

**Revisions including transparency of beneficial
shareholders and collaborative engagement**

Principles for Responsible Institutional Investors

《Japan's Stewardship Code》

- To promote sustainable growth of companies through
investment and dialogue —

Draft revisions

**~~The Council of Experts on the Stewardship Code (FY2019)~~
Financial Services Agency**

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“Stewardship responsibilities” and the role of the Code

In this Code, “stewardship responsibilities” refers to the responsibilities of institutional investors to enhance the medium- to long-term investment return for their clients and beneficiaries (including ultimate beneficiaries; the same shall apply hereafter) by improving and fostering the investee companies’ corporate value and sustainable growth through constructive engagement, or purposeful dialogue, based on in-depth knowledge of the companies and their business environment and consideration of sustainability (medium- to long-term sustainability including ESG factors) consistent with their investment management strategies.

This Code defines principles considered to be helpful for institutional investors who behave as responsible institutional investors in fulfilling their stewardship responsibilities with due regard both to their clients and beneficiaries and to investee companies. By fulfilling their stewardship responsibilities properly in line with this Code, institutional investors will also be able to contribute to the growth of the economy as a whole.

***The “Background” section has been transferred to the end of the document.**

Aims of the Code

1. ~~As stated in the box at the beginning of this report, i~~In this Code, “stewardship responsibilities” refers to the responsibilities of institutional investors to enhance the medium- to long-term investment return for their clients and beneficiaries by improving and fostering the investee companies’ corporate value and sustainable growth through constructive engagement, or purposeful dialogue, based on in-depth knowledge of the companies and their business environment and consideration of sustainability consistent with their investment management strategies. This Code defines principles considered to be helpful for institutional investors who behave as responsible institutional investors in fulfilling their stewardship responsibilities with due regard both to their clients and beneficiaries and to investee companies.
2. At a company, the board of directors has the responsibility to enhance the corporate value by exerting adequate governance and proper oversight on the management, taking decisions on key policy and business matters as stipulated in Japan’s Corporate Governance Code. The function of the board and that of institutional investors as defined in the Code are complementary and both form essential elements of high-quality corporate governance, which are indispensable in ensuring the sustainable growth of the company and the medium- to long-term investment return for the clients and beneficiaries. With due regard to the roles of both the board and institutional investors, the Code promotes constructive engagement, or

purposeful dialogue, between institutional investors and investee companies. The Code does not invite institutional investors to interfere with the finer points of managerial matters of investee companies².

3. Activities by institutional investors done to discharge their stewardship responsibilities (hereafter, “stewardship activities”) should not be seen to be confined to voting, although voting is an essential element of stewardship activities. Stewardship activities include proper monitoring of the investee companies and constructive engagement with them done to discharge the stewardship responsibilities to foster sustainable growth of the companies³.

4. In the Code, two categories of institutional investors are identified: “institutional investors as asset managers” (hereafter, “asset managers”), which are entrusted to manage funds and invest in companies; and “institutional investors as asset owners” (hereafter, “asset owners”), including providers of funds.

The asset managers are expected to contribute to the enhancement of the corporate value of investee companies through day-to-day constructive dialogue with them.

The asset owners are expected to disclose their policies on fulfilling their stewardship responsibilities and contribute to the enhancement of the corporate value of investee companies through their own actions and/or the actions of the asset managers, to which they outsource their asset management activities⁴.

The asset managers should aim to know the intention of the asset owners so that they can provide services as expected, and the asset owners should aim to assess the asset managers in line with the Code, not placing undue emphasis on short-term performance.

Effective and appropriate stewardship activities by institutional investors ultimately aim at the enhancement of the medium- to long-term investment return for the clients and beneficiaries. Institutional investors and their clients and beneficiaries should both recognize that costs associated with stewardship activities are an indispensable element in asset management.

5. Parties such as proxy advisors and investment consultants for pensions which provide services at the request of institutional investors, etc. to contribute to the institutional investors’ effective execution of stewardship activities (hereafter “service providers for institutional investors”) are expected to play important roles in enhancing the functions of the entire investment chain running from their clients and beneficiaries to the investee companies. Principle 8 of the Code specifically applies to service providers for institutional investors.

² ~~In addition, the Code does not preclude a decision to sell a holding, where this is considered in the interest of clients and beneficiaries.~~

³ In order to facilitate constructive dialogue between institutional investors and investee companies, the Financial Services Agency published “Clarification of Legal Issues Related to the Development of the Japan’s Stewardship Code” to clarify legal issues related to the large shareholding reporting and the tender offer rules (TOB rules) in February 2014. <http://www.fsa.go.jp/en/refer/councils/stewardship/20140226.pdf>
<https://www.fsa.go.jp/en/refer/councils/stewardship/index.html> [to be updated]

⁴ Apart from the Code, the Asset Owner Principles (published on August 28, 2024) provide common principles that are considered useful for asset owners in fulfilling their responsibility (fiduciary duties) to manage their assets while taking into account the best interests of beneficiaries.

The other principles of the Code, including guidance, also apply to them as far as the principles do not conflict with Principle 8.

6. The Code primarily targets institutional investors investing in Japanese listed shares. The Code may also apply to other asset classes as far as it contributes to fulfilling “stewardship responsibilities” mentioned in the beginning of the Code.

“Principles-Based Approach” and “Comply or Explain”

7. The principles in the Code should be applied in a manner suited to the specific conditions and situations of each institutional investor (“institutional investor” here including any service providers for institutional investors, with this definition applying to the preamble hereafter). For example, the manner in which the Code is implemented may differ, depending on such factors as the investor’s size and investment policies (e.g., whether the policies are oriented toward long-term or short-term returns, or active or passive strategies).

8. To allow for such flexibility, the Code adopts a principles-based approach instead of a rule-based approach; a principles-based approach in this context expects institutional investors to fulfill their stewardship responsibilities focusing on substance, while a rule-based approach would prescribe actions to be taken by investors in detail.

The significance of a principles-based approach is as follows: even if principles may look abstract and broad on the surface, they can work effectively if relevant parties confirm and share the aim and spirit of the principles, and review their activities against the aim and spirit, not necessarily against the letter of the principles. In implementing the Code, institutional investors should respect such intent of the principles-based approach.

9. The Code is not a law or a legally binding regulation. ~~The Councils~~The Financial Services Agency expects that those institutional investors who support the Code and are prepared to accept it to publicly disclose their intention.

10. The Code adopts the “comply or explain” (comply with the principles or explain why they are not complied with) approach. If an institutional investor finds that some of the principles of the Code are not suitable for it, then by explaining a sufficient reason, the investor can choose not to comply with them. In other words, an institutional investor who made its intention to accept the Code public does not have to comply with all of the principles uniformly. Institutional investors, when they make the aforementioned explanation, should aim to articulate to clients and beneficiaries the approach they chose to adopt in lieu of the principles they have decided not to comply with.

Both institutional investors and clients and beneficiaries are encouraged to familiarize themselves with the “comply or explain” approach. In particular, due regard should be paid

to the specific situations of the institutional investors who made their intention to accept the Code public; it is not appropriate to focus on the letter of the Code and automatically consider that an investor who does not comply with a part of it is not fulfilling its stewardship responsibilities.

In order for institutional investors to earn sufficient understanding from their clients and beneficiaries, in the process of complying with the principles, it is considered beneficial for institutional investors to proactively explain their specific implementation activities.

11. To make institutional investors' acceptance of the Code transparent, ~~the Councils~~the Financial Services Agency expects institutional investors who accept the Code to:

- publicly disclose on their website:
 - their intention to accept the Code; and
 - disclosure items based on the principles, including guidance, of the Code as below:
 - (i) specific information that is required to be disclosed by the principles, including guidance, of the Code, such as the policy on how they fulfill the stewardship responsibilities; and
 - (ii) if they do not comply with some of the principles, including guidance⁵, an explanation of the reason;
- annually review and update the disclosed information and publicly disclose such update if it takes place; and
- notify the Financial Services Agency of the address of their website (the URL) used to disclose the information above.

~~The Councils also expect t~~The Financial Services Agency to will publish the information about the—_institutional investors who have made the disclosure in a tabular form.

~~4.12. The Councils expect that the Code~~The Financial Services Agency will continue to be improved the Code in response to the progress in the implementation of the Code by institutional investors (including progress in acceptance and disclosure of required information) and in light of global developments. ~~The Councils expect the Financial Services Agency to take appropriate steps so that the Code will be reviewed periodically, about once every three years.~~ Reviewing the Code ~~periodically~~ is supposed to enable institutional investors and their clients and beneficiaries to be better versed in the stewardship responsibilities, and help the Code to become more widely accepted in Japan.

~~12.~~

⁵ Guidance may not necessarily specify that certain actions should (or should not) be taken, and it is not necessarily required to explain the reason not to implement such guidance.

Principle 4

Institutional investors should seek to arrive at an understanding in common with investee companies and work to solve problems through constructive engagement with investee companies.

Guidance

- 4-1. Institutional investors should endeavor to arrive at an understanding in common^{13,14} with investee companies through constructive dialogue^{15,16,17} with the aim of enhancing the companies' medium- to long-term value and capital efficiency, and promoting their sustainable growth. In case a risk of possible loss in corporate value is identified through the monitoring of and dialogue with companies, institutional investors should endeavor to arrive at a more in-depth common understanding by requesting further explanation from the companies and to solve the problem¹⁸.
- 4-2. In order to engage in constructive dialogue with investee companies, institutional investors should, in response to requests from investee companies, explain the status of the shares they own/hold to investee companies and should disclose in advance their policies on how to respond to requests from investee companies.
- 4-3. When they engage in the issues of sustainability, institutional investors, should consciously engage in dialogue that is consistent with their investment management strategies and that leads to the medium- to long-term increase of corporate value and the sustainable growth of companies.
- 4-34. Because passive management provides limited options to sell investee companies' shares and needs to promote their medium- to long-term increase of corporate value, institutional investors should actively take charge of engagement and voting from a medium- to long-term perspective.

¹³ The effort to arrive at an understanding in common may result in an agreement to disagree, but may provide a better understanding on why they disagree.

¹⁴ In order to arrive at a common understanding with an investee company on priority issues of the management policy including governance structure (use of independent officers, etc.) and review of business portfolio, it is considered beneficial that institutional investors have dialogue with non-executive officers (independent outside directors and *kansayaku* (audit and supervisory board members), etc.) of the company.

¹⁵ When institutional investors have an engagement team dedicated to dialogue with investee companies, internal communication with other teams is important.

¹⁶ Constructive dialogue between institutional investors and investee companies should not be merely driven by the size of shareholdings. ~~That being said, there are cases when it is appropriate for institutional investors to explain to investee companies how many shares they own/hold.~~

¹⁷ Institutional investors should not fall into formalism, such as to regard having a dialogue itself as the aim.

¹⁸ Institutional investors may select investee companies with which they intend to engage with more in-depth dialogue in light of the outcome of previous dialogue.

- 4-45. Institutional investors should have a clear policy in advance on how they design dialogue with investee companies in various possible situations¹⁹.
- 4-56. In addition to institutional investors engaging with investee companies independently, ~~it would be beneficial for them to engage~~ with investee companies in collaboration with other institutional investors (collaborative engagement) ~~is also an important option as necessary~~²⁰. When considering methods for dialogue, it should be kept in mind whether they will lead to constructive dialogue that contributes to the sustainable growth of investee companies.
- 4-67. In principle, institutional investors can well have constructive dialogue with investee companies based on public information, without receiving information on undisclosed material facts. The “G20/OECD Principles of Corporate Governance” and the Tokyo Stock Exchange’s “Japan’s Corporate Governance Code” set the principle of the equitable treatment of shareholders, which applies to the handling of undisclosed material facts. Institutional investors that have dialogue with investee companies should be aware that the companies are expected to abide by the principle and should in essence be discreet in receiving information on undisclosed material facts²¹.

¹⁹ The policy can differ between, for example, asset managers and asset owners.

²⁰ The Financial Services Agency ~~published “Clarification of Legal Issues Related to the Development of the Japan’s Stewardship Code” in February 2014 and clarified its interpretation as to when of the scope of how~~ “joint holders” under the large shareholding reporting (and “a person in a special relationship” under the TOB rules) will be applied (see footnote 3). <http://www.fsa.go.jp/en/refer/councils/stewardship/20140226.pdf>
<https://www.fsa.go.jp/en/refer/councils/stewardship/index.html> [to be updated]

²¹ When an institutional investor needs to receive information on undisclosed material facts due to a special relationship with an investee company, it should first take necessary steps to secure compliance with insider trading regulations, such as the suspension of trade of the company’s stocks, before having a dialogue with the company.