to long-term growth strategies to the stakeholders in response to the Corporate Governance Code, and has been making "micro-level" efforts. Even though companies are earnestly talking about themselves at their own micro level issues, the next actors in the investment chain who listens to the companies tend to stick to macro-level, "one-size-fits-all" standards and to ignore characteristics of individual companies. This tendency causes an increased concern over the structure of the investment chain. Individual Japanese company composes the first part at the micro level, but the investors compose the second part at the macro level. These two parts will not match. The issue of proxy advisors also lies here, and we cannot say that Principle 5-4 of the Stewardship Code is complied.

In this connection, [As the third point, I'm concerned about governance issue of asset management companies within financial groups – the issue which other members have also discussed. I understand that there are issues rooted in conflicts of interest. However, I don't think it is right to encourage them to blindly follow advice from proxy advisors to cope with conflicts of interest. That is just replacing one problem with another problem. We need to avoid the situation where a certain formal response is replaced by another formal response without substance. Therefore, we need to ensure that they do not choose to blindly follow advice from proxy advisors.

Finally, my fourth point is a request from the companies concerning engagement. The division of IR [investor relations] and SR [shareholder relations] on the institutional investors' side is

inefficient. As Ms. Takayama shared some examples, many companies still find that IR information they provided is not made use of for SR. Since general shareholders' meeting is held only once in a year, the companies hope that IR information, which they regularly or annually provide, is certainly shared within each institutional investor. It would be better, if institutional investors corrected any interruption of the information flow due to such formal factors as different locations or different persons in charge.

That's all.

[Ikeo, Chairman] Mr. Uchida, please.

[Uchida, member] Thank you very much.

I'd like to briefly talk about constructive dialogue. In Mr. Iwama's reference material, at the bottom of page 9, there is a description starting from "In a certain company, a short-term investor expressed a harsh opinion about distribution of retained earnings..." This is a good example of constructive dialogue, which the companies, including ourselves, want to have. Although it is a little problematic that this company had not taken an active stance toward dialogue in the past, it is extremely important, in constructive dialogue, to achieve mutual understanding of corporate management from the long-term perspective. It is, needless to say, important to generate short-term profits, but it is also necessary to take a balance with the long-term growth. We place an emphasis on promoting long-term investments through constructive dialogue.

The reason we place an emphasis on the long term is related with the main objectives of the Corporate Governance Code: to increase earning power, or corporate value over mid- to long-term. We cannot realize it unless we manage the business from the long-term perspective to facilitate innovation, not from the short-term perspective. It is said that the time scale for innovation is decades. Regardless of whether it is application innovation or business model innovation, it occurs at the time scale of decades. Therefore, we need to take a balance between the short-term and the long-term. In the meantime, while conducting IR activities, we feel that investors' time scale is a little different from ours. Compared to business companies like us, their perception of time scale for investment is a little shorter. Accordingly, without having proper dialogue, in terms of the shareholder composition, short-term investors may account for a disproportionately large percentage. We are afraid of such a situation, and thus consider it is

necessary to actively have constructive dialogue. For that purpose, it is extremely important to explain our long-term strategies as information necessary for constructive dialogue, and, if appropriate, research & development philosophy or business principles.

My second point is similar to what Mr. Takei mentioned. When we actually have dialogue with investors, we find that they deal with IR and SR separately. Therefore, it takes our time and effort. Honestly speaking, it would be good if something were done. In the first place, the issue of governance, and the issue of long-term investments or strategies should be linked together. Accordingly, it should be necessary for institutional investors to look upon them as a package and make judgment. I believe that there is a need to examine how IR and SR should be. That's all.

[Ikeo, Chairman] Please keep in mind that we have only one minute left.

[Iwama, member] As a "defendant," I appreciate it that you gave me an opportunity to defend our position at the end.

With regard to what approaches our members have taken to prevent conflicts of interest, it is actually described on pages 8 to 10 of the detailed version of our survey results, although not included in the summary version. We asked these questions in order to find out the members' responses to Principle 2 of the Stewardship Code, which requires institutional investors to manage conflicts of interest in fulfilling their stewardship responsibilities, while putting the interest of their client and beneficiary first. Therefore, we asked each member company how they respond to the Principle. I believe that this question should have been included in the former survey on the exercise of voting rights as well. The implementation of the Stewardship Code has cast a spotlight on this issue, and we consider that our industry needs to make serious efforts. So please take a look at the said pages in the detailed version later.

Furthermore, it is not true that the independence of an asset management company, whose shares are held by its parent financial institution, is completely suppressed. In fact, recently, an increasing number of top management has been seriously considering this issue. I understand your concern, but I'd like to add that a steady progress has been made in this area as well.

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 discussions.

We will continue our discussions at the next meetings. So I'd like to close today's discussion. As usual, the secretariat will sort out and summarize today's discussion, and based on it, we will have further discussion.

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

[Tahara] As for the date of the next meeting, we will inform you later. We hope to have the next meeting in a month or less, if possible. Thank you very much.

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