

Minutes of the 2nd Council of Experts Concerning the Japanese Version of the Stewardship Code

Note that this English version of the minutes includes liberal translations and omissions, and is not a complete translation of the minutes in Japanese.

1. Time and date: 3:00–5:00 pm, September 18 (Wednesday), 2013
2. Place: Financial Services Agency

[Kansaku] We will start today's meeting with lectures by two experts on the Stewardship Code in the U.K.

First, Ms. Ryoko Ueda, Chief Research Fellow at J-IRIS Research, will talk about the background of the development of the U.K. Stewardship Code and give an overview of its principles.

Secondly, Mr. Sadakazu Osaki, Head of Research at Nomura Research Institute, Ltd., will lecture on the operational status of the U.K. Stewardship Code based on his interviews with institutional investors in the U.K.

Then we will conduct hearings on the status of the industry's efforts concerning the involvement of institutional investors with the investee companies.

Today, Mr. Tokunari (Trust Companies Association of Japan), Mr. Matsushima (The Investment Trusts Association, Japan), Mr. Noguchi (Japan Investment Advisors Association (JIAA)) and Mr. Takeshi Okazaki (General Manager of the Planning Department, JIAA) will talk about efforts by asset managers. In addition, we would like to ask JIAA to refer to their recent U.K. visit to conduct research on the Stewardship Code.

Firstly, Ms. Ueda, please start your 15-minute presentation.

[Ms. Ueda] I am Ueda of J-IRIS Research. I will report on the background and principles of the U.K. Stewardship Code using Material 1. My presentation will also cover the recent revision to the code.

Please look at page 4, which provides an overview of the framework of value improvement systems in the U.K. The U.K. follows a kind of value chain concept, where improvements to the value of listed companies will generate benefits to the shareholder, the asset manager if the shareholder is the institutional investor and the U.K. national interest if the asset owner is a pension fund. Therefore, the existing framework was established based on the view that improvement of the value of listed companies will improve value for the final beneficiary and ultimately result in the prosperity of the whole economy.

I will explain the main history related to the U.K. Stewardship Code in the next page. On the back of series of corporate scandals, the "Report on the Financial Aspects of Corporate Governance" (Cadbury Report) was issued by the Cadbury Committee in 1992, promoting corporate reform and the improvement of corporate governance at listed companies. It is important to note that the Institutional Investor Committee (IIC, formerly the Institutional Shareholders' Committee), an association of institutional investors, was involved at the initial stage.

Please look at the notes on this page. The IIC includes the National Association of Pension Funds and the Association of British Insurers. The operation of the Committee is mainly led by these asset owners, with asset managers following their leadership.

Looking at the historical background, the reform of corporate governance seems to have accelerated after 1992. However, post financial crisis in 2007, such efforts for corporate reform was viewed as insufficient; especially, the responsibility of the institutional investor as a shareholder was highlighted. As a result, commissioned by the U.K. Treasury, the Walker

Review issued in 2009, recommended the formulation of a stewardship code under the ownership of the Financial Reporting Council (FRC). In addition, the Walker Review recommended the development of a systematic framework where an investment chain is created in line with the existing governance system from the “soft law” approach (please refer to the diagram on page 4). Based on the recommendation, the U.K. Stewardship Code was established in 2010.

Further, the Walker Review recommended the biennial revisal of the code. Based on this, the initial U.K. Stewardship Code was revised in 2012, and will be reviewed as required in future.

A summary of the Walker Review’s recommendations is given on pages 6. The Walker Report originally aimed to improve the corporate governance of financial institutions. However, as these recommendations were deemed suitable for improving the corporate governance and the overall value of listed companies, the scope of the report was expanded to include investments in listed companies. Therefore, the principles of the U.K. Stewardship Code are substantially aligned with the Walker Review.

So, who drafted the U.K. Stewardship Code? As briefly mentioned on page 5, the Code was drafted by the IIC, and the draft was adopted without revision as the U.K. Stewardship Code, which evidences the substantial influence of institutional investors.

Please look at page 7. I will talk about the background of the U.K. Stewardship Code. Based on the research conducted between 2010 and 2013, the number of institutional investors publishing the statements of the U.K. Stewardship Code increased significantly during that period. The research conducted immediately before the 2010 implementation of the U.K. Stewardship Code indicated that large asset managers invested management resources in order to comply with the U.K. Stewardship Code, while small and medium asset managers remained passive due to the cost burden associated with the adoption of the code. Small and medium asset managers have recently started adopting the U.K. Stewardship Code, but the quality of disclosure has had a problem, which triggered the 2012 revision.

Page 8 shows the results of my interviews with the U.K. supervisory authority as to the rationale behind using the term “stewardship”. The term “stewardship code” is used in the Walker Report. The most simple definition of the term is "to manage assets for others", originating from the concept of managing (or stewarding) property for a manor house, etc. in the U.K. with the long history.

Then why not use the term “fiduciary duty”? Although the distinction is rather unclear, I was advised that the term “stewardship” was selected to capture the broad sense of relationship among parties within the investment chain including asset managers, asset owners, other service providers, etc., which is not necessarily clear-cut and contractual. Still, the meaning of the term “stewardship” is vague and confusing, and there are organisations that do not adopt the term. For example, the International Corporate Governance Network (ICGN) clearly states its non-use of the term “stewardship”, using instead the expression “responsibilities of institutional investors”. It is important to understand the historical background in the U.K. to understand the meaning of “stewardship” fully.

Next, moving on to page 10, I would like to give an overview of the U.K. Stewardship Code. Firstly, I will talk about the structure of the U.K. Stewardship Code. The code is structured with the introduction explaining the foundation of the code, including sections titled “Stewardship and Code” and “Application of the Code”.

It should be noted that as the U.K. Stewardship Code aims to achieve the prosperity of the U.K., it is applied primarily to institutional investors that are registered in the U.K. and investing in listed companies in the U.K.

The introductory section is followed by a section explaining the “Comply or Explain” approach as used in the U.K. Corporate Governance Code.

The section “Comply or Explain” is followed by the seven principles of the U.K. Stewardship Code. I will explain each principle on page 12 and thereafter. Each principle of the U.K. Stewardship Code is followed by guidance, providing important and noteworthy points for application of the code.

Firstly, Principle 1 refers to the disclosure of a statement concerning stewardship activities. Principle 1 clarifies the purpose of the stewardship activity; that is, the generation of benefits for investee companies, investing companies, and the economy as a whole. The principle also promotes long-term corporate success through effective stewardship. Further, the code stipulates that institutional investors should publicly disclose their policy on how they will discharge their stewardship responsibilities. The 2012 revisions to the code made clear that the policy statement should be different between asset managers and asset owners.

Principle 2 refers to conflicts of interest. Instead of promoting the elimination of conflicts of interest completely, the principle refers to a methodology for managing conflicts of interest assuming that conflicts of interest will inevitably arise. The principle also stipulates that it is the institutional investor’s duty to act in the best interests of clients and beneficiaries.

Principle 3 refers to the monitoring of investee companies by institutional investors, identifying specific methods of monitoring, issues related to monitoring activities, etc.

Expanded from Principle 3, Principle 4 relates to the engagement between investee companies and institutional investors. This principle gives guidance on the method of escalating stewardship activities and when and in what circumstances such escalation should occur.

Following Principle 4, Principle 5 details collective engagement to cover circumstances when multiple investors collaborate with each other in engagement. This means that cooperation among investors may be effective if engagement by a single investor is insufficient. This principle was recently revised to require institutional investors to enhance disclosure of their policy on collective engagement, which should indicate the timing and circumstances in which the institutional investor would consider participating in collective engagement.

Continuing on, Principle 6 on page 17 requires disclosure in relation to the exercise of voting rights, which is considered the most influential issue in practice. The U.K. Stewardship Code takes the view that institutional investors should seek to exercise their voting rights for all shares held, and publicly disclose their voting activities. Furthermore, when proxy voting or other voting advisory services are used, Principle 6 requires disclosure of the purpose of the use of these services, how and to what extent institutional investors rely on recommendations made by such services.

Page 18 shows the results of a status survey by the U.K. Investment Management Association, detailing the status of disclosure of voting activities. According to this, 65% of total institutional investors that responded to the survey disclosed their voting activities in some form, 68% of which disclosed their voting actions for all individual proposals as indicated in the figure 2. On the other hand, 33% of respondents indicated non-disclosure, noting that some of them disclosed such information only to their clients.

Principle 7 on page 19 clarifies the duty of institutional investors to report periodically on their stewardship and voting activities to their clients, beneficiaries, etc.

In 2012, the guidelines attached to 7 Principles, rather than the principles themselves, were revised to improve operation of these principles more specifically.

I will leave out the explanation on the next subject “The Key Points of the Amendment to the Code in 2012”, which was briefly covered in my presentation so far.

Finally, page 32 shows the fact that the stewardship code is currently a global issue, with various countries having ongoing discussions.

[Kansaku] Mr. Osaki, please start your 15-minute presentation.

[Mr. Osaki] I am Osaki from Nomura Research Institute, Ltd. In July 2013, I visited the U.K. with Mr. Horie, my colleague and a member of the Council, to conduct an interview survey to understand how the U.K. Stewardship Code is adopted by institutional investors in the U.K. We also exchanged opinions with law firms and the supervisory authority as to legal and regulatory issues related to stewardship. I would like to talk about this.

Before I start my presentation, I would like to note that our interview survey may be viewed as biased, because we could not survey any listed companies. Thus, please keep in mind that the presentation here is, in a sense, one-sided.

I would like to give my presentation using Material 2, which provides a brief agenda. Please look at page 1. As explained by Ms. Ueda, the concept “engagement”, namely, dialogues, meetings or some form of communication between listed companies and institutional investors, is central to the exercise of stewardship.

I would like to talk about the specifics of how engagement is practiced. Firstly and expectedly, pension funds (the asset owners) and investment management companies (the asset managers) have personnel who are responsible for engagement. Judging from the name cards presented by these people, it seems that people who are in charge of exercising the stewardship code are also in charge of corporate governance/responsible investment, having solid experience in activities associated with the exercise of voting rights and the enhancement of corporate governance.

Obviously, these people attend meetings with listed companies. We found it very interesting that fund managers, who principally make investment decisions, often attend these meetings. We interviewed those who are responsible for engagement, and they commented that fund managers have a less difficult time in giving opinions to and gaining understanding from listed companies, as they are the shareholder in a true sense, making decisions to purchase shares. Therefore, engagement cannot be exercised separately from asset management and investment decisions. This is the key feature of engagement.

In addition, in reality, engagement activities, such as meetings and conference calls, are conducted primarily by asset managers. While in some cases asset owners directly contact listed companies, asset owners are normally responsible for evaluating asset managers in terms of how active and systematic their engagement and other stewardship activities are, which is one of the criteria to select appropriate asset managers. Hence, direct contact with listed companies by asset owners is rarely seen.

Next, who are the attendees from listed companies? Meetings between listed companies and investors as part of the investor relations (IR) activities are actively and commonly held. But IR meetings normally and directly involve IR personnel, and direct contact with top management is exceptional.

On the other hand, investors view engagement activities as meaningful if there are opportunities to communicate with top management or the chief financial officer (CFO) on finance-related issues. In the U.K., engagement often take place between outside directors and investors, in line with the current trend to encourage outside directors to have an active dialogue with shareholders from the viewpoint of strengthening corporate governance.

On to the issues discussed through engagement and the number of listed companies targeted for engagement. As described on page 2, it is not necessarily appropriate to target all investee companies for engagement, as diversification of investment will expand the number of investee companies in the investment portfolio. In our survey, there was one asset management company that annually met all portfolio companies for engagement purposes.

Nevertheless, please note this company's investment portfolio was concentrated and such an engagement approach is exceptional.

Normally, for example, when the investor feels uncertain as to the proposed agenda for a general shareholders meeting, engagement is implemented to discuss related issues further (ex-ante). It is also common to see engagement that is closely connected with the exercise of voting rights. For example, when the investor ended up casting an opposing vote, engagement is implemented to better understand the background of such a proposal (ex-post).

Additionally, while engagement is normally carried out upon request from the institutional investor side, some investee companies actively seek engagement in order to obtain opinions from the investor side on specific proposals.

Further, as mentioned before, it is physically difficult to conduct engagement with all the investee companies. Target companies for engagement are often selected in light of cost effectiveness. For example, asset management companies would target companies with which a significant impact is expected through engagement, such as those invested in by a large number of fund managers within the institution (large exposure), those facing serious issues and seeking support, etc., rather than implementing engagement periodically or routinely for formality purposes.

In this case, material issues will arise in relation to passive asset managers making index investment. There are two widely accepted theories on whether these asset managers should exercise voting rights actively. While some argue that passive asset managers should at least endeavor to improve corporate performance through the exercise of voting rights, as they are not allowed to disinvest in companies which are components of the index, others believe that exercising voting rights is not necessary because index investment should be operated at the lowest possible cost. These theories are applicable to engagement, and there is no mainstream view.

Please look at page 3. As explained by Ms. Ueda, adoption of the U.K. Stewardship Code is not required mandatorily, and the so-called "comply or explain" approach is taken for disclosure/explanation of the compliance status regarding the U.K. Stewardship Code. I would like to refer to the purpose of such an approach. I may be biased but in Japan, the "comply or explain" approach is at times used as a tentative measure to avoid the "hard landing" of a rule when, despite the supervisory authority's desire, full compliance with such a rule is not possible at one time. Some consider that the decision whether to take the "comply or explain" approach is made based on the relative strength between the maker of a rule and those required complying with such rule. However, I do not think the same applies in the operation of the stewardship code.

That is, the Corporate Governance Code is also exercised under the "comply or explain" approach, but practically applicable to all listed companies. In this sense, the Corporate Governance Code is very close to being a mandatory rule. However, as in the reference material provided by Ms. Ueda, for example, only 101 asset managers have adopted the U.K. Stewardship Code. Needless to say, considering the size of the U.K. asset management industry, the number of asset managers licensed by the Financial Conduct Authority (FCA) is considerably larger than 101.

As such, it is important to first understand that the U.K. Stewardship Code is not adopted by all related parties. For example, small and medium asset managers generally have difficulty complying with the stewardship code. However, taking a little different view, the investment policy of hedge funds, etc., for example, is to work to improve performance through short-term investments focusing on arbitrage opportunities or other events, not through taking a long position. Therefore, some consider that it is not effective to uniformly require these entities to comply with the stewardship code. Therefore, these entities may give very negative

explanations such as a lack of appropriate personnel as a reason for not appointing an external director. However, for the stewardship code, they may be able to give a positive explanation such as the inappropriateness of applying principles in light of their investment strategies. Considering this, I think taking the “comply or explain” approach is very important.

There is certainly no issue for asset owners to allocate their assets to those for whom compliance with the stewardship code is not necessary given their investment strategies (i.e., investment management companies). Thus, compliance with the stewardship code is not mandatory to fulfilling the duties of trustee. This is very important.

Principle 5 encourages collective engagement, which is considered important from the perspective of prevention of free ride. In other words, if a company’s performance can improve through engagement, enjoying the benefit from it without making efforts is dishonest and unacceptable. However, through our interview survey, an unexpectedly large percentage of institutions showed an unwillingness to participate in collective engagement, noting that this is partially because the target of our interview survey was mostly leading institutional investors. They seem to prefer to remain largely independent, conducting one-to-one engagement as much as possible and allowing some free ride to occur.

On the other hand, there may be movements that encourage collective engagement. According to a newspaper article in June 2013, leading institutional investors including Schroders and L&G initiated actions towards establishing an investor forum as proposed in the Kay Review issued in July 2012.

Finally, please look at page 5. I would like to refer to two important legal aspects surrounding engagement. First, I will talk about the aspect associated with insider trading regulations. Engagement is interaction behind closed doors; the higher the importance of engagement, the higher the possibility of communication of material facts that are not publicly available. I understand that this is some kind form of communication in the U.K. However, it should be noted that the U.K. Stewardship Code stipulates in the guidance that the communication of material facts is allowed only if asset managers consent to such communication in advance, which is widely practiced. The code also requires that listed companies should advise the length of period that the communicated information remains undisclosed, and asset managers, of course, withhold trading until the communicated information is disclosed publicly.

The Greenlight Case in 2012 attracted public attention in relation to this. The U.S. hedge fund, after executing transactions, was identified as having used insider information for trading and charged penalty payments by the supervisory authority despite the fact that the fund clearly showed unwillingness to receive insider information. While there are various views and opinions on this judgment, the information subject to this case could be viewed as equivalent to insider information regardless of the hedge fund’s intention. In any case, we cannot separate engagement from insider trading regulations.

The other legal aspect is associated with the TOB regulation or the reporting regulation for large shareholdings. For example, there is a concept of a joint holder, which is also stipulated in the Financial Instruments and Exchange Act in Japan. Specifically, when exercising voting rights collectively, the voting is aggregated under both regulations. This is a challenging issue from the perspective of collective engagement. In the U.K., the Takeover Panel (deemed official supervisory authority) that supervises TOB regulations is currently taking a position to facilitate collective engagement as much as possible and stipulates non-application of the collective shareholding provision unless these shareholders request the investee company to appoint their group representative as a director.

As Ms. Ueda reported earlier, the stewardship code has been gaining global attention. The reporting requirement as to large shareholding is certainly an issue of concern, if not an

obstacle. In the U.S., the reporting requirement regarding large shareholdings includes the passive investment exemption, which is equivalent to the special reporting in Japan, allowing simplified annual reporting to the investors that are not actively involved in the management of the investee company. The U.S. investment management companies strongly desire to be qualified for this clause. As a result, asset managers are extremely reluctant towards adopting the stewardship code, although asset owners are actually keen to adopt. That is, active engagement means active involvement in the investee company's management. This is not recognized as passive investment and such asset managers may be subjected to regular reporting for large shareholding, requiring reporting within a very short period upon exceeding a shareholding of 5% - I think it was within 5 business days in the U.S. A substantial amount of administrative work is involved for this reporting. Aside from the solution, this is widely recognized as a legal issue associated with engagement.

[Kansaku] Please feel free to ask questions, express your views, etc., about the presentations by Ms. Ueda and Mr. Osaki.

[Horie, member] I would like to ask Mr. Osaki a question in relation to the last topic (legal issues). Do you think that Japan is practically facing similar challenges in relation to various engagement activities between investors and listed companies?

[Mr. Osaki] This is entirely my personal view, but issues will likely arise in relation to insider trading regulations. According to the latest revised Financial Instruments and Exchange Act, transmission of undisclosed material facts itself is considered a breach of such Act with the condition that the transmission is for the purpose of making profits or avoiding losses for the investor. Therefore, the environment is not so supportive for productive and extensive engagement unless there is some kind of safe harbor.

As to the regulation for large shareholding report, the regulation does not allow special reporting when making important suggestions, etc. Moreover, the regulation requires general reporting prior to making important suggestions, etc. The topics to be discussed at engagement are not predictable; thus, institutional investors essentially become concerned with regulatory risks in some way.

[Eguchi, member] I would like to confirm a point with Mr. Osaki on collective engagement. In the presentation, you expressed your gained view that leading institutional investors prefer to conduct engagement independently rather than through collective efforts. I think collective engagement is the most well-known form of engagement in the U.K. Collective engagement took place quite actively up until 20-30 years ago led by major institutional investors such as Prudential Insurance Company, but it is not so active anymore. Did your interview survey capture the changed view of institutional investors or is it simply that reaching common understanding within the investors' community is not easy? Please provide your view on this.

[Mr. Osaki] We did not investigate adequately to understand the background to that. It may be because respondents of our survey coincidentally had a negative view towards collective engagement. However, I would like to point out that investors are becoming more diverse than before. Extremely roughly, considering the trend such as the increasing influence of hedge funds, an increasing number of investors may prefer not to share their investment policies with each other.

[Furuichi, member] As explained by Mr. Osaki, it is the common understanding that

engagement itself is considered part of the investment chain. In addition, I totally agree with the statement on page 2 of the Material 2 “Given that the purpose of engagement is to improve the performance of asset management, it is considered inappropriate to make it a routine matter”. The Japanese version of the stewardship code should be discussed and developed based on such a concept, taking into consideration the costs and risks of imposing regulations.

We should then refer to examples in the U.K. Please advise if there are specific effects of the U.K. Stewardship Code from either a macro or micro perspective, such as those in which listed companies achieved medium to long-term growth by restructuring the industry, resulting in the improvement of the performance of asset management, which is one of the goals of the Japanese version of the stewardship code.

[Ms. Ueda] Empirical analysis of effectiveness of engagement is actually very difficult. From the investor’s point of view, implementation of the U.K. Stewardship Code was meaningful, setting out an appropriate environment to initiate engagement. Specifically, I was advised that engagement was found effective in case of misconduct, although, as mentioned by Mr. Osaki, there are various opinions as to collective engagement.

In addition, the payment of excessive remuneration to executives including large banks has been a serious social issue in the U.K. and I was advised that engagement including collective engagement helped highlight this problem and improve the situation. However, it is very difficult to verify whether there was any substantial benefit from engagement and measure, quantify and analyse the effects.

[Tanaka, member] I would like to give my impression of legal issues related to engagement, the last topic in the presentation by Mr. Osaki. When using the U.K. Stewardship Code as a reference, it is extremely important to identify the legal issues related to engagement in Japan and clarify our interpretation to them. It is also important to make laws that function as a safe harbor if necessary.

As listed in the presentation, further review is necessary to understand what would trigger the reporting for large shareholding as joint holders, in addition to issues related to insider trading regulations and the stricter reporting requirement upon act of making important suggestions. Namely, it is essential to analyze and understand how many cases would be subjected to the provision of aggregating the shareholding of multiple investors and the reporting requirement for large shareholding for the reason that they have prior consent over the exercise of voting rights.

I think the term “consent as to the exercise of voting rights” should be considered strictly in light of the legal definition. The legal definition of consent is an agreement a related party gives the counterparty something to be performed in the future. As such, communicating a plan to exercise voting rights with multiple investors who are coincidentally planning to exercise voting rights should not be viewed as legal consent. I am deeply concerned that the scope of consent will be excessively broad without a clear-cut definition.

Secondly, I have been studying this type of engagement in the U.S., although it may not be called as engagement in the U.S. This had once become a problem in relation to the proxy regulation. Considering the possibility that cooperative activities among investors will be regarded as “proxy solicitation” due to the broad scope of such term, rules were established as a safe harbor in the early 1990s.

In my view, it is highly unlikely that cooperative actions among investors will breach the proxy solicitation clause because under Japanese law, proxy solicitation means the formal solicitation of proxy statement regarding the exercise of voting rights. I do not anticipate any

issues will arise but please refine the definition of proxy solicitation if necessary and review the necessity of creating a safe harbor.

[Oguchi, member] I have a comment/question. I would like to start with my comment. As mentioned by Messrs. Osaki and Tanaka, there were concerns with the act of making important suggestions and the reporting for large shareholding when I started dialogues with companies six years ago. Many investment management companies had noted these as obstacles in communicating with investors.

I wanted to further clarify the situation and acquired information from the Financial Services Agency (FSA). The FSA disclosed three key factors to determine whether the act in question falls under the definition of “act of making important suggestions” on December 13, 2006 and their view on solicitation as to the exercise of voting rights on March 31, 2010, both of which are available on their web site. First, three key criteria limit the scope of act of making important suggestions as follows: (i) actions falling under a specific condition. For example, those that are “material” or involve a “substantial amount”; (ii) those involving influence that will likely distort the management’s independent business judgment; and (iii) those involving suggestion, not consultation. Given that the criteria gives specific definition and excludes normal communication, I felt that there would not be many cases that will fall under the above criteria, noting this does not remove our concerns completely.

Further, the FSA indicated their view that dialogues as to the exercise of voting rights will not be viewed as de facto collective shareholding as long as the dialogue does not go beyond mere discussion. However, agreeing with each other as to the exercise of voting rights will trigger the classification of de facto collective shareholding.

In sum, these issues are attracting substantial attention, and I would like to emphasize the necessity of clarifying these issues. At the same time, I would like to point out the importance of maintaining a balance between investors and listed companies. In addition to the investor’s views mentioned in the presentation, as far as my investigation goes, some investee companies maintained that an integrated approach, rather than individual contact, is more effective, thus, collective engagement will function quite effectively.

For example, the globally adopted United Nation’s Principles for Responsible Investment (PRI) accept use of engagement service providers, which offer joint engagement and engagement services separately from the client’s assets. Our company provides this type of service. Apart from whether to use this service, operation of collective engagement should be left to the institutional investor’s creative ideas/approaches. In my opinion, investors should participate in collective engagement if necessary after identifying and clarifying the issues associated with it.

Next, I would like to ask a question. The U.K. Stewardship Code refers to asset owners in detail. The second paragraph of the section “Application of the Code” stipulates that asset owners and asset managers may choose to outsource to external service providers some of the activities associated with stewardship. However, they cannot delegate their ultimate responsibility for stewardship. Asset owners should ensure the accountability of asset managers in carrying out stewardship. By doing so, asset owners can fulfill the responsibility towards the beneficiary.

As illustrated in the reference material presented by Ms. Ueda, the U.K. Stewardship Code’s requirements for asset owners, who are positioned the closest to the ultimate beneficiary, are quite strict. On the other hand, as mentioned by Mr. Osaki, there are various issues with asset managers contacting listed companies directly. They need to take various approaches towards companies and deal with cost issues. Moreover, there is a debate whether to include hedge funds in the definition of the asset manager.

In order to comply with the code, how can asset owners such as pension funds, resolve issues and fill the gap with asset managers? For example, I wonder whether the asset owner, when appointing a hedge fund as asset manager, should give guidance to the hedge fund and advise that it is not necessary to sign the stewardship code because the investment policy of the hedge fund is to achieve short-term profitability. Please comment on the approach taken by the asset owner to fill the gap between responsibilities of asset owners and asset managers.

[Mr. Osaki] My understanding is that asset owners are committed to the the U.K. Stewardship Code as a whole; as such, they are not required to comply with the code uniformly on a day-to-day basis. Therefore, as mentioned before, asset owners create their asset mix, and select appropriate asset managers suitable for each asset class. They could select a hedge fund as asset manager when a certain asset class is unrelated to the stewardship code. In that sense, I understand that asset owners would select asset managers based on the disclosed investment policy of each asset manager, rather than individually instructing asset managers.

Considering this, I do not think there is a gap between the asset owner and the asset manager. Rather, asset owners are aiming to create an asset mix/manager mix that would result in effective stewardship as a whole.

[Hamaguchi, member] I would like to comment in relation to Mr. Oguchi's question. On page 12 of the presentation material prepared by Ms. Ueda, the asset owner's responsibilities are substantially different from the asset manager's. However, I do not quite understand the difference.

Additionally, I would like to ask a question. The issue of conflicts of interest on page 13 is also applicable to asset owners. The sponsors for corporate pension funds are generally listed companies, thus, public pension funds in western countries are keener on adopting the stewardship than corporate pension funds. Corporate pension funds remain relatively passive, and they often leave the responsibility to their advisories. In the U.K., many asset owners have signed the stewardship code to date. Pension funds sponsored by financial institutions in the U.K., such as Barclays and RBS that went through crisis, are quite large-scale. Please advise, with specific examples if possible, how they manage the conflict of interests as the asset owner and try to convince the public.

[Ms. Ueda] Firstly, as per roles or expected functions of asset managers and asset owners on page 12, the difference between the two is in that asset owners are primarily clients of asset managers while, as discussed by Mr. Osaki, asset owners act on behalf of ultimate beneficiaries considering overall asset allocation.

For example, in terms of disclosure in the U.K., I was advised that asset owners are expected to place top priority on beneficiaries, who are normally individual investors, and implement disclosure carefully towards these beneficiaries. However, disclosure by asset managers is slightly different. Asset managers act largely on behalf of asset owners as their clients.

As such, when disclosing information, for example, some asset managers answer that they do not disclose individual results of exercise of voting rights, as they consider it sufficient if the asset owners are satisfied. Generally, the asset manager and the asset owner are differentiated from each other based on whether they are connected with a client who is a provider of funds or directly linked to a beneficiary who is the ultimate investor.

As for conflicts of interest, the U.K. Stewardship Code does not necessarily ignore the conflicts of interest issue associated with asset owners. The stewardship code recognizes various types of conflicts of interest, in view of counterparties such as the companies behind institutional investors or clients. Ongoing discussions are centered on accountability,

increasing transparency of how asset managers are managing conflicts of interest, rather than confirming that the issue of conflicts of interest doesn't exist.

[Mr. Osaki] I would like to complement the explanation by Ms. Ueda. I had an impression that corporate pension funds in the U.K. are extremely sensitive towards conflicts of interest between beneficiaries of pensions and umbrella organizations, probably because of past scandals. When we visited a pension fund operated by multiple companies in conjunction with the survey, staff in charge of corporate governance said that their management would not be affected by the umbrella organization's business. To mention another example to evidence to this, a certain pension fund, where the chairman of a participating company is also a director of said pension fund, advised us of casting an opposing vote to a proposal to reappoint a director as Chairman of that participating company. In my view, apart from judging the right or wrong of such voting, staff in charge of governance seems to have been acting for the benefit of the ultimate beneficiary regardless of the identity of the shareholders.

[Kansaku] Next, we would like to hear an update on the status of the industry's efforts.

Tokunari member, please report on the efforts in the trust business industry within 15 minutes or so.

[Tokunari, member] I am Tokunari from Mitsubishi UFJ Trust and Banking Corporation. Today, I would like to mention the status quo of dialogues with investee companies as the Trust Companies Association of Japan and as Mitsubishi UFJ Trust and Banking Corporation (Mitsubishi UFJ Trust) in comparison with the U.K. Stewardship Code.

Please look at Material 3 titled "Trust industry's efforts concerning the involvement of institutional investors with the investee companies (English version is not available)".

The Trust Companies Association of Japan issued a notification to member trust banks regarding the exercise of voting rights in March 2003. This notification stipulated and promoted the development and enhancement of members' guidelines for exercising voting rights from the viewpoint of the fiduciary duty of care. Further, based on the 2009 report by the Study Group on the Internationalization of Japanese Financial and Capital Markets, which was established within the Financial System Council Sectional Committee on Financial Systems, the Trust Companies Association issued a notification in July 2009, requiring further enhancement/disclosure of members' guidelines regarding the exercise of voting rights and the aggregation/disclosure of voting activities. Further, Mitsubishi UFJ Trust, from the perspective of enhancing the corporate value of investee companies, is continuing its efforts to reinforce dialogue with investors. The product lineup includes the ESG fund, which executes investment focusing on environment, society and governance.

Moreover, Mitsubishi UFJ Trust conducts dialogues with investee companies through two parties, one through analysts and fund managers who selects investment targets, and the other through the department responsible for the exercise of voting rights. Dialogue is sometimes conducted simultaneously for both parties but I would like to give an explanation of each separately. Firstly, the number of dialogues through fund managers, analysts, etc. is about 5,600 per year for the investment coverage consisting of 800 companies, including attendance at earnings results briefings. Issues discussed at these dialogues include a wide range of subjects, such as management strategies, financials as well as corporate governance.

Secondly, dialogues between investee companies and the department in charge of the exercise of voting rights total about 140 per year. As we disclose the guideline for exercising voting rights, matters discussed at dialogue meetings are mainly consultation from the investee company as to the details of such guideline; for example, specific examples of cases

in which Mitsubishi UFJ Trust would cast opposing votes.

I would like to explain our principle in exercising voting rights. A trustee is bound by law to fulfill obligations such as duty of loyalty and duty of care for the trust's beneficiary. Hence, voting rights are exercised to improve earnings from the investment made on behalf of the beneficiary.

Based on such an assumption, for example, in appointing directors or dealing with directors' retirement bonuses, Mitsubishi UFJ Trust in principle casts an opposition vote, should there be a possibility of enterprise value being reduced or a corporate governance issue arising.

Next, I will talk about Mitsubishi UFJ Trust's decision-making process in relation to the exercise of voting rights. Based on the standard set by the industry, the Mitsubishi UFJ Trust's guideline for exercising voting rights is publicly disclosed on its website. This guideline is our company's internal rule, and a committee on exercising voting rights (Voting Committee) has been established with a managing director as the chief executive of trust assets business unit (authorized person to exercise voting rights) and the ESG Group acting as secretariat.

I would like to refer to the flow of our decision-making process. Day to day dialogues with the investee company take place first; then the proposed agenda is examined carefully using the information acquired from dialogues and performance data. Through the process of analyzing the proposed agenda in question, a draft plan strategizing the voting will be developed in light of the guideline for discussion at the Voting Committee. This Voting Committee is independent of other trust and banking businesses such as the lending department, operated and supervised under the chief executive of trust assets business unit responsible as a trustee of entrusted assets. The Voting Committee will decide on whether to cast an opposing vote or an affirmative vote for each proposal for each company. The voting instruction is made to the shareholder nominee such as custody service provider, The Master Trust Bank of Japan and so on.

Continuing on, I would like to talk about specific actions by Mitsubishi UFJ Trust in comparison with the seven principles in the U.K. Stewardship Code. Principle 1 requires institutional investors to publicly disclose their policy on how they will discharge their stewardship responsibilities. In Japan, not only the Trust Business Act regulating trust business operators, but also the Trust Act that is categorized as general law or common law stipulates the fiduciary duties in an equivalent scope with the Trust Business Act. Additionally, as mentioned before, the Trust Companies Association of Japan requires member trust companies to devise/publicly disclose guidelines for exercising voting rights, and aggregate/disclose their voting activities.

Next, Principle 2 requires a robust policy on managing conflicts of interest in relation to stewardship that should be publicly disclosed. For trust banks, the Trust Act as well as the Trust Business Act, strictly sets out the fiduciary duties. Further, the Banking Act and the Financial Instruments and Exchange Act also require necessary actions in order to avoid damaging the customer's interest unfairly. Accordingly, Mitsubishi UFJ Trust has developed and publicly disclosed its policy for managing conflicts of interest. Our actions are aligned with this policy.

Six focus points are listed in the guidance for the monitoring of investee companies under Principle 3. Specific actions taken by Mitsubishi UFJ Trust for each focus point are described in the presentation material.

Principle 4 states that institutional investors should establish clear guidelines on when and how they will escalate their stewardship activities. Mitsubishi UFJ Trust does not have a concrete guideline. However, it is important to note that the U.K. Stewardship Code lists circumstances that may trigger intervention by institutional investors; namely, when there are concerns with the investee company's strategies, performance, corporate governance,

compensation and risk management approach. From this point of view, Mitsubishi UFJ Trust, in the analysis of proposed agenda, requests explanations to the investee companies as to (i) the use of retained earnings if the investee company holds financial assets at a level more than necessary; (ii) measures to prevent recurrence if failing to observe laws/regulations; and (iii) the appropriateness of the size of the board of directors if the number of directors is scheduled to increase.

Principle 5 refers to cooperation among investors. As mentioned previously, there are various views on this, and Mitsubishi UFJ Trust does not participate in such activities. However, we are engaged in exchanging views on how guidelines should be for exercising voting rights, etc. with other trust banks and financial institutions.

Principle 6 states that institutional investors should have a clear policy on voting and disclosure of voting activity. In this regard, Mitsubishi UFJ Trust exercises voting rights for all shares held in accordance with the voting guideline, which was developed and publicly disclosed following the notification by the Trust Companies Association of Japan. Further, the outcome of voting is sorted, aggregated and publicly disclosed.

Principle 7 requires periodic reporting to the beneficiary. Mitsubishi UFJ Trust annually reports voting activities to its beneficiaries. In addition, the external auditor conducts audit on the process of managing trust assets by Mitsubishi UFJ Trust and the audit result is disclosed on its website.

I would like to end up my discussion on actions by Mitsubishi UFJ Trust in comparison with the U.K. Stewardship Code.

Lastly, I would like to talk briefly about important points in terms of asset management and corporate governance from the perspective of the institutional investor. As discussed in the last meeting, it seems to be inadequate to uniformly require investee companies to adopt a certain form of corporate governance, given the diverse characteristics of these companies such as business operation, size of the business and so on. Doing so is very much presumptuous, and thus we would like to have significant dialogues through which individual companies will consider ideal form of corporate governance. We would like to share the view created through their consideration.

Another issue I would like to refer is the concentration of timing when general shareholders meetings are held. The staff in charge of the meetings faces a substantial workload in June every year, having to review the agenda of 1,400 investee companies practically within two weeks. From this point of view, a day-to-day dialogue with the investee company is also very useful to deal with the workload and make appropriate judgments.

[Kansaku] Next, Matsushima member, please talk about actions taken by the Investment Trusts Association, Japan within about 15 minutes.

[Matsushima, member] I will explain using the material distributed (English version is not available). Shares of Japanese companies held by investment trusts have accounted for roughly 2-4% of total share value since 1986 (4.5% at the end of FY 2012). The share percentage that changed significantly from 1986 to 2012 includes: investments by foreign corporates (increased from 5.3% to 28%), financial institutions as a whole (declined from 41.5% to 28%), and corporates (declined from 30% to 20%). The decline in shares held by financial institutions and corporates matches with the increase in foreign corporates.

On the other hand, the invested amount by all investment trusts inclusive of private investment trusts in domestic shares, calculated using the then budget that aggregated financial results for FY 2012, totaled 17 trillion yen. According to the data separately calculated by the Investment Trusts Association, the outstanding balance of domestic shares

held by publicly held investment trusts amounted to 12.5 trillion yen at the end of August, of which 8 trillion was accounted for by passive index investment trusts such as ETFs, etc. and the remaining 4.5 trillion yen held by active investment trusts.

Next I would like to give an update on dialogues with investee companies. There are primarily two goals in having dialogues. One is to get a grasp of the status of investee companies, which is considered equivalent to monitoring in the U.K. Stewardship Code. Checkpoints for dialogues are extensive, covering short-term changes in business conditions and long-term management policy/philosophy.

The other is to communicate investment policy as the investment management company, including actions equivalent to engagement in a broad sense.

I would like to touch on methods of dialogue. For ease of understanding, I would like to explain with statistics for Daiwa Asset Management Co. Ltd (Daiwa). In 2012, the number of communications by internal analysts and fund managers totaled 9,700, consisting of attendance at 3,480 briefings and 6,220 visits and phone interviews. In 2013, up to the end of July, the number of investee contact totaled 5,597. Removing seasonality such as account settlements, etc., the number of contacts through visits and phone interviews increased by 530 compared with the same period a year ago. We intend to increase visits and phone interviews further.

Currently, there are 16 analysts and 18 fund managers in Daiwa. Many listed companies hold briefing meetings in May. In May 2013, the number of contacts with investee companies by our analysts totaled 1,098, including 609 briefings and 489 independent dialogues. When adding about 220 meetings by fund managers, about 1,300 contacts are made per month. This means only slightly less than 70 contacts per analyst, which I think is significantly large number. We very much appreciate the cooperation of investee companies for providing us opportunities to have dialogue with them. At the same time, considering the number of contact made by a single company like Daiwa, I would imagine that it is quite hectic for these investee companies to deal with communication with investors.

Our efforts in relation to corporate governance include the setting up of a team and the appointment of staff responsible for exercising voting rights in addition to analysts who mainly make investment decisions.

I would like to talk about the exercise of voting rights. Investment trust management companies are regulated under the framework consisting of industry-wide laws/regulations and self-regulation by the Investment Trusts Association, Japan. The framework has set a basis for developing the system for voting, consisting of two levels with laws/regulations specifying the exercise of voting rights by instruction of the investment management company rather than trust banks as shareholder nominees, which is further constrained by the self-regulatory rules of the Investment Trust Association.

There are detailed focus points aligned with the self-regulatory rules by the Investment Trusts Association, Japan and function as a so-called guideline. In sum, the guideline stipulates that the instruction to exercise voting rights should be made only when such action will profit the beneficiary; rules concerning the decision-making process, authority and responsibilities, and the screening standards should be developed and publicly disclosed; and voting activities in May/June, when many listed companies hold their general shareholders meetings, should be disclosed by the end of August.

As specific examples, cases at Daiwa disclosed on its website are attached to the reference material. The basic principles for the exercise of voting rights are aligned with the laws/regulations and self-regulatory rules noted earlier. The principles also refer to the prevention of conflicts of interest.

The guideline and screening standard for exercising voting rights set out trigger events that

call for detailed review prior to voting, such as when there are concerns with the investee company's performance, etc. The guideline and screening standard also set out the standard for deciding whether to cast an opposing/affirmative vote for individual proposals.

Because of the time constraint, I will leave out the explanation of individual cases. As a basic principle, however, we have specified cases that should not automatically trigger affirmative voting for each predetermined category, while generally taking a position to consider affirmative voting.

The summary of our voting activities at general shareholder meetings in May and June, disclosed on August 16, is attached to the reference material. The style of disclosure is similar among other companies.

Next, I would like to talk about actions taken by investment trusts in comparison with the U.K. Stewardship Code. I would like to note that the information in the table illustrated in the presentation material was created based on our discretionary judgment, using the information acquired through interviews with multiple investment trusts and our company's status. Thus, it should be viewed as an example, rather than reflecting the overall status of members of the association.

The status regarding (i) "stewardship activity" under the Principle 1 is marked as "Δ" to reflect partial involvement, as there is no active involvement in engagement and collective engagement.

For (ii) "development and disclosure of stewardship policy" is marked "○". Investment trusts disclose their approval/disapproval on governance, etc. In this sense, basic engagement/involvement is considered roughly achieved.

The item (iii) "integration of the stewardship into a broader investment process and disclosure" is marked "○". In this regard, we have seen some enhancement through signing the United Nation's PRI and adopting Principles for Financial Action for the 21st Century in Japan.

We have marked "○" for Principle 2 "conflicts of interest" as detailed previously.

Items (i) and (ii) "continuous implementation, verification, etc." under Principle 3 "monitoring" are marked "○" reflecting active involvement and dialogues.

Items (iii) and (iv) "dialogue and confirmation, etc." is marked "Δ" as these are not practiced extensively in accordance with the description of the code as it is.

As for items (v) and (vi) "active involvement as the insider", we are taking the stance of no-involvement.

Our stance significantly differs from the guideline as to when and how to escalate stewardship activities under Principle 4. So far, we have not initiated active engagement and collective engagement with other investors, and there is no plan to implement such activities in the future. Investment trusts need to buy/sell shares in their portfolio based on the customer's request for subscription and cancellation on a day-to-day basis. As such, it is my personal view that it is not viable to take the position of an insider that will disable trading activities through participation in the management of the investee companies.

Now I will talk about the United Nation's PRI, a common standard developed in 2006 with six principles to help integrate consideration of ESG issues by institutional investors into investment decision-making. PRI is similar to the U.K. Stewardship Code, illustrating a mild sense of cooperation and encouraging some kind of engagement.

About 1,200 companies including 28 Japanese companies have signed up to PRI to date.

In addition, Principles for Financial Action for the 21st Century was set up in Japan to widely disseminate the concept of responsible investment to domestic financial institutions that are non PRI signatories. The principles encourage consideration of ESG issues and engagement with investee companies as a duty of institutional investors in their investment

management.

In the investment trusts association, we as investors share views through PRI, Principles for Financial Action for the 21st Century, and the aforementioned framework that regulates investment trusts. Additionally, there is a framework to promote influencing investee companies through the uniformly required disclosure. This can be considered collective engagement under Principle 5 although not in a strict sense.

For the exercise of voting rights under Principle 6, please refer to the cases provided previously.

As for recording and reporting stewardship activities under Principle 7, it is conservatively marked “△” as we have not acquired enough information on the situation in the U.K.

The comparison here is between our efforts and the contents of the U.K. Stewardship Code, rather than the actual operation status of the code in the U.K. In my opinion, however, stewardship within the framework of investment trusts industry in Japan is practiced at acceptable level.

Although there is no information in the reference material, I would like to conclude the presentation by referring to some issues, which in my view, are important when considering the Japanese version of stewardship code and the economic growth.

As I noted in my presentation, a mechanism exists to ensure that each member company in the investment trust industry will conduct investment activities in accordance with the duty of trustee, focusing on corporate governance. Additionally, large number of dialogues took place to date. However, as I mentioned at the start of the presentation, the investment in domestic shares by investment trusts only represents about 4.5% of the market value of domestic shares, two thirds of which is accounted for by index investments. This means that our task is to increase holdings of domestic shares or to increase the outstanding amount of active investments. In this regard, we will continue our efforts to build a track record of performance in investment management.

Some may support stricter guidelines for the exercise of voting rights, etc., but I believe in the dynamism and persuasiveness of the free market principle in the selection process through buy/sell activities in the capital market. I would like to give you examples of selection process involved in actively managed funds. Out of funds with more than 10 billion yen and actively managed by Daiwa, the smallest portfolio had 54 names; the largest portfolio in funds investing in small and medium companies had 276 names. Among Daiwa’s funds investing in domestic shares and actively managed funds, the largest portfolio has only about 110 names for an outstanding amount of about 100 billion yen.

As the size of funds grows, competition in capital markets will become more intense which should ultimately boost the industry as a whole.

Further, I would like to see the continued efforts of listed companies to improve their business performance. I also would like to request listed companies to disclose information in a timely manner, as the dialogue between the investor and the listed company starts from the transmission of information from listed companies.

[Kansaku] Mr. Noguchi and Mr. Okazaki, please report on actions taken by the Japan Investment Advisors Association and your visit to the U.K within 15 minutes.

[Noguchi, member] I am Noguchi from DIAM Co., Ltd. (DIAM). Thank you very much for giving me an opportunity to talk about measures taken by the Investment Advisors Association, etc.

First, the association’s administration office will talk about the results of the interview survey conducted on association members. I will then give remarks.

[Mr. Okazaki] I am Okazaki of the administration office of the Japan Investment Advisors Association. I will proceed with the presentation using Material 5 (English version is unavailable).

For this meeting, we have conducted an interview survey of 8 member companies investing and managing more than 250 billion yen entrusted by domestic pension funds, etc. in domestic shares, including analysts for domestic shares, portfolio managers that manage investment, staff in charge of corporate governance who execute voting rights, and those in charge of engagement.

As for the status in relation to dialogue with investee companies, firstly, investment managers and analysts conduct periodic monitoring (about once every quarter) and contact investee companies to obtain information on financial performance prospects.

Secondly, according to the survey, meetings with management such as the CEO or CFO of the investee companies are held once or twice per year to understand the broad future direction of investee companies. Some respondents highly valued such meetings as these meetings provide opportunities to hear from the management of the investee company directly or to inform the investment policy directly to the management.

Thirdly, corporate governance issues. Many investee companies visit investment management companies prior to the general shareholders meeting to give explanations to gain affirmative voting for the proposed agenda or to enhance in depth the understanding of the investment management company on a specific proposal.

Lastly, reporting to the beneficiary. All respondents answered that they had received requests from some major public funds for annual reporting, in which the rationale for voting actions is also required.

Especially, some respondents receiving entrustment from overseas beneficiaries such as U.K. pension funds adopting the Stewardship Code had received inquiries as to engagement activities.

Regarding the self-regulatory rule and rules for voting, I would like to refer to the background of the implementation of these rules. At the entry of investment advisory companies into the business of pension management in 1990, the Ministry of Finance addressed its view that the right to instruct, if necessary, can be delegated to discretionary investment management service providers, based on which the self-regulatory rule, “appropriate exercise of voting rights in relation to discretionary investment management agreement”, was implemented more than 20 years ago.

Then in late 1990, the exercise of voting rights gradually gained attention as a mean of improving corporate governance due to the continued slowdown in domestic stock markets. Thereafter in line with the mainstream view that establishing corporate governance will contribute to improving shareholder value over the long-term, some of major pension funds (the asset owners) have set out provisions for exercising voting rights in their investment policies, and become increasingly active as to the exercise of voting rights through the discretionary investment management companies.

Based on the above, in August 2001, the Japan Investment Advisors Association established a study group on exercising shareholder rights including voting rights, which issued a report in 2002 calling for the revision of the 1990 self-regulatory rules.

Central to the self-regulatory rules are Rule 2 “to develop guidelines for instructing exercise of voting rights, etc.”; Rule 3 “to publicly disclose basic principles of such guidelines”, Rule 5-1 “to instruct the exercise of voting rights only to the benefit of the client; and Rule 6-1” “to disclose aggregated results of instructions for exercising voting rights etc.”.

[Noguchi, member] In accordance with the rules explained by the administrative office, DIAM has developed a basic policy on the exercise of voting rights, established a framework and set a procedure for voting. These are disclosed on the company's website.

The key point is that from the perspective of the fiduciary duties, voting rights, etc., should be exercised for the interests of the beneficiary. Also, the goal of the exercise is to encourage investee companies to comply with corporate ethics, make efforts to maximize shareholders' interests, and establish an appropriate framework for corporate governance; and to exercise rights only for the benefit of the beneficiary.

The judgment regarding the exercise of voting rights is made by the committee for exercising voting rights, based on the delegated authority of the board of directors. The committee consists of the chairperson who is the director in charge of the investment management division (currently myself), and the committee members are only those belonging to the investment management division and appointed by the committee chair. This means that the committee does not involve personnel from the planning and marketing divisions in order to avoid the exercise of voting rights influenced by business relationship, etc.

As the specific procedure for exercise, the committee conducts an individual review all proposals and makes an overall judgment in line with the standard for judgment partially described in the presentation material. It is noted that last year, the committee held roughly 100 meetings primarily in relation to exercising voting rights and corporate governance. Dialogues with the investee company totals about 100. This includes about 60 visits by issuers, tens or so communications through phone calls, etc. and tens or so communications triggered by DIAM's inquiries to confirm individual proposals, such as details of prevention measures against reoccurrence of certain events, the appropriateness of the number of directors and the rationale behind an increase in the number of directors.

[Mr. Okazaki] I will explain the results of the association's interview survey on specific actions taken in relation to the principles of the U.K. Stewardship Code. Firstly, Principle 1 requires public disclosure of the policy on how to discharge stewardship responsibilities. In Japan, a stewardship code has not been developed yet. However, Principle 1 is deemed satisfied as a policy has been developed and publicly disclosed as to the exercise of voting rights, which is the core of the U.K. Stewardship Code.

Quite a few respondents took the view that voting rights are practically exercised in the interests of the beneficiary under the discretionary investment management agreement from the perspective of the fiduciary duties, thus fulfilling the duties under stewardship may partially satisfy fiduciary duties.

As for Principle 2 "conflicts of interest", a specific provision has been set in the policy for exercising voting rights, which is publicly disclosed. Separately, some respondents mentioned the existence of a provision for conflicts of interest as a group company.

For the monitoring of investee companies in Principle 3, as mentioned previously, day-to-day monitoring is conducted in relation to the status of dialogue with investee companies.

There were largely two kinds of actions taken in relation to timing and method for escalating stewardship activities stipulated in Principle 4. One is to deal with scandals at the investee company as required, given the fact that periodic monitoring is conducted on a daily basis. The other is to set a quantitative trigger in relation to earnings such as ROE. For example, some investment management companies have developed an escalation process to warn the investee company upon hitting such trigger for three consecutive years.

As mentioned many times in earlier presentations, there was no company conducting the

collective engagement stated in Principle 5. All respondents to the interview survey agreed that in order to act collectively with other investors, a clarification is necessary in relation to the legal framework such as the reporting for large shareholding and the act of making important suggestions.

All of respondents of the survey have policies for voting and disclose voting activities in line with Principle 6. Voting rights are exercised in the interests of the beneficiary as a client, and voting decisions and reasons behind the specific voting are separately disclosed to the beneficiary if requested. Additionally, the majority of respondents opined that as the discretionary investment management agreement is an exclusive agreement, it is not necessary that information related to the client's assets such as voting decisions is disclosed, or disclosure is not possible due to the confidentiality agreement with the beneficiary.

Finally, in terms of Principle 7's requirement for periodic reporting regarding stewardship activities, etc., to the beneficiary, respondents provide reporting to the beneficiary on an as-required basis. Moreover, as noted previously, periodic reporting is provided based on the request from some of major pension funds, etc. There was one investment management company that proactively reported issues such as corporate scandals to the beneficiary without receiving requests.

[Noguchi, member] The presentation material provides a summarized version of our survey results. The investment advisory industry have been conducting constructive dialogues with investee companies in order to fulfill the fiduciary duties to the beneficiaries such as pension funds, and to increase the share values of the investee companies over the medium to long-term. As such, it is fair to say that the seven principles under the U.K. Stewardship Code are generally practiced in the investment advisory industry.

Some addressed their view that mutual understanding among pension funds (asset owners), investment advisory companies (asset managers) and investee companies could be promoted by the introduction of a Japanese version of the stewardship code, and the share value of investee companies could be increased over the medium to long-term by constructive dialogue, thereby creating a win-win relationship.

However, as mentioned earlier, in order to act collectively with other investors (collective engagement), it is necessary to conduct a review in relation to the existing legal framework such as the reporting for large shareholding or the act of making important suggestions.

Additionally, it is viewed appropriate to disclose voting activities on an aggregate basis as currently implemented.

Further, in the interview survey, some shared the view that a considerable amount of time and labor would be necessary, if in future the development of a framework to facilitate active engagement focusing on dialogue with investee companies is required or if pension funds requests voting based on guidelines deviating from the policy of the investment advisory company. This means an increase in costs for the investment advisory companies, but such costs in principle should be borne by their customers.

There was a request that the investee companies should increase the use of electronic voting platforms to enable investment advisory companies to review the proposed general shareholders meeting agenda in-depth and exercise their voting rights effectively.

While there has been some improvement, the timing of general shareholders meetings is still concentrated in a certain period. Some survey respondents requested a further decentration of the days on which shareholders meetings are held and early issuance of meeting notices so that they can review the proposed agendas adequately.

[Mr. Okazaki] Mr. Iwama, Chairman of the association, and I visited U.K. in July 2013 to

learn the status of stewardship activities post implementation of the U.K. Stewardship Code. I would like to briefly touch on the findings of the trip.

We visited two major pension funds, the associations for pensions/life insurance companies, the investment advisory association, FRC that developed the stewardship code, etc.

I will introduce three main opinions. Firstly, all parties are positive about the “comply or explain” approach, as imposing an excessive number of rules will cause a “mechanical check” or “tick the box” approach. That is to say, the code will be adopted just for formality purposes, and thus lose effectiveness. The term “spiritless” was used to express such state.

Secondly, in relation to the effects of implementing the code, investment management companies started thinking about the appropriate way to practice the code that matches with the style of their investment management. They also started considering how they can add value to their performance using the code, based on which investors can designate an appropriate investment management company. Further, investment management companies became responsible for providing their clients with easy-to-understand reporting as to the application of the code. As such, pension funds, etc., became aware of and started showing interest in the code and its operation status by the trustee.

Lastly, we were advised that shareholders with a long-term perspective learned to share goals with the management of investee companies, aiming to achieve a solid relationship with a good level of tension. These are the major opinions provided to us through the hearing.

[Noguchi, member] I would like to end my discussions in relation to the investment advisory industry. Please continue your cooperation and discussion with us regarding the introduction of the Japanese version of stewardship code.

[Kansaku] Thank you. Now I would like to start free discussion. Please provide opinions/comments regarding any issues in addition to those related to previous presentations.

[Horie, member] Throughout today’s presentation, it was explained that adequate measures have been taken regarding the exercise of voting rights. However, I have a slightly different understanding of such facts. First, from the perspective of the investment management industry, investment management companies have been destroying value for customers for more than 10 years. This means that we have not provided returns to investors. This was mentioned by Mr. Oba at the last meeting. Claiming that adequate actions have been taken for the exercise of voting rights in spite of the value destruction does not seem reasonable to me. This Council, in the first place, was set up to discuss how investment management companies should fulfill their duties to investors, recognizing the failure to generate returns for investors in the past. As such, I would like to hear more constructive opinions.

However, to comment from the position of investment management companies, an adequate framework for the exercise of voting rights does not exist in Japan, which was pointed out by both “the Japan Investment Advisors Association” and “the Trust Companies Association of Japan”. The first issue associated with this is the concentration of the schedule for general shareholders meetings. It has already been made clear that such a concentration can be practically avoided by separating the record date and the account settlement date, and the concentration issue is not caused by legal constraints. Investee companies are expected to remedy this situation. The second issue is that it is undesirable if substantial shareholders cannot attend general shareholders meetings, and I wonder whether substantial shareholders themselves can take practical measures on this, although the actual effects of such measures are uncertain. These two issues need to be cleared.

Lastly, certain proposals for general shareholders meetings such as the selection of directors,

for which investee companies consult with investors considerably before the formal proposal, should be disclosed to and discussed with investment management companies further in advance. I would like to seek collaboration from investee companies to facilitate engagement.

[Miura, Director, Corporate System Division, Ministry of Economy, Trade and Industry (METI)] Thank you for today's presentation. It was valuable and informative.

I would like to briefly introduce an ongoing project at METI. This project deals with somewhat similar issues to those addressed by Mr. Horie. The project, named "Corporate Reporting Lab" was launched by METI given the ministry's experience in handling corporate accounting and disclosure issues. The project indeed attempts to promote dialogue between the investor and the investee company, supported by some of the members attending the meeting today.

The project is indeed working to find solutions to facilitate better communication between the investor (shareholder) and the investee company, that is, to facilitate the two to understand each other as to what is being asked and what needs to be communicated. While there are timing issues as to general shareholders meetings, recognizing the possibility of misunderstanding by the investor and the investee company, thinking that the other party does not know what to ask or what to say, we have just obtained information from investors including Mr. Eguchi as to what information is necessary from the investor's point of view, and from listed companies as to what information is available. We are trying to provide an opportunity (we call this "practice round") on the common platform to understand the general requirements of investors and investee companies as a basis of the IR activities of individual companies.

As part of this, on July 16, 2013, similar to Kay Review in the U.K., METI has launched a project to study further the true purpose of conducting dialogue, that is, instead of conducting dialogue just for formality, to create a relationship between the investor and the investee company to improve earnings power and enhance capability for sustainable value creation by domestic investee companies. To date, the project has already had three meetings, intending to publicly disclose the discussion points soon.

Like this, METI have been studying to understand the ideal form of communication between investors and investee companies and disclosure. We will give feedback in some form if our efforts generate good results.

In this sense, today's presentations were very useful and we will incorporate the information into future discussions at METI.

[Eguchi, member] I would like to add some comments here, as our work was mentioned by Mr. Miura. Our activity at the Corporate Reporting Lab is driven by our understanding that neither the investor nor the investee company may have a clear idea about how to conduct engagement. From this understanding, what we do actively is to communicate the investor's interests and viewpoints to the investee company. Then the investee company will be able to understand what will practically attract the investor's attention, and this will generate mutually beneficial conversations for both parties. We have implemented this type of communication as a "trial attempt" with METI's support with several companies including the Council's member companies.

Separately, we have been conducting engagement with other companies on the individual basis using the questionnaires that summarize the investor's interests and viewpoints. It is probably important to mention that this type of communication did not exist in the past. Last week, we had an opportunity to meet with the CFO of a leading manufacturing company in Japan and talk about the company's corporate governance framework for an hour. At that time,

we were advised by the contact person that it was the first time for the CFO to receive a visit from an investor to discuss the company's governance regime.

Our impression in conducting engagement has been that companies have very actively participated in the conversation with us although most of them must have had very few prior experiences of such communication. In addition, their response was very positive, commenting that the meeting was fruitful. In this sense, it is regrettable that these communications never happened in the past, thus we intend to encourage this further.

As such being the case, I think it will be productive if we can discuss the stewardship code from the point of view of how to provide support to activities that are already underway but still at an early stage.

[Oguchi, member] Mr. Horie's comments are painfully true. An entity on the investor side like us should sincerely regret the fact that we could not contribute to improving the earnings power of Japanese companies. Various actions have been taken to achieve effective engagement from the investor side as shown in the aforementioned data and questionnaire. However, it is necessary to always check whether such actions are sufficient to increase enterprise value and truly deserve time and effort from the perspective of investee companies.

In the previous discussion, the word "sprit" was used in relation to developing a meaningful stewardship code. In developing the Japanese version of the stewardship code, investors need to behave in a way that will generate a win-win situation constantly, as their actions will take up valuable time for investee companies. The frequency of meetings with companies, often mentioned throughout today's meeting, is surely important. However, in my view, quality is more important than quantity. Moreover, as a questionnaire survey cannot capture every issue facing individual investee companies, it is necessary for investors to conduct an in-depth review of individual investee companies and create the stewardship code to promote dialogue that will also function for the benefit of investee companies. As mentioned by Ms. Ueda, it is important to keep in mind the original purpose of the stewardship code, that is, contribution to Japan's economy.

[Oba, member] I would like to mention a few things that may supplement Mr. Oguchi's comment. Firstly, in relation to Mr. Horie's comment, it is regrettable that in spite of extensive efforts, overall corporate growth, let alone that of specific individual companies, has not been sustainable for a few decades. I believe that as the establishment of the Council was driven by such a situation, the Council should aim to achieve sustainable corporate growth. Hence, we need to analyze the various efforts made to date and clarify whether modifications are necessary in terms of methodologies used, whether analysis from different angles is required, etc.

As I mentioned in the last meeting, Tokio Marine Asset Management has launched the Engagement Fund, through which we take actions for sustainable corporate growth. Conducting dialogue in relation to the Engagement Fund is extremely difficult. By this I mean that as in Ms. Ueda's presentation material (first part of page 11), engagement involves a full understanding of extensive issues covering strategies, earnings performance, risk profile, capital structure, governance including corporate culture and compensation at the investee company. As such, in a sense, solid knowledge is also necessary for investors.

Without it, effective engagement is not possible. The fact that there has not been adequate engagement activity despite various efforts by various industries perhaps implies some room for improvement in relation to the above.

Further, in order to be more convincing, I would like to refer to a management guru, Mr. Konosuke Matsushita. About 50 years ago, Mr. Matsushita already made a statement related

to, so to speak, the stewardship code. The statement is available in a book published by PHP Institute, Inc. It reads “it is very much desirable that even the shareholder representing only a small fraction of ownership should encourage the management, the head clerk of a company, with authority and knowledge as the central character of a company.”

It may not be noticeable if skimming through the statement, but the key point is to have a dialogue with the management with authority and knowledge. I feel that Mr. Matsushita is saying that the true sense of engagement cannot be achieved without preparation with an adequate level of knowledge.

[Kawada, member] I would like to make a few comments from the viewpoint of investee companies. As mentioned in the last meeting, dialogue is extremely important for investee companies. Investee companies are taking a positive view on dialogue out of their desire to understand their shareholders’ views, the rationale behind their comments and their intentions/interests; and to communicate/promote an accurate understanding of corporate earnings to shareholders, for investee companies need to obtain approval by majority shareholders as long as listing stocks on exchanges.

We appreciate the fact that institutional investors are interested in our company. This may relate to earlier comments, but frankly speaking, there are questions from investors who are not so familiar with the company. In this case, we are not sure whether to give general answers or specific and detailed answers. Overall, we remain positive on receiving various opinions.

My second comment is on issues related to the concentration of meeting dates for general shareholders meetings and the request for issuance of the meeting notification further in advance. There are many listed companies with a large number of shareholders. JX Holdings, Inc. has about 180,000 shareholders, which is considered medium in size. First, we need to confirm shareholders as of the record date, which takes an unexpectedly long time. Data aggregation in relation to this takes about 3 weeks for JX Holdings, Inc. Then, the notification of meeting will be printed and dispatched by mail, which currently takes about 2 weeks to complete. Issuing notifications much earlier is physically difficult, and I would like to ask for understanding from the investor side.

Also generating consolidated financial results takes roughly one month, which means that these results are ready at the end of April through the first week of May. Combined with this schedule, it will take a long time till the notification can be issued. Nonetheless, JX Holdings, Inc. targets the delivery of notifications three weeks in advance of the general shareholders meeting, which is earlier than the legal deadline. Considering the factors mentioned above, three weeks in advance is the earliest possible time frame that we can arrange the delivery of the notification.

Also, I would like to note efforts made by investee companies. There are quite a few listed companies that send out an English version of the meeting notification, in an effort to provide information to foreign institutional investors in advance, gain their understanding of the meeting agenda, and thereby facilitate a smooth exercise of voting rights.

[Furuichi, member] I would like to make one comment in relation to the purpose of the Council. It is necessary to accept the current situation seriously, and utilize the past results in considering new initiatives.

However, I do not think it is reasonable to hold investors responsible for the decline in share price as compared to 25 years ago. Indeed, Japanese stock market share price did not go up for the last 25 years. However, an increase in a certain country’s share price, if any, is probably not the direct outcome of solid engagement activities by investors in such country.

In my view, initiating discussions based on criticism of the past will not generate a rational outcome. Discussions should be held productively for the future, considering the pros and cons of individual initiatives in the past.

While initiatives from the investor side such as the development of the stewardship code is important, it is also necessary to discuss issues related to the governance of investee companies such as whether their governance is equivalent to those practiced in the U.K. in light of the U.K. Corporate Governance Code or advanced governance framework in other countries.

I do not deny the importance of serious discussions but that does not mean outright criticism of actions in the past. Perhaps some of the actions in the past in Japan were more advanced than those in the U.K. Also, discussions concerning the Japanese version of stewardship code should incorporate the fact that the management of companies in Japan are fundamentally working to achieve an improvement in their enterprise value over the long term.

[Matsushima, member] I sincerely apologize if my explanation sounded like I disagree with the development of the stewardship code in Japan. I just wanted to describe the current status from the view point of The Investment Trusts Association, Japan, in comparison with the U.K. Stewardship Code.

That is to say, as mentioned before, it is necessary to indicate so-called best practices. The Investment Trusts Association, Japan aims to support growth of Japanese companies through achieving the goal of increasing subscription to more active and larger funds through winning trust from customers. I never meant to say that the current situation is fully satisfactory, but to mention the fact that various industries are making efforts in their own way and we should expand from there. I hereby ask for your cooperation on this.

[Noguchi, member] As advised by Mr. Oguchi and Mr. Oba, a high quality of dialogue is definitely necessary. In order to ensure the quality of dialogue, listed companies, investment trusts and investors all agree that it is necessary to enhance enterprise value over the long term, thereby achieving the growth of share price, and provide returns to plan sponsors and beneficiaries.

However, as commented by Mr. Furuichi, it may not be appropriate to hold investors entirely responsible for the decline of Nikkei average over the past 20 years from 40,000 yen to 20,000 yen and to below 10,000 yen. Related parties, including market participants, issuers, institutional investors and fund providers, all should work together. Thus, there is no situation where only one party is the target of criticism or appreciation. I sincerely hope our discussion will progress towards implementation of the Japanese version of the stewardship code in this way.

[Kansaku] The opinions provided today will be used as reference when we make specific considerations in the future. At next meeting, we will continue our hearing from related parties, etc. and sort out issues related to stewardship.

Finally, I would like to ask the secretariat if there is a closing message.

[Yufu] We are considering 3 pm on October 18th (Friday) as the next meeting date. We will formally inform you when the date is fixed.

End