

Revision of the Stewardship Code

Mmmm dd, yyyy

The Council of Experts on the Stewardship Code (FY2019)

I. Background

1. The Council of Experts on Japan's Stewardship Code established Japan's Stewardship Code on February 26, 2014. Approximately three years have passed since the Stewardship Code was revised by the Council of Experts on Japan's Stewardship Code on May 29, 2017. During this period, over 250 institutional investors have signified their commitment to the Stewardship Code, and the Corporate Governance Code has been revised in June 2018. While progress has been made in corporate governance reform to a certain extent under these Codes, it has also been pointed out that their effectiveness should be further enhanced.
2. Under these circumstances, on April 24, 2019, the Council of Experts Concerning the Follow-up of Japan's Stewardship Code and Japan's Corporate Governance Code (convened by the Financial Services Agency and Tokyo Stock Exchange) published an opinion statement entitled "Recommended Directions for Further Promotion of Corporate Governance Reform" (hereafter, the "Opinion Statement"). The Opinion Statement called for further revision of the Stewardship Code in order to enhance the effectiveness of corporate governance reform, referring to the importance of enhancing the quality of engagement between investors and companies, and encouraging proxy advisors and investment consultants for pensions to provide support and advice to institutional investors to enhance the functions of the investment chain as a whole.
3. Following up on the Opinion Statement, the Council of Experts on the Stewardship Code (FY2019), convened by the Financial Services Agency (referred to collectively with the "Council of Experts on Japan's Stewardship Code" and the "Council of Experts on the Stewardship Code," hereafter as the "Council"), met three times after October 2019 and discussed the revision of the Code. Based on these discussions, the Council has generated and published the Stewardship Code revision draft (hereafter, the "Revision Draft") to request comments from the public in accordance with "III. Issues for consultation."

The Stewardship Code revised version will be finalized after reviewing the comments.

II. Major issues of the Revision Draft and their viewpoints

1. The Opinion Statement made recommendations on the:
 - improvement of disclosure of the reasons for voting decisions, stewardship activities with companies, its results and self-evaluation of stewardship activities by asset managers,
 - consciousness in engagement regarding issues on sustainability including ESG factors,
 - supporting stewardship activities of corporate pensions,
 - establishment of organizational structures by proxy advisors, disclosure of proxy advisory processes (including the organization), and direct and proactive engagement with

companies, and,

- development of structures for conflicts of interest management and disclosure of its activities by investment consultants for pensions, and other issues.

The Council decided to discuss these issues and incorporate them in the Revision Draft.

2. Furthermore, the following issues have been covered during the discussion process of the Council, in addition to the issues mentioned in the Opinion Statement.

- Is it important that stewardship activities be carried out with consciousness of leading to the medium- to long-term increase of corporate value and the sustainable growth of companies?
- Consideration of ESG factors would not only reduce business risks, but also lead to profit opportunities. Taking into consideration the current rapidly changing trends on ESG issues around the world, those changes themselves may also affect risks and opportunities. Is it beneficial to integrate sustainability including ESG factors into the investment process?
- Are there cases where the application of the Code to assets other than listed shares, such as fixed income bonds, is beneficial for the institutional investors which invest in such assets, even though the purpose of the Code is to increase the medium- to long-term corporate value and there may be cases where conflicts of interest arise between shareholders and bondholders?
- Should the parties which assist institutional investors manage conflicts of interest, in addition to investment consultants for pensions?

The Council discussed the above issues and decided to incorporate them in the Revision Draft in response to the above comments.

A member also commented on a measure put in place by a private organization. When asset owners receive reports from asset managers on the status of their stewardship activities, there are some developments toward using a common format introduced by the private organization. It is expected that such initiative will further be developed in supporting asset owners with carrying out effective stewardship activities. Provided, however, it is important that monitoring through such initiative will not be formalistic, but be aware of enhancing its quality.

In addition, the following comments were also raised during the discussion in the Council. Further review by the Council based on actual conditions is considered necessary. The Financial Services Agency is also expected to review them.

- With the expansion of passive investment, is it necessary to review how to improve engagement?
- Some people point out that the “Clarification of Legal Issues Relating to the Development of Japan’s Stewardship Code” does not give sufficient clarification on the scope of collaborative engagement. Is it necessary to review measures on this?

III. Issues for Consultation

(Application of the Stewardship Code to asset classes other than listed shares)

【Preamble: “Aims of the Code”】

Question 1-1.

What do you think about the new provision stipulating that “The Code primarily targets institutional investors investing in Japanese listed shares. In addition, the Code may also apply to other asset classes as far as it contributes to fulfilling the stewardship responsibilities mentioned in the heading of this Code.” (Preamble: “Aims of the Code”), revising the current Code assuming that institutional investors will invest in Japanese listed equities? And why do you think so?

Question 1-2.

Are there any points to be noted when institutional investors apply the Code to other asset classes? Please provide reasons, if any.

(Issues of sustainability including ESG factors)

【The beginning of the Preamble, Preamble: “Aims of the Code,” Principle 1 and Principle 4】

Question 2.

What do you think about incorporating issues of medium- to long-term sustainability including ESG factors (“sustainability”) in the Revision Draft? If such a phrase is incorporated, how should it be incorporated?

In addition, what do you think about the text of the Revision Draft expecting consideration of this issue in Principle 1 regarding the policy to fulfill their stewardship responsibilities? Please provide reasons, if any.

(Stewardship activities of corporate pensions as asset owners) **【Principle 1】**

Question 3.

What kind of measures should be stipulated to encourage asset owners, such as corporate pensions, to participate in stewardship activities?

(Disclosure of the reasons of “for” or “against” at proxy voting) **【Principle 5】**

Question 4.

What do you think about expecting asset managers to explain their reasons of “for” or “against” at proxy voting when they disclose voting results by individual company and agenda basis?

What do you think about Guidance 5-3 in the Revision Draft requesting institutional investors to “disclose the reasons of votes on the agenda of investee companies, either “for” or “against”, which are considered important from the standpoint of constructive dialogue with the investee companies, including those suspected to have conflicts of interest or those voted contrary to their voting policy”? And why do you think so?

(Principles concerning service providers for institutional investors)

【Preamble, “Aims of the Code” and Principle 8】

Question 5-1.

What do you think about the creation of the new Principle 8, concerning “service providers for institutional investors”, which requests that service providers for institutional investors develop structures for conflicts of interest management etc. (Guidance 8-1), and that proxy advisors develop human and operational resources as well as disclose their voting recommendation process (including the resources) (Guidance 8-2) and exchange views actively with companies upon necessity (Guidance 8-3)? And why do you think so?

Question 5-2.

What are the points to be noted regarding the scope of “service providers for institutional investors” when they include not only proxy advisors and investment consultants for pensions, but also may widely include institutions which have a function to contribute to asset managers and asset owners in carrying out effective stewardship activities? And why do you think so?

Note: The draft Code stipulates that “service providers for institutional investors” are defined as “The parties which provide services to contribute to institutional investors in carrying out effective stewardship activities in accordance with requests for services by institutional investors, etc., such as proxy advisors and investment consultants for pensions” (Preamble, “Aims of the Code”).

(Others) **【whole issues】**

Question 6.

Please provide comments and their reasons on revised provisions of the Revision Draft beside the above issues.