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

June 1, 2016

[Ikeo, Chairman] It is already past the scheduled opening time, so I'd like to open the eighth Council of Experts Concerning the Follow-up of Japan's Stewardship Code and Japan's Corporate Governance Code.

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

Today, continued from the previous meetings, I'd like you to discuss constructive dialogue between companies and institutional investors. During the previous discussion, many of you raised the issue of conflicts of interest, so I'd like you to mainly discuss conflicts of interest today.

In connection with this topic, today we invited Mr. Hiroki Sampei, Director of Research at Fidelity International here. We also invited representatives from Asian Corporate Governance Association (ACGA) - Mr. Douglas Henck, Chairman, and Mr. Jamie Allen, Secretary General, who will be arriving here later. As many of you know, ACGA aims at facilitating the implementation of corporate governance throughout Asia, and its membership comprises more than 100 organizations, such as global investment managers and pension funds. As soon as Mr. Henck and Mr. Allen arrive here, we will listen to their presentation.

First, I'd like to ask a representative of the Financial Services Agency (FSA) to explain today's topics.

[Tahara, Director of the Corporate Accounting and Disclosure Division, FSA] In accordance with Material 1 and Material 2, I'm going to explain the summary of the members' previous discussion and illustrations that visualize the discussion in an easy-to-understand way.

Let me start from Material 1. Today we'd like you to discuss conflicts of interest, so we summarized your opinions on conflicts of interest, which have been expressed at this Council. In addition, I'd like to share public comments we received.

First of all, as general statements, bullet point number 1 titled "conflicts of interest in general" states that it is necessary for institutional investors to soundly fulfill their fiduciary

duties for ultimate beneficiaries. The concept of fiduciary duty is essential to the entire investment chain. From that perspective, it was pointed out that it is necessary to discuss conflicts of interest, as a real-world event, in the investment chain.

Public comments we received include such a suggestion that the Council should discuss more the issue of conflicts of interest with institutional investors, and how it affects them when they fulfill their stewardship responsibilities. Another commenter expressed their doubt about whether institutional investors that accepted the Stewardship Code, have been earnestly executing their stewardship responsibilities. For instance, last year, a company's proposal for issuing class shares was approved by its general shareholders meeting, and some people commented that they could not understand why many institutional investor shareholders, who have stewardship responsibilities, supported such a proposal.

Following such general statements on conflicts of interest, we summarized the members' opinions on conflicts of interest involving asset managers in bullet point 2. There would be cases where asset managers do not have good governance. Especially, there are some cases where asset managers have not provided clear explanations on how to manage conflicts of interest with their parent financial institutions.

In this regard, a member commented that conflict of interest with an institutional investor within a financial group is not a Japan-specific issue, by referring to the UK's case. Since this type of conflict of interest is inevitable, it is important to discuss what procedures are required in order to effectively eliminate influence of such conflicts of interest under such an assumption.

Furthermore, there is distrust in the entire investment chain. The members pointed out necessity of enhancing governance of asset managers, and increasing the independence of asset managers, in case they are subsidiaries of financial institutions to dispel such distrust.

It would be extremely important to appoint top management, who has experience as buy-side analyst or CIO, and fully understands fiduciary duties and the spirit of stewardship, instead of sending a person without experience in asset management from a sales company within the financial group as President of an asset manager.

As a public comment in this connection, it was pointed out that most of Japanese asset managers are under the control of leading banks or life insurance companies, and interests of a

parent company do not always match with interests of an organization that entrusted its investment management to an asset manager. Many asset managers in Japan are affiliated with financial institutions, and there is a doubt about the effectiveness of their management of conflicts of interest. There is a possibility that the so-called Chinese Wall between a parent company and an asset manager is in fact very vulnerable, and the Follow-up Council could pay attention to this point. It is essential to respect asset managers' responsibilities to act in the best interests of stakeholders. We have received such public comments.

In this regard, as I'll explain later, we'd like to suggest that it would be necessary to discuss what we consider conflicts of interest in general, not limited to specific cases within financial groups: for instance, a case where an asset manager of a corporate pension fund exercises their voting rights on proposals of a sponsor company for a pension scheme.

Bullet point 3 summarized views on the cases where there are trade relationships between institutional investors and investee companies. In addition to conflicts of interest with a parent financial institution, in Japan, typically shown in case of trust banks, there may be cases of conflicts of interest between the asset management division and the corporate business division within the same entity.

Furthermore, in case of such companies as life insurers that have corporate clients, it may be difficult to genuinely exercise their voting rights, but they are expected to fulfill their responsibilities as institutional investors without feeling restrained by such business relations.

For shareholders who fundamentally have conflicts of interest with an issuing company, it is difficult to exercise their voting rights for the benefit of ultimate beneficiaries from the pure standpoint of shareholders. For instance, a concern was raised regarding whether they can vote against proposals of issuing companies.

In this regard, we received a public comment, stating the current disclosures by life and general insurers are insufficient due to lack of disclosures on their voting activities.

Bullet point 4 is about corporate pension funds. It is expected that not only public pension funds but also private pension funds will accept the Stewardship Code in the future, although it may not be easy due to the resource constraints or relations with sponsor companies.

Lastly, bullet point 5 summarized the members' discussion on how to address conflicts of interest.

The first point is that in order to dispel any concerns about conflicts of interest, it is important for institutional investors to formulate and publish clear policies for managing conflicts of interest. They are expected to show a course of action in an externally convincing way.

The second point would be rather about an approach to address the issue, in case an institutional investor is perceived to have conflicts of interest. It was pointed out that it is not sufficient to outsource the exercise of voting rights to an independent third party.

Lastly, one of the effective ways to dispel doubts about conflicts of interest is disclosure of voting activities. In the insurance industry, the percentage of the companies that have disclosed their specific policies on the exercise of voting rights or voting results by agenda, is low.

That's all for my explanation of opinions of the Council members and public comments we have received so far.

Now I'd like to explain Material 2. It includes illustrative charts related to the bullet point 2 of Material 1, which I have just explained. We hope you will use this material as a case study for today's discussion. As an example, we set a situation where a certain company proposed introduction of anti-takeover measures at the general shareholders meeting, and illustrated three typical cases of possible conflicts of interest involving an asset manager who exercises its voting rights on the proposal.

Let me explain Case 1: when a company intends to adopt anti-takeover measures, the company places pressure on a securities company, which is a trading counterparty, to make its subsidiary asset manager vote for the proposal. As the illustrative chart shows, when the company plans to introduce the anti-takeover measures, the company approaches the securities company on the right-hand side to ask its subsidiary, which is an asset manager holding its shares, to exercise its voting rights in support of the proposal.

The relationships between the parties are the same in Case 2. However, in this case, the securities company, which is a parent company of the asset manager, is actually involved in the anti-takeover measures. The parent company has a business relationship with the issuing company, and will benefit from the anti-takeover measures. Therefore, in order to facilitate the smooth adoption, the parent company places pressure on its subsidiary asset manager to vote for the proposal.

In Case 3, as is commonly observed, the issuing company has its corporate pension fund. And the pension fund approaches the asset manager, to whom it entrusted investment management, and places pressure on the asset manager to vote for the proposal to support its sponsor company's adoption of the anti-takeover measures.

That's all for my presentation about Material 1 and Material 2. Thank you.

[Ikeo, Chairman] Thank you very much.

Next, I'd like to ask Mr. Sampei from Fidelity International to make a presentation. Mr. Sampei prepared Material 3 for reference.

Now I'd like hand it over to you.

[Mr. Sampei, Director of Research at Fidelity International] I'm Sampei from Fidelity International. It's my pleasure to be here.

In relation to the issues raised now, I'd like to share some overseas examples of how they address the issues by using Material 3.

Please look at the slide number 3. First of all, I'd like to explain what measures are taken for such investment vehicles as so-called investment funds (investment trusts). As you know, in the United States, investment funds usually take the form of a mutual fund. However, the term "mutual fund" is a kind of slang expression. The formal name is "Open-End Investment Company" as written here.

Similarly, the majority of investment funds in Europe take the form of SICAV, which is an abbreviation for a French phrase meaning "Investment Company with Variable Capital," as shown in the brackets. In the UK, recently, they have increasingly adopted the form of OEIC or "Open-ended Investment Company." Traditionally, in the UK, "Unit Trusts" had been common, but now they have been increasingly shifting to OEICs. This is related to the fact that SICAVs have become widely seen in the European Continent: to make the UK investors or the UK's asset management (investment) products easier to understand, they have been shifting toward OEICs in the similar structure to SICAVs.

Then what is the current governance structure for each type? As I briefly mentioned, each of these forms includes the word "Company." Therefore, they are corporate-type open-end investment funds. Because they are corporate-type, they have boards that perform oversight functions. As for mutual funds in the United States, strictly speaking, they are divided into two

categories: corporation-type and trust-type. Accordingly, their boards are called by different names: Board of Directors or Board of Trustees, respectively. They are the same. SICAVs in Europe also have boards - Boards of Directors. In case of OEICs in the UK, the form of the board is slightly different.

Then, while having the Board of Directors, how does governance work? Similarly to the governance of other companies, their boards have independent directors. In the United States, in accordance with the SEC's rule, the majority of the members are independent. In fact, the large majority of the members are independent directors. Let me share an example of the Fidelity Magellan Fund, which is a mutual fund of our company. The board consists of 8 independent directors and 2 directors from the asset management side.

Meanwhile, in case of SICAVs, a typical form in Europe, the regulation requires boards to have at least one independent director. The board composition varies from fund to fund. In case of Fidelity Funds managed by our company, the board consists of 6 independent members and 6 members from the asset management side, being 50:50.

The UK's case is slightly different. You can see the detailed explanation about differences between SICAV and OEIC on the slide number 4. In the UK, "depositary" comprising so-called beneficiaries is responsible for oversight. I think it has taken on the mechanism of traditional unit trusts. Anyway, depositaries are performing oversight functions, being totally independent from the asset managers.

Now I'd like to explain structures and possibilities of governance of corporate pension funds as shown in slide 5.

First of all, from the moral perspective, institutional investors, as the term "institution" suggests, have public responsibilities, and one of the institutional responsibilities is fiduciary responsibility. While setting it as the ultimate goal, as well-documented, they pursue mid- to long-term returns.

Another institutional responsibility is social responsibility, which is very important. For instance, when they act as market participants, they are responsible for performing the market function, price formation function or other functions taking into account the economic rationality of the market, and also are responsible for wide-ranging social impact. From this perspective, I'd like to refer to Examples 1 to 3. In Example 1, British Telecom set up a

separate fiduciary named BTPS. Marks & Spencer and Unilever also established separate fiduciaries. And each of them signed the UNPRI (the United Nations Principles for Responsible Investment) to be keenly aware of their social responsibilities and to make announcements. I'll give you an additional explanation in the next slide.

Example 2 is an old story. There used to be an index fund management company named BGI in the Barclays Bank Group. Barclays Bank is a listed company in the UK. At that time, there was a situation like Case 3 of Material 2: Barclays Bank is comparable to the company framed in the rectangle in Case 3, and BGI is the asset manager. At that time, what did BGI do upon the exercise of its voting rights, in case it held Barclays Bank's shares? Even if BGI appropriately used its own judgment when voting, outsiders would still have a doubt about conflicts of interest. Therefore, BGI took such an approach that as far as its shares in Barclays Bank are concerned, BGI did not exercise its voting rights at its own discretion.

Example 3 explains our company's principles in response to the Stewardship Code. Our company is not listed. We are not a full-service financial institution, but specialize in the asset management. Therefore, we are unlikely to get in the similar situation to Barclays' and BGI's. However, in the event of any conflicts of interest, we will not make voting decisions by ourselves concerning such shares. Instead, we will follow a third party's recommendation, or if it is still difficult, we will abstain from voting. In this way, we have a rule to ensure that it is obvious that there is no conflict of interest.

I'd like to briefly explain the policies of three companies in Example 1, as stated in slides 6 to 9. Slide 6 shows voting policy of BTPS - British Telecom Pension Scheme. This is from the original English text. I'm sorry that I have not prepared the Japanese translation. They articulated their voting policies and how to control conflicts. In case of BTPS, they outsource their proxy voting to Hermes Equity Ownership Services (EOS). In the last part of the presentation by the FSA representative, he referred to the comment that it is not sufficient to outsource the exercise of voting rights to an independent third party. Hermes EOS is not merely providing advice on the exercise of voting rights, but is also undertaking engagement activities. In my opinion, this is a significant difference. Concerning how they conduct such tasks, coincidentally, today's Nikkei runs an article about Volkswagen on page 7, and explains a little about Hermes' roles. It would help you to have a concrete image.

Please turn to page 7. Marks & Spencer also outsources their proxy voting to a third party. Although it is just a coincidence, they also contracted out it to Hermes EOS. Again by coincidence, the third one, Unilever, is also using the same company. Because of the extremely high profile, Hermes is often chosen by the UK companies, especially such large listed companies. I didn't select these examples in an arbitrary manner.

Just for reference, as for governance of investment funds that I mentioned earlier, the governance norms are principle-based, and they have the Code of Conduct, as shown on page 9 and thereafter. Please take a look at the first line of Principle 1 on page 9. It states that the Board should ensure that high standards of corporate governance are applied. This is obvious, because they are corporate-type investment funds. Accordingly, almost all of the following principles are similar to those of corporate governance.

Please turn to page 11, and take a look at the part marked in red. It is written that at least one independent member should be included in the Board. Although I won't go into more details, to summarize governance structures in overseas countries, similarly to corporate governance, it is required to clearly separate oversight and execution. Ensuring the clear separation means that many outside independent members are included in an oversight body. By doing so, they avoid conflicts of interest and fulfill their accountability.

I earlier referred to OEIC in the UK. The concept of corporate governance can be applied to various organizations, and they have been increasingly adopting the corporate-type as their form of organization. Therefore, as shown in the earlier-mentioned examples of Fidelity Magellan Fund and Fidelity Funds in the UK, attributes of outside members are outside directors of listed companies or the equivalent – top management of listed companies or academic experts. Accordingly, the perspective from which governance is carried out is exactly the same as that of listed companies.

That's all for my presentation.

[Ikeo, Chairman] Thank you very much.

Mr. Henck and Mr. Allen from ACGA have arrived. Now I'd like to ask them to make a presentation. Pease note that Mr. Henck prepared Material 4 for reference.

The presentation will be made in English. Simultaneous interpretation is to be provided. To listen to the Japanese interpretation, please set the channel on your receiver to channel 1.

Now I'd like to hand it over to you.

[Mr. Henck, Chairman, ACGA] Thank you Mr. Chairman and good morning everyone. I apologize for making my presentation in English, but that's really the only choice I have.

You can see on page 2, the agenda we have, my role today is just to act as an introduction really to provide a very short perspective of history, whereupon Mr. Allen will follow through with some of the detailed areas that we've been asked to talk about. The agenda is on page 2.

If you look on page 3, you'll see the core principles of corporate governance that the Asian Corporate Governance Association tries to instill in all the work that we do. If I could talk about this for a moment, there are a lot of definitions and questions, well, what do you mean by corporate governance and a lot of organizations use the term in different ways. We try to boil it down to some principle – core – some high core principles upon which we then use our judgment in terms of providing specific guidance from time to time.

Number one is transparency, there is always a question of balance in terms of the management of a corporation and how transparent it should be, but in this day, particularly with the digital revolution happening in all of our industries, transparency is becoming more and more a part of our daily lives and so the very real question of just where is that balance.

Accountability that the managers of a corporation are stewards for the shareholders, for all the stakeholders for that matter. And where is that accountability and are they being transparent about it and are they providing it.

Fair treatment of shareholders and stakeholders. This is my favorite theme. It's one where if people ask me the simplest term of corporate governance, my term would be to treat all of the shareholders fairly, including particularly the minority shareholders, where you often have a minority percentage owned by a family or by a small number of shareholders who are controlling the company and if they are disadvantaging, if they are in some way treating the minority shareholders in an unfair disproportionate matter, if there is a win-lose equation there, then my definition is that you're in violation of corporate governance principles at that point.

Board independence in a strategic role in my view is a way of ensuring that all of the shareholders are treated fairly. A lot of the issues we have with respect to independent directors, with proper accounting and audit committees and so forth relate to that question.

And then finally to act on behalf of the ethics and integrity, again getting back to the

stewards that we are with respect to our shareholders.

So on page 4, a little bit of history about the Asian Corporate Governance Association. It was founded in 1999. One of the cofounders Mr. Allen to my right and it was founded by a gentleman in the investment world who felt that the 1997 Asian financial crisis was fundamentally an absence of corporate governance. And if you look through the region at that time, if you look at the 11 countries we follow in our organization, you'll find that there were only two or three examples anywhere in the region with respect to rules, with respect to independent directors, rules with respect to proper audits, rules with respect to corporate governance and so forth. There was almost a complete absence of any kind of corporate governance oversight, if you go back to 1999.

Today I'm pleased to say in 2016 that there has been a lot of progress, notably in your own country here in the last couple of years with the stewardship code that you have promulgated. But if you look across the region, our objective as an organization has been to further advance corporate governance principles. In a sense, it's a never-ending battle because how can you get high enough. I am happy to talk about some of the shortcomings in my own home country, the United States or in England for that matter. But nevertheless it is a journey that has made progress and will continue to make progress.

We are an independent organization. We are a nonprofit organization. We have 111 organizations who are members. This is up from 5 that we had in 2000, so again we've grown by quite a lot. And you can see that our members represent some $24 trillion of investments around the world, and so when we do a survey of our members, we actually have some strong financial oomph with respect to what we're doing.

Part of the question that one gets into, I am on page 5 now, part of the question that one gets into with respect to corporate governance is how you do make progress. One of the things that I have observed is the question of box-ticking that you just – independent director check, you know, audit committee check and it is indeed true that it is often the case where corporations will comply by form but not by substance. However, when I look back at the last 15 plus years, I do find that there is something of an evolution. There is an organic growth that happens. If in 2005 a company was required, for example, to have a certain number of female directors or a certain number of independent directors, well check independent but this

was the fellow I grew up next door to, you know, or it was some other person who was really not necessarily a brother or a blood relation, but someone that they were close friends with. Over time and particularly as the next generation comes along, you do observe that pretty soon they say, “Gee, maybe we should get independent directors who can provide some real value to us, perhaps we can find some people who can – that we can take advantage of.” And so I personally see the box-ticking as a necessary evil that sometimes happens on the way to getting the substance that it is really required to do. It takes time, it takes the right attitude, sometimes it takes a generation, but I do feel that there is some progress being made.

In terms of the formality on page 5, what often happens as you can see is that the corporate - excuse me, the countries in the region will introduce a corporate governance code, often includes a comply or explain, I know that’s a current issue here, and then later our view is that you need a stewardship code. Interestingly, in Japan, you've done it the other way around. You had the stewardship code first and you are to be applauded for that because so far as I know it's the first in the region. But as far as the corporate governance code, several countries were ahead of you, I am trying to find a polite way to say that. But the – you were - you were first in the stewardship code and well done, but the two together really when groups like this one figure out how to comply with that and to move that along, that is strong progress being made. Again, there will be the danger of that box-ticking that goes on and my advice would be yes, some of that will happen, you should try to avoid it, you should try to get past it as soon as possible. But it's not the end of the world, it's better to have it than not to have it in – in my perspective.

Finally, on page 6, this is the last of my slides. What is the overarching approach that we’re looking at? And the answer is that company boards and management teams really need to look at their work in a different way. There simply is going to be more transparency as we talked about earlier. There is going to be more accountability as we talked about earlier. And so getting into that – that balance of where that legitimately goes is – it is a challenge. If you read my biography, you’ll see that I’m responsible for a number of companies in the region and have been for some time, I sit on a number of boards. It is true that I don't particularly want to talk every day the issue that comes across my desk - that - that gets a little bit silly. If I have a challenge, I'd like to try to have some effort to deal with it and so where

is that balance? And the answer is that if I'm not going to be able to deal with it and if a whole quarter goes by and if the earnings start to get reported and so forth and this is an issue that must be dealt with and has shareholder implications, then I need to have some serious discussions with the board and to figure out, okay so exactly where is our responsibility for treating all of the shareholders fairly, making sure people who are making investment decisions are doing so on a basis that is fair.

Institutional investors have a very important role to play here. Institutional investors is the one stakeholder that have been relatively quiet in our progress on corporate governance. A lot of the progress that we've made in Asia has come from the top down, it's from the – it's come from the government down, imposed upon the industry, much less so from the investors up to the – to the corporations. And so the question becomes when does that balance get reached? My view again would be that it is inevitable that the shareholders will insist on having proper corporate governance. The more it's understood, the more they will understand that, and as investors of these shareholders money - at the end of the day it's all – it all comes down to individuals, even if you're – even if you're investing on behalf of a pension fund, that pension fund is at the end of the day for individuals, and they are going to demand that kind of accountability and fair treatment with respect to - with respect to the investments that are had.

So, ladies and gentlemen, that's a brief introduction. As I said, we were requested to speak on some very specific topics of interest to this group, and I'll turn that over to Mr. Allen.

【Mr. Allen, Secretary General, ACGA】 Thank you Mr. Henck The issues I've been asked to speak about, addressing conflicts of interests and also how to encourage passive investors to become more engaged in corporate governance. So, I'm going to put - present some practical ideas on conflict of interests first. One of the issues here is how can asset managers in Japan manage and mitigate their conflicts of interests, particularly when voting shares. The ownership of asset managers in Japan does present some challenges. So how do they address these potential conflicts?

One possible solution that is being presented is to have an independent committee to review voting decisions. I think this is an interesting idea. I try and think about these ideas in terms of how you actually would implement them and it strikes me that it would be quite difficult to implement an independent committee to review all the major voting decisions. The proxy

season is extremely busy. To have an independent committee means you have people from outside your company who are going to be sitting on this committee. It's little difficult to see how that committee could review a lot of voting decisions, perhaps they could review some of the major, most significant risks in – when investors are voting. So, whether such a committee would really have the time to devote to reviewing the voting decisions is I think an important question.

Clearly, if such a committee is set up - and I'm not saying it shouldn't be set up - but if such a committee is set up, then that would need to be – need – need to make decisions based on either a materiality threshold or take a risk-based approach so that it reviews just the most significant material voting problems that an asset manager has.

Second issue is disclosure of voting records. So, this is the idea that you don't just vote but you actually disclose how you vote. Again, it's a useful idea, but if the disclosure is only at the aggregate - aggregate level – in other words, if you are only disclosing the total number of votes you do every year, the total number for, against, and abstain on all the resolutions for all the companies you vote, then I would suggest that information is probably of limited use. A much better solution would be voting disclosure down to the actual company level. If you get company level voting disclosure - and I'll show you, I'll talk a little bit in a moment about what's happening in other parts of the world, then you do have more transparency of the voting decisions and that would hopefully incentivize asset managers to think about their conflicts of interests.

Turning over to page 8. The third idea, and I think this is really probably the place to start is to have a clear voting policy. So, this is an asset manager developing an internal guideline that has market credibility and allows asset managers to vote based on what is best for their clients and beneficiaries. So this should, if implemented properly should give the asset manager consistent standards on which to base voting decisions and hopefully should reduce arbitrary pressure from the parent company. So if an asset manager, even those owned by a parent company, has a clear voting policy, if it votes consistently according to that policy, then that should hopefully protect it from ad hoc arbitrary interference from the parent company. This could also be augmented by requiring asset managers to explain why they have voted in a particular situation, for example why they have voted for parent company, clients, in a conflict

of interests situation. So, if there is a sensitive issue, these asset managers could be required to explain why they have voted in that particular way.

And the fourth issue is parent level disclosure. This is an idea where perhaps the financial services agency should require parent financial institutions to explain how they allow their asset managers – how they allow their asset manager subsidiaries to play a fiduciary role and to vote independently because clearly the asset managers are managing money on behalf of a wide range of beneficiaries, not merely on behalf of their parent, so the onus really is on the parent to explain how they allow their asset managers to play their full fiduciary role in an independent way.

Turning to page 9, we have done a short – well, we've done a survey recently of our investor members looking at how they actually vote and whether they have voting policies and whether they disclose voting records down to the company level. So, of the 111 members organizations, we have 75 institutional investors, 84% of those actually have a voting policy, 64% do disclose votes down to the individual company level. You may wonder why it's not a 100% for voting policy and not a 100% for voting down to the company level. The reason is simply that some of our members are smaller funds, small boutique funds, managing money on behalf of private investors or family offices or, you know, smaller institutions. So therefore, they don't have the same public interests obligations and duties that the larger asset owners, pension funds and the asset managers have. So, the 84% that have a voting policy and the 64% that disclose are the larger mainstream funds.

To give an example here, you can see from an American organization, the American Funds, how it discloses voting down to the individual company level. So this is required under US law, you can see for each of the directors here how they've actually voted on each director. I hasten to add all the votes here are in favor, this is not always the case, some of our members do occasionally vote against directors of companies, but this particular example is really just here for illustrative purposes and shows you, you know, the level of detail you get from this voting disclosure.

If you turn over the page, page 10, you will see AMP Capital which is an Australian fund. This is one of their funds. It's called the Blue Chip Fund, and it - you can see this is just the first page from their Blue Chip Fund report. It actually discloses all of the companies it holds

and all of the resolutions it's voted for or against. Again, you can see there is only one against on this page. If you actually look at the whole report, you'll see a much wider range of voting both for, against, and also abstain. So this is the kind of level of detail you get now in Australia.

If you turn over to page 11, you will see some of the market rules and practices on institutional voting. So you can see Australia, United States, and India all require disclosure of the voting policy, all require disclosure of voting records and also require disclosure down to the company level. Korea, Malaysia, Thailand require voting policies and voting records, but they don't require disclosure down to the company level.

And then turning over to page 12, this is my final slide. This is on encouraging passive investors to engage. There is a lot of discussion in corporate governance as how do you get passive investors to take governance seriously. Some people would say, they don't need to take governance seriously, they're passive investors. So, you know, whatever they do doesn't make a difference. We would actually say that's an incorrect view. There has been a long history in corporate governance of passive investors around the world actually taking a very active interest in governance, and the reason initially was passive investors cannot sell their shares, clearly, they don't select the shares. So engagement and taking corporate governance seriously is one of the few ways that they can actually deal with governance problems in companies and add value to those companies.

Secondly, passive investors are mostly long-term shareholders, by definition often with long-term liabilities. Hence, they do have an incentive to enhance the value of their shareholdings where they can.

Thirdly, numerous asset manage - asset owners around the world are passive investors, mostly pension funds as I mentioned. Many of these have had voting policies for a long time. They actively vote their shares and they're increasingly engaged. So, when we set up our association, some of our earliest members were asset owners who came from a passive investment industry or approach. They were the ones, the first ones in their own markets to actually start developing corporate governance policies and voting.

But clearly passive investors own hundreds if not thousands of shares, so if they are going to engage, then clearly they have to be quite selective in choosing which companies they engage

with. One of our members owns 9000 companies around the world, they clearly can't – they can vote on all those companies, but it's very difficult to vote in a very informed way on 9000 companies and it's impossible to engage with 9000 companies. So what they do is they take a risk-based approach where they focus on the most material significant companies and issues and that informs how they vote their shares in an informed way and also how they engage with companies. Thanks very much.

[Ikeo, Chairman] Thank you very much.

Now I'd like to open it up for discussion. Taking these presentations into account, I'd like you to discuss the case studies about conflicts of interest when exercising voting rights, as presented by the secretariat earlier.

Mr. Toyama is absent today, but he submitted his opinion paper, which we distributed to you. The paper was sent to the members in advance, so I won't read it out here. Please give consideration to Mr. Toyama's opinion paper, where necessary, for the discussion.

Who would like to start?

Mr. Iwama, please.

[Iwama, member] Asset managers' governance or structures involving conflicts of interest is a major topic here. As I shared at the last meeting, our Association conducted a survey. When asset managers are subsidiaries that are wholly or largely owned by financial institutions, we understand it is true that they are highly likely to face conflicts of interest. However, it is also true that they have been making significant efforts to get rid of conflicts of interest. For example, in the company I used to work for, a subsidiary uses its own judgment to exercise voting rights, being completely independent from the parent company. We had a structure with no room for the occurrence of any conflicts of interest.

The problem was how to completely block conflicts of interest with client institutional investors. This is related with how the company is managed. I believe that there has been steady progress in such areas as establishing an organization or function which can make objective judgments, appointing outside directors, or ensuring that the parent company does not intervene in ordinary business management of the subsidiary. However, when looked at from the outside, will these efforts be properly understood? Considering the fundamental structure, they may still be perceived to be doubtful. So the challenge is how we cope with it.

As one of the roles of our Association, as I mentioned at the last meeting, we should identify such areas for improvement through our annual survey, and discuss such challenges within our industry for improvement. We believe it is important to continue such efforts.

[Ikeo, Chairman] Thank you.

Mr. Era, please go ahead.

[Era, member] Thank you. Taking today's presentation into account, I'd like to share efforts of BlackRock, and how the company consider and address conflicts of interest in practice.

First, what I consider extremely important is awareness. The corporate objectives and the code of conduct, "mission and principles," including the expression "Fiduciary to Our Clients." The concept where interests of our clients or ultimate beneficiaries come first. As mentioned earlier, this is embedded in our code of conduct, and referred to as the criterion for value judgment in every situation, ensuring that the concept takes root in our company. So we put great value on it, and not only make voting decisions, but also adhere to this criterion for action and value judgment in various situations.

Next, I'd like to share our practical approach for making voting decisions under circumstances where there are concerns about potential conflicts of interest. There are 4 components.

The first component is the establishment of the guidelines for the exercise of voting rights, which provide principles for making voting decisions on proposals. BlackRock fully discloses the guidelines on its website. Furthermore, we also disclose the voting trends, thus ensuring transparency of our policy and voting activities. As for the full disclosure of the guidelines, we also use this as a tool to gain understanding of our views from a broad number of investee companies effectively and efficiently. With such intention, we decided to clearly disclose the guidelines on our website.

The second component is establishment of a team that makes judgments based on the guidelines for the exercise of voting rights. Actually, I am responsible for the exercise of voting rights in Japan, and we have established a dedicated function called Investment Stewardship Team. This team undertakes all voting activities in accordance with the guidelines for the exercise of voting rights. We also have another independent committee structure called Investment Stewardship Committee. This committee oversees voting activities of our team,

which is responsible for execution, and changes and updates of the policies and guidelines. In other words, we ensure the separation of execution and oversight in this way.

The third component is the fact that our function is separated from business responsibilities, to prevent us from considering potential business relationships between BlackRock and the investee companies. Of course, the team works with functions responsible for business in order to serve and help clients. However in doing so, we only share general policies or general trends and it is our basic policy not to share our voting decisions, intentions with particular clients before the general shareholders meetings.

The last component is the same as the effort referred to earlier today: in case there is a strong concern about potential conflicts of interest, we delegate voting decisions to a third-party proxy advisor. We delegate the voting decisions, but share our guidelines with the third party organization, so that the advisor can judge the voting rights in accordance with our view and policy. We ensure transparency in this way.

We clearly discloses these practices in the guidelines for the exercise of voting rights or the guidelines concerning stewardship responsibilities. That's all for my brief explanation of BlackRock's efforts and practices.

[Ikeo, Chairman] Thank you.

Mr. Nishiyama, please go ahead.

[Nishiyama, member] Thank you. I think the issue concerning conflicts of interest is very important. On the other hand, in Japan, we often hear criticism that the exercise of voting rights tends to be just for formality. If we see the issue of conflicts of interest too seriously, I'm afraid it may lead to another problem, formalism, in that area. So I'd like to ask a question to Mr. Sampei. You explained the current practices concerning the exercise of voting rights in other countries, and mentioned that the board includes both members from the asset management side and independent members. What are the attributes of the members from the asset management side? And are the perspectives of analysts or portfolio managers reflected in voting decisions? Or are the decisions made solely by the committee?

Furthermore, with regard to the disclosure of voting activities by life and general insurance companies, recently an increased number of the companies have disclosed individual policies and case examples by capturing the feature of individual companies. I believe that is very good.

However, because they focus on such details, I feel that it has become difficult to understand under what policies life and general insurance companies exercise their voting rights. Therefore, while it is very important to look at company level voting disclosures as well as specific features, in order to comprehend overall voting activities, I hope that the Council will have more in-depth discussions on such disclosure of voting activities.

That's all.

[Ikeo, Chairman] Thank you.

Could you answer the questions?

[Mr. Sampei, Director of Research at Fidelity International] Thank you for the questions. I think the questions you asked are related to slide 3 concerning the board composition – inside members vs. independent members. As for the attributes of directors from asset managers, for example, Magellan Fund has 2 inside members, and Fidelity Funds has 6 inside members. They are executives in charge of investment or asset management – in fact, senior executives. However, since these funds are corporate-type investment funds, the boards are responsible for governance of overall business execution of the entire companies, so they are not committees that review every single agenda item for voting. Please consider their boards exactly the same as the boards of ordinary listed companies. Did I answer your questions?

[Ikeo, Chairman] Mr. Oguchi, please.

[Oguchi, member] Thank you. I'd like to make 2 points, and also ask a question to Mr. Jamie Allen. My first point is about the disclosure of voting activities. Today's agenda is conflicts of interest. In the last part of Material 1, it is written that one of the most effective ways to dispel concerns about conflicts of interest is the disclosure of voting activities. I agree with that. Meanwhile, as Mr. Jamie stated, according to page 11 of ACGA's material, in other countries including the U.S. – since 2004 in the U.S., I think – they have already made disclosures at the company level.

While Japan's Stewardship Code was established by reference to the UK's Stewardship Code, it does not require the disclosure at the company level. According to the survey of actual conditions published by the UK's Investment Management Association in June 2015, three-fourth or 75% of asset managers, which disclose their voting record, have made company-level voting disclosures. I remember that Dr. Ueda quoted the figure at the Council

of Experts concerning the Stewardship Code at that time, and the percentage has now increased. Having been aware of such a global trend, given that there are concerns about conflicts of interest as illustrated in Material 2 – regardless of whether such conflicts actually occur, some argue that disclosures at the aggregate level are not sufficient for dispelling concerns about conflicts of interest, and that disclosures at the company level should be considered, along the lines of the global trend. I think that such an argument would be natural. What do we think of such individual disclosures or disclosures at the company level in Japan? If such disclosures are not feasible, it is required to seriously consider this issue, including reasons why they are not feasible: I feel that Japan needs to provide explanations as in those under the 'Comply or Explain' approach. Otherwise, we cannot respond to the concern expressed by Mr. Jamie.

My second point is about asset owner's roles in corporate pension funds in Material 1. As it is written in the general statement about conflicts of interest, fiduciary duties are important throughout the investment chain. I totally agree with it. Then I believe that it is essential to ensure that the investment chain will not be broken. In the entire investment chain, what roles does an asset owner play? It would be the same as the roles of the board in a company. That is the oversight function. The execution itself is undertaken by an asset manager, or stewardship service provider like our organization. In order to provide adequate returns to ultimate beneficiaries, I believe that it is essential for an asset owner to oversee the execution in a highly effective manner.

As written on page 2 of Material 1 concerning corporate pension funds, although there are issues of resources or conflicts of interest, it is required to fulfill fiduciary duties in the entire investment chain. Even though fiduciary duties are fulfilled in some parts, if there is any missing part, it won't work. Certainly, there is a problem pointed out earlier. Nonetheless, I believe that we need to consider roles of asset owners in the investment chain as seriously as when considering roles of the boards in the framework of corporate governance.

Therefore, as written in the material, the acceptance of the Stewardship Code would be the precondition. It was earlier mentioned that formality like box-ticking is not totally wrong. I agree. It would be worth starting with working on the formality, but such a form has to be effective. This is exactly the same as our discussion on the boards' roles: we discussed that their roles should not be mere formality. What is needed for that? I believe that it is important

that people, who are equivalent to shareholders of companies, play their roles in this investment chain. Then who are those people? They are beneficiaries – ultimate beneficiaries – who are the equivalent of shareholders of companies. So they should check whether asset owners are fulfilling their fiduciary duties in a substantive sense.

Mr. Toyama raised 4 points in his opinion paper. As his third point, he wrote about institutional investors as asset owners. He stated that asset owners are not perceived to have fulfilled their fiduciary duties by delegating everything to institutional investors to which they entrusted their asset management. He also wrote that in case of pension funds, asset owners should disclose their compliance status to the pension scheme members. Then I consider that beneficiaries should perform the function of checking activities of the asset owners. Actually, this is stipulated in Guidance 6-2 under Principle 6 of the Stewardship Code: "institutional investors as asset owners" should in principle report at least once a year to their beneficiaries on their stewardship policy and on how the policy is implemented. Making use of the venue of such reporting, the beneficiaries, who are equivalent to shareholders of companies, hold asset owners accountable. I believe that we should consider such a mechanism, concept, system or something that contributes to revitalizing the entire investment chain.

Finally, although this is not today's main topic, I'd like to talk about engagement activities of passive investors, which is written on page 12 of Mr. Jamie's material. Since this is related to today's topic and may be an important point for our future discussion, I'd like to ask a question. As written here, "given large holdings, passive investors must be selective in choosing companies to engage with." This is reasonable. In this connection, as Mr. Sampei mentioned earlier, today's newspaper reported that Hermes EOS is calling for shareholders to vote against Volkswagen's proposals for appointing President, directors and supervisory board members.

So when passive managers engage with companies with limited resources and costs, they need to select such holdings that have significant market impact, and be open about their engagement activities, thereby soliciting support from other investors or facilitating other investors' activities. I think this would be an effective way of engagement for passive investors. So I'd like to know what view global passive investors have.

【Mr. Allen, Secretary General, ACGA】 Can I clarify Toshi, what is the view of global

invest - asset owners in terms of choosing specific companies with which to engage to set an example? Is that the question?

[Oguchi, member] Yes, I assume that passive investors engage with relatively large companies in the market, whose activities have significant impact, or spillover effect – in other words, passive investors conduct engagement activities to improve the entire market. Therefore, they choose companies with a strong impact. For passive managers, selecting large-cap companies or companies with typical problems would be the most efficient way to engage. Active managers engage with investee companies, but I assume passive managers carry out engagement activities in this kind of selective way.

【Mr. Allen, Secretary General, ACGA】 They choose based on, I think, where their largest shareholdings are and that may be a sectoral choice, it may be a geographic choice. They also choose based on where their experience is. So, a European fund that has a large number of holdings around the world may well invest, engage, and vote a lot more in Europe than in Asia. I mean, typically we see that. You know, they don't have the people in Asia, they don't have the local knowledge, they don't have the language, they don't have the travel budget sometimes, it can be as basic as that. So, you know, they try and select, you know, they have very limited resources typically. Asset owners, I think, as everybody knows have far fewer resources to do all this work than asset managers. Hence, you know, there is a very important role clearly for asset managers to play asset managers around the world, they are on the ground, they are much - often much larger organizations than asset owners with much larger budget.

So, the asset owners have a real challenge. You know, they have to have very careful in, you know, choosing strategically important invest - investments and sectors and countries with which to engage. So, you know, I think there is a range of approaches they take, but typically, you know, it's those sorts of factors that – that drive their decisions. And also where they feel they can make a difference, so if they're based in Netherlands, they will probably think they can have much more impact on companies in the Netherlands than companies in China. It's also, you know, choice is made depending on where they can actually operate. So, it's very easy to go to a shareholder meeting in Europe, it's much harder to go to a shareholder meeting in Asia, not just because, you know, the travel distance but also because of sometimes, you

know, cultural issues, legal issues, political issues. You know, trying to get into a shareholder meeting in China and voting against the company is extremely difficult to do. We have cases where investors vote shares in China, they vote against the company, the company rejects the votes and the shareholder says, "Why have you rejected my votes?" and the company says, "Well, you're voting against the resolution and you haven't given us any reason why you're voting against the resolution." And so the company secretary would just out of - and these are true cases, will just reject the votes, I don't think this is legal but - you know, you can't argue with some things in China.

So it – clearly, they have to prioritize and consider where they can have the biggest impact and what is the most efficient way to choose, but it's a very tough job. I think it's in some ways even tougher for big asset owners and for asset managers because they have such limited resources.

[Ikeo, Chairman] Dr. Ueda, please.

[Ueda, member] Thank you. First of all, before expressing my opinions, I'd like to thank ACGA representatives for the presentation.

As written on page 7 of ACGA's material, it was suggested that company-level voting disclosure would be a better solution. This is the global trend. As Mr. Oguchi also mentioned, for instance, on page 9, it is written that 64% of ACGA members disclose whether they voted for or against each proposal at the individual company level. For instance, I suppose that the percentage of companies, which signed the Stewardship Code in the UK, is rather low.

In my opinion, ACGA members have certain number of resources, have a high-level of awareness, and actually take actions, and therefore, the percentage is as high as 64%. If small- and medium-sized investors are included, I assume that the percentage will decline. I regret that we are not in a position to easily understand what companies consider. For instance, I wonder whether the companies are ready to accept the company-level voting disclosure, in other words, whether the companies are fine with the situation where certain investors or certain pension funds disclose whether they voted for or against their director nominees. This may be a psychological issue. Therefore, I'm not sure whether the management of Japanese companies is comfortable with such public disclosure. On the other hand, there is a strong demand from the companies for information on how investors have voted on their proposals.

While dialogue is becoming more significant, I believe that the companies want to know voting decisions made by investors or shareholders whom they are aware of.

Unfortunately, however, while the importance of dialogue and transparency is much talked about, there still are cases where investors are reluctant to respond to inquiries from companies. When I talked with investors, they said they would respond. However, when I said so, a representative from one of the leading Japanese companies said, "You say so, but when we actually make inquiries though their fund managers or analysts, a half of them do not provide any answers." So while public disclosure is important and could be set as a future goal, what is needed first is information sharing in a way that the institutional investors reply to inquiries from the companies. Having done that, if the companies are ready for public disclosure, they could move in that direction. Excuse me, I usually support Jamie's opinions, but I have a different view on this matter. So I made this comment.

Now I'd like to talk about today's main topic, conflict of interest. Looking at illustrative charts in Material 2, which were prepared as case studies, I found that conflicts occur between the profitability of the entire financial group and fiduciary duties, despite the fact these two are in different spheres. That is the reality. I assume that the secretariat prepared these case examples in order to express concerns, based on a significant number of actual cases. Speaking from the perspective of the management of a financial group, earnings from its client business companies are larger, when institutional investors, particularly Japanese asset owners, are famous for low fees. This could be a reason for conflicts of interest. Moreover, in case they are listed, they are pressured by the market in terms of the financial group's earnings. There is such a circulation.

It is required to establish a mechanism to block off the exit, as I have mentioned several times. Even under the circumstance where a client company or parent company puts pressure on an asset manager, it is desirable that the asset manager can make such an excuse as "I understand your point, but it is difficult to do so." Without the mechanism allowing for such an excuse, while asset managers are told to fulfill their stewardship responsibilities or fiduciary duties, they have to face another kind of pressure. It's a pity. So it is necessary to develop, clarify, or raise awareness of such a mechanism. It is needed to create such an environment involving not only asset managers like us, but also their client companies and parent

companies.

Awareness-raising is one thing. As for awareness-raising, as Mr. Toyama also mentioned in his paper, since the Japanese people tend to be considerate of others, even though a client company does not put pressure on a subsidiary asset manager to support its anti-takeover measure, an account manager of a securities company may apply pressure on behalf of the client company. Capable account managers are likely to do so. To eliminate such a possibility, we should consider a mechanism to block such influence.

As for Cases 1 and 2 of Material 2, I think there is a common solution for these 2 cases. Jamie also made a similar point on page 7. That is the establishment of a committee in charge of the exercise of voting rights. However, the establishment of the committee alone may become merely a formality, so the committee requires two things: one is objectivity, meaning that outside members represent views from outside the company, and another is transparency. The objectivity can be achieved by the appointment of outside members, the transparency can be achieved by preparing meeting minutes. The point is creating an environment where they will not be pressured by a statement like “This investee company is a client of our parent company.” They do not necessarily have to make the public announcement, but should have such a system in place.

In addition, it is necessary to develop procedures concerning what proposals should be presented to such a committee. It is reassuring to know that Jamie also made the same comment in his paper. Now is the peak season of general shareholders meetings in June. If such a committee is required to review every single proposal, it will be beyond its capacity and thus may fall into the formality. Therefore, it is necessary to clarify, in advance, individual cases of potential conflicts of interest and the one covering such cases. If they can explain such things to asset owners, it will contribute to enhancing reliability, I think.

Case 3 is problematic. I understand that this is the case where a corporate pension fund, being a client of an asset manager, gives consideration to its sponsor company’s benefits and pressures the asset manager. I think there are two approaches. One is for the corporate pension fund itself. The possibility of the Ministry of Health, Labour and Welfare, which is in a position to supervise corporate pension funds. The first one is a soft approach, helping corporate pension funds understand the intention of the Stewardship Code, and facilitate their

acceptance of the Code. In addition, I'm thinking about a possibility of a more aggressive approach for clarifying and materializing fiduciary duties. For instance, in case of the employees' pension scheme in Japan, I heard that individual instructions on financial instruments are prohibited: in other words, it is prohibited to provide instructions on purchase or sale of individual instruments. Then putting pressure on someone to make them vote for or against proposals of an individual sponsor company, is included in the scope of individual instructions? I assume it is outside the scope at this moment. This may be a topic outside the scope of this Council.

Let me share an example from the UK. There is an industry pension fund for the UK's utility companies. Its board members include CEO in the industry. That pension fund voted against a listed company's proposal for re-appointing the CEO, who serves as a board member of the pension fund. That CEO made a sour face, but understood such a decision from the standpoint of the board member of the pension fund. Nonetheless, he looked glum. In the UK, those who wear "double hats" have two different mentalities. Since it takes time to change mentality, I'm wondering if we could establish a certain mechanism while waiting for such a change.

I'm sorry for taking a long time. Finally, in Case 3, is there any approach to directly reach asset managers? If a corporate pension fund owns huge assets, and has its own account with an asset manager, it may not matter whether it votes for or against proposals. Yet in many cases, assets are managed in an aggregated, joint account, I assume. Then, as a result of a certain company calling for voting for anti-takeover measures, all other clients' monies i.e. voting rights in that joint account are used in support of the proposal. That is problematic. From the perspective of fiduciary responsibilities, an influence of a certain conflict of interest affects fiduciary responsibility of all clients. So unless we do something like providing guidelines to clarify that such acts are not allowed, asset managers will be caught in a dilemma in terms of their relations with clients.

I'm sorry for my excursive statement. I just thought it would be necessary to help asset managers out of such dilemma. Thank you for taking a long time.

[Ikeo, Chairman] Do you have any comments?

【Mr. Allen, Secretary General, ACGA】 Just commenting on Ueda-san's comment about

investors needing to respond to companies, I do agree. I think one of the interesting things with stewardship codes is that they now – it's not just about investors talking to companies, engaging with companies and getting more information from companies. It's about investors, the stewards talking to directors as stewards and trying to help the company as a whole. And clearly in that context, investors have much greater responsibilities now to focus on their own governance, as Sampe-san was talking about, having clear policies as to why they do what they do, acting in as fiduciaries for their own clients and being more transparent in how they are engage – how they are implementing their corporate governance and voting policy. So, stewardship codes put a lot more onus and burden on investors to – to really participate in this process. So, I hope that none of the investors that are refusing to talk to companies are our members. If they are, please let me know, we will have a chat with them. Thank you.

[Ueda, member] In reality, even though a management company takes a positive stance toward disclosure, there are some cases where analysts do not want investee companies to know the fact they voted against their proposals. Investors feel difficulty to inform the companies of such voting decisions, from fear of damaging trust relationships. So the current status is not as transparent as expected. Some call for company-level voting disclosure, but before that, as the basis of dialogue, they, investors, should provide information. As long as companies and markets are pressured to enhance the transparency and fulfill the accountability, investors should have a dialogue with not only their own clients but also their investee companies.

[Ikeo, Chairman] Can't you make it more concise?

[Ueda, member] I'm sorry. Even though asset managers have their policies to do so at the company level, I often hear that they do not do so at the individual analyst level, so I hope to see the improvement on a practical level. I'm sorry for taking a long time. No more comments from me.

[Ikeo, Chairman] Director-General would like to make a statement.

[Ikeda, Director-General of the Planning and Coordination Bureau, FSA] Concerning disclosure of voting records, there is a debate whether it should be at the company level or at the aggregate level. Under the current industry rule, disclosure at the aggregate level is required. Although there is criticism against disclosure by insurance companies, companies in

other industries disclose their voting records at the aggregate level in accordance with the industry rule. Let me share the historical background of this practice. In 2009, the Financial System Council discussed this issue. The Council was chaired by Professor Ikeo, and I served as the secretariat in the capacity of the FSA's Director. At that time, in the United States, the SEC required investment companies to make company-level voting disclosure. We, therefore, discussed the possibility of such company-level voting disclosure in Japan, but in the end, the Council's report suggested disclosure at the aggregate level. Speaking of the background, it was not because companies opposed to disclosure at the company level. During the discussion at that time, asset managers pointed out that if Japan adopted the similar rule, there would be an increased risk for investment companies to be pressured by issuing companies or various external organizations with regard to voting decisions, and thus the freedom of exercising their voting rights would be impeded.

In response to various pressures, President of the asset manager tries to remove such pressure by answering, "In our company, all voting decisions are made by an external or independent committee, so President cannot do anything," thereby securing their independence. On such occasions, if there was the rule for voting disclose down to the company level, they would be told, "That's not true. The company has a clear handle on it," and exposed to increased pressure. So it was pointed out that there was a concern over such a rule. Therefore, the aggregate disclosure was required by the rule. That is the historical background. Nonetheless, this discussion took place many years ago, so it would be necessary for this Follow-up Council to consider the possibility under the current circumstance. I just wanted to share the historical background.

[Ikeo, Chairman] Thank you. I forgot about the background. Thank you for reminding us.

Mr. Tsukuda, please go ahead.

[Tsukuda, member] Thank you. First of all, I'd like to thank Mr. Sampei from Fidelity and Mr. Henck and Mr. Allen from ACGA for great presentations. They were very insightful. Today's main agenda is conflict of interest. Actually, I used to work for a bank, and I was involved in strategies or personnel policies of a subsidiary asset manager. As my basic stance, I believe that the asset management industry is of strategic importance in Japan, as I mentioned before. Therefore, I'd like to make some comments from the perspective of developing the

industry.

When we discussed appointment and withdrawal of Chief Executive Officer (CEO) in previous meetings, excellent keywords were used: objectivity, timeliness and transparency. I use these key words wherever I go. This time, I have been wondering what keywords for addressing conflicts of interest could be. Personally I was thinking that transparency and accountability would be significant keywords.

However, while listening to ACGA's presentation, I realized that a model answer is written on page 3 of ACGA's presentation material. Although the header reads "Core Principles of Corporate Governance," all of these principles would be applicable to addressing conflicts of interest. The first principle is "transparency," which I just mentioned. Although there would be differences in the degree of transparency – 100% transparent or half-transparent, the transparency is important.

The second principle is "accountability."

The third principle is "fair treatment of shareholders/stakeholders." In terms of achieving a balance between interests of a client company of a parent company or of another department, and a fiduciary, the fair treatment would be essential.

The fourth principle is "board independence." I interpret it as managerial independence of asset managers. At the last meeting, I stated that independence in personnel affairs is required. Top management of an asset manager should not be someone sent from its parent company; instead, the asset manager should develop human resources, who deeply understand fiduciary liability, and are qualified for the top management. "Independence" in this fourth principle would not only refer to independence in personnel matters. It would refer to the importance of independence in overall corporate management.

Finally, the fifth principle is "ethics and integrity." I believe these are also important points. I believe that these would be the keywords for addressing conflicts of interest.

Then, specifically how should we address the issue of conflicts of interest? As Dr. Ueda raised the point, and as Director-General Ikeda explained the historical background, some solutions are proposed on pages 7 and 8 of ACGA's material. I'm afraid that the first one, "independent committee to review voting," would not really be feasible. The second solution "disclosure of voting records," which we have been discussing, is important. Whether

company-level voting disclosure is appropriate in the current environment would be debatable.

In the meantime, there have been recent cases where the percentage of votes “for” outside director nominees has suddenly dropped to 70%, or the percentage of votes “for” some proposals is less than 60%. On the other hand, Japanese institutional investors continue to mechanically vote “for” proposals. Is that the right thing to do? In that sense, I consider that it would be important to establish a policy, in one way or another, for facilitating voting disclosure at the company level to make visible who voted how, while giving thoughtful consideration to asset managers. Probably that’s what we should do today.

The third one, “clear voting policy,” is an obvious solution. It is important to disclose clear and specific voting policy. Concerning the last solution, “parent-level disclosure,” I’ve been thinking of an opposite thing. AGCA proposed that parent companies should explain how they allow asset management subsidiaries to play their fiduciary role without interference. However, for the purpose of enhancing the managerial independence of asset management companies, as I earlier mentioned, I believe that subsidiary-level rather than such parent-level efforts should be required: specifically, asset management companies should consider and establish their own policy for addressing conflicts of interest. I suggest that asset management companies could do that in order to enhance their managerial independence. There would be a gap between the subsidiary level and the parent company level. I consider it is important to discuss how to fill the gap.

That’s all.

[Ikeo, Chairman] Thank you very much.

Mr. Kawakita, please.

[Kawakita, member] Concerning overall discussion on conflicts of interest, I know today’s main agenda, the exercise of voting rights, is an important topic. However, I believe that it would be more important that institutional investors, particularly mutual funds and asset managers, reflect on their past conduct. Currently, in Japan’s securities market, the share of mutual funds is very small, indicating a poor level of confidence of individuals. It is because of their past conduct or performance. They should think about that first – how they could eliminate conflicts of interest in that sense. There first should be discussion, which consequently contributes to making Japan’s securities market better, and enables asset

management subsidiaries of financial institutions to play a more active role. The exercise of voting rights should be regarded as one of the issues for that purpose.

Concerning the exercise of voting rights, other members have already expressed their views on voting disclosure at the company level. Such disclosure would be one of the solutions, thereby making it evident what each asset manager is thinking about, and what institutional investors have thought. In that sense, it would provide reference information. However, when a huge volume of voting records is disclosed, certain entities may be capable of analyzing such data, but generally it is not easy for others to understand the data.

Then another solution would be third-party committees or boards which review cases with potential conflicts of interest, as many people have already discussed. The said committees or boards discuss the cases in advance or re-examine the result of voting, and such results are announced by each institutional investor. Such combination of methods would be one solution.

Another point is related to Case 3 of Material 2. As several members mentioned, I also consider that it is important for pension funds as asset owners to sign the Stewardship Code. Yet that's not sufficient in terms of performing fiduciary duties. GPIF will announce results of its investment at the end of July, but it is necessary to consider whether it falls under timely disclosure. Under this circumstance, they should not feel at ease just because they have already signed the Code or demonstrated their conduct. Certain follow-up is required, I believe.

Thank you.

[Ikeo, Chairman] Ms. Takayama, please.

[Takayama, member] In connection with voting disclosure, I'd like to share some information on the current state of dialogue between companies and investors.

Before the establishment of the Stewardship Code, most Japanese institutional investors did not disclose their voting records, even if companies made inquiries. However, in the past several years after the implementation of the Stewardship Code and the Corporate Governance Code, many institutional investors have changed their stance. When requested by companies to disclose how they voted on the companies' proposals, an increasing number of institutional investors respond to such requests. In case of large institutional investors, all but a few say they do so.

However, as for the timing of the disclosure, they do not disclose anything about their

voting decisions before general shareholders meetings. Most of them say they will disclose after the general meetings. Dr. Ueda referred to actual cases where companies complain that investors do not disclose their voting activities upon request. The timing may be an underlying factor.

On the other hand, as for staff members of companies who are in charge of general meetings, particularly resolutions at general meetings, what they want to know most is whether investors support or oppose their key proposals before the general meetings. There is a significant need for such information. However, only a limited number of investors disclose such information. Then to what extent do the companies request the investors to disclose their voting records after the general meetings? Although there is no statistical data, the need is high before the general meetings, because companies are eager to know whether their proposals will be approved; but the number of such inquiries declines after the general meetings, because they feel relieved once the general meetings are over. That would be the actual situation.

Nonetheless, voting records are very important messages from the investors to the companies. Therefore, I believe that the companies should ask for voting disclosure, and continue to have dialogue with the investors over the long-term, based on the results.

That's all.

[Ikeo, Chairman] Thank you.

Mr. Callon, please.

[Callon, member] I also believe that they should go for company-level voting disclosures, and now is the right time. That should be transparency and accountability, which Mr. Tsukuda referred to. Naturally, asset managers have their reasons, and issuing companies have their reasons, but I don't think it is right to keep the ultimate customers uninformed. Therefore, since ultimate customers entrusted asset managers with their money, they have a right to know how the asset managers exercise their voting rights. Nevertheless, I am fully aware of the significance of this judgment. So taking this opportunity, I'd like to ask the three guest speakers about global best practices of company-level voting disclosures, or views on whether or not such disclosures should be made, and what is the desirable way of introducing such disclosures, if you are in support of them. I'd like to hear your comments, if any.

[Mr. Sampei, Director of Research at Fidelity International] Thank you for your questions.

As for company-level voting disclosure, for instance, our London officediscloses all company-level voting records. Therefore, if I'm asked whether it is internally possible to go for company-level voting disclosure, I say it is possible. So as for our global funds which invest in Japanese equities, we have already disclosed voting records in such a way. Accordingly, a half of our disclosures are done in such a way. Therefore, based on the disclosures, if all funds exercise their voting rights looking in the same direction, I can guess their voting results even now. The only one difficulty stems from our practice of diverse exercise of voting rights. Each fund makes its own final voting decisions. As a result, it is possible that a certain fund votes "for" and another fund votes "against" the same proposal. That's a little complicated.

I'd like to make another point concerning why company-level voting disclosure are not currently made in Japan. Engagement has just become widespread in Japan. For instance, as Ms. Takayama mentioned earlier, if representatives from a company visit us to provide prior explanations and ask us about our opinions, we will inform them of our basic voting policy. It is easy to communicate the policy. We have this kind of standards and policy, so we have no choice but to vote against this proposal. If you change it in this way, we can vote for it. We have such conversations with them. Such dialogue has increasingly taken place, and the companies have been increasingly making inquiries. In that sense, if such interactions become sophisticated enough to produce a better outcome, and if there remains a gap despite constructive dialogue, the investor will vote "against" the company, and disclose the voting record, so that it is widely known to the public. I think that would be good, but right now, Japanese companies and investors have not reached that level. We are at the stage where dialogues just started. At that stage, it would be debatable that investors should abruptly disclose the fact they cast "against" votes. Nonetheless, if I'm asked whether or not it is possible, I would say it is possible.

【Mr. Allen, Secretary General, ACGA】 I think if you're talking about how to encourage asset managers who are not disclosing to disclose, well, I think one of the most efficient ways to do that would be regulation, you know, that's happened in other markets where they are required to disclose. That's not necessarily simple or easy to do that. So – you know, and that may not be something that can happen quickly in every market.

Second approach is industry associations. In Australia, for example, the Financial Services Council set a policy for its members on voting disclosure down to the company level, having a voting policy, disclosing voting records and disclosing down to the company level. That's actually an industry association standard; it's not a regulatory standard per se.

Another way I think it can happen is through media pressure. If some large asset managers, asset owners are disclosing their detailed voting records and others aren't, then typically at some point the media gets interested in that and starts to - writing about it in the press.

We also see nonprofit organizations are putting pressure on asset managers, asset owners. We also see beneficial owners themselves, sometimes the pension fund, sometime the beneficiaries of the pension fund or the clients of the – the asset manager actually coming together and putting pressure on these institutions to either vote or have a particular policy. That's how some of the – in the UK, that's how some of the – some of our members started their whole corporate governance sustainability policies because they were getting pressure from their own beneficiaries.

And I think the third, last way is - is, you know, commercial self-interest. I think, increasingly, you know, this is seen as something that a well-managed professional honest asset manager should have and a professionally managed asset owner should have, so I mean gradually just the logic of – particularly on the asset manager side commercial self-interest I think starts – starts to kick in.

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

[Takei, member] Thank you. I have questions to Mr. Sampei. On page 5 of your presentation material, you quoted Fidelity's policy as an example, "In the context of proxy voting, where there may be a conflict with Fidelity's own interests, we will either vote in accordance with the recommendation of our principal third party research provider or if no recommendation is available, we will not vote." What kind of proposals falls under this category? What conflicts of interest relating to proposals require such treatments? That is my first question.

The second question. In Japan, proposals for elections of directors/officers would be generally considered to be the most important among all proposals to general shareholders meetings. Concerning proposals for election of directors/officers, could you tell me to how often you face the cases where there may be conflicts of interest? It does not have to be based

on accurate statistical data, but what image do you have for the real situation? I'd like to ask these two questions first, and will express my opinions later.

[Mr. Sampei, Director of Research at Fidelity International] Thank you for your questions. As for your first question about proposals in that category, our financial group is not listed, so there are hardly any such cases. This provision is for unexpected cases, but in reality, we hardly ever face such cases. A possible scenario would be as follows: when our company manages both the corporate bond fund and the equity fund, a certain corporate action may benefit corporate bond holders, but negatively affect shareholders. Then how should we manage such a conflict of interest? That would be the only possible scenario.

Fortunately or unfortunately, strictly speaking, Japan's Stewardship Code does not include corporate bond investors in its scope, in my understanding. The UK's Stewardship Code does include them. Although they are not included in the scope in Japan, we take precautions against a broader range of cases.

Your second question is about conflicts of interest relating to proposals for elections of directors/officers.

[Takei, member] Have you ever felt that a financial group, which should have voted "against" a proposal for elections of directors/officers, actually cast a "for" vote?

[Mr. Sampei, Director of Research at Fidelity International] In the real world?

[Takei, member] Especially in Japan.

[Mr. Sampei, Director of Research at Fidelity International] In terms of what I felt, if "against" votes accounted for 30% - that's unlikely – some 20%, I feel that it has a significant meaning. Since there are significant loyal votes, such proposals are rarely voted down. So, if a nominee received 20% "against" votes, I think there is a significant doubt about the nominee. Despite that, the proposal is approved, without being discussed. That should be a problem, in terms of a result. Therefore, regardless of voting activities of financial groups, we should consider that proposals with a low percentage of "for" votes may have some problems.

[Takei, member] I see. Thank you.

Now I'd like to express my view. Today we are discussing conflicts of interest involving financial institutions. That is an important issue, but we have focused only on the exercise of voting rights. Upon making voting decisions, there are only three options: "for," "against" or

“abstain.”. As I mentioned in the last meeting, we should not suggest any measures which could encourage another formal reaction. To avoid being viewed as having voted “for” a proposal for the interest of their parent company, they may decide to vote “against” the proposal as a formal reaction. The disclosure of voting records we have discussed today would also have some side effects. I’m afraid there is such a risk that could encourage such formal reactions. Therefore, we need to address the issue in a way that ensures they do not go for such formal or superficial reactions. As a premise, we need to dispassionately examine to what extent conflicts of interest with their parent companies emerge upon the exercise of voting rights, and how serious they are.

Furthermore, as Mr. Toyama also stated in his paper, if there are conflicts of interests, and thus asset managers delegate their decision-making to a third party, such decisions are merely another formal reaction. I asked the question to Mr. Sampei, and he said there rarely are such proposals that exists severe conflict of interests. A policy that may lead to third party delegation as another formal reaction is not advisable. Mr. Iwama earlier reported that asset managers have been making substantive efforts, having various alternatives depending on specific cases. I believe that it is important to promote such efforts, depending on the degree of conflicts of interest. If a policy suggests one specific measure, it is concerned that it may lead to another formal reactions.

[Ikeo, Chairman] I see.

[Mr. Henck, Chairman, ACGA] Forgive me, just a quick response. I think we have to be very careful about jumping to conclusions about the way that investors will necessarily vote. You brought up the issue about being a – a vote that is in benefit of the shareholders, but perhaps against society. I think it is reasonable to assume that asset managers are human beings and may well take into account, “Well, this gives me a short-term dividend, but this is going to endanger the company staying – staying afloat and what is in the best long-term interest.” You have asset managers who are very short-term focused and those – those who are not.

In the same way, the question about having a consultant gets into the very question about perceived conflicts of interests versus real conflicts of interests and sometimes having that third-party coming in like Hermes came in that example is a perfectly reasonable way for a

board of directors to say, “Yes, we did vote with the parent company's interest, but in fact, we have consultants here who are saying that that's a reasonable choice and at the end of the day we have brought that forward in a reasonable way.” So, there are always going to be balances when you're looking at the stakeholders, and I think we have to be careful to assume that everybody is necessarily going to be in favor of a short-term quick yen rather than something longer term. Thank you.

[Ikeo, Chairman] Time is running out.

Mr. Kanda, please.

[Kanda, member] Thank you. I’d like to briefly make 3 points.

My first point overlaps with what Mr. Takei stated. I also think that today’s topic is difficult, not in terms of how to manage conflicts of interest, but in terms of the issue of conflicts of interest at the time of exercising voting rights. We know various approaches to manage conflicts of interest - typically, disclosure of information. However, the exercise of voting rights is at the other end of the spectrum relative to dialogue. Our council has a lot of dialogues, but usually does not vote in the end. We have only 3 alternatives, “for,” “against” or “abstain,” when voting, so we should not discuss conflicts of interest looking only at the occasion of voting. Instead, we should look at the entire process, including dialogue and voting, and then consider how to address conflicts of interest at the time of exercising voting rights within the framework of conflict management in the entire process, including dialogue.

Allow me to talk about details. I found it interesting that Mr. Sampei’s company may choose to “abstain,” in addition to voting “for” or “against” proposals. On pages 9 to 10 of ACGA’s material, there are columns to indicate whether its members cast “for” or “against” votes, but no column for “abstain.” He also referred to diverse exercise of voting rights. I may have misunderstood, but there is no way to identify whether they cast both “for” and “against” votes on the same proposal from the format on pages 9 and 10 of ACGA’s material.

Moreover, when we say “the exercise of voting rights,” it may not be limited to voting on proposals submitted by the company or another shareholder by means of threefold choice - for, against or abstain – as Mr. Takei said. Alternatively, since shareholders generally can make their own new proposals if they satisfy certain qualifications provided in the Companies Act, should they even exercise their shareholder’s proposal right? Furthermore, depending on

specific situations, they need to approach other shareholders to convince them to make the same voting decisions as themselves. I'd like to know the actual situation in this aspect. Anyhow, in terms of approach, where there is no conflicts of interest, it is difficult to argue the exercise of voting rights in the first place. Unless we discuss it, I don't think we can efficiently discuss the exercise of voting rights involving conflicts of interest. This is my first point.

My second and third points are rather simple matters. My second point is about the ambiguity of the concept "institutional investors." Mr. Sampei stated that in the United States and other countries, investment companies adopted the form of corporation, and thus have boards. That is true, but what about ordinary industrial corporations? Aren't ordinary industrial corporations also subject to rules concerning conflicts of interest when voting or conflicts of interest in general? Ordinary companies also have shareholders, who contribute money. In that sense, I'm wondering why today's topic does not cover ordinary corporate shareholders.

My third point is regarding separate categories within institutional investors. Institutional investors are divided into asset owners and asset managers, and the Stewardship Code is applicable to proxy advisors, etc. as well. Mr. Toyama stated in his paper that asset owners should not delegate everything to asset managers, and asset managers should not delegate everything to proxy advisors. I agree with his point. However, what is an appropriate way of delegation concerning the exercise of voting rights? The best thing to do is to abstain? Actually, depending on the situation, "abstain" often means either "for" or "against," and it does not necessarily mean a neutral position. Then, from the perspective of the ultimate beneficiaries or pension recipients as Mr. Oguchi mentioned, they have no choice but to delegate everything to someone else. Therefore, we should more thoroughly examine such a chain of delegation or multitiered fiduciary, and sort out the degree of fiduciary duties in such a situation. In particular, when it comes to managing conflicts of interests when exercising voting rights, we need to address various specific cases.

That's all.

[Ikeo, Chairman] We have almost run out of time, but I'd like to have a comment from Mr. Iwama at the end.

[Iwama, member] May I?

[Ikeo, Chairman] Sure.

[Iwama, member] Thank you. As for self-regulating guideline of Japan Investment Advisers Association (JIAA) concerning the exercise of voting rights, our central focus is "adequate provision of instructions for the exercise of voting rights under discretionary investment contracts" as posted on JIAA's website. We established this self-regulating guideline in 2002, and have monitored, oversighted our members' actions in accordance with the guideline. I distributed our survey results the other day. We have a clear guideline to strive for eliminating any conflicts of interest concerning the exercise of voting rights. Based on our annual survey results, I believe that our member firms are aware of it and have taken necessary measures, to assure you.

My concern lies between the parent company and the corporate pension fund in the illustrative chart of Material 2. In the United States, there is ERISA (the Employee Retirement Income Security Act), which is applied to corporate pension funds, and strict fiduciary duties are imposed. In that sense, the situation does not allow parent companies to make various requests to corporate pension funds as they like. However, considering that the position of corporate pension funds is weaker, they may be influenced in various ways, I am afraid.

So in that sense, the key would be the optimal attitude of pension funds or asset owners how they could well-manage or eliminate their conflict of interests.in general. So I suppose that we should consider what policy asset owners have to address manage conflict of interests properly.

Basically, we, asset managers have strict fiduciary duties, and it is only natural that we fulfill such duties. Then we need to remove any conflicts of interest. Despite being a subsidiary, if there are any conflicts of interest with our parent company, we do not follow the parent company's instruction. Please note that we certainly have such a structure in place.

[Ikeo, Chairman] I'm sorry that I could not facilitate the meeting effectively, and we have run out of time. I know many of you have much more to say.

As I always mention, this is not the end of our discussion. We will continue our discussion at the next meetings, so I'd like to close today's proceedings.

Finally, 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 make the arrangement and inform you

later.

Furthermore, concerning constructive dialogue between companies and investors, the topic at issue, we consider that it is necessary to listen to voices of foreign investors, in addition to Japanese investors. Based on your discussions up to the last meeting, we prepared a questionnaire and sent it out to dozens of foreign investors who signed the Stewardship Code, and investors all over the world through ACGA and ICGN. We hope to report the results at the next meeting or later, where appropriate.

That's all from the Secretariat.

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