

Minutes of the 3rd Council of Experts Concerning the Japanese Version of the Stewardship Code

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

[Kansaku] Continuing from the last meeting, we will hear presentations about efforts being made by related industries in regard to intervention by institutional investor in the management of their invested companies. Today, two members of the Council, Mr. Furuichi of the Life Insurance Association of Japan (LIAJ) and Mr. Hamaguchi of the Japan Pension Fund Association, will give presentations. Then, the Council's secretariat will explain the discussion points for developing the Japanese version of the Stewardship Code.

[Furuichi, member] Today, I will talk about the efforts of Japan's life insurance industry. I will first explain the characteristics of investment management by life insurance companies. Then, I will talk about efforts being made by Nippon Life Insurance Company (Nissay) as well as the life insurance industry as a whole, including dialogue between life insurance companies and investee companies, etc., in accordance with the topics requested by the secretariat in advance.

Investment management by life insurance companies includes the following characteristics. Firstly, investment management needs to achieve stable returns to cover the assumed rate of interest. Life insurance companies set aside part of the premium paid by their customers in the policy reserve and fulfill the future obligations of insurance contracts. The premium payments are discounted at the assumed rate of interest, thus insurance companies need to generate stable returns to cover that rate.

Secondly, the long-term nature of life insurance products. Most life insurance contracts are long-term, typically 20 years, 30 years or lifelong, during which life insurance companies are obliged to make payments against claims by the policyholder. Given such a liability, it is important for life insurance companies to manage assets by investing in public bonds, loans, stock markets, etc., that will likely generate receipts of interest and dividends over the long term, not the short term return.

Next, I will explain the status of equity investments by life insurance companies.

While asset allocation by life insurance companies to public and corporate bonds has recently been increasing, the asset allocation to equity has been decreasing as a result of enhanced asset-liability management (ALM) and risk management. The shareholding of life insurance companies reached 12-13% of total shareholding by investors in the past, but declined to 4.1% at the end of FY 2012. However life insurance companies still have certain amount of stocks in Japanese market.

Based on the above, I will talk about the stance of life insurance companies in terms of investing in stocks using the case of Nissay. Nissay's stance toward investing in stocks include (i) to attempt to make investments that will contribute to the prosperity of Japanese economy and society primarily through long-term and diversified investments in light of the nature of the liabilities and public profile of life insurance companies mentioned earlier; (ii) to invest in companies that are generating solid earnings and will likely achieve sustainable growth and in those that are positive toward distributing returns to shareholders; and (iii) to constantly pass on to policyholders the increased value (dividend, etc.) of the investee companies received by Nissay as a long term shareholder.

When making long-term investments in stocks rather than trading for short-term returns, it is important to conduct dialogues with investee companies with the aim of improving their enterprise value.

As to dialogues with investee companies, firstly, as one of the industry-led initiatives, I would like to

introduce the research towards the improvement of the shareholder value conducted annually by LIAJ since 1974.

The research aims to improve shareholder value on a long-term basis through adequate communication and sharing of issues between companies and shareholders. The research, which is considered effective, involves the entire life insurance industry and covers a massive number of investee companies.

For example, last fiscal year, LIAJ conducted a survey with a wide range of questions, targeting 1,129 listed companies and 144 investors. Based on the results of the survey, LIAJ set out and disclosed the requests towards investee companies, including development and disclosure of medium term management goals, and appropriate profit distributions to the shareholder.

LIAJ also actively communicates with listed companies that are target of this annual research by sending them research reports, etc. The effects of the communication are partially evidenced by the recent increase in listed companies that publicly disclose their medium term management goals.

As far as I know, activities, such as analysis of surveys targeting investee companies and communication with companies based on such analysis, are not practiced in other countries; and can thus in a sense be viewed as a unique and advanced approach.

Next, Nissay's efforts for dialogue with its investee companies can be divided into two main categories: day-to-day dialogue and dialogue associated with the exercise of voting rights.

Through day-to-day dialogue, Nissay meets with its investee companies directly via onsite visits and earnings results briefings, and discusses issues and concerns related to their overall business operation, risk profile, etc.

As for dialogue associated with the exercise of voting rights, first, I will talk about Nissay's basic principles towards the exercise of voting rights.

The basic principles include: (i) to share with investee companies the awareness of issues for improving enterprise value and shareholder distributions by having dialogues with individual companies at each process of engagement, instead of making judgments uniformly by relying on the formal and short-term oriented standard; (ii) when examining each proposal for the general shareholders meeting, a) to conduct necessary shareholder engagement, etc., including dialogue if there is a concern with the investee company damaging the shareholder's interests by violating laws or regulations, etc.; and b) to demonstrate Nissay's intention by exercising voting rights or disinvesting from the investee company if there is no improvement through dialogue.

Next, I will explain the specific process for voting. The process for voting, together with the basic principles mentioned earlier, is disclosed publicly on Nissay's website.

Nissay has independently developed a guideline for exercising voting rights. In accordance with this guideline, Nissay appropriately exercises voting rights for all proposed agenda items for all shares held, in about 2,500 companies.

Specifically, Nissay, based on the guideline, first conducts screening of the proposals of its investee companies, which cover various issues such as appropriation of surplus, the level of executive compensation, revisions to articles of incorporation and changes to shareholder composition, etc.

Then, Nissay conducts a further review on the proposals extracted through the screening process, and conducts an interview with the investee company if further inquiry is necessary. Based on this, Nissay makes a final decision on whether to cast an approve or an opposition vote on each proposal.

It should be noted that Nissay spends a substantial amount of time and effort in going through this process for all shares held. For example, roughly in excess of 4,000 hours are spent in conjunction with the exercise of voting rights in June alone, when most investee companies hold general shareholders meetings.

We intend to continue our efforts to carry out these tasks carefully, as these are an important part of the dialogue process. However, if possible, we would like to see some improvements in the concentrated timing of general shareholders meetings.

Next, I would like to discuss Nissay's stewardship activities in comparison with the U.K. Stewardship Code.

For Principle 1, Nissay has developed a guideline for the exercise of voting rights. In addition, major life insurance companies, including Nissay, publicly disclose the principles behind their voting.

For Principle 2, a policy for conflicts of interest has been developed in accordance with the Insurance Business Act and it is publicly disclosed.

Principle 3 is practiced by the monitoring of the investee company's earnings performance, news releases, etc., by analysts; and by confirming management issues, risk profile, etc., through various levels of dialogue.

As for Principle 4, if necessary, Nissay conducts dialogue with the investee company upon occurrence of events that may cause damage to the share value over the medium to long term, such as stock offering issuance or corporate scandals.

Further, as noted earlier, Principle 5 is practiced through industry-wide efforts towards share value improvement.

For Principle 6, Nissay publicly discloses its policy regarding voting rights, and exercises voting rights for all shares held in accordance with the detailed guideline. Nissay publicly discloses on its website example cases where it decided to cast opposition votes as a result of further review and dialogue conducted as necessary.

In terms of Principle 7, the last principle, Nissay revises the disclosure it makes in relation to Principle 6 when necessary.

To conclude my presentation, please allow me to add a few comments from the investor's point of view regarding what is necessary for Japan's capital markets and economy to achieve medium to long-term prosperity.

Firstly, I think it is important to encourage various attempts by individual institutional investors to achieve effective shareholder engagement.

Taking the LIAJ's initiative as an example, LIAJ has conducted a questionnaire survey with investee companies and communicated with them by utilizing the survey results. Still, some improvements can be made to the survey process. It may be possible to contribute to improving the medium to long-term value of investee companies by changing the contents of the survey and the forms of feedback provided and the way of appeal to investee companies.

Secondly, it is necessary to improve the environment for communication between investee companies and institutional investors.

As I mentioned earlier, the timing of general shareholders meeting is concentrated in June. This has

prevented investors from having a smooth dialogue with investee companies. Thus, the environment for communication should be improved by staggering the timing of general shareholders meetings, etc.

To make the Japanese version of the Stewardship Code meaningful, it is essential to get as much investor participation as possible. Thus, we need to develop a Code that is agreeable by as many institutional investors as possible.

In other words, we should reflect on critical factors - should I call it “spirit” or “principles” - which are central to the Japanese version of the Stewardship Code, rather than simply setting out detailed rules.

Lastly, when reviewing and discussing the Japanese version of the Stewardship Code, we are required to reflect the discussions at the Council on Economic and Fiscal Policy, which, in its interim report, pointed out the importance of nurturing a sustainable economy without excessively relying on unsustainable short-term profits.

We should also support efforts for building a sustainable economy by providing medium to long-term financing to investee companies while complying with the principles of the Japanese version of the Stewardship Code.

[Hamaguchi, member] Today I would like to comment on a few constraints surrounding the governance activities of corporate pension funds. Corporate pension funds mentioned here refers to about 15,000 corporate pension funds including small-scale pension funds and the Japan Pension Fund Association, which manages its own assets.

I would like to note the limited ability of corporate pension funds to bear costs and allocate human resources. Most corporate pension funds have only one staff member managing investments for them. Due to the large size of its managed assets, the Japan Pension Fund Association has around 30 staff managing investments. However, compared with pension funds in western countries, expenses and human resources for investment management are limited in a budget strictly controlled by sponsors, board of directors or the Ministry of Health, Labor and Welfare.

In such conditions, when compared with other investment management activities directly linked with quantifiable results, setting up a framework to comply with the Japanese version of the Stewardship Code is not a top priority for asset owners from the perspective of fiduciary duty, given the unclear cost effectiveness and free rider issues. At the same time, if we work on stewardship activities without an adequate framework, then dialogue with the investee companies would be ineffective, remaining within the realm of formality without substance. Overall, I have to say that under the existing system, it will be extremely difficult to actively monitor, intervene, and engage with investee companies as set out in the U.K. Stewardship Code.

In addition, issues related to conflicts of interests will inevitably arise, for corporate pension funds need to work together with their sponsor companies to improve the financial soundness of the pension fund. As a result, their stewardship activities are ineffective. Private pension funds in western countries are also generally passive towards stewardship activities; while public pension funds remain active.

In such an environment, we expect asset managers with assets entrusted for active management to carry out governance activities including the exercise of voting rights. Asset managers, I believe, are acting with the intention to fulfill our expectations.

On the other hand, low cost, passive investment management involves thousands of investee companies. Stewardship of large number of investee companies is very costly, and thus, in reality, governance activities are carried out in light of cost effectiveness. The Japan Pension Fund Association conducts passive investment in-house, while developing a standard for voting focusing on corporate performance and making efforts to improve operational efficiency via outsourcing part of activities. We conduct

direct dialogue with investee companies, although the frequency of such dialogue is limited.

I would like to end my explanation on the status of corporate pension funds. Next, I would like to talk about efforts made by public pension funds in comparison with corporate pension funds. The size of public pension funds is far larger than corporate pension funds, amounting to 150 trillion yen in aggregate for 4 organizations including the Government Pension Investment Fund Japan (GPIF) and 3 mutual aid associations including the National Public Service Personnel Mutual Aid Association. On the other hand, as I mentioned earlier, aggregate assets managed by 15,000 corporate pension funds amount to 80 trillion yen, with the largest being the Japan Pension Fund Association at 10 trillion yen.

Therefore, the public pension's capacity to absorb costs associated with human resources and the development of a framework necessary for stewardship activities is surely greater than the corporate pension sector. In addition, public pension funds can have more influence on investee companies when exercising voting rights and conducting dialogue. Further, public pension funds are probably less exposed to conflicts of interest issue than corporate pension funds. We often hear concerns about the possibility of government interference in corporate management, which, in my view, can be avoided by developing a governance system for fulfilling duties of trustees, such as supervision by a highly independent board of directors.

As such, similar to western countries, public pension funds, such as GPIF and mutual aid associations, have the ability to strengthen their governance activities further. In doing so, however, cost effectiveness, that is, to what extent such activities will improve the investment's performance, should be examined carefully.

I would like to move on to the next subject. I will provide my personal view regarding potential measures to improve the function of stock market. My first point relates to the cross holding of shares. One of the reasons behind the inferior overall performance of Japan's stock markets relative to western countries is that despite the existence of quite a few blue chip companies, many Japanese companies have had a stagnant share price as well as operating performance for a long time. Perhaps this is because these companies face less risk of receiving votes against their proposals at the general shareholders meeting or becoming a takeover target; even if their share price declines well below their book value.

The rate of institutional investors casting opposition votes is fairly high against investee companies with poor performance, but almost no proposal had actually been rejected in the past. I presume that this is because the conventional cross shareholding mechanism is still intact. Indeed, while the shareholding of listed companies by banks and life insurance companies has been declining on average, share holding by corporate entities remains high at 20% or more. Since this is an average, I suspect that there are companies with a significantly larger portion of shares owned by corporate entities. This, if confirmed, can be considered as the cherry-picking of shareholders by company management, and this significantly interferes with the function of the stock markets. In view of this, it may be appropriate to develop a new regulation for controlling cross shareholding.

Active dialogue and the intervention as stipulated in the U.K. Stewardship Code will take effect only with a threat in the market, that is, the fear of potential weakening of the share price. In reality, it is not easy to initiate a dialogue with investee companies without leveraging such fear in a positive way. There is no need to stop dialogue with well-established and financially sound companies that are positive towards having dialogue for further improving their performance. However, we cannot expect that improvement of the stock market as a whole will be achieved only by communicating with these blue-chip companies.

I will move on and comment about the need to set restrictions on the adoption of anti-takeover defense measures. More than 500 listed companies have adopted anti-takeover defense measures, despite the fact that the Financial Instruments and Exchange Act appropriately sets out rules for stock market activities such as takeovers and that a majority of institutional investors disapprove of such measures. To

date, the anti-takeover measures have been very rarely exercised but possibly this may have been functioning as an invisible barrier against industry consolidation and the entry of foreign investment. Despite the difficulty from a legal point of view, I wonder if it is possible to place restrictions on the adoption of anti-takeover measures, considering the importance of the government's policy of encouraging foreign direct investment.

My final comment is from an entirely different angle and it is about possibility of changing the index used by institutional investors in managing their investment portfolio passively. Generally, institutional investors use TOPIX, which contains over 1,700 share names. Comparing TOPIX with indices used in other major countries, such as the S&P 500 in the U.S., FTSE 100 in the U.K. and DAX 30 in Germany, the number of names included in TOPIX is clearly too many relative to Japan's market size. Furthermore, the Nikkei Stock Average is hard to use, or I should say, not suitable for passive investment because it is not market-value weighted.

Unfortunately, there is no alternative that is appropriate for passive investment; thus institutional investors are left with TOPIX. This is affecting the share prices of small size companies and as a result causing a disciplinary problem among issuer companies.

Therefore, there is a need to develop a new index that will include significantly fewer names than TOPIX. In addition, such an index should be made suitable for passive investment management with sufficient transparency, calculated on a market value weighted basis and adjusted for free floating. Moreover, it is extremely important to note that development of a highly liquid future market is essential to facilitate rebalancing in passive investment, trading, etc. This type of index is traded as the main product in the futures market in the U.S., the U.K. and Germany.

In relation to the index containing blue chip shares, according to the media, the Tokyo Stock Exchange (TSE) is considering the introduction of an index with a replenishment mechanism that incorporates qualitative evaluation of corporate governance, etc. I do not disagree with the idea. However, in my opinion, for passive investment management, an index with a simple share selection mechanism, where a certain share will be included if the price rises thereby encouraging vigorous competition among listed companies, is more suitable.

However, in order to develop such an index successfully, cooperation among all related parties is essential, including the FSA, stock exchanges and related industries such as securities firms, investment advisory companies, investment trusts, and pension funds. In fact, the Japan Pension Fund Association developed and started using an index with a narrower range of index names. This index is still effective but not widely used. There are various reasons behind it such as the lack of a futures market for this index. Above all, there are so many traditions binding all related parties, and it is difficult to bring all related parties together without a strong determination to remove such traditions.

[Kansaku] Thank you. We will move on to free discussion.

[Tachibana-Fukushima, member] I apologize for asking a very simple question, but please let us know the proportion of life insurance companies that actually exercise their voting rights and reject proposals and publicly disclose their voting activities. In addition, please describe the trend of the proportion over the last 10 years. Is it increasing or decreasing?

[Furuichi, member] There are no statistics for the life insurance industry as a whole, as disclosure of voting activities is not uniform among life insurance companies. What is the significance of acquiring such a figure?

[Tachibana-Fukushima, member] I am interested in how many Japanese companies are acting against the expectation of shareholders. According to today's explanation, a dialogue takes place first to discuss issues. When no improvement results from the dialogue, voting rights will be exercised. I just wanted to

see the ratio of companies that resolved issues based on the dialogue to those that did not because dialogue was not effective.

[Furuichi, member] I understand the purpose of your question. In my view, however, conducting in-depth dialogue is more important. Is there any meaning to simply aggregating the number of opposition votes? For example, it is not necessarily accurate to conclude that an institutional investor whose opposition votes accounted for 30% of its total voting activity is better than the investor with 20%.

[Tachibana-Fukushima, member] I am not seeking to evaluate the policing activities of asset owners and asset managers and give an assessment. In reality, foreign investors, when looking to invest in Japanese companies, often debate the frequency of corporate scandals in Japan. I would like to get a grasp of the actual status.

As I commented at the first meeting, I have the impression that Japanese companies are generally conscientious about corporate governance. There are companies who are unknowingly engaging in misconduct, but they are completely different from those knowingly committing such acts. I am interested in how many companies would respond to the asset owner/manager's warning, admit their mistake and correct their actions; how many of them would not respond to the warning and continue their activities in question; and how many of them correct their misconduct appropriately through their own governance system before receiving warnings. As an external director placed for the purpose of governance, I would like to understand the actual status regarding misconduct committed consciously.

[Furuichi, member] As I mentioned earlier, there is no information for the life insurance industry as a whole, as disclosure of voting activities are different among life insurance companies.

Referring to an individual company, however, Nissay targets and conducts in-depth reviews of about 2,500 investee companies, out of which we extract about 800 for further review. We interview a little more than a half of the companies after the further review, and less than 10% of the companies are evaluated as unsatisfactory. Some investee companies change their management policy as a result of dialogue; others do not. Nevertheless, even for a company that would not modify its policy, we remain open to accepting their policy if sufficient explanation is provided and it is convincing. For example, if there is no dividend distribution for the current fiscal year but excess earnings will be used for long-term capital expenditure, or aside from the action on the misconduct itself, measures to prevent reoccurrence of such misconduct are taken to complement the insufficient corporate governance system.

[Tachibana-Fukushima, member] The reason why I asked for the data is that the decision whether to develop the Japanese version of the Stewardship Code as a "soft law" or a "hard law" depends on the proportion of companies that will fall under the scope of the Stewardship Code. Thank you.

[Oguchi, member] Firstly, I totally agree with Mr. Hamaguchi's comment on the anti-takeover defense measures. Our foreign clients especially are mostly against the anti-takeover defense measure. However, almost all proposals for adopting anti-takeover measures have been approved so far. I read in a magazine about a set of data prepared by Investor Communications Japan (ICJ), a provider of electronic voting platforms. The data provided information on the voting decisions of domestic and foreign institutional investors at general shareholders meetings in June 2012 over the anti-takeover defense measures of companies that are participating in the platform. The data is considered reliable, covering a little over 400 listed companies, accounting for 70% of market value.

Electronically generated, I believe we can assume this data was systematically generated. According to this, 40% of domestic institutional investors and 90% of foreign investors voted against the anti-takeover defense measures. However, based on Mr. Hamaguchi's presentation, the proposals associated with the anti-takeover defense measures have been approved. This means there are more investors casting affirmative votes than opposition votes. I am not saying that casting an affirmative vote

is not appropriate, but we will be able to discuss the anti-takeover measures issue in more detail if the views of institutional investors exercising voting rights regarding the anti-takeover defense measures, etc., are made clear through efforts to enhance transparency.

Secondly, I would like to ask a question. I agree with Mr. Hamaguchi's earlier statement about the limited ability of corporate pension funds to allocate costs and human resources, and I will ask a question on this basis. According to Principle 7 of the U.K. Stewardship Code, engagement by the asset owner can either be direct with the listed company or indirect through the investment management company. If the Japanese version of the Stewardship Code is applied to corporate pension funds, is it possible for corporate pension funds, in their indirect engagement through investment management companies, to participate in or contribute to the Code by selecting an investment management company and requesting them to fulfill their needs or by selecting those already meeting their needs?

[Hamaguchi, member] I have no objection to your idea. At the same time, corporate pension funds would continue direct engagement activities as the asset owner, and thus direct involvement is possible for a part of the Stewardship Code. I note, however, that this needs to be done in light of cost effectiveness.

On the other hand, we interview each asset manager every year to obtain information regarding their voting activity and details of dialogue, during which we can request a more active engagement with the investee companies. It should be mentioned that the Japan Pension Fund Association alone has a number of appointed asset managers. Some asset managers actively work on engagement and generate good investment performance. Thus, it may be useful to discuss and understand the strength of each asset manager and entrust assets to the one that meets specific needs and support its activity. However, we should keep in mind that solid investment returns must be generated as a result of this process.

[Furuichi, member] I would like to clarify my previous comment that less than 10% of companies are considered unsatisfactory. This is based on the latest year's results, and the figure will vary year by year.

[Kansaku] Next, the Council's secretariat will explain discussion points in formulating the Japanese version of the Stewardship Code.

[Yufu] Please look at Material 3. I would like to note that this was drafted for providing discussion points towards the formulation of the Japanese version of the Stewardship Code.

Please look at page 1, which relates to the preamble to the Japanese version of the Stewardship Code. The first white bullet point under section (1) titled "Background and purpose of the Japanese version of the Stewardship code" refers to the action plan under the Japan Revitalization Strategy approved by the cabinet: with the aim of promoting the sustainable growth of companies, a wide range of institutional investors will conduct constructive dialogue with investee companies.

The second white bullet point refers to the purpose of the Stewardship Code, stating that the purpose of the U.K. Stewardship Code is also to promote long-term corporate success via measures that will contribute to the prosperity of the ultimate fund providers; and that effective stewardship will benefit companies, investors and the overall economy.

The third white bullet point indicates that ideas outlined under the Japan Revitalization Strategy and the U.K. Stewardship Code do not contradict each other, thus the Japanese version of the Stewardship Code may include the intent of both.

Section (2) refers to the expression "stewardship responsibilities". The first white bullet point explains the deliberate use of such a term to cover a broad range of responsibilities including those for the ultimate provider of funds managed by the institutional investor, as well as the narrow sense of fiduciary responsibilities based on a direct trustor-trustee relationship.

Moving on to the second white bullet point, this expression is not so familiar in Japan. As such, I am wondering if we could rephrase it to “responsibilities of institutional investors” to cover the same scope in the Japanese version of the Stewardship Code. We would like to hear your advice and opinions on this. Please note that in this document the term “responsibilities of institutional investors” is used for convenience.

Section (3) on page 2 refers to institutional investors subject to the Code. As in the first white bullet point, the Japanese version of the Code is a soft law; hence it is not legally binding. As such, unlike laws and regulations, it is not always necessary to clearly define the scope of application. Therefore, is it possible to deliberately leave the cut-off point in a definition of an institutional investor unclear; that is, not to establish a clear boundary in the definition of an institutional investor so that a broad range of entities can be included in the Code’s scope of application. As mentioned in the note below, the U.K. Stewardship Code takes the same approach.

The second white bullet point refers to the expected roles of institutional investors. The roles of the institutional investor of asset owner and asset manager are fundamentally different. As such, the Japanese version of the Stewardship Code, if necessary, should be drafted differentiating between these two. As noted below, the U.K. Stewardship Code also draws a distinction between the two.

The third white bullet point. Proxy advisors and investment consultants, although they are not institutional investors, can exert considerable influence on institutional investors in their attempt to discharge their responsibilities such as the exercise of voting rights and the development of their investment policy. In view of this, it may be appropriate to expand the scope of the Japanese version to include proxy advisors and investment consultants. As noted below, the U.K. Stewardship takes the same approach.

Please look at page 3.

Fulfilling the responsibilities of an institutional investor will incur additional costs, and the acceptable level of costs is different from one institutional investor to another, depending on their size and investment policy. Therefore, it may be necessary to place a clause in the Japanese version, stating that the Code should be applied in line with the size and investment policy of each institutional investor. As indicated in the note below, the U.K. Stewardship Code also sets out a clause that the Code is not uniformly applicable to all signatories.

As to the geographical coverage of the Japanese version of the Stewardship Code, the cabinet-approved Japan Revitalization Strategy directs that the Japanese version of the Stewardship Code should be formulated with the aim of promoting the sustainable growth of Japanese companies. Hence, it may be appropriate to state in the Japanese version that the Code is formulated to be applied to institutional investors investing in the shares of Japanese companies, with a view to promoting the sustainable growth of Japanese companies. As indicated in the note below, the U.K. Stewardship Code is also applicable to institutional investors investing in the shares of U.K. companies.

Page 4 refers to the application of the Code. Please look at the first white bullet point. In terms of application, two steps can be taken. Firstly, decide whether to accept the Japanese version of the Stewardship Code, i.e., whether to become a “signatory” as it is called in the U.K.

Secondly, if deciding to adopt the Code, it is not mandatory to comply with all the principles in the Code. If there are principles that have not been applied, then explanation should be provided as to why the investor has not complied with those elements of the Code.

The next white bullet point is unique to the Japanese version of the Stewardship Code. Instead of uniformly taking the “comply or explain” approach, it may be suitable to distinguish (i) principles that

require explanation for non-compliance, for example, by using the wording “institutional investors should...”, from (ii) principles, under which non-compliance does not require immediate explanation, such as relatively advanced approaches and activities for which pressure to adopt in a uniform manner is not appropriate for the time being. Actual examples include the German Corporate Governance Code.

Please look at page 5. In order to promote the widespread use of the Stewardship Code via increasing transparency as to the status of Code adoption by institutional investors, it may be appropriate to require institutional investors to publish on their websites a statement that describes how they applied each of the Code’s principles, and to notify the FSA. If some of the Code’s principles have not been applied, it is sufficient to explain why they have not complied with those elements. The FSA should then disclose the list of these institutional investors publicly.

The second white bullet point relates to the possibility of requiring institutional investors to publish on their websites information that needs periodic disclosure such as the results of voting, and to notify the uniform resource locators (URLs) of the website to the FSA, which in turn will disclose the list of such URLs.

Page 6 relates to the provision of periodic review in the Japanese Stewardship Code. The Stewardship Code can be improved by reviewing how it is being applied. In view of this, it may be appropriate to stipulate the requirement of periodic review, for instance, every 3 years, of the Japanese version of the Stewardship Code. As stated in the note, the U.K. Stewardship Code also includes a clause requiring a periodic review every other year.

The section titled “Others” refers to the approaches to be taken only in the Japanese version of the Stewardship Code if implemented. The Japanese version of the Stewardship Code is currently being developed as a soft law. The rules-based approach, instead of the principles-based approach, is widespread in Japan. As the principles in the Code seem too vague at first glance, there may be a concern that a principles-based approach will not be taken seriously. I suspect many of you had such an impression when you read the U.K. Stewardship Code for the first time. In light of this, it may be useful to stipulate the significance of the principles-based approach in the Japanese version of the Stewardship Code.

I have attempted to draft the significance of the principles-based approach, which is encircled by a dotted line. Is it accurate to say the significance of the principles-based approach may be to take a fresh look at, share and reaffirm among related parties the purpose and the essence of the principles that are seemingly matters of course; then to judge individually whether each party’s action is truly appropriate in light of such purpose and essence, not in light of the principle in the sense of formal language of rules?

The next white bullet point highlights the importance of efforts by investee companies as well as institutional investors, to promote constructive dialogue between institutional investors and investee companies. In view of this, the Japanese version of the Stewardship Code may need to insert a clause promoting action for constructive dialogue by ensuring that investors will have adequate time to thoroughly review proposals for general shareholders meetings.

I will explain the details of each principle.

Firstly, Principle 1. Principle 1 in the U.K. Stewardship Code states that institutional investors should publicly disclose their policy on how they will discharge their stewardship responsibilities. I will leave out the explanation on the guidance to this principle. As stated at the bottom of page 7 (marked with a two-toned arrow), we need to confirm whether it is fundamentally acceptable to utilize this principle in the Japanese version, considering issues of concern when asset owners outsource some of the tasks to asset managers or when institutional investors outsource their tasks to proxy advisors, etc., which are listed in the guidance 2 in the table titled “Outline of the U.K. Code” in page 7.

Next, Principle 2 on page 8. The U.K. Stewardship Code sets out that institutional investors should have a robust policy on managing conflicts of interest in relation to stewardship which should be publicly disclosed.

Please look at the two-toned arrow at the bottom of the page. Do we all agree with utilizing the framework under the U.K. Stewardship Code in terms of Principle 2? At the last meeting, I recall some expressed the view that the conflict of interest issue is managed properly as outlined in Principle 2.

Pages 9 and 10 refer to Principle 3. The U.K. Stewardship Code requires that institutional investors should monitor their investee companies.

Please look at the two-toned arrow on Page 10. While generally utilizing Principle 3 of the U.K. Stewardship Code, potential modifications are itemized with hyphen bullets on page 10. First, reflecting the Japan Revitalization Strategy, which directs the formulation of the Japanese version of the Stewardship Code aiming to encourage sustainable corporate growth, it may be appropriate to add the underlined portion to Principle 3 of the U.K. Stewardship Code. That is, the Japanese version may be drafted to read that institutional investors should monitor their investee companies in order to encourage sustainable growth of the companies.

The second hyphen bullet mentions “Above 2”. This refers to the guidance 2 in the table titled “Outline of the U.K. Code” on page 9, listing key issues from (a) through (f) in relation to the monitoring of investee companies. What is our view on these key issues?

Returning to page 10, the first bullet point under the second hyphen bullet addresses concerns with potential misunderstanding of Principle 3. If focusing on individual key monitoring items, institutional investors may wrongly understand that they only need to focus on the lists in the monitoring of their investee companies. The second bullet point addresses the view that institutional investors themselves should retain the capability to make judgments and select the monitoring focus from various possibilities, instead of relying on the Code’s specification.

The third hyphen bullet mentions “Above 5”, which refers to the guidance 5 in the table on page 9. The U.K. Stewardship Code stipulates in the guidance to Principle 3 that institutional investors may or may not wish to be made insiders. An institutional investor who may be willing to become an insider should indicate in its stewardship statement their willingness to do so and the mechanism by which this could be done.

Please return to page 10. The U.K. Stewardship Code was drafted assuming that investee companies will disclose information selectively to specific shareholders. At the second council meeting, we heard an opinion that institutional investors in Japan will never wish to become insiders given the concept of equality among shareholders. Therefore, the Japanese version of the Stewardship Code should be drafted considering such circumstances.

Please look at page 11. Principle 4 of the U.K. Stewardship Code states that institutional investors should establish clear guidelines on when and how they will escalate their stewardship activities.

Please look at page 12. First, please look at the section marked with a two-toned arrow. The guidance to Principle 4 stipulates that if companies do not respond constructively when institutional investors intervene, then institutional investors should consider escalating their actions. How should we incorporate this into the Japanese version of the Stewardship Code?

The first hyphen point relates to the wording of Principle 4. It may be appropriate for the Japanese version to include a statement, for example, that institutional investors should focus on sharing awareness and solving problems through dialogue with investee companies, rather than escalating actions based on the outcome of intervention.

In relation to the bullet point under this, at the last council meeting, we received an opinion in relation to Principle 4 that institutional investors would request their investee companies to provide adequate explanation upon occurrence of problems, etc., instead of escalating actions towards investee companies based on the outcome of intervention, although, as a matter of course, casting an opposition vote is possible.

This will be a similar discussion from before, but please look at item “Above 4” in the next hyphen point refers to the methods of escalating actions from (a) through (g) outlined in the table on page 11.

Returning to page 12, what is our view on detailing methods of intervention? The first bullet point refers to a concern with the possibility of institutional investors complying with Principle 4 just for formality purposes all the more if methods of intervention are specifically provided. The second bullet point suggests that there are various ways to intervene in investee companies, and institutional investors should decide on which approach to take, instead of following the methods individually laid out for them. In view of this, it may be appropriate to set out in the Japanese version, for example, that institutional investors should have a clear policy on how they intervene with investee companies in accordance with the circumstance that they are facing.

Please see page 13. Principle 5 of the U.K. Stewardship Code states that institutional investors should be willing to act collectively with other investors where appropriate.

Please look at the paragraph marked with a two-toned arrow. Taking actions against individual investee companies collectively with other institutional investors may not fit the actual conditions in Japan very well.

As noted with the hyphen bullet, two different approaches regarding collective engagement were mentioned at the last council meeting. One is that investors exchange general ideas among themselves; for example, about the exercise of voting rights, etc. The other, as provided in the second hyphen bullet, was to take no action in terms of collective engagement towards an individual investee company in view of maintaining a relationship of trust, confidentiality, etc., with the investee company.

I will move on to Principle 6 on page 14. The U.K. Stewardship stipulates that institutional investors should have a clear policy on voting and the disclosure of voting activity.

Please see the paragraph marked with a two-toned arrow on page 14, asking if applying the framework of the U.K. Stewardship Code to the Japanese version is essentially acceptable. The first hyphen bullet suggests that Principle 6 should stipulate that, in addition to having a clear voting policy as required by the U.K. Stewardship Code, institutional investors should work on developing a policy that will facilitate sustainable growth of their investee companies and avoid making a policy just a standard for formality purposes.

The second hyphen bullet relates to the guidance 2 of the table on page 14. The U.K. Code’s disclosure requirement as to voting activities does not include the disclosure of individual voting, i.e., disclosure of voting results by individual investee company and by proposal. According to statistics reported at the last council meeting, in the U.K., 65% of institutional investors disclose their voting activities in some way, 44% of which disclose voting activities by individual company and by proposal.

The third hyphen bullet relates to the guidance 3 in the table, suggesting the addition of a clause stating that institutional investors, in using the external proxy advisor, should not mechanically rely on the advisor’s recommendation. Instead, they should make voting decisions independently and responsibly based on their dialogue with investee companies.

Please see page 15. Principle 7 of the U.K. Stewardship Code reads that institutional investors should

report periodically on their stewardship and voting activities to their beneficiaries. I believe the periodic reporting to their beneficiaries referred in this principle assumes the individual reporting provided to specific beneficiaries based on trust agreements, etc.

The two-toned arrow on page 15 recommends the following modifications to Principle 7, while essentially accepting the application of the framework under this principle.

The first hyphen bullet relates to the guidance 2 and 3 in the table. While generally relying on these in terms of reporting to the beneficiary, it may be appropriate and realistic to consider disclosing certain information that can be disclosed to the public, in view of circumstances where the beneficiary does not require reporting or where the institutional investor has no capability to provide reporting to the ultimate beneficiaries individually.

The hyphen bullet below relates to the guidance 4 in the table on page 15, requiring that asset managers should obtain an assurance report, which may be unfamiliar to some of us. In short, an assurance report is prepared by certified public accountants or CPAs in the U.K. when they check on the internal controls of companies in a manner simpler than the audit process. By utilizing this process, the U.K. Stewardship Code requires the obtaining of an assurance report prepared by CPAs as described in the guidance 4.

In this regard, I have checked the disclosure status of randomly selected U.K. institutional investors. Despite the stipulation in the guidance that investors that acquired an assurance report should disclose such fact, I actually did not find any company disclosing receipt of an assurance report. I did not cover all institutional investors in the U.K., thus this does not mean there is absolutely no investor making disclosure as to the assurance report. Nevertheless, as far as my random sampling goes, there is no disclosure as to the assurance report. In view of this, I would like to conclude that the requirement for an assurance report is not necessary in the Japanese version of the Stewardship Code.

Please turn to page 16. To conclude my presentation, I will talk about additional principles that are unique to the Japanese version. My suggestions are provided on this page.

First, some members opined that investors should acquire a certain amount of knowledge in order to conduct fruitful dialogue with investee companies.

Secondly, in view of such opinion, it may be suitable to add principles unique to the Japanese version, for example, a principle stating that institutional investors should acquire the capability to hold dialogue appropriately and make judgments based on a high level of knowledge and deep understanding regarding the issues of concern, in order to facilitate sustainable growth of their investee companies.

Thirdly, in doing so, it may be appropriate to add guidance, for example, the following items to the unique principle (itemized using hyphen bullets under the third bullet point on page 16). Firstly institutional investors should make efforts to gain deep understanding of their investee companies and their business environment. Secondly, institutional investors should develop a framework necessary for conducting dialogue and making judgment appropriately based on a high level of knowledge and deep understanding of related issues. Thirdly, institutional investors should conduct ex-post verification as to whether their dialogue and judgments were appropriate or not.

I would like to hear your views and opinions regarding other potential additions to the Code.

[Kansaku] Let's discuss the preamble to the Stewardship Code based on the explanation by the secretariat.

[Kawada, member] First, I feel the second bullet point under the section titled "Others" on page 6 is a little strange. I agree with the statement that efforts by investee companies, as well as institutional investors, are important for constructive dialogue between institutional investors and investee

companies. However, it is difficult to understand why such expectations for investee companies should be stipulated in the Code. I understand that, the purpose of the Stewardship Code is to stipulate the responsibilities of institutional investors. Of course, I do not deny the statement itself, but I would like to clarify the meaning of the clause for investee companies being inserted into the Code .

[Yufu] We are talking about inserting a clause into the preamble to the Code, which does not relate to the “comply or explain” approach. We are asking for your opinions regarding the possibility of adding a clause assuming that. At the last council meeting, Mr. Kawata, council member, explained that investee companies are making efforts as much as they can for an early release of the proposed agenda for the general shareholders meeting. I also remember hearing the idea at the last council meeting that it is desirable to separate the record date for confirming shareholders and the account settlement date for the fiscal year, which would leave some time until the actual date of the general shareholders meeting.

Additionally, electronic voting was mentioned at today’s meeting. Given the views regarding investee companies that have been addressed in all three meetings to date, we are considering the possibility of describing expectations towards investee companies in the preamble to the Code. Of course the Code will cover institutional investors, not investee companies, and such clarification will be made in the Code.

[Eguchi, member] I would like to refer to the peculiarity of the use of the term “responsibilities of institutional investors”. Institutional investors are the intermediary for investment. The function, in a way, as an intermediary for the investment activities of the ultimate beneficiary in the investment chain. This primary responsibility of institutional investors is a little different from the stewardship responsibilities.

One of the important responsibilities of institutional investors as an intermediary is to achieve diversified investment at an extremely low cost, which is not achievable by an individual investor alone. This is socially significant, contributing substantially to the efficiency of financial markets. Institutional investors are responsible for this. Another important responsibility would be to remove the gap between the share price and the fundamental value of the investee company by identifying the fundamental value of the individual company and executing trading by benchmarking the share price against the identified fundamental value. These are the types of activities that may be considered as being primary responsibilities of institutional investors. They are a little different from the stewardship responsibilities in the U.K.

[Kansaku] Do you have any expression in mind to replace “responsibilities of institutional investors”?

[Eguchi, member] I do not have an alternative name for it. We could only specifically state the types of activity that may also be considered as being the institutional investor’s responsibilities. The important task is to clarify on their linkage with the types of activity, which I mentioned earlier, that may be considered as the institutional investor’s primary responsibilities.

[Noguchi, member] The third white bullet point on page 2 includes proxy advisors and investment consultants in the scope of institutional investors. Investment consultants in the U.K. are not fully identical to those in Japan, so this is probably a mistake in the translation process. I do not remember seeing any cases where investment consultants advise on the exercise of voting rights in Japan, and I asked the Japan Investment Advisors Association, which confirmed that Japanese investment consultants hardly ever advise on voting. Therefore, I thought it would be appropriate to remove investment consultants in the Japanese definition from the scope of the institutional investors to whom the Japanese version will be applied.

Although I do not quite understand the definition of investment consultants in the U.K. Code, pension consultants may be qualified as investment consultants, given their active involvement with plan sponsors.

[Matsushima, member] In relation to page 1, if my understanding is correct, the purpose of the Stewardship Code is to enhance sustainable corporate growth while fulfilling the trustee's duties. I think this is the case with the U.K. Stewardship Code. The significance of the Code is to enhance both corporate growth and the interests of investors. Thus, I read that the trustee's duties and stewardship are two different concepts.

[Yufu] I do not have a fixed view on the interpretation of the concept, although the paragraph can be read as you did.

[Matsushima, member] The reason behind my comment is the fact that various council members have mentioned passive and active investment management, both of which, according to the U.K. Stewardship Code, should act to achieve the purpose of the Code.

In reality, as I explained at the last council meeting, the aggregate outstanding balance of passively managed funds is larger than that of actively managed funds. In managing investments passively, asset managers are required to hold the shares of companies that are components of the investment index almost all the time, which means passive investment managers must maintain 1,700 or more of names in their investment portfolio if it is TOPIC linked. As such, if the primary goal of the Stewardship Code is to enhance the sustainable growth of investee companies, passive investment managers, which essentially cover all listed companies, cannot avoid facing the challenge of fulfilling such purpose in the process of developing a realistic framework and internal guidelines.

On the other hand, there is a conflict over whether to pursue active dialogue, engagement and screening even if these actions do not necessarily meet the cost constraints, requirement from the beneficiary, and specific mandate from the investment advisory company. In that sense, we should try to maintain a balance between the duties as a trustee and sustainable corporate growth at various investment stages. Quite a few people addressed their concern as to the difficulty in developing a framework for their business operation if the Stewardship Code is drafted to mean that monitoring, intervention and engagement should be conducted in every type of fund management; hence my comment.

[Yufu] I understand Mr. Matsushima's concern now. In this regard, I would like to point out that taking into consideration such issues as Mr. Matsushima's, we have drafted the first white bullet point on page 3, which states that the extent to which stewardship is applied differs among institutional investors depending on their size and investment policy (active, passive, etc.).

I would like to comment on the secretariat's inclination to incorporate size of institutional investors in addition to their investment policy, such as passive or active, as one of the factors to determine the degree of applying the Code to them. As the secretariat of the council, I started thinking about this issue when I was writing the statement on page 3, because the Government Pension Investment Fund (GPIF) with outstanding assets of some 120 trillion yen under management maintains a passive investment policy in terms of investing in shares. The extent to which the Stewardship Code should be applied to GPIF as a passive asset manager is a very important issue, and this is currently under discussion at the Cabinet Secretariat's experts meeting.

In view of this, the application of the Stewardship Code may be determined appropriately based on a matrix consisting of multiple factors such as investment policy (active or passive), size of investment, and term of investment (long or short).

[Oguchi, member] I have a comment that may relate to this question. There is a paragraph on page 2 stating that the cut-off point of the definition of institutional investor will be kept ambiguous deliberately. I think this is a good idea, as we aim to develop a Stewardship Code that is realistic and achievable. At the same time, we should remain cautious about the risk that the Stewardship Code will not function in practice and become a mere framework.

The U.K. Stewardship Code, for example, at least broadly defines asset owners, which includes pension funds, insurance companies, investment trusts and other collective investment vehicles. Please indicate your intention as to whether to identify these core asset owners in writing as subject to the “comply or explain” approach of the Japanese version of the Stewardship Code.

[Yufu] Our basic stance is not to refuse to take on anything other than what is discussed in this material; we are assuming that various additions and explanatory notes will be necessary when we start drafting the Stewardship Code. I would like to hear your opinions regarding the issues you just addressed.

[Oguchi, member] I think we can utilize the paragraph in the U.K. Stewardship Code outright, as I simply thought that the paragraph fits the situation in Japan.

[Kansaku] Next, please provide your views and opinions in relation to Principles 1 and 2 (pages 7-8 of the reference material).

[Horie, member] I would like to ask questions regarding Principle 2. I do not quite understand what circumstances will fall under the scope of this principle. For example, as mentioned by Mr. Hamaguchi, let us assume that an investment management company received an entrustment of shares from a corporate pension fund. This corporate pension fund, as part of its parent company, follows the views of its parent company, and hence does not wish to vote against a proposal for the entrusted shares. However, a different corporate pension fund views the casting of an opposition vote as appropriate from the viewpoint of improving enterprise value. To what extent should asset managers be required to detail conflict of interest situations? For example, when voting against a proposal seems appropriate from the viewpoint of improving enterprise value but casting an affirmative vote seems appropriate for the portion of shares entrusted by the parent company requesting the affirmative vote, should asset managers disclose the fact that they partially voted against the proposal of an investee company? To what extent should asset managers disclose conflicts of interest?

Keeping the Stewardship Code’s principle in relation to conflicts of interest within a general principle level will not adequately facilitate the prevention of conflicts of interest in practice. Therefore, specific cases that would give rise to conflicts of interest should be given in the Stewardship Code as examples.

[Kansaku] Please provide your views/opinions for Principles 3-4 (pages 9-12 of the reference material).

[Eguchi, member] As already noted by the secretariat, I feel that the effect of listing specific action points in the Code is mostly negative. In practice, if specific action points are listed, we tend to create checklists and end up just quantifying our actions against the list. Thus, there is a high risk that the form rather than the content will be reviewed. Therefore, I agree with the secretariat and would feel uncomfortable as to the listing of specific action points.

[Ishida, member] I would recommend adding wording such as “considering the capital efficiency” or “incorporating an effective use of shareholders’ capital”, etc., in addition to the suggested modification to Principle 3 on page 10 that states “institutional investors should monitor their investee companies in order to encourage the sustainable growth of such investee companies”.

The reason behind my suggestion for additional language is the fact that the Stewardship Code has become a widespread global issue. Thus, it is important to identify unique feature of the Japanese version of Stewardship Code. However, it is not easy to incorporate specific matters to the Stewardship Code, because the Stewardship Code, given its nature, should remain general principles. Additionally, reflecting national characteristics, Japanese are very strong at following detailed rules while they are not so keen on taking actions based on a given principle. Thus, I think the Japanese version of the Stewardship Code should have some special features.

Such special features should be in line with current conditions in Japan; that is, such features would deal with issues that foreign investors have with Japanese companies. The most common issue would be the poor capital efficiency. However, requiring improvement of ROE, etc., in the Stewardship Code is too specific and somewhat peculiar, given the nature of the Stewardship Code. However, it would be less peculiar if we just add wording such as “considering capital efficiency”. Moreover, this would capture the attention of overseas investors, giving the impression that the Japanese version of the Stewardship Code is working to resolve existing issues.

The Japanese version of the Stewardship Code will become a mere concept unless it is somewhat aligned with prevailing conditions in Japan. Again, while the Stewardship Code is a set of principles, we are expected to develop the Japanese version reflecting characteristics unique to Japan.

Lastly, we often hear the term “dialogue” in the talk of the Stewardship Code, the definition of which is unclear. Conducting dialogue, of course, is important, but I cannot get a grasp of what should be discussed in these dialogues. Considering this, the Japanese version should include something specific such as the efficiency of capital, which can be used a topic of dialogue.

[Eguchi, member] Continuing from my earlier comments, I do not think that the way the word “monitoring” is used is appropriate. Monitoring implies a surveillance of investee companies by investors. But what we'd like to promote is the long-term growth of investee companies, thereby building a win-win relationship between institutional investors and their investee companies. What we'd like to promote is not a one-way surveillance.

The term “monitoring” is often used overseas. We should conduct an in-depth review on whether to use this term. Our discussion should first focus on the enhancement of the sustainable growth of investee companies, which is the primary goal of the Stewardship Code, and what investors can do towards that goal.

[Kansaku] We will move on to Principles 5 and 6 (pages 13-14 of the reference material). Please give your opinions/comments.

[Furuichi, member] I would like to comment on Principle 6. The policy regarding the exercise of voting rights is naturally different among institutional investors depending on their asset size, type, and investment horizon. It is important for them to disclose their policy clearly and communicate it to their investee companies.

However, the detail of disclosure as to voting activities, that is, whether to disclose sample cases, aggregation of data, or by-company data, can be left to the discretion of each institutional investor.

As mentioned by Mr. Eguchi, problems may occur if the Code is too detailed. As mentioned by the secretariat, it is important to take the principles-based approach.

[Noguchi, member] I will comment on the disclosure of voting activities in Principle 6. We disclose the aggregated results of voting, which is the industry-wide approach. Investment management companies function as trustees for their clients based on a discretionary investment management contract. Thus, we provide a periodic report to our clients on an as-required basis from the viewpoint of the duty of confidentiality under the contract. We prefer this type of approach.

The aggregate results of voting are currently listed on our website, but in our view, disclosure of detailed voting activities should be performed on a case-by-case basis based on the client's needs.

[Kawada, member] As for the policy for exercising voting rights described in Principle 6, I agree with the description of the reference material. Instead of setting out formal standards, the Stewardship Code should be drafted to encourage institutional investors to facilitate the sustainable growth of the

companies they invest.

[Eguchi, member] Apologies for making a similar comment, but the phrase, escalation of intervention, has certain connotations in the overseas context. As I mentioned earlier, the concepts used in the U.K. Stewardship Code reflect the investment culture unique to the U.K. I feel strongly that their straightforward translation would not be suitable in the Japanese context.

This applies to the case of “intervention” as well as “monitoring”. Does “intervening” mean managing a company? I do not think institutional investors are interested in managing their investee companies, which should be clarified. This is the uniqueness that can be highlighted in the Japanese version of the Stewardship Code in comparison to other countries.

[Tokunari, member] I feel quite worrisome about usage of the term “intervene” as used in Principle 4. What we can do as an asset manager is limited; it is impossible for us to intervene in the management of the investee company other than by casting opposition votes as a result of having discussions with our investee companies. I agree with the secretariat’s proposed modification in relation to escalating intervention on top of page 12. However, the last sentence on page 12 “institutional investors should have a clear policy on how they will intervene in the management of their investee companies in accordance with the circumstance that they are facing” assumes intervention by asset managers. I do not think asset managers have means to “intervene” in the management of their investee companies. It seems to be quite necessary to review and analyze the issues substantially if we adopt Principle 4 of the U.K. Stewardship Code in the Japanese version.

[Oguchi, member] As we are talking about the Japanese version of the Stewardship Code, our discussion tends to focus on how to translate and convey the meaning of the U.K. Stewardship Code in Japanese. It was skipped earlier, but please see the section titled “shareholding by domestic and foreign investors” on page 3. The Japanese version of Stewardship Code is applicable to all institutional investors investing in shares in Japan, which obviously includes global institutional investors overseas. According to Mr. Furuichi’s presentation material, shareholdings by foreign investors already account for 30% of Japanese shares.

If translated back into English the Japanese version of the Stewardship Code developed through reviewing and revising the U.K. Stewardship Code, may differ from the original wording in English. Nothing is wrong with that, but we will still be facing the issue as to what selections of wording are appropriate. Honestly, I do not understand whether such a situation will be understood by foreign investors or why we should take the risk of altering the U.K. Stewardship Code. The U.K. version must have been the outcome of much discussion, so if it sounds strange in Japanese, I think the translation is probably wrong. I am afraid that global institutional investors would be confused, if the Japanese version translated back to English sounded completely different from the U.K. version.

I would like to comment again that I agree with the necessity of selecting the Code’s wording carefully, simply for ease of understanding and clearly to avoid misunderstanding. However, as the Stewardship Code covers global institutional investors investing in shares in Japan, it should be drafted aiming to be accepted by this audience as well.

[Ishida, member] I would like to comment on the disclosure of voting activities in Principle 6. In general, any investee companies that are interested in the Stewardship Code under discussion here would have a basic understanding of the standard, in accordance with which institutional investors exercise their voting rights. However, in reality, only a fraction of investee companies have such an understanding; many others, including those listed on the First Section of the Tokyo Stock Exchange, would not really understand the reasons behind the voting against their proposals at the general shareholders meeting. This evidences the fact that the exercise of voting rights is not functioning as a way for shareholders to communicate their intention to their investee companies; which is a more immediate issue of concern than those associated with the disclosure of voting activities.

Therefore, while it is important to discuss how voting activities should be disclosed, we need to first focus on how institutional investors can give adequate feedback to their investee companies as to their reasons for casting opposition votes. Without appropriate feedback, investee companies will remain confused and maintain a negative attitude towards the opposition vote, despite the investor's intention to send a constructive message with such voting.

This does not nurture a constructive relationship between institutional investors and their investee companies. Only when institutional investors give feedback on the reasons behind their voting will the act of exercising voting rights become meaningful; thereby enhancing engagement activities with investee companies. Merely disclosing voting activities will not be effective without investee companies understanding the reasons. Thus, the act of exercising voting rights will be more meaningful if institutional investors take a step further than simple disclosure, and actively inform the reasons behind their opposition vote to the investee companies.

[Furuichi, member] I totally agree with Mr. Ishida's opinion. Institutional investors should communicate the reasons behind their voting against proposals to their investee companies; what I am saying is that institutional investors should disclose such information to their investee companies, not necessarily to the public. In this sense, we should remain very cautious about disclosing by-company voting information.

Apart from the question as to the effectiveness of our current initiatives, in order to gain an understanding of investee companies, institutional investors should take adequate time to screen issues and continue their dialogue with the investee companies including dialogue before voting.

[Kansaku] Lastly, please provide your opinions/comments on Principle 7 and principles unique to the Japanese version of the Stewardship Code (pages 15-16 of the reference material).

[Oguchi, member] I highly value the statements written on page 16, the last page of the reference material. Incorporating these into the Japanese version is meaningful, as they will add unique characteristics to the Code as the Japanese version.

On the other hand, going back to my earlier discussion in relation to shareholding by domestic and foreign institutional investors, a major departure from the U.K. Stewardship Code that global investors would find in the Japanese version is probably the exclusion of Principle 5, so-called collective engagement. Considering current conditions in Japan, excluding collective engagement seems reasonable. However, acting collectively with other investors, call it collective engagement or not, is actively requested already, viewed as an effective method of communication from the perspective of investee companies as well as investors lacking resources.

For example, use of an investor platform is recommended in the Kay Review, which was discussed on a separate occasion. Considering positive views like this on a global perspective, excluding the concept of collective engagement entirely from the Japanese version will cause misunderstanding. As such, if I were to draft the Stewardship Code independently, I would add wording after the statement on page 16 referring to the sustainable growth of investee companies and so on. Specifically, after the sentence "institutional investors should acquire the ability to hold dialogue appropriately and make judgments based on solid knowledge and an in-depth understanding of issues of concern", I would insert a comment referring to collective engagement, stating, for example: In order to facilitate this, collective activity with other investors can be used if deemed necessary.

That is to say, I do believe that a single institutional investor has a limited ability to conduct engagement alone due to their lack of resources and knowledge. Thus, if deemed necessary, it may be reasonable to work collectively with other investors and utilize their knowledge and skills. An alternative approach towards collective engagement like this may be drafted as a unique principle in the Japanese version, to

replace Principle 5 of the U.K. Stewardship Code.

[Eguchi, member] Expanding from Mr. Oguchi's last point, it is a good thing that institutional investors conduct engagement by consulting with each other. However, as discussed at the first council meeting, there are various legal issues involved with collective engagement. The guideline to this principle should emphasize the necessity of resolving such legal issues.

Changing the legal system is a time-consuming task, which therefore cannot happen simultaneously with the release of the Japanese version of the Stewardship Code. However, it is desirable that investors act together to deal with governance issues of investee companies. This is completely different from concerted actions taken when facing mergers and acquisitions. Thus, it is important to send, through the Japanese version, a positive message that collective engagement is socially desirable. The Code should include a statement that collective engagement is socially desirable and efforts should be made to reform the related legal framework.

[Tachibana-Fukushima, member] The translation-related problem addressed by Mr. Oguchi is a concern. When foreign investors read the Japanese version of the Stewardship Code translated into English, they will indeed recognize, for example, the term "engagement" as defined in English. Thus, it is likely that the intended meaning of the term "engagement" in the Japanese version may not be conveyed properly. The wording in the U.K. Stewardship Code must have been selected carefully through several levels of refinement; hence, the definition of each term is commonly understood in English-speaking countries. Of course, we should incorporate unique characteristics of Japan to the Japanese version. However, if a certain term is expressed in a different word in Japan, we should clarify the definition of such a term so that we can explain the reason behind such selection adequately, just like the "comply or explain" approach.

I received the English translation of the minutes of the first council meeting, which I had to revise quite substantially as the English translation of my comments was very difficult to understand. The Japanese version of the Stewardship Code should be translated very carefully, paying attention to how a Japanese word used with a certain definition is expressed in the context of English, and what wording is best suited from the governance point of view. Otherwise foreign investors may flag such a term as inappropriate. I felt concerned hearing about the translation issue Mr. Oguchi rightfully pointed out earlier. Please consider this issue carefully.

[Oguchi, member] Going back to Principles 3 and 4, indeed, there is a risk that the listed action points under the guideline to these principles may be viewed as limitative listing. On the other hand, these lists may be useful as they give examples of appropriate actions and enhance clear understanding of these principles. It is a difficult issue: a limitative listing will likely cause an inadequate tick box compliance with the principles, while no listing will cause confusion as to what needs to be done in the application of the principles. As I refrained from giving this comment earlier, I would like to add this from the viewpoint of making the Code easy to understand.

[Furuichi, member] I would like to comment on principles unique to the Japanese version. It is important to acquire solid knowledge and an in-depth understanding of related issues. However, the ex-post verification suggested in the third hyphen point would be technically difficult to implement. If, after obtaining the institutional investor's advice on the divestiture of a certain division, dividend payouts, the maintenance of retained earnings, etc., the investee company's performance improved or its share price rose, it would not be possible to judge whether the outcome was due to engagement, forex movement, or the investee company's efforts. We should remain modest and assume that the rise in share price was largely the result of the investee company's efforts, and the institutional investor's engagement activities had only limited effects. Please note that by remaining modest, I do not mean that the institutional investor should be inactive on engagement with investee companies. However, this ex-post verification, in practice, may cause problems for institutional investors.

In addition, based on comments from many of you, there are two views on detailing action points. First, without detailing specifics, institutional investors will be confused as to the exercise of the Stewardship Code; second, the Stewardship Code should take a principle-based approach, setting out an overall concept first by establishing common ground among institutional investors. In my opinion, the Stewardship Code should essentially be developed in a soft law approach (the “comply and explain” approach). It would be misleading to call it loose, but the Stewardship Code should remain something that can be commonly accepted by institutional investors without too many details.

[Kansaku] Please provide additional opinions, if any, on the entire presentation from the preamble through to the end.

[Eguchi, member] I would like to comment on the issue of whether to list individual action points, which has been mentioned a number of times. The specific actions and circumstances we can itemize are something that we can predict at this moment, and based on my experience, probably the most ordinary actions. Actions and circumstances that are key to the principles are often those that cannot be itemized. Therefore, I think it is more important to ensure that principles are established, rather than listing specifics.

[Ishida, member] Overall, the Japanese version of the Stewardship Code is discussed in light of the framework of the U.K. Stewardship Code. The concept of Stewardship Code has spread globally, by looking to the U.K. Stewardship Code as a model. Are we going to look at other available stewardship codes or just use the U.K. Stewardship Code as the basis of the Japanese version?

[Yufu] That is a very difficult question to answer. In preparation for the next council meeting, we are currently reviewing other principles including the ICGN Statement of Principles for Institutional Investor Responsibilities, which was developed by the International Corporate Governance Network (ICGN), an international organization for institutional investors which is similar to the U.K. Stewardship Code; and the United Nation’s Principles for Responsible Investment that is comparable with the U.K. Stewardship Code. These principles contain similar concepts with the U.K. Stewardship Code, and we are studying the key points.

We need more time to decide whether to book a time slot specifically for this subject at the next council meeting, but any way, we will deliver the information as to these two principles for your reference either through the council meeting or by email.

[Tachibana-Fukushima, member] Not an opinion, but I would like to make a comment in relation to Mr. Yufu’s comment. I did not attend the last council meeting, and therefore missed the opportunity to hear the presentation then. Page 32, the last page of Ms. Ueda’s presentation material for the last council meeting titled “Stewardship Code Spreading Globally”, provides a list of stewardship codes developed by various countries including Canada, South Africa, the Netherlands, Switzerland and Italy; stewardship codes developed by international organization such as ICGN, and recommendations for the formulation of a code by the Securities Commissions of Malaysia, etc. Can I assume that you have roughly reviewed all of these already?

[Yufu] We did not review all of those listed in the material as the council’s secretariat. Rather, we would like to ask for Ms. Ueda’s inputs. The material was not prepared by the secretariat and, therefore, we did not review all the listed documents.

[Eguchi, member] I am not sure if this relates to the Stewardship Code, but I read a newspaper article today reporting on Third Point LLC’s decision to withhold its support for Sony’s proposal to spin off its entertainment unit. An action like this is key to facilitating the sustainable growth of Japanese companies, which will likely be missed out of the Stewardship Code. We should consider ways to link this type of action with the Stewardship Code.

[Oguchi, member] I would like to make a comment in relation to the explanation given earlier by Mr. Kawada. The U.K. Stewardship Code originates from the Corporate Governance Code. In Japan, the Stewardship Code will be developed before a corporate governance code. Although unrelated to today's discussion, will there be discussions in the future regarding a corporate governance code that has similar characteristics to the Stewardship Code.

[Yufu] It is difficult to answer to your question as a secretariat member for the FSA. I suspect you are aware of this, but principles for corporate governance already exist. The principles of Corporate Governance for Listed Companies were drafted by the TSE based on the OECD Principles of Corporate Governance.

I am also aware of the fact that the TSE's principles are not necessarily widely known to issuers such as companies, etc.

[Kansaku] We will move on to specific discussions towards formulation of the Japanese version of the Stewardship Code starting the next council meeting and thereafter.

[Yufu] We are aiming to hold the next council meeting in November. We will adjust and fix the meeting date considering the schedule of each member, etc., and send the basic meeting notification accordingly.

End.