

Summary of Public Consultation on Revisions to the Stewardship Code

March 2020

The Council of Experts on the Stewardship Code

Summary of the Public Consultation: Overview

❑ Public Consultation was held from December 20, 2019, with respect to “Issues for Consultation” on “Revision of the Stewardship Code”.

【Period】

December 20, 2019 ~ January 31, 2020

【Number of Letters】

To the Japanese version : 44 individuals/entities, To the English version : 23 individuals/entities

※ 3 of letters to the Japanese version were under joint signatures from many individuals and groups.

Summary of “Issues for Consultation” on “Revision of the Stewardship Code”

Q 1-1	What do you think about articulating that the Code apply to cases where institutional investors invest in other asset classes ? And why?
Q 1-2	Are there any points to be noted when institutional investors apply the Code to other asset classes?
Q 2	What do you think about incorporating “sustainability (medium- to long-term sustainability including ESG factors)” in the Revision Draft and its implementation in Principle 1? How should it be incorporated?
Q 3	How to encourage asset owners, such as corporate pensions, to participate in stewardship activities ?
Q 4	What do you think about expecting asset managers to disclose their voting rationale with respect to either “for” or “against” votes ? What do you think about its implementation in Guidance 5-3? And why?
Q 5-1	What do you think about the creation of a new Principle 8 and its Guidance, concerning “service providers for institutional investors” ?
Q 5-2	What are the points to be noted with respect to defining “service providers for institutional investors” as including not only proxy advisors and investment consultants for pensions, but also more broadly institutions which have functions that contribute to institutional investors’ and asset owners’ effective execution of stewardship activities? And why?
Q 6	Comments for the entire Revision Draft

Summary of the Public Consultation 1: Q1-Applying to Other Asset Classes

- ❑ With respect to applying to other asset classes, **the greater part of the comments agree** with the Revision Draft.
- ❑ While some comments suggest strengthening the wording, others say that it is not ready that the Code applies to other asset classes yet.

Key Comments

<Agree with the Revision Draft>

- Institutional investors take stewardship responsibilities in asset classes other than listed shares.
- With the promotion of sustainability in investee companies, it becomes naturally required to consider other asset classes.
- It is a **global trend** to apply to other asset classes.
- **In the context of financing in investee companies, other asset classes also affect governance of the companies.**
- ※ Major points that were raised with respect to the application of the Code to other asset classes
 - As signatories are a diverse collection of businesses, asset size, etc., **the Code should ensure enough flexibility for each institutions to implement stewardship activities.**
 - As **stewardship activities by shareholders are most effective, stewardship activities for equities should be prioritized** over other asset classes.
 - **A conflict of interest could occur between shareholders and bond holders.** Thus attention should be paid that bond holders do not encourage companies to accumulate excessive retained earnings.
 - While there exist conflicts of interest between shareholders and bond holders, if an institutional investor holds positions in both debt and equity of the same company, the institutional investor would be able to align both perspectives.
 - It should be noted that **the way to apply the Code would be different for each asset class.**

<Disagree with the Revision Draft>

- In Japan, at this stage, institutional investors should **focus on equity governance**, rather than other asset classes.

- ❑ With respect to applying to other asset classes, the Revision Code **keeps the same wording in the Revision Draft.**

Summary of the Public Consultation 2: Q2-Sustainability

- ❑ With respect to “sustainability”, **the greater part of the comments agree** with the Revision Draft.
- ❑ While some comments suggest strengthening the wording, others say that it is not ready to include “sustainability” yet.

Key Comments

<Agree with the Revision Draft>

- Sustainability will have more impact on long-term corporate value and investment return.
- Sustainability is being recognized as important as an international trend.
- The Revision Draft expects institutional investors to consider sustainability **consistent with their “investment management strategies”, and intends to avoid its consideration being a formality.**
- **Major institutional investors have already taken into account** sustainability (medium- to long-term sustainability including ESG factors) as a key element in their engagement.
- The Revision Draft requires consideration of sustainability **in order to increase corporate value.**

<The Code should **strengthen** the wording>

- “Sustainable benefits for the economy, the environment and society” should be set as an ultimate goal of the Code as UK Stewardship Code does.
- Sustainability should be taken into account without limitation like “consistent with their investment management strategies”.

<The Code should **keep the wording in the current Code**>

- Institutional investors need to first improve governance in their investee companies, rather than E and S.



- ❑ With respect to “sustainability”, the Revision Code **keeps the same wording in the Revision Draft.**

- ❑ Many comments suggest, or introduce experiences, to encourage asset owners, such as corporate pensions, to participate in stewardship activities.
- ❑ With respect to encouragement of asset owner's stewardship activities, **the greater part of the comments agree** with the Revision Draft.

Key Comments

<Agree with the Revision Draft>

- Most asset owners already entrust their assets to external asset managers. It is clarified that **what asset owners should be required to do is monitor the asset managers.**
- It is meaningful to **encourage** corporate pensions to accept the Code.
- **The Revision Draft states "in line with their size and capabilities, etc.", which will enable asset owners to take variety of stewardship activities,** and have enough flexibility.
- **Asset owners play an important role in the entire investment chain.** The encouragement of asset owner's stewardship activities will encourage asset managers to implement the Code.

<Disagree with the Revision Draft>

- The encouragement of asset owner's stewardship activities could result in a focus on form rather than substance in their monitoring.
- "In line with their size and capabilities, etc." would be unnecessary under a "comply or explain" approach.



- ❑ With respect to the encouragement of asset owner's stewardship activities, the Revision Code **keeps the same wording in the Revision Draft.**

Summary of the Public Consultation 4: Q4-Voting Rationale on Either “For” or “Against”

- ❑ With respect to voting rationale on either “for” or “against”, **more than half of the comments agree** with the Revision Draft. Some of them suggest specific ideas as to which item should be disclosed.
- ❑ While some comments suggest strengthening the wording, others suggest not including it in the Revision Code yet.

Key Comments

<Agree with the Revision Draft>

- The disclosure of particular and detailed information could lead to the disclosure of the specific content of dialogues, and adversely affect future dialogue by undermining mutual trust with companies. On the other hand, under the Revision Draft, institutional investors would still have discretion **to some extent as the scope of disclosure is not detailed too much.**
- It is a good implementation **as the rationale of voting decisions by institutional investors look unclear in some cases.**
- It will promote greater transparency within institutional investors’ decision making process, which will enhance **the accountability of institutional investors** particularly if there are potential conflicts of interest.
- It lets asset owners know in details how asset managers make voting decision. The voting policies and practices of asset managers are **a key part of asset owners’ selection process** and should be sufficiently clear.
- ※ Suggested cases to be disclosed: when voting against company proposals or for shareholder proposals, when each institutional investor selects agendas by their own, when voting against the election of board members, when voting decisions are inconsistent with the voting policy, etc.

<The Code should **strengthen** the wording>

- The voting rationale for all individual agendas should be disclosed.

<Disagree with the Revision Draft>

- Voting rationales have already been disclosed to clients, and it should be unnecessary to disclose them to the public.



- ❑ With respect to voting rationale regarding either “for” or “against”, the Revision Code **keeps the same wording in the Revision Draft.**

Summary of the Public Consultation 5: Q5-Service Providers for Institutional Investors

- ❑ With respect to service providers for institutional investors, **the greater part of the comments agree with the creation of a new Principle 8.**
- ❑ There were opinions both for and against the Guidance. In Particular, the following comments were submitted for Guidance 8-3 (proxy advisors should actively exchange views with companies).

Key Comments for proxy advisors' active exchange of views with companies (Guidance 8-3)

<Agree with the Revision Draft>

- Proxy advisors should actively exchange views with companies

<Disagree with the Revision Draft>

- The Revision Draft seems to say that as publicly disclosed information is insufficient, proxy advisors must exchange views with companies before their proxy advice.
- If proxy advisors are required to actively exchange views with companies, additional costs will be incurred to them while overlooking insufficient corporate disclosure.
- Proxy advisors should make proxy recommendation based only on publicly available corporate disclosure.



- ❑ **Basically, the Revision Code keeps the same wording in the Revision Draft.**

*To avoid confusion, a part of Guidance 8-3 (proxy advisors should actively exchange views with companies) is revised to articulate that proxy advisors should rely upon corporate disclosure as it is important.

Summary of the Public Consultation 6: Q6-Other Comments (1)

- ❑ With respect to Footnote 16 (disclosure of how many shares institutional investors own), disagreeing opinions were submitted.

Key Comments

<Disagree>

- Footnote 16 could put excessive importance on the amount of shareholdings and make it main theme in engagement, while the quality of constructive engagement is not necessarily linked to how many shares the institutional investors own. Under circumstances in which the quality of engagement with Japanese companies should be improved, the Footnote 16 should be removed.
- There is a concern that **institutional investors might lose opportunities for constructive engagement with companies** when (i) **they hold no shares at the moment** but would like to engage in dialogue in order to decide whether to invest or not, or (ii) **their holding shares are decreased** due to external factors, e.g. clients' unwinding mutual funds, etc.
- Recognizing actual shareholders is not a matter of engagement. It should be based on legal obligation and rights, and therefore it is not appropriate to be written in the Code.
- The number of shares institutional investors own could change day by day. The disclosure requirement will increase **administrative burdens**.



- ❑ Footnote 16 is revised to articulate that constructive dialogue is important regardless of the amount of shares institutional investors own/hold.

□ There were also the following comments, including topics about **corporate governance, etc.**

Key Comments

- **How to deal with large shareholding report regulation should be clarified, as they are closely related to collaborative engagement.**
- **How to encourage enriched engagement while passive management is increasing should be considered.**
- **Diversify the timing of General Shareholders Meetings and the earlier disclosure of materials for General Shareholders Meetings should be encouraged.**
- **Developing and utilizing internal audit divisions should be promoted.**
- **Actions should be taken toward further reducing cross-shareholdings .**
- **To ensure the effective stewardship activities of corporate pensions, it is important to strive for conflicts of interest management in sponsor companies.**



□ **It is expected that relevant authorities, including the Financial Services Agency and the Follow-up Council*, will hold further discussions on these topics.**

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