

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

September 23, 2016

[Ikeo, Chairman] It's already the scheduled start time, so I'd like to open the ninth 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.

It's been quite some time since the last meeting, but I'd like you to continue discussion on constructive dialogue between companies and institutional investors. Today, the secretariat will share some opinions on this topic from foreign institutional investors.

Furthermore, today we will also have a video conference, with the participation of Mr. Brian Rice, Portfolio Manager, from the Corporate Governance Division of CalSTRS – the California State Teachers Retirement System in the United States, which is one of the world's largest pension funds.

Later today, Mr. Rice will make a presentation, and then participate in our discussion, but he will stay with us only until around 10 a.m. due to other commitments.

Now I'd like to hand it over to a representative of the Financial Services Agency (FSA).

[Mr. Tahara, Director of the Corporate Accounting and Disclosure Division, FSA] I'm going to explain it in accordance with Material 1 first.

Material 1 summarized opinions from foreign institutional investors concerning "Constructive Dialogue between Companies and Institutional Investors". Please turn to the next page. In the first box, we summarized the nature of this material. With the intention to make this Council the venue for open discussion, we ask for and receive public comments from time to time. Regarding dialogue between companies and institutional investors, we sent a letter to institutional investors, specifically those who signed up for Japan's Stewardship Code and foreign institutional investors who have submitted their opinions, to solicit their opinions on major topics which have been discussed by this Council. We received their

responses, as previously introduced. We prepared this material by compiling their opinions in response to the letter. We categorized such opinions into 4 major topics, which we have discussed so far: 1. Governance of institutional investors/conflicts of interests; 2. Disclosure of proxy voting results by individual company basis; 3. Engagement of passive funds; and 4. Roles of asset owners.

Please turn to page 3, which shows opinions on the first topic - asset managers' governance and conflicts of interest. Many commenters asserted that, in order to ensure effective stewardship activities, it is important to have robust governance structures, including an independent oversight, and to manage conflicts of interest. In doing so, it was pointed out that clear voting guidelines should be set, and an independent committee should be established for making decisions on proxy voting. In addition, as an example of how asset managers address conflicts of interest, it was suggested that an asset manager which has a parent company should have an independent board.

Let's take a look at the bullet points below. As shown in the fourth bullet point from Legal & General Investment Management in the UK, the fifth one from Oasis Management in Hong Kong, and the seventh one from an anonymous large fund in North America, based on the fact that Japanese asset managers generally belong to large financial groups, the commenters raised a question whether interests of parent financial institutions may not necessarily be aligned with those of asset owner clients. They expressed concern about Japan's asset management structures, stating that "Chinese Wall" between an asset manager and its parent financial institution may be very weak. Accordingly, they suggested that asset managers should establish an independent committee to secure transparency and independence.

As shown in the third, sixth, and eighth bullet points, commenters shared examples in the Netherlands, Sweden, and the UK. For example, in the Netherlands, asset managers are required to disclose expected cases of conflicts of interest. In Sweden, asset managers in bank groups have an independent board in place. In the UK – I assume this is an example of the commenter –, in case there is any potential conflicts of interest, they form a proxy voting verification team, and confirm whether voting rights are exercised in accordance with their voting policy.

Please turn to the next page, which is about disclosure of voting results. We received public

comments stating that, from the perspective of fulfilling accountabilities as fiduciaries, transparency in voting results should be secured. As shown in the second and third bullet points, some pointed out that mere disclosure of aggregated voting results is not sufficient in terms of accountability or management of conflicts of interest. Furthermore, some suggested that, in company-level disclosures, ideally they should disclose reasons why they voted “for” or “against” individual proposals. This was suggested by ICGN, an international association of institutional investors, as the first commenter, and a large fund in the North American as the seventh commenter. Among asset managers which responded to our letter, many of them make company-level disclosures of voting results to the public. Actually, the second, third, sixth, and eighth commenters have been doing so. Others have reported individual voting results to their clients.

Please turn to page 5. It’s about the engagement of passive managers. Here, it was pointed out that passive managers cannot sell their shares, and thus engagement is essential for increasing corporate value over the mid- to long-term. This is the same view as this Council’s.

In case of dialogue between passive managers and a large number of investee companies in their portfolios, passive managers need to take a creative approach as resources permit – for example, having dialogue with large-cap companies which have problems. We also received information on how they select counterparties of such dialogues, namely from Aberdeen Asset Management in the UK in the third bullet point; AP4, a Swedish pension fund in the fourth bullet point; and a large fund in the North America in the fifth bullet point. The first commenter, a Hong Kong fund, pointed out that Japan’s passive funds have not taken a positive stance toward such dialogue so far.

Please turn to the next page. The last topic is roles of asset owners. We found a consensus among respondents that asset owners are responsible for monitoring asset managers’ activities. It was pointed out that asset owners should include rules concerning stewardship activities in their mandates to asset managers, and that asset owners should provide asset managers with a clear direction concerning their policies for dialogue, and regularly follow up on outcomes.

Furthermore, in Japan, there is a situation where corporate pension funds are reluctant to sign up for the Stewardship Code due to the lack of resources. Taking into account such an underlying reason, asset owners should take action to the greatest possible extent – for

example, requesting asset managers to provide explanations on their stewardship activities. As shown in the first bullet point, it was ICGN that suggested setting rules regarding stewardship activities. AP4, a Swedish pension fund, referred to an approach toward dialogue, and APG Asset Management, a Dutch investment advisor, suggested the monitoring. And it was Aberdeen Asset Management in the UK that shared its opinion on corporate pension funds.

That's all for my explanation of Material 1.

Now I'd like to explain Material 2.

As shown on the front cover of Material 2, ICGN, a global organization of institutional investors, published "ICGN Global Stewardship Principles" in June 2016.

Please turn to page 1. As shown in the second bullet point, the Principles presented ICGN's views on best practices in relation to investor stewardship obligations, policies and processes, and were intended to provide various regulatory authorities and standard-setting bodies with a comprehensive model of stewardship, which was developed based on its global experience. As shown in the last bullet point, as for the content itself, ICGN's Principles consist of seven principles. Part 2 provides Guidance pertaining to interpretation of each Principle. Part 3 describes specific roles of each market participants.

Please turn to page 2, which quoted 7 Principles. Principle 1 describes how governance should be – of course, it means institutional investors' governance. Principle 2 is about developing and implementing stewardship policies. Principle 3 is about monitoring and assessing investee companies. Principle 4 is about engaging companies and investor collaboration. Principle 5 is about exercising voting rights. Principle 6 is about promoting long-term value creation and integration of environmental, social and governance (ESG) factors. Principle 7 is about enhancing transparency, disclosure and reporting. Today, I'd like to introduce what is written about said 4 topics in these Principles, for your reference.

Please take a look at page 3. It shows what is written in ICGN's Principles regarding asset managers' governance as well as managing conflicts of interest. As mentioned earlier, Principle 1 stipulates internal governance as the foundations of effective stewardship: "Investors should keep under review their own governance practices to ensure consistency with the aims of national requirements and the ICGN Global Stewardship Principles and their ability to serve as fiduciary agents for their beneficiaries or clients." For instance, Guidance 1.2 under the

heading of “Independent Oversight” states “Investors should be overseen by governance structures that act independently and without bias to advance beneficiary or client interests. This may involve the need to separate or ring-fence investment activities for clients from the investor’s own commercial pressures. Such independent governance structures should be subject to periodic independent review to ensure they meet expectations of accountability and effectiveness.”

Furthermore, Guidance 1.6, for instance, focuses on conflicts of interest. It says that “Investors should have robust policies to minimize or avoid conflicts of interest and such policies should address how matters are handled when the interests of clients or beneficiaries diverge from each other. Investors should rigorously review their investment activities and their client interests to identify and appropriately manage real or potential conflicts of interest.” And as examples of conflicts of interest, it refers to “situations in which an investor in a company also provides financial products and services to the same company”, and asserts that “Such conflicts of interest should be disclosed, along with the remedies to mitigate them.”

Please turn to page 4. Under Principle 7 for enhancing transparency, disclosure and reporting, Guidance 7.5 focuses on accountability. Here it reads that “Investors should disclose to their beneficiaries or clients their key internal governance arrangements in order to be held effectively accountable for exercising stewardship duties on their behalf.”

Please turn a page. This is ICGN’s Principle related to our second topic – disclosure of voting results. Principle 5 refers to exercising voting rights, and Guidance 5.3 under the heading of “Voting records” refers to this topic. “Investors should regularly disclose their actual voting records publicly on their website as well as directly to clients. Voting records should indicate whether resolutions were cast for, against, or abstained.” This description is based on the assumption that they make company-level disclosure of voting records.

Now I’m moving on to page 6. It shows ICGN’s descriptions related to our third topic – engagement of passive managers. This topic is covered by Guidances for multiple Principles as points to note for stewardship activities by passive managers. For example, Guidance 2.5, which focuses on stewardship oversight, stipulates that “Asset owners with passive or index-linked strategies should take into account the stewardship capabilities of the asset manager”.

Furthermore, Guidance 3.2 under the heading of “Risk Analysis” stipulates that “Investors should develop methods or risk-based tools to identify and prioritise portfolio companies for further analysis and engagement” and “This is particularly important for asset owners and managers with passively run portfolios, where the number of companies held in portfolios may be large.”

Please turn to the next page. Finally, I’d like to explain ICGN’s Principle concerning roles of asset owners. Under Principle 2 for developing and implementing stewardship policies, I’d like you to look at Guidance 2.3 with the heading of “Delegation”. Here it stipulates that “Asset owners cannot delegate their fiduciary responsibilities, and where they are unable to exercise stewardship over investee companies directly, they should ensure that their asset managers are undertaking these activities on their behalf through contracts or by other means.”

Moreover, Guidance 2.4 with the heading of “Investment Contract” describes that “Asset owners should clearly incorporate their expectations regarding stewardship practices in the awarding of investment management agreements and in selecting asset managers to ensure that the responsibilities of share ownership are appropriately and fully delivered in the interests of their beneficiaries.”

Furthermore, Guidance 2.5 focusing on “Stewardship Oversight” stipulates that “Asset owners should effectively oversee and monitor asset manager stewardship activities and their consistency with the asset owner’s investment beliefs, policies and guidelines.”

Also in Part 3: Ecosystem of stewardship, roles of asset owners are described as shown in the box at the bottom of the page.

ICGN’s Principles were adopted just recently, and thus reflect the current international community’s views. And the content is very relevant to our discussion. That’s why I explained ICGN’s Principles today.

That’s all from me.

[Ikeo, Chairman] Thank you very much.

Now I’d like to invite Mr. Rice from CalSTRS for his presentation related to today’s topic. Mr. Rice prepared Material 3 for his presentation.

The presentation will be made in English, and the simultaneous interpretation service will be provided. I believe that a receiver was distributed to each participant. To listen to the

Japanese interpretation, please tune in to channel 1.

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

[Mr. Rice, Portfolio Manager, CalSTRS] Thank you. Good morning everybody, it's a pleasure to be able to join you today. I'm here representing CalSTRS, The California State Teacher's Retirement System. My hope is to be able to give you details on how CalSTRS approaches corporate governance, particularly approaches engagement and proxy voting.

If you turn to slide 1. First, I want to give you some brief background on CalSTRS. With the retirement system for California's Public School Teachers we have almost 900,000 members and beneficiaries. We have about a 190 billion in assets under management, and we've been serving the retirement needs for teachers for more than a 100 years.

Slide 2. This shows CalSTRS asset allocation. Most of our portfolio is public equity; about 56%. We have 16% in fixed income, 12% real estate, 11% private equity and the rest is in infrastructure, innovation and cash.

On slide 3. This slide shows the percentage of internally and externally managed assets in our – outside of our public equity. As you can see fixed income is mostly managed internally; 80%, but all of our private assets, private equity, real estate, infrastructure those were all managed externally.

On slide 4. Turning now to CalSTRS investments in public equity. We have about 107 billion in total investment, 64% or 68 billion is invested in the United States. 36% or 39 billion is invested outside the US, and in Japan we have about 8 billion invested in public equity. If you look at our public equity investment passive versus active about 60% is passive, 40% is active. In terms of our Japanese equity investment about 4.8 billion is passive and about 3.2 billion is active. At CalSTRS, all passive public equity investment is internally managed, and all active investment is externally managed.

Slide 5. How CalSTRS approaches public equity investment? Our portfolio holds over 7000 companies; small positions in each and since we're mostly passive owner we're going to own some portion of a company as long as it's in an index and that could mean decades. At CalSTRS we say we own the market, so we need to engage the market to be more long term. So we're engaging government officials, exchanges, investors, fund managers, and companies. For our active funds – fund managers we want to engage them to incorporate environmental,

social, and governance or ESG considerations when they're choosing companies to invest in and to support our passive investment funds we want to engage companies directly on ESG issues.

So slide 6. Since we're focusing on engagement in proxy voting I thought I would mention the unit I work in; corporate governance because we do the proxy voting and engagement for CalSTRS. CalSTRS corporate governance is an asset class; we're not part of public equity that we do support public equity. That's an unusual arrangement for a pension fund. Most corporate governance groups are a part of public equity. We have 12 staff in the corporate governance group, and we also have responsibility for externally managed public equity portfolios, the focus on governance and sustainability.

Turning to slide 7. Now, I'll talk about CalSTRS engagement efforts. We use a three step process to identify companies to engage. First, we determine an issue to focus on. This issue can come from internal staff discussion, it can come from board members; CalSTRS board members, an issue for engagement can sometimes come from a teacher.

Once we have an issue we want to focus on we want to determine which sectors or industries are exposed to that issue. Sometimes it's just one sector, sometimes it can be several, sometimes all sectors can be – particularly governance issues. Then what we want to do is analyze available information on companies in the sector or sectors. So we look at websites, public filings, surveys. We have data service providers who give us company information and we're looking for companies that do – are not or do not seem to be paying attention to the issue we're focused on.

So turning to slide 8. This slide is a flow chart at how our engagement goes after we've selected companies. The first thing we do is send a letter to the companies that I will indicate who we are, what the issue is we're concerned about and why we think the issue puts value of our investment at risk. And we'll ask the company for a call or a meeting to discuss the issue. If there's a response to our letter we'll set up a call or meeting, if there's not a response we'll generally try to send another letter. If we don't get a response to the second letter or if in the call or meeting we have with the company and we don't get a resolution and by that I mean we want the company to show us that they are paying attention to issue, we want the company to agree to look into the issue. If that doesn't happen then we will often file a shareholder

proposal, and we do that to let the company know we're serious about the issue and now we're wanting them to look into the issue. And we also want to see what percentage of the shareholders agree with us.

Turning to slide 9. These are the environmental, social and governance issues we're engaging on at CalSTRS environmental issues we're talking to companies about energy efficiency and their energy use. We're talking to oil and gas companies about gas leaks, and we're talking to companies about their water use. Social issues, we're focused on diversity of corporate boards and executives. We think that the greater the diversity of the company the better the company will do, and also we want companies to be focused on human rights, over health and safety and we believe that companies that harm people are bad investments.

Governance issues, we're focused on majority vote standard for director elections; what we call in the United States proxy access. We believe that shareholders should be able to nominate candidates for company boards, and we're also focused on executive compensation particularly compensation policies and practices that don't seem to be tied to performance.

Slide 10. So, we do collaborate and engage with other investors, we work with a lot of other investors – two organizations that are shown on this slide. These are organizations that are either US or global, some of them focus on governance; others focus on environmental and the social issues.

Slide 11. Most of our Asian engagement efforts and therefore our Japanese engagement efforts are done largely through the Asian Corporate Governance Association or the ACGA. The distance between our country and yours and Asian markets, language issues that makes direct engagement difficult. So, through the ACGA we're focused on director independence, capital efficiency and a system of independent auditing. We are also part of a global investor effort to engage Japanese companies on director independence; this is outside the ACGA. Some of the other issues we feel make engagement difficult in Asian markets particularly in Japan, the concentration of annual meetings and the short time to review proxy information.

Slide 12. Continuing with engagement in Japan. Some of our beliefs, CalSTRS believes that all asset owners are particularly passive asset owners should engage companies, so certainly Japanese owners should engage companies too. We don't think that you should accept companies as they are, try to work with them to incorporate best practice governance.

Work with them to make sure that they're treating people in the environment with respect. The biggest passive owners we hold companies long term as I indicated, we can't sell and therefore we face more risk particularly more long term risks.

CalSTRS also believes that all asset owners should engage the managers who invest their money; we believe it's a duty to our beneficiaries to make sure these managers are making decisions in our best interest. We want to make sure the managers are managing risk; we want to make sure the managers are avoiding conflicts. We also believe that managers should engage companies; managers are picking companies to buy, engage with helps we believe make better decisions. Manager engagement with companies can also help direct the companies to do better.

Slide 13. I'd like to now turn to proxy voting. CalSTRS vote all of our proxies; we don't have managers vote them for us. Internal, external, passive, active all the funds, all the proxy voting for all those funds comes to corporate governors group. We do disclose all of our votes on our website. We ask for transparency in the financial markets, we believe we need to be transparent. We also believe we have a duty to vote the best interest of our beneficiaries; the public school teachers and we believe that disclosing our proxy votes allows the teachers to verify that we are doing this.

As this slide shows, we vote quite a few proxies every year. 2015, we voted 77,000 proposals at over about 7900 meetings. CalSTRS votes proxies on the Glass Lewis platform. Glass Lewis votes based on how we tell them to vote based on our guidelines. These guidelines are also published on our website. There are certain proxy issues that we vote ourselves. We have full visibility and access to all the votes, and we can change any vote at any time.

Slide 14. As I mentioned we have our own proxy voting guidelines, and as I mentioned these are disclosed on our website. This slide is intended to just highlight how we approach what I call the major issues, and these guidelines we apply these across countries. So for directors generally, we will support directors unless we feel there's a conflict of interest, poor attendance at board meetings or if there's a lack of independence on a board. Auditors, we generally support auditors unless we find they do other work for the company that they're auditing, particularly consulting work for that company. And compensation, we support

proposals, compensation plans unless we don't think there's a line there between a value creation.

On slide 15. This is just intended to give you an idea of the number of votes per major issue and how we voted. As you can see directors represent most of the votes we passed 73% and as you can see we vote four directors far more than we vote against them. Auditors represent 12% of our vote, and again we vote for auditors far more than we vote against. And compensation plans total about 14% and as is the other two we vote for or far more compensation plans we vote against.

Slide 16. There seems to be a lot of discussion around proxy voting, disclosure proxy votes, conflicts surrounding proxy voting. It's CalSTRS position that the owners; the asset owners should vote their proxies if they can, and we believe we have a duty to our beneficiaries to vote proxies in their best interest. Voting the proxies yourself assures that you are doing that, you are voting in your beneficiary's best interest. An owner can't vote, the managers, external managers should vote for them, but they should vote based on the client wishes and they should report to the client; the owner how they voted. If the owner doesn't have input into the vote we believe the managers need to disclose votes to them, disclose individual votes. It's our opinion that aggregating votes doesn't give the clarity that's needed. Unusual votes could be hidden in that aggregation and disclosing individual votes helps avoid conflict.

And as I mentioned before, we believe disclosure it's a duty to – the manager has a duty to the client and we as owners have a duty to our beneficiaries.

Finally on slide 17 just to conclude. Again, I'd like to point out Japan's a large part of CalSTRS investment portfolio, it's our second largest equity market, we actually – there's an incorrect number I apologize, we have 8 billion not 6 billion investment there. I want to say we're very pleased with the changes in Japanese over governance that have occurred recently. Certainly, the stewardship code, the corporate governance code, increased director independence, improving ROEs. Certainly encourage efforts, these efforts to continue and welcome an opportunity to work with Japanese companies, regulators and investors exchanges and share best practices.

I thank you for the opportunity to present to you. We look forward to the Q&A.

[Ikeo, Chairman] Thank you. Now I'd like you to start discussion, taking into account Mr. Rice's presentation. As I mentioned earlier, Mr. Rice will participate in the discussion only until around 10 a.m., so I suggest that you ask questions, if any, to Mr. Rice first, and then share your own opinions in the second half of the session. Is that OK?

Mr. Tsukuda, please go ahead.

[Tsukuda, member] On page 15, you disclosed your voting results. The top issue was election of directors, and the number of "Against" votes was 5,600, which is a quite impressive figure. It really impressed me. What were the reasons for casting those "Against" votes? Could you tell me some common reasons? This is my first question.

The second question: what were typical reactions of companies when you cast "Against" votes, and what constructive dialogue have you made with them after that? I'd appreciate it, if you could share your experience to the extent of your knowledge.

That's all.

[Mr. Rice, Portfolio Manager, CalSTRS] Certainly. So, I would say the biggest reason we vote against directors is a lack of independence on the board. I would have to, and I can probably get the statistic for you in terms of what percentage, but I believe it's – it's a lack of – of independence. Sometimes when we don't like when we think that the company has a compensation policy it is not in the best interest of shareholders. We vote against the policy, and then we'll vote against the directors on the compensation committee. So that can add to the vote total. So it's probably the two largest reasons. Certainly, the reaction – and this is from a US perspective. We really don't hear from non-US companies in terms of our director votes, but most companies really don't engage us on why we voted against directors. The few that do we're certainly happy to talk to them and give them our reasoning behind and – and if we can sort of you know work with them. But we really don't have a lot of dialogues with – with companies as to why we vote against directors.

[Tsukuda, member] Thank you very much.

[Ikeo, Chairman] Mr. Tanaka, please.

[Tanaka, member] First of all, in your presentation material, page 14 summarized "Proxy Voting: Guidelines", and the guideline concerning the issue of "Directors" includes such an expression as "lack of board independence" at the end of the column.

Actually, in this Follow-up Council, we have discussed the board's independence several times. According to the survey of the Tokyo Stock Exchange, if I remember correctly, Japanese companies listed on the First Section, on average, have 9 directors, 2 out of whom are outside directors. Do you consider that such a situation lacks board's independence, or 2 outside directors are satisfactory? This is my first question.

Another question is related to page 15. As Mr. Tsukuda mentioned earlier, these figures are very impressive. Regarding "Election of Directors", in particular, the ratio of "For" votes and "Against" votes is around 2:1 – the number of "Against" votes exceeds one third of the total votes. For instance – I assume we will discuss this point later – in Japan, there are many cases where directors come from insurance companies, banks, or trust banks. Such a situation may become a point to be discussed in relation with such issues as board's independence as well as conflicts of interest. What is the view of CalSTRS regarding this situation? As you mentioned earlier that CalSTRS has been making significant investments in Japan, I'd like to know your approach to such issues.

These are the questions for now.

[Mr. Rice, Portfolio Manager, CalSTRS] Thank you for the question. I – CalSTRS position is that boards should be two-thirds independent. So from our perspective six of the nine should be independent. Though I think we understand that growing the level of independence on a board is a process and we certainly can't expect our preferred level of independence to happen overnight, so to speak. You know I think certainly independence on boards we believe helps to avoid conflicts of interest sort of helps to avoid what we call sort of the group think, but also we believe that independence helps to provide independent directors help provide a diverse set of opinions and experiences and ways of looking at problems and coming up with solutions. So, managing conflict of interest is an important part of independence but we believe that there's more reasons behind having a-a – a more independence on boards.

[Tanaka, member] May I continue?

[Ikeo, Chairman] Yes, please.

[Tanaka, member] Prior to CalSTRS' presentation, the Financial Services Agency provided the explanation. Have you listened to it? In Material 1, there are 3 points at issue, and I'd like

to know CalSTRS' view on them.

The first point is related to page 3. It is stated, "A solid governance structure including independent oversight, and conflicts of interest management is important for effective stewardship activities." Then it continues, "There are comments to urge establishing ... an independent committee for proxy voting judgement." This is a recommendation concerning governance of asset managers, not investee companies, and they call for the independence of the board – the establishment of an independent committee. I'd like to know CalSTRS' approach to this point.

Also I'd like to know CalSTRS' understanding of the term "independence". These are my first set of questions.

The second point is about the transparency of voting results, which is mentioned on the next page. You may have already answered a similar question earlier, but I'd like to ask another question about election of directors, which is one of the most significant agenda items at general shareholders meetings. For instance, in case 9 directors are to be elected, do you consider that disclosures are required on the individual candidate level, instead of the aggregated level, by disclosing whether you voted for or against candidate A, candidate B, candidate C... separately? Do you explain reasons for casting "for" or "against" vote to each candidate? These are my second set of questions.

The last point is concerning page 5. The second bullet point on page 5 suggests dialogue with large-cap companies with significant issues as passive managers' approach to dialogue. I can understand that the priority should be given to large caps, but I'm not clear about "companies with significant issues". If CalSTRS also takes the similar approach, specifically what do you think such companies are like?

For instance, do you see a situation where PBR is just 0.4 as a problem? What about a continuous decline in earnings per share? If passive managers select target companies for engagement based on 'issues' or 'problems' in addition to the market capitalization, what do you think target companies for your engagement are like? I mean, "companies with significant issues" — what are they like? I'd like to ask these 3 sets of questions.

[Mr. Rice, Portfolio Manager, CalSTRS] Okay. So let's see, I'll try to take the – in order I think looking at material one that was provided I think we would agree certainly that – that

independent committees are necessary. I meant that's one of our guidelines in – in voting for directors is that the board should have as I said the two-thirds independence but all the committees – we use the committee structure here, compensation committee, nominating committee, audit committee and all those committees should be entirely independent. So we would certainly agree with those points. I think you asked about definition of independence.

I would again refer to our guidelines on – on our website to get a you know more robust definition, but really it's about that there are no – that – that the director doesn't work for the company, doesn't do business with the company, doesn't have a family member who does business with the company, and hasn't – and – and I apologize I'm not exactly sure – I want to say it's like about a – a 5 year – there's a window of time between when they did work. So a director could have worked for the company, but then there's a period of time that needs to pass before they're considered independent. So it's really the criteria around independence. And would see in terms of engaging with large cap you know I think we find that we do engage more with large cap companies, but probably the reason is because we have more invested with them, so we have more exposure in terms of choosing the company and the issues. I think here as I pointed out – I think it was you know the slides – and we kind of break it down between environmental, social, governance issues. You know right now from a governance standpoint we think you know director election standards are important. In the US, there's been traditionally a polarity vote standard, so whoever gets the most votes wins and when – when you have as many candidates as board seats nobody loses. So that's why we're trying to push companies towards to the majority vote and if the director doesn't get a majority of the votes they offer the resignation.

Now we think the big issue is and I said before allowing shareholders has a right to nominate a candidate to – to be considered – you know a director candidate. So, that's an issue that we're – we're focused on, and then you know we think that environmental, and social issues also present risks and companies particularly the US aren't paying attention to those issues so we engage companies could be focused on those issues. And – oh, and – and you asked about the director votes. We disclose how we vote on individual directors, so I think that would be our – you know preferred standard. I think those were all your questions. So please, if I missed one let me know.

[Ikeo, Chairman] Dr. Ueda, please.

[Ueda, member] Thank you. Mr. Rice, thank you very much for your presentation. On page 8 of your material, you presented a flowchart of engagement, showing step-by-step escalation procedures. I think that these procedures are a very useful reference for Japanese asset managers.

I have a question in this regard. As the first step, CalSTRS sends letters to companies. I assume that you send such letters to either all investee companies or selected companies. In doing so, I'm concerned about a risk that it might become a mere formality on the side of institutional investors, just reporting the figures like "we sent letters to this many companies, and had meetings with this many companies." Instead of pursuing substantive engagement, I'm worried that, in Japan, they might focus on the numbers of letters sent and dialogues for the sake of formality. In this regard, what efforts have you made to secure the substance, avoiding the formality?

In this connection, for example, how do you evaluate institutional investors' activities in terms of stewardship activities or engagement? Unlike investments, such performance cannot be evaluated based on certain figures. I'd like to know how you evaluate the quality of stewardship activities.

[Mr. Rice, Portfolio Manager, CalSTRS] Yes thank you for the question. So as – on page 7, we try to take as I had said you know, three steps. So the first, what issue – so take a step back, when you own as many companies as we do we try to – to pick issues that are a bit broad. So they might capture more of the market than say you know, I'm looking at a particular company or what a particular company is doing. So, I'll – I'll talk about majority vote standards I think that's a good example. You know, we thought as I said that's a – a proper vote standard for directors, and we wanted to change it. So, we took – we looked at each year for the last five – we looked at a 100 companies that didn't have that standard and we sent them all a letter, and we asked them to please adopt the standard, and the ones that did for the most part you know had – you know we're willing to do it, and the ones that didn't we found a shareholder proposal asking them to do it.

And – and year over year we've tracked the results and I think that over the last 5 years we've actually gotten you know over 350 companies to change. So, really it's – it's about –

so you-you – you have to – you have to keep track of the companies that you’re engaging. You have to keep track – we-we create databases, you have to keep track of whose responding, whose not. You have to keep track of you know what their position on the issues are. It-it does take some – some effort to-to monitor it, but in terms of evaluating the activities you know that depends on the issue as I said with voting standards the ones that agree to do it or-or don’t. You know it’s pretty easy to track. In terms of environmental issues it’s a little bit more difficult. I think that’s something that we’ve you know keep trying to-to work on and get better at.

You know a lot of times you know I would say maybe depending on-on the issue a lot of the companies just don’t – as I said they don’t respond to us. You know that’s why we send follow-up letters, but you know just – just have to be diligent and-and as I said you know, keep-keep a database of what you’re doing.

[Ikeo, Chairman] Mr. Iwama, please.

[Iwama, member] Thank you for sharing various information. I have a question about disclosure of proxy voting results. CalSTRS set up guidelines, and discloses voting results in detail. At the same time, CalSTRS requires its asset managers to report their voting results.

In Japan, it is a common practice that institutional investors aggregate their voting results into major categories of proposals and disclose them. Now there actually is ongoing discussion that they should make company-level disclosures. I understand that CalSTRS discloses all voting results down to the company level on its website. Furthermore, CalSTRS requires individual managers to report company-level voting results. Does CalSTRS require individual asset managers, which you work with, to disclose their voting results down to the company level? I’d like to know the actual situation.

[Mr. Rice, Portfolio Manager, CalSTRS] I – I do think that managers should disclose how they’re voting for their clients though we vote all of our own proxies ourselves, we took that responsibility away from our external managers several years ago. When I started here we – we voted the US proxies ourselves, and our external managers voted the non-US proxies and then we gave them our voting guidelines for them to follow and then expected them to report to us quarterly I believe how you know each individual proxy how they voted. We found that managers – several managers more than one manager would own the same company, and one

manager would vote one way and the other manager would vote the other way.

So, we built up the resources to do it all ourselves. So that all of our proxies are voted in the same way, but certainly you know believe that you know, if you you're voting proxies on behalf of somebody else – we vote them on behalf of the teachers we should disclose to the teachers, to the public how we vote them. If the managers are voting on behalf of a fund like CalSTRS that manager should be disclosing at least to the fund how they're voting the proxies and they should do it in-in discreet of detail as they can.

[Iwama, member] I see. Let me ask you an additional question. Regarding asset managers which CalSTRS works with, do you require such managers to disclose their voting results down to the company level?

[Mr. Rice, Portfolio Manager, CalSTRS] Our managers don't vote for us anymore. So, we don't. I – I – I'm saying generally you know we believe the managers do that for their clients but it's up to the client to demand that from the manager.

[Iwama, member] Thank you very much.

[Ikeo, Chairman] Please go ahead.

[Tanaka, member] Please allow me to ask one more question. Regarding corporate governance in Japan, I heard many foreign investors consider that the establishment of the Corporate Governance Code and the Stewardship Code once created a momentum for the improvement of corporate governance, but the progress has recently slowed down. This is related with page 17 of your presentation material. Mr. Rice, have you heard such voices? Or do you support such a view? If so, while you wrote "Encourage efforts to continue" at the bottom of page 17, specifically what progress do you think necessary for moving forward to realize the philosophies of Japan's Stewardship Code or Corporate Governance Code?

[Mr. Rice, Portfolio Manager, CalSTRS] Yes. My opinion is that progress hasn't slowed. I have been involved in –in – in CalSTRS efforts in – in Japan for over 10 years, and I think that there's been a lot as I indicated in slide 17, a lot of positive changes that have occurred the last few years. You know, our work through the – through the ACGA, we do meet with – with representatives from – I believe – it's SuMi Trust who gives us updates on a regular basis about governance Japan and from what I can tell a steady progress – good progress continues to be made, so I wouldn't – wouldn't agree with that. And like I said certainly you know,

there are things that you do in Japan that we should probably do in the US, and – and I think that you know there's great opportunity for us to-to work together and share best practices.

[Ikeo, Chairman] May I consider that you have already asked necessary questions to Mr. Rice?

Then I'd like to end the video conference with Mr. Rice from CalSTRS. Mr. Rice, thank you very much for sharing your precious time with us. (*applause*)

I'd like you to resume discussion. Material 1 presented 4 points at issue. In addition, I'd like you to express your opinions on such issues as asset managers' abilities.

Please go ahead.

[Era, member] Thank you. We have been discussing disclosure of voting results and conflicts of interest at this council, and the topics have become a commonly debated topics among the investor community as well. The other day, at the Forum of Investors Japan, I had an opportunity to discuss personally with a group of people who are in charge of investment of Japanese and foreign asset management companies –Asset Managers. So I would like to express my view, also taking into account the opinions raised at the forum.

First, I think it was pointed out at the last meeting that investors do not seem to inform companies of how they have voted. I interviewed the Asset Managers on this point. In fact, after the general shareholders meetings, if companies ask whether they cast “for” or “against” votes, or request face-to-face meetings to discuss the reasons for voting for/against certain proposals, most institutional investors, including ourselves, have responded to such requests.

The case maybe slightly different when we receive inquiries concerning the voting decisions prior to general shareholders meetings. For example, some provide clear answers regarding whether they will vote for or against the proposals in accordance with their proxy voting guidelines. Or if such request have been made before the proposals to a general shareholders meeting have been finalized, some investors, according to their policies, inform the companies of their proxy voting guidelines and communicate their views as much as possible, expecting that such inputs may change the proposals. If it is after the proposal have been finalized, they give a sense of whether they will vote for or against the proposals, while clearly noting that these are not final decisions.

These subtle differences in their responses may be the cause of the perception that

investors are reluctant to provide information regarding their voting decisions. However, I found that asset managers basically inform – or consider it is important to inform – investee companies of their voting decisions.

Next, I believe that there are circumstances which potentially involve conflicts of interest in exercising voting rights, and thus it is very important to discuss how to resolve such potential conflicts. I don't think it is a Japan-specific issue. In every country, such concerns exists in one form or another. Accordingly, the international community has been discussing desirable ways to manage such conflicts, including some of the practices introduced today.

I also introduced previously, such practices may also include outsourcing of vote decisions to third-party proxy voting agencies based on the asset manager's own guidelines, or disclosing proxy voting guidelines and policies on company websites.

When discussing whether such practices to manage conflicts of interest are appropriate or not, I believe it is very important to consider pros and cons. The degree of concern for conflicts of interest may vary significantly based on the circumstances. Therefore each company should seriously consider appropriate practices taking into account each circumstances. Such an opinion was raised at the last meeting, and many asset managers strongly supported such opinion.

As for company-level disclosures of voting results, I also discussed this at the forum, from a viewpoint of this disclosure as a measure to resolve conflicts of potential interest.

On this point, the conclusion was that many asset managers believe they have no issues with communicating their voting results directly to investee companies, however disclosing the results to the public is another story.

Specifically, they seemed concerned about the situation where the media may pick up only a part of their voting activities – typically, the mere fact they voted for or against a certain proposal – without showing the whole picture. In other words, under such situation, although it was originally meant to be dialogue between investors and companies, asset managers will be required to respond at different level beyond the trust relationship between company and investor, which is likely to adversely affect the trust relationships.

That corresponds to the experience in the United States. Since 2003, company-level voting disclosures have been required of mutual funds in the United States. It is said that those who

actually refer to such company-level disclosures are mass media, academics, or advisors specialized in supporting shareholders' meetings.

Furthermore, I also had extensive discussions regarding whether company-level voting disclosures will enhance the dialogue itself. Many voiced their concern about this point as well. Dialogues are based on the trust relationship, and unless there are exceptional circumstances both parties will basically keep the discussion private. This is the very basic yet essential aspect of constructive dialogue.

On the other hand, in an extreme case, a company-level disclosure may reveal to the public the fact that two parties have not reached an agreement in their dialogue. Therefore, several asset managers expressed their concerns about the consistency between such disclosure and this important basics of dialogue.

This is an extremely important point, particularly in other countries. In other countries, discussions and dialogues prior to finalizing proposals to general shareholders meetings are considered to be most important. When the proposal draft seems problematic, dialogues are held between investors and companies prior to the general shareholders' meetings to hopefully change the proposal to more supportable one. As a result, at the time of the actual vote, the ratio of "for" votes will be high. I think this is a direction preferable in Japan as well.

Although, as a result of such disclosure, I am afraid of a possible situation where the focus will be placed merely on the result of the vote, and emphasized in a confrontational manner, in a distorted way. That may spoil the positive momentum of dialogue, or harm the reputation of both the company and asset manager, which will be significant demerits.

Therefore, from a viewpoint of promoting and enhancing dialogue and corporate governance, I would say the disadvantages of company-level disclosures are significant. Considering the fact that there are various measures to manage conflicts of interest other than company-level voting disclosures, I believe that introducing company-level disclosures at the moment has significant drawbacks.

That's all.

[Ikeo, Chairman] Thank you. I should have told you earlier that although Mr. Toyama is absent today, he submitted his opinion paper. I believe everyone has a copy, and it was sent to the members in advance. So I will not read it out here, but please take his opinion paper into

account, as necessary, in your discussion.

Mr. Oguchi, please.

[Oguchi, member] Thank you. Mr. Brian Rice explained “all CalSTRS proxies voted by staff” as shown on page 13 of his presentation material. In other words, the pension fund exercises all of its voting rights by itself, without delegating its voting to asset managers. This may be alien to Japan. As explained earlier, CalSTRS believes that its proxies should be voted on by its own staff members, because CalSTRS has a responsibility to public school teachers in California. If it delegates its voting to asset managers, some asset managers may vote “for”, and others may vote “against” the same proposals of the same company. Then CalSTRS cannot take responsibility as the asset owner. That’s the idea.

In fact, this is not a rare case globally. Our clients also have a similar mindset: although they outsource some tasks, they establish voting policies by themselves and ensure that voting is carried out according to such policies. Although Japanese asset owners have not yet reached that level, taking into account such asset owners’ view, I’d like to express my opinion about today’s topics – conflicts of interest and disclosure of voting results.

I revisited Guidance 2-1 of the Stewardship Code, which stipulates the relationship between conflicts of interest and voting: “...they inevitably face the issue of conflicts of interest from time to time, for example, when voting on matters affecting both the business group the institutional investor belongs to and a client or beneficiary. It is important for institutional investors to appropriately manage such conflicts.”

As Mr. Era mentioned earlier, the issue of conflicts of interest is not Japan-specific, but can be seen in other countries as well. Therefore, as pointed out previously at this Council, disclosure of voting results is widely recognized as an effective measure to dispel concerns about conflicts of interest. As shown in Material 1, in which opinions of foreign institutional investors are compiled, I believe that this is the global standard. To be straightforward, when there is a doubt about conflicts of interest, in order to make a rebuttal statement, disclosure of voting results could serve as counter-evidence. To put it the other way round, without such counter-evidence, even if investors say there are no conflicts of interest, they cannot provide valid explanations when they are required to make independent voting decisions as stated in ICGN’ Principle 5. That’s Brian’s explanation from today, as well as foreign institutional

investors' understanding as shown in today's material from the secretariat.

Then to what extent should they make disclosures? On page 4 of Material 1 prepared by the secretariat, under the heading of "2. Disclosure of Voting Results", it is pointed out that disclosures at the aggregate level are not sufficient, and disclosure at the individual company level are required. This was also written in ACGA's presentation material last time. In a certain sense, this is a result from global discussions - a consensus. Then from the viewpoint of those who support the consensus, in order to gain global understanding that institutional investors appropriately manage conflicts of interest as stipulated in Guidance 2-1 of the Stewardship Code, I believe that disclosing voting results down to the individual company level is a necessary condition.

Especially, as Mr. Tahara explained, there is concern about the structures of Japanese asset managers. If the level of concern about conflicts of interest is higher than that in other countries, to dispel such concern, I believe that we have no choice but to seriously discuss the necessity of company-level disclosures of voting results.

Furthermore, as for passive managers' engagement, there are various differences between passive and active managers' engagements. As stipulated at the beginning of the Stewardship Code, engagement is "based on in-depth knowledge of the investee companies and their business environment". However, passive managers invest in the entire market, so they do not need in-depth knowledge of the investee companies in the first place.

Furthermore, Preamble 7 the Code stipulates that "Institutional investors and their clients and beneficiaries should both recognize that costs associated with stewardship activities are an indispensable element in asset management." However, when low cost is passive managers' competitive advantage, there should be a severe limitation in costs, for which they can gain understanding. In that sense, we must look at passive managers with a different limitation from active managers. In my understanding, after all, engagement with investee companies in the passive funds needs a screening process to choose companies with significant issues and large market caps", as shown on page 5 of Material 1. As Brian also mentioned earlier, passive managers concentrate on meaningful dialogue by focusing on selected companies based on the materiality. In a certain sense, it would be a natural move. This is the same point which we discussed with Mr. Allen, Secretary General of ACGA, at the last meeting.

I'd like to make another point regarding passive management. After all, passive managers do not have the freedom to select or trade stocks. Then I think it is possible for them to have open dialogue to some extent. They will not sell or purchase stocks as a result of dialogue. Therefore, they could make dialogue a little more open, taking advantage of the inability to sell stocks, and aim at the spillover effect on the entire market. This is an approach which active managers can hardly adopt, and passive managers may need to take such an open dialogue approach, from the perspective of the cost effectiveness.

Finally, briefly speaking, asset owners are responsible for monitoring, and do not have sufficient resources, as written on page 6 of Material 1. While I was reading ICGN Global Stewardship Principles among today's materials, I found the last section – Part 3 – is very interesting, although the phrase “Ecosystem of Stewardship” used as the title of Part 3 is not familiar to me. Briefly speaking, I think the point is that they should make effective use of outsourcing, given the lack of resources.

Suppose it is applied to the current situation in Japan. The lack of resources has been a challenge for pension funds, and pension consultants have supplemented the resources by providing support including various kinds of advice to corporate pension funds, etc. In this light, in the future, pension consultants as well as service providers in new business categories, if any, can complement the lack of resources on the side of asset owners, by rendering services so that the pension funds can fulfill their stewardship responsibilities in a substantive – not formal – manner. Precisely because of the lack of resources, the pension funds focus their effort on monitoring, I suppose. Brian explained that CalSTRS uses Glass Lewis. It does not mean that CalSTRS leaves everything to Glass Lewis, but uses their platform and lets them follow CalSTRS' policy for proxy voting. I believe that this is a good example where asset owners fill the gap in resources by using service providers, and fulfill their stewardship responsibilities.

That's all.

[Ikeo, Chairman] Thank you very much.

Mr. Nishiyama, please.

[Nishiyama, member] I'd like to talk about disclosure of voting results. Personally, at this stage, it would be too early to move on to company-level disclosures. At this stage, voting

results are disclosed by category of major proposals, but there still are inconsistencies regarding methods for disclosures among institutional investors. So it would be a little too early to move on to company-level disclosures in terms of steps to be taken. Instead, at this stage, it would be more meaningful to enhance the disclosures by category of major proposals.

Furthermore, I'd like to refer to conflicts of interest, when they proceed to the company level. A manager I know told me a story like this: although there currently are concerns about conflicts of interest, for example, in such a way that investors are pressured by companies through securities companies or financial institutions, as pointed out last time, the manager has not actually been pressured in that way, nor have their voting decisions been actually distorted by such things. Nonetheless, the manager said that they cannot always exercise their voting rights from a completely free or independent standpoint without taking such things into account at all.

Therefore, in case an institutional investor votes against a company's proposal, there may be negative consequences. When such concerns have not been completely cleared, if they move on to company-level disclosures, I'm afraid that there will be a risk of putting such pressures on those who exercise their voting rights.

Consequently, when the transparency in conflicts of interest is called for, I'm worried about a risk of causing adverse effects. So in case of moving on to the next stage, it is necessary to enhance investee companies' awareness that it is problematic to pressure investors into voting for their proposals, for example, through financial institutions, including securities companies, or other routes. Or parent financial institutions of asset managers need to ensure that the asset managers do not have to consider such things the parent companies' interest, etc. Without clearing such issues, I'm afraid that conflicts of interest and company-level disclosures will not be properly linked.

Therefore, in case of moving on to the next phase, it is necessary to ensure that investee companies and financial groups as a whole have a strong recognition of what is problematic. I believe that it is more appropriate to move on to that [company-level disclosures] only after such a step.

That's all.

[Ikeo, Chairman] Thank you very much.

Professor Kawakita, please.

[Kawakita, member] I'd like to share my opinions on 2 topics: proxy voting, and passive management. Regarding disclosure of voting results, it is appropriate to disclose major results or a summary version. As I mentioned last time, even if they disclose all results, the range of those who analyze such results are limited. Generally, disclosing all results may not be user-friendly and we do not know what problems may arise.

Another point raised is relationships with companies. If institutional investors and companies can have fundamental dialogue, the companies can get a sense of whether the investors will vote for or against their proposals through such dialogue. Therefore, I don't think it is necessary to be worried about that part.

I discussed this issue with several people. They told me that the section in charge of proxy voting may not always be the section in charge of actual analysis. I believe that these two sections should work together, and findings of analysts should be communicated to those who exercise voting rights. This is how it should be. Without that, it is impossible to have fundamental dialogue. And if they vote merely for the sake of formality, disclosures of voting results would reveal relationships with the companies. That's my understanding.

Another topic is dialogue in case of passive management. Originally, passive managers are not expected to have dialogue with individual investee companies. Instead, they trust and invest in the market. Accordingly, dialogue and passive management are not really compatible. I understand that dialogue is an activity for active management. However, I consider that it may not be appropriate to completely deny dialogue in case of passive management.

From such a perspective, while there are currently almost 2,000 companies listed on the TSE First Section in the Japanese market, many pension funds adopt the passive management strategy using TOPIX, which is a group consisting of the said companies, as a benchmark. I don't think it is so appropriate. Based on my own activities as an analyst, I'm aware that there are quite a few companies inappropriate for investing in. The other day, I found that companies which I had considered incompetent were performing poorly. Although this may be like spitting against heaven in a certain sense, I would argue that it is necessary to carefully judge how many TOPIX companies or companies listed on the TSE First Section are qualified as investee companies in a true sense.

Another thing is the relation with costs. Having dialogue incurs costs. Ultimately, asset owners must bear such costs. In that sense, it is important to select counterparties of dialogue, as stated in CalSTRS' presentation. In case of Japanese companies, I got an impression that the targets could be limited to roughly 200 companies, although I do not necessarily mean that the targets should be Nikkei 225 companies.

Another point. It would be necessary to consider what a passive manager should do after voting against a certain company's proposal at its annual general meeting. If the passive manager has cast "against" votes for several consecutive years, it constitutes an indication of its view that the company in question is not appropriate as an investee company. Then it is necessary to take such actions as removing it from the index or disclosing a summary version of voting results including the fact that it voted against the company's proposals.

Incidentally, if an investor cast an "against" vote and did not take any subsequent action, it would be recognized as the boy who cried wolf. The life insurance industry, where I used to work, has conducted a research on shareholder returns since around 1980. Although they talked about increased dividends, they did not sell many shares. The investee companies did not increase dividends. Similar things may happen. Therefore, I believe that passive managers' proxies could be voted on by themselves, but in reality, a better mechanism should be sought for.

That's all.

[Ikeo, Chairman] Thank you.

Mr. Uchida, please go ahead.

[Uchida, member] Thank you. To confirm how the industrial circle responds to voting disclosures down to the company level, I interviewed with several companies. Some made positive comments, and others made negative comments. I'd like to share both positive and negative comments here.

As a positive remark, some referred to the Corporate Governance Code: Supplementary Principle 1.1.1 clearly states that "When the board recognizes that a considerable number of votes have been cast against a proposal by the management ..., it should analyze the reasons behind opposing votes and why many shareholders opposed, and should consider the need for shareholder dialogue and other measures." They said that if institutional investors disclose

their voting results, it will facilitate such dialogue, so they will openly and squarely have dialogue with the investors.

On the other hand, there should be the following cases: an institutional investor established, disclosed, and announced its proxy voting guidelines; if the investor formally follows the guidelines, it must vote against a proposal of an investee company; but through dialogue with the company, the investor may make a substantive judgement and vote for the proposal. We have dialogue for that purpose. However, if company-level voting results are widely disclosed to the public, institutional investors will be exposed to a risk of receiving criticism or requests for explanations regarding why they voted for certain proposals, which they should have voted against in accordance with their guidelines. They may receive such criticism or requests not only from concerned parties, but also from a wider audience. Then some institutional investors may want to avoid such situations, and opt for formally following their voting guidelines. Some expressed such concern.

Regarding the exercise of voting rights, as proposed in Material 1 for the seventh meeting of the Follow-up Council, proxy advisors also need to make their judgments based on substance instead of formal judgments. Institutional investors also need to examine the quality of advice, etc. and make judgements based on substance, instead of formally following the advice from proxy advisors. These are important points.

Accordingly, although now company-level voting disclosures are considered as one of measures for institutional investors to avoid conflicts of interest, we have to avoid the situation where the company-level voting disclosures change into pressures upon institutional investors and proxy advisors to opt for mere formal voting. We need to be careful about that.

That's all.

[Ikeo, Chairman] Thank you.

Mr. Callon, please.

[Callon, member] I found today's discussion on company-level disclosure very helpful. While I believe company-level disclosure is an important goal, I also recognize the importance of the counter-arguments from members whom I deeply respect. For example, I understand the concerns about the challenges that may result from such disclosure. Nonetheless, we need to focus on what is good for Japan. Company-level disclosure, in tandem with shareholders

sincerely communicating with companies about their votes for or against companies' proposals and the reasons for their votes, is an essential part of constructive dialogue between companies and shareholders.

I also recognize that some companies are not happy with the prospect of company-level disclosure, and the media may report on "unfavorable" votes. Investors need to be prepared for this, but what they ultimately need to think about is their fiduciary responsibilities. If it is their own money, investors do not have to disclose to the public how they invest. However, when institutional investors are investing on behalf of a broad number of beneficiaries, explaining their voting activity to clients is a part of their fiduciary responsibilities. I would add that among the various stakeholders in public companies, only shareholders have voting rights. I thus believe that institutional investors have a responsibility to all stakeholders when they vote. There are concerns about company-level voting disclosure in other countries as well. Nonetheless, there is a global consensus that company-level disclosure is best practice. Japan is fully capable of adopting this best practice and promoting mature and constructive dialogue between companies and shareholders. Japan's institutional investors need to engage in constructive dialogue with portfolio companies and explain why they support or oppose proposals as an inherent part of fulfilling their fiduciary responsibilities. Since shareholders come to issues from a different position from companies, they can have different views. Precisely because of this, constructive dialogue fosters greater mutual understanding. If Japanese companies and shareholders can engage in this kind of mature discussion, it would generate extraordinary progress.

[Ikeo, Chairman] Mr. Tsukuda, please.

[Tsukuda, member] Almost all opinions expressed today focused on company-level disclosures. Before discussing company-level disclosures, I'd like to make some comments on asset managers' governance, which is the first of 4 topics presented by the secretariat today.

Concerning of asset managers' governance, it is stated that "it is important to have robust governance structures, including an independent oversight, to manage conflicts of interest." I totally agree with this statement. In order to ensure the entire investment chain properly works, asset managers play significant roles. There are high expectations for asset managers, so I believe it is important to work on such things.

In fact, when I talk with top managers of companies, I still hear them saying, “While discussing issues with asset managers, they point out various matters regarding our governance. But what about governance of the asset managers?” In this regard, it is important that those who suggest it should be the first to do it.

Now I’d like to talk about today’s hot issue – disclosure of voting results. Although some members expressed opposing views, Mr. Callon supported company-level disclosures. I agree with Mr. Callon. I believe that disclosures of voting results should be made at the company level.

In his opinion paper, Mr. Toyama shared a perspective of a concerned party.

One of the members pointed out the situation where institutional investors may be criticized or requested to provide explanations by a wider community other than concerned parties. Certainly, there may be such concerns. Conversely speaking, in full view of everyone, as Mr. Toyama wrote, “Public disclosure of voting results will create an opportunity to have such discussion squarely and openly.” An institutional investor voted against a proposal by a company: after having extensive discussions, the investor carefully made a decision to vote against the proposal. Then it is important for the investor to make its voting results open, and fairly have dialogue with the company, whose proposal it voted against.

Mr. Era stated that disadvantages of company-level disclosures are significant. I agree with that. I believe that it is important to examine pros and cons, consider what should be achieved in the current environment, and decide which should be given priority. Furthermore, as Mr. Nishiyama mentioned, there actually are cases of putting pressure to institutional investors – it’s embedded in the Japanese culture.

Meanwhile, fundamentally, the real problem is that decisions are distorted due to such pressures. So in order to fulfill stewardship responsibilities in a real sense, I believe that it is necessary for institutional investors to reconfirm that they should overcome such pressures, and act for the benefit of shareholders.

Taking these matters into account, what should be done? I consider that what is written in Mr. Rice’s material as the third point on page 16 is the essential point. Under the statement reading “Require manager to disclose vote & reason for vote,” it is written that “Transparency can help eliminate conflicts.” After all, it comes to the issue of transparency. Eventually, the

transparency could eliminate conflicts. To relate it to the secretariat's material, by making company-level voting disclosures, which corresponds to the second of 4 topics, they can achieve progress in managing conflicts of interest, which corresponds to the second half of the first topic. So I believe that we should promote that.

Mr. Era's comments on advantages and disadvantages also stay in my head. Then what should we do? I consider that we could bring about the next step in the Stewardship Code – in other words, a revision of the Code. Under the 'Comply or Explain' approach, let institutional investors have an option, but they need to explain reasons for non-compliance. It would be the best to indicate the direction where institutional investors are expected to state such reasons or disadvantages openly and squarely.

That's all.

[Ikeo, Chairman] Thank you very much.

Dr. Ueda, please.

[Ueda, member] Thank you. Many members have discussed company-level disclosures, on the premise of addressing conflicts of interest. I'd like to briefly make 3 points: conflicts of interest, internal governance, and asset owners' roles.

First of all, I'd like to say thank you for introducing ICGN Global Stewardship Principles. I am a member of ICGN's shareholder responsibilities committee, which have involved in developing these Principles. I'm delighted that you introduced these Principles.

In these Principles, the importance of internal governance is pointed out. The essential part of today's discussion is how to nullify the effects or substance of conflicts of interest, since conflicts cannot be completely avoided. It is a global trend to discuss such internal governance. I don't think it is a Japan-specific issue.

During discussions at ICGN, we often talk about "a governance body within an institutional investor." It could be a board of directors, council, or board of governors. It would be necessary to discuss specifically how to make such a governance body effective in Japan as well.

In doing so, we should look at not only asset managers, but also the entire financial groups to which they belong. It is inefficient to tell asset managers alone to secure the independence, avoiding conflicts of interest. I suggest that we should discuss possible measures for the entire

groups to avoid potential effects of conflicts of interest.

This issue is now much talked about in Japan, because the UK's Stewardship Code places an emphasis on dialogue with external parties. I believe this is also an important discussion topic under Japan's Stewardship Code. On such a premise, company-level disclosures are hotly debated today. I sort of feel that it is too early to adopt such disclosures. It was argued that company-level disclosures could be used as evidence for absence of conflicts of interest, but I got an impression that the advocates are leaving a solution, which should be separately sought for, to such disclosures. As a result of discussing methods to eliminate conflicts of interest or to nullify their effects, if the environment is ready to accept company-level disclosures, it should be all right to go for it. It sounds like a chicken and egg situation.

Rather, what I consider problematic now is the fact that there are some institutional investors who do not disclose their voting results even at the aggregate level. Japan Investment Advisers Association developed its own disclosure format and method for classifying company proposals, which are already generally recognized. We could use them as a *de facto* tool for disclosures in Japan, and ask institutional investors, especially asset owners, to make aggregate disclosures there. That could be the first step.

Having done so, if it is considered necessary to disclose voting results at the company level, instead of the aggregate level, institutional investors which want to do so on a voluntary basis, or those who consider it necessary could proactively do so. In the United States, only mutual funds make company-level disclosures. In the UK, there are large, reliable, long-term investors who declared that they will not do so. Therefore, it is not an issue of whether or not to go for it. I feel that it is about creating an environment where those who want to make company-level disclosures can do so.

Finally, as written in the last part of the secretariat's material, I believe that asset owners have significant roles in this discussion. I consider that it is necessary to create an environment which makes it easier for asset owners to sign up for the Stewardship Code. Looking at the entire investment chain, it would be necessary to give consideration to the problem of corporate pension funds and other asset owners concerning the lack of resources. For example, when many asset owners, especially corporate pension funds, have not signed up for the Code, it would be necessary to have a comprehensive discussion for making it easier for such funds

to join. For instance, if all asset managers provide reports in the format developed by the Japan Investment Advisers Association, asset owners with limited resources will only have to compile the data in an Excel file, and can easily make disclosures; and asset managers will be able to save the trouble of tailoring their reports for specific client asset owners.

That's all.

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

[Tanaka, member] Although it is not included in today's materials, I have thoroughly read "Report of the Working Group on Asset Management" published by Japan Securities Dealers Association in June. I believe Mr. Iwama participated in the Working Group. In this report, it is stated that "For example, according to Edelman's Trust Barometer, the level of trust in the financial services sector in Japan remains comparatively low. Furthermore, within the financial services sector, the lowest level of trust is given to the investment advisors/asset management sector." And the Report concluded that "Meeting the fiduciary duty of asset management companies concerns product and performance as well as the governance structure and transparency of asset management companies' management (specifically, identifying elements of conflict of interest that exist with customers, explicit preventive measures to eradicate these conflicts, etc.). Fulfilling fiduciary duties will be impossible without simultaneously resolving both of these types of concerns."

I believe that this Report is very important and well-articulated, and we should consult with it. I'd like to make several comments. One is related to company-level disclosure. I have listened to other members' comments about it. Mr. Era, Mr. Uchida, and Mr. Callon made excellent points. I have served as a director of a publicly held company in the United States for roughly 10 years in total. Let me share with you the practices adopted over there. In CalSTRS's material, at the bottom of page 11, under the heading of "other issues of concern", "concentration of AGM dates" – annual general meetings of shareholders – and "timing of proxy information" are pointed out. CalSTRS is concerned about these issues. And that fact is closely related with the issue of company-level disclosures. I think they do not have time to have discussions. Even though institutional investors are told to engage with investee companies, they have extremely limited time for engagement in Japan. I think CalSTRS referred to that.

According to my experience abroad, we receive a variety of papers and letters from various investors prior to general shareholders meetings, and we have relatively plenty of time to deal with them. We have substantial dialogue and conduct engagement activities. Sometimes we agree with each other, and sometimes we don't. In most cases – maybe more than 90%, we have reached an agreement. Consequently, we have mostly cast “for” votes, not “against” votes.

In case we had no choice but to vote “against” a proposal, we explained at the general shareholders meeting that while the company's material stated this and that, we held a different point of view. Whether or not to disclose voting results at the company level is the last part of the entire process, so I think it is not meaningful to discuss only that part. Similarly to Mr. Callon, I believe that Japan should go for company-level disclosures. However, it is very important to look at other elements, including processes prior to such disclosures, the process of discussion, and the depth of engagement.

Therefore, as CalSTRS' representative mentioned, a key point is that sufficient time should be allocated for engagement. For that purpose, it may be necessary to amend the Companies Act and other regulations, but I believe this is the point to be discussed.

My second point is about the issue of conflicts of interest. I understand the problem with financial groups, as pointed out by Dr. Ueda, because I used to belong to such a group. As I don't belong to the group any longer, I'll talk from an independent standpoint. Frankly speaking, Japan's situation is very special after all. Insurance companies and trust banks lend money, and also make investments. In Japan, unlike Europe and the United States, lending operations are not subject to lender liability. In other words, the said financial institutions have an aspect of being lenders as well as insiders. What they do would be subject to lender liability claims, if done in the United States: for example, in case they find something is wrong with a company, they will send their personnel to the company. There are differences in characteristics of lending operations between Japan and the United States in the first place.

Taking trust banks for example, they conduct such special lending operations, manage assets of pension funds, and may also do real estate brokerage. Such businesses are carried out by one company. Suppose that a trust bank lends money to a real estate company, provides real estate brokerage services on its behalf, and manages its pension fund. Even if a representative

of the bank says, “We have no conflicts of interest,” how many people in this room believe that? Frankly, they have such issues. In Japan, they have been operating in such a way, under a business model called “trust banking model” for many years. I have no doubt that it is the point at issue.

Maybe this issue needs to be considered in terms of system or institution. Life insurance companies have exactly the same problem. Besides, many life insurance companies still adopt the corporate form of mutual company, and their governance is not sufficiently established. I believe that we should not hesitate to point out such issues, and should address the issues.

Professor Kawakita referred to passive management earlier. I interviewed and talked with many people about that. Today, on page 12 of CalSTRS’ material, I found under the first heading of “Role of Japanese owners” that it is written “Asset owners with passive strategies should engage with portfolio companies to be better.” CalSTRS recognizes that “long term nature of passive ownership” is subject to “more risk exposure.” I totally agree with that. While it is passive management, in fact, companies also want long-term investors. Meanwhile, by making long-term investments, investors are exposed to more risks over the long term. Investors, therefore, do not merely rely on figures in the market, when they make such investments. Naturally, there is the issue of costs, but from the said perspective, I feel it is wrong that passive managers do not actively conduct engagement activities, etc.

Finally, I’d like to share my view regarding what is the most important point in this discussion. CalSTRS made various points, and so did the English version of ICGN’s Principles, which the secretariat distributed today. I believe that what is written on page 16 of CalSTRS’ material is very important. On the second line, it reads “Your responsibility to beneficiaries to vote in their best interests”: institutional investors should always make decisions in the best interests of beneficiaries.

Next, it reads “Manager votes based on client wishes.” In my understanding, it recommends that we should always consider whether we, institutional investors, are discussing or making decisions in the best interests of people at the bottom of the investment chain – considering what they wish.

Therefore, in this discussion, I think we need to ask ourselves for whom we are discussing, and also need to ask the same question to those who participate in the discussion.

That's all.

[Ikeo, Chairman] Thank you very much.

We are running out of time. Please go ahead.

[Takayama, member] As for company-level disclosures, I support such disclosures. Although there are both advantages and disadvantages, considering relationships between companies and investors, I believe that advantages outweigh disadvantages. As for the timing to introduce company-level disclosures in Japan, however, we do not yet have a conducive environment. This is associated with asset managers' governance. As Dr. Ueda mentioned earlier, internal governance of asset managers is globally becoming a major topic, and there is a consensus that it is a very important point. Therefore, I consider that Japanese asset managers should establish robust governance structures first, and then move toward company-level disclosures.

Concerning asset managers' governance, some points are indicated on page 3 of the secretariat's material. Merely setting proxy voting guidelines or establishing an independent committee for that purpose is not sufficient. It is important that boards – boards of directors – at the top of asset managers secure full independence. Only if boards have the independence, they will be able to solve the issue of conflicts of interest, and establish the structure for making the best decisions for beneficiaries among various other stakeholders. I consider it would be desirable to establish such structures first, and then move on to company-level disclosures.

Mr. Tanaka referred to Japan-specific circumstances. Certainly, it is an important point in terms of large figures. Looking at ownership structures of Japanese companies, assets managed for pension funds amount to roughly 50 trillion yen. Who manages the assets? In most cases, the assets are managed by major trust banks, and some by investment advisors. Assets invested in Japanese stocks by top 3 trust banks amount to roughly 25 trillion yen: most of them are managed for pension funds. Accordingly, when such a large portion is managed by trust banks, taking into consideration Japan-specific circumstances as Mr. Tanaka mentioned, how to address this point will be a big issue in the future.

That's all.

[Ikeo, Chairman] Thank you very much.

As usual, I'd like to ask Mr. Iwama to make final remarks. Please be advised that we are

running out of time.

[Iwama, member] Thank you for the opportunity. As Mr. Tanaka mentioned earlier, on page 16 of CalSTRS' material, it is written that "Manager votes based on client wishes." That's our position. The point is what clients wish. I think there is a general trend of calling for company-level disclosures – as a global trend. So how shall we respond? In Japan, as Dr. Ueda introduced it earlier, the Japan Investment Advisers Association has worked on compiling voting results for many years, seeking the best way to do so. Furthermore, the Association has required member companies to establish guidelines, and disclose them to the public. As a result, the member companies have fulfilled such requirements. I believe that we have generated certain positive effects. However, regarding whether or not to go for company-level disclosures, I personally consider that eventually, company-level disclosures will be adopted, going with the times. However, such a move should be made while considering various issues raised earlier today.

As a trend in Japan, GPIF is considering various things, and there will be various moves. It will be one of the key issues when considering what we should do in order to perform well, while going global.

Another point is related to passive management. Large passive funds have financial resources, and thus, are also sort of required to carry out engagement activities in order to raise the general quality of their engagement skills. Recently, such a trend has become very obvious. Specifically how to do so, should depend on what each asset owner believes. It may not be necessary to define what should be done.

Lastly, concerning asset managers' governance or what should be done for enhancing their reliability, as pointed out earlier, it depends on the extent asset managers can clearly explain to external parties how they manage or resolve conflicts of interest. Regardless of corporate structures, all asset managers should keep such things in mind, take actions accordingly, and demonstrate improvement. That is very important. From such a perspective, we'd like to make further efforts in the future.

I have more to say, but my time is up. I'll stop here.

[Ikeo, Chairman] I know you still have plenty to say, but it is already past the scheduled closing time, so I'd like to close today's discussion. We will continue our discussions at the

next meetings, and the secretariat will sort out and summarize our discussions so far.

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

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

[Ikeo, Chairman] Thank you very much.

Now I'd like to declare the meeting adjourned. Thank you for your participation.