

The First Council of Experts on the Stewardship Code

1. Date and Time: January 31, 2017 (Tuesday) 15:30-17:30
2. Venue: 13F, Central Government Building No. 7, Meeting Room No. 1

[Tahara, Director of the Corporate Accounting and Disclosure Division, FSA] As it's already the scheduled opening time, let me start.

Please note that camera crews are here only for the opening part of the Council today.

Now I'm handing it over to Mr. Chairman.

[Kansaku, Chairman] Now I'd like to open the meeting of the Council of Experts on the Stewardship Code. Thank you very much for taking time out of your busy schedule.

I'm Kansaku from the University of Tokyo, and Chairman of this Council. It is my pleasure to be working with you.

First of all, Mr. Ikeda, Director-General of the Planning and Coordination Bureau, the Financial Services Agency will make opening remarks.

Mr. Ikeda, I'm handing it over to you.

[Ikeda, Director-General of the Planning and Coordination Bureau] I'm Ikeda, Director-General of the Planning and Coordination Bureau, the Financial Services Agency. It is my pleasure to deliver the opening remarks, representing the secretariat.

As you know, the Stewardship Code was established in 2014, and the Corporate Governance Code was established in the following year 2015, as a part of the Government's growth strategy. Under these two Codes, we have seen a certain progress in companies' governance reforms, and it is received that dialogues between institutional investors and companies have been increasing.

On the other hand, it is pointed out that some companies still provide superficial responses to the Codes. Every institutional investor has their own approach to dialogue or the effectiveness of dialogue. It is also pointed out that asset managers' measures for managing conflicts of interest are not always appropriate.

Under such circumstances, the Council of Experts Concerning the Follow-up of Japan's Stewardship Code and Japan's Corporate Governance Code, which was established under the

Financial Services Agency, published an Opinion Statement titled “Effective Stewardship Activities of Institutional Investors” last November. The Statement recommends the revision of the Stewardship Code, stating that, in order to deepen corporate governance reform and move its focus from ‘Form’ to ‘Substance’, it is beneficial, for example, to increase the effectiveness of institutional investors’ engagement in listed companies.

We convene this Council of Experts in response to this recommendation. We’d like to request the members to have active discussion toward the effective revision of the Stewardship Code. We appreciate your participation in this deliberation process, taking time out of your busy schedule.

That’s all from me. Thank you very much.

[Kansaku, Chairman] Thank you very much.

Next, I’d like to ask a representative of the secretariat to introduce the members, and explain the draft operating guidelines of this Council.

[Tahara, Director of the Corporate Accounting and Disclosure Division, FSA] I’m Tahara, Director of the Corporate Accounting and Disclosure Division of the Financial Services Agency, and assuming the responsibilities as the secretariat. Thank you for your participation.

First, I’d like to introduce the members of the Council in the order of the seating chart, starting from the right hand side. Dr. Ryoko Ueda.

[Ueda, member] Good afternoon, I’m Ueda. It’s my pleasure to be working with you.

[Tahara] Mr. Toshiro Ueyanagi.

[Ueyanagi, member] It’s my pleasure to be working with you.

[Tahara] Mr. Akiyoshi Oba.

[Oba, member] It’s my pleasure to be working with you.

[Tahara] Mr. Toshiaki Oguchi.

[Oguchi, member] It’s my pleasure to be working with you.

[Tahara] Mr. Takahito Kato.

[Kato, member] It’s my pleasure to be working with you.

[Tahara] Mr. Junichi Kawada.

[Kawada, member] It’s my pleasure to be working with you.

[Tahara] Ms. Kerrie Waring.

[Waring, member] It's my pleasure to be working with you.

[Tahara] Ms. Chiho Shimada.

[Shimada, member] It's my pleasure to be working with you.

[Tahara] Mr. Hiroshi Shimizu.

[Shimizu, member] I'm honored to be here.

[Tahara] Mr. Scott Callon.

[Callon, member] It's my pleasure to be working with you.

[Tahara] Ms. Yoshiko Takayama.

[Takayama, member] It's my pleasure to be working with you.

[Tahara] Mr. Masaaki Tanaka.

[M. Tanaka, member] It's my pleasure to be working with you.

[Tahara] Mr. Wataru Tanaka.

[W. Tanaka, member] It's my pleasure to be working with you.

[Tahara] Mr. Iwao Nagashima.

[Nagashima, member] It's my pleasure to be working with you.

[Tahara] Mr. Daisuke Hamaguchi.

[Hamaguchi, member] It's my pleasure to be working with you.

[Tahara] Mr. Sadayuki Horie.

[Horie, member] It's my pleasure to be working with you.

[Tahara] Mr. Akitoshi Masuda.

[Masuda, member] It's my pleasure to be working with you.

[Tahara] Mr. Toshinao Matsushima.

[Matsushima, member] It's my pleasure to be working with you.

[Tahara] As shown in the member list in Material 1, Mr. Hideaki Tsukuda, and Mr. Kazuhiko Toyama will also participate in this Council as members, although they are absent today.

Next, I'd like to introduce the observers. Mr. Ao, Executive Officer of the Tokyo Stock Exchange, Inc.

[Ao, observer] I'm Ao. I'm honored to be here.

[Tahara] Ms. Aoyama, Director, Private Pension Division, Pension Bureau of the Ministry

of Health, Labour and Welfare.

[Aoyama, observer] I'm Aoyama. I'm honored to be here.

[Tahara] We invited two more observers to this Council: Mr. Fukumoto, Director, Industrial Finance Division of the Ministry of Economy, Trade and Industry, who will be here later; and Mr. Takebayashi, Counsellor, Civil Affairs Bureau of the Ministry of Justice, who is absent today.

The Financial Services Agency serves as the secretariat of the Council. Due to the time constraint, I won't introduce the secretariat members. Please refer to the seating chart for their information.

Now I'm moving on to the operating guidelines. Please take a look at Material 2. We'd like to propose that this Council should be operated in accordance with the draft guidelines in Material 2.

I'll turn it over to Mr. Chairman.

[Kansaku, Chairman] Thank you very much.

Is it all right to proceed in this way?

(Members voiced, "No objection.")

[Kansaku, Chairman] Thank you. I will proceed in accordance with the guidelines.

Now I'd like to proceed with the agenda. As written in Material 1, we hold the meetings of this Council of Experts with the aim of revising the Stewardship Code. The Council of Experts Concerning the Follow-up of Japan's Stewardship Code and Japan's Corporate Governance Code, for which the Financial Services Agency and the Tokyo Stock Exchange served as the co-secretariat, published the Opinion Statement for the Stewardship Code last November, recommending a revision of the Code taking the Opinion Statement into consideration.

Prior to kicking off this Council toward the revision of the Code, I'd like to ask the secretariat to explain the current status of the Stewardship Code, as well as the Opinion Statement of the Follow-up Council. I'd like to hand it over to the secretariat.

[Tahara, Director of the Corporate Accounting and Disclosure Division, FSA] I'll briefly explain the current status of the Stewardship Code, and the Opinion Statement of the Follow-up Council, in accordance with Material 3.

The first part is titled "Status of the Stewardship Code". After explaining this part, I'd like

to explain what is written in the Opinion Statement.

Please turn to page 3, with the heading of “I-1 Status of the amount of funds for domestic stock investment by institutional investors”. This page shows the overview of institutional investors’ investments in domestic shares. We prepared this material based on available statistical data, so these figures may not always be consistent. Please note that the data is just for capturing the entire picture.

Please take a look at the right-hand side first. The total market value of listed shares in Japan recorded approx. 520 trillion yen as of March 31, 2016. Out of the total, the value of shares held by investment trusts, investment managers and trust banks, etc. was 90 trillion yen, with the following breakdown: publicly offered investment trusts for 25 trillion yen, and investment managers for 50 trillion yen. Furthermore, roughly life insurance companies held shares with the value of approx. 20 trillion yen, and non-life insurance companies held shares with the value of approx. 7 trillion yen. These actors accounted for a significant percentage of shareholdings.

Following that, as a trend in the last one or two decades, the percentage of foreign corporations’ shareholdings has been drastically increasing. Foreign corporations, including business corporations, held 150 trillion yen. The number of foreign institutional investors, whose shareholdings in Japanese companies exceed 5 trillion yen, has been increasing, as shown below.

Asset owners are positioned behind these investors, being closer to ultimate beneficiaries. Public pension funds and corporate pension funds invest in shares for approx. 50 trillion yen.

Please turn to page 4. The number of institutional investors, which have signed up to the Stewardship Code, has increased to 214 during the last 3 years, showing a steady growth.

The breakdown of such institutional investors is shown on the next page [p.5]. Their attributes are shown on the left-hand side. We classified them into 5 categories, from investment managers to others. We consider that the composition ratio is almost proportional to the values of their shareholdings which I mentioned earlier. The percentages of Japanese and foreign institutional investors seem to be close to the percentages of their shareholdings.

On the next page [p.6], we summarized the status of their compliance with each Principle of the Stewardship Code. Actually, asset managers and asset owners do not always state

whether they complied with these Principles or chose to explain. So we reviewed their reports: when we found they clearly chose to explain reasons for non-compliance, we classified such cases as “Explain”, shown in yellow in the bar chart. Judgement on whether or not they complied is up to each institutional investor which signed up to the Code. Whether their compliance is substantive or superficial would be a point at issue, so we included this data in the material.

Now I’d like to move on to the Opinion Statement. Please turn to page 8. It shows an overview of the Follow-up Council. I believe all of you know it, so I won’t explain it here.

Please turn to page 9. We summarized key points drawn from “Effective Stewardship Activities of Institutional Investors” published by the Follow-up Council on November 30, 2016. We also distributed the entire text of the Opinion Statement today. Although the implementation of the Stewardship Code and the Corporate Governance Code set a necessary framework for the corporate governance reform, as Director-General explained earlier, it is pointed out that their acceptance of the Codes tends to be superficial, and thus it is necessary to deepen the reform, moving its focus from ‘Form’ to ‘Substance’. We consider that, by doing so, it is important to ensure that the investment chain, the flow of which is shown in a clockwise fashion, works properly so that it leads to a virtuous cycle of the economy. Institutional investors’ roles are extremely important in that context. The Follow-up Council, therefore, had extensive discussion, and made recommendations shown in 2 word balloons in the center of this page.

Starting from page 10, I’ll explain 5 categories of recommendations in the Opinion Statement of the Follow-up Council and related Principles of the Stewardship Code.

The first category is effective oversight by asset owners. Concerning what roles asset owners should play, the Follow-up Council raised 3 points. The first point is that asset owners should conduct their own stewardship activities to the greatest extent possible; and in case they don’t do so, they should require asset managers to carry out effective stewardship activities. The second point is that when selecting or issuing mandates to asset managers, asset owners should clearly specify issues and principles which they expect from asset managers with regard to stewardship activities, including proxy voting, in order to ensure effective stewardship activities. The third point is that asset owners should effectively monitor asset managers to

ensure that their stewardship activities are aligned with policies of the asset owners, making use of the asset managers' self-evaluations, etc.

You are expected to discuss the revision of the Principles and Guidance of the Stewardship Code. We consider that this issue is most relevant to Principle 1 and related Guidance, which require institutional investors to have a clear policy on how they fulfill their stewardship responsibilities.

Please turn to the next page. Let me explain the format of this material, which is common to all issues raised. The Follow-up Council received public comments for their discussion. Such comments were already introduced at the Follow-up Council, but I'd like to share such comments here as well.

As described in the column titled "Points", foreign institutional investors made the following comments: asset owners have responsibilities to monitor stewardship activities of asset managers; asset owners should include provisions on stewardship activities in contracts with asset managers, and provide clear instructions regarding their engagement policy and regularly follow up on results.

Page 12 summarizes the second category of recommendations – effective stewardship activities of asset managers, governance of asset managers, and management of conflicts of interest. Concerning effective stewardship activities of asset managers, it is pointed out that institutional investors, especially asset managers, should conduct effective stewardship activities based on in-depth corporate valuations and taking a mid- to long-term perspective. In doing so, it is important for them to make careful judgments by taking note of the particular circumstances of individual companies, rather than mechanically applying formal criteria or depending on proxy advisors.

Concerning enhancement of asset managers' governance and management of conflicts of interest, the Follow-up Council suggested that in order to secure the interests of ultimate beneficiaries and prevent conflicts of interest, asset managers should have in place such governance structures as independent boards and/or third-party committees for making proxy voting decisions and carrying out oversight; and asset managers should identify specific circumstances that may give rise to conflicts of interest, and set out and disclose specific policies on how they can avoid such conflicts of interest.

The next recommendations are from the perspective of capabilities and experience of asset manager's senior management team. It is suggested that an asset manager's senior management team should have adequate capabilities and experience to effectively fulfill stewardship responsibilities, and the team composition should not be based on something like the internal logic of the financial group, to which the asset manager belongs. It is pointed out that senior management should recognize that they are responsible for enhancing the asset manager's governance and managing conflicts of interest, and promote measures to address such issues.

In terms of relevant principles of the Stewardship Code, we consider that these recommendations are related to Principle 2 concerning a policy for managing conflicts of interest, as well as Principle 5 concerning a clear policy on proxy voting decisions and disclosure of voting results.

The chart on page 13 shows the situation of whether asset managers have disclosed their policies for managing conflicts of interest in accordance with the current Code. The point here is that the percentage of asset managers which referred to proxy voting is just slightly over a half, which implies that their policies are not yet specific enough – that remains an issue. Furthermore, even though they referred to proxy voting, we got an impression that only few asset managers went into detail on how they should address each specific situation.

Page 14 shows possible circumstances that may give rise to conflicts of interest. These were shared and discussed by the Follow-up Council, as well as the Working Group on Financial Markets of the Financial System Council. The case on the left is a possible conflict of interest within a financial group, and the case on the right is a possible conflict of interest between corporate business department and asset management department in the same entity. I'd like you to take a glance.

Page 15 summarizes comments from foreign institutional investors. They expressed their opinions that solid governance structure and management of conflicts of interest are essential for effective stewardship activities, and that asset managers should establish clear proxy voting standards, or independent committees for making proxy voting decisions. These comments were shared at the Follow-up Council.

Now I'm moving on to the third issue on page 16. The third issue is about engagement of

passive managers. Passive management provides limited choice in terms of selling shares of investee companies, so passive managers should conduct engagement activities more proactively and exercise their voting rights [from the mid- to long-term perspective]. We assume that these recommendations are relevant to Principle 4 of the Stewardship Code, which require institutional investors to work to solve problems through constructive engagement or purposeful dialogue with investee companies.

Please turn to the next page. These are related comments from foreign institutional investors. They point out that Japanese passive funds may not have been active in engagement.

Page 18 shows the fourth issue – enhanced disclosure of voting results. In order to secure interests of ultimate beneficiaries and to prevent conflicts of interest, it is recommended that asset managers and the like should make it a principle to disclose company/proposal-level voting results to the public, not merely to asset owners, at a minimum based on a “Comply or Explain” approach. If it is not appropriate to make such disclosures based upon specific circumstances of certain institutional investors, they should actively explain the reasons why.

These are relevant to Principle 5 and Guidance 5-3 of the Stewardship Code, which stipulate disclosure of voting results. We assume we need to review this Principle and Guidance.

Please take a look at page 19. While 214 institutional investors have signed up to the Stewardship Code so far, we investigated the disclosure status of their proxy voting results. As for company-level voting disclosures, only 9% of 152 investment managers and 8% of 26 pension funds have made such disclosures. Almost all of them are foreign institutional investors. The light green parts represent investors which disclose aggregate voting results by major categories of proposals - for example, election of directors. The yellow parts represent investors which disclose aggregate voting results by separating company’s proposals and shareholder’s proposals. The orange parts represent investors which chose to explain, and the red parts represent investors which neither disclosed nor explained. The status of compliance or disclosures still varies significantly. We consider that it is a challenge to increase the transparency.

Concerning this issue, as shown on page 20, we received public comments from foreign institutional investors. They point out that it is required to secure the transparency for fulfilling

fiduciary duties, and disclosures of aggregated voting results are not sufficient in order to prevent conflicts of interest.

Page 21 summarizes the fifth issue – self-evaluation of asset managers. It was pointed out that asset managers should conduct regular self-evaluations of their implementation of the Stewardship Code, including items which I have mentioned, and disclose the results to the public. As mentioned at the beginning, such self-evaluations may help asset owners select and evaluate asset managers.

We assume that this recommendation is relevant to Principle 7 of the Stewardship Code, which stipulates that institutional investors should have necessary knowledge, skills and resources.

That's all from me about the status of the Stewardship Code, and the Opinion Statement of the Follow-up Council. Thank you very much.

[Kansaku, Chairman] Thank you very much.

Now we will be hearing the presentation by Ms. Kerrie Waring from ICGN, an international organization of institutional investors.

With regard to the Stewardship Code, at the 2016 ICGN Annual General Meeting, the members ratified the ICGN Global Stewardship Principles, which articulated ICGN's views on best practices of investors' policies on stewardship activities, etc. The ICGN's Principles were introduced at the Follow-up Council, and were referred to during the preparation of the Opinion Statement. Today, in order to have deeper understanding of the Opinion Statement of the Follow-up Council, we'd like Ms. Waring to make a presentation on the ICGN's Principles as well as global trends.

Ms. Waring will make a presentation in English, and consecutive interpretation service will be provided.

Now I'd like to hand it over to Ms. Waring.

[Waring, member] Thank you, Chairman, and let me say from the outset congratulations to this council and the Financial Services Agency for such excellent work in driving so many amazing positive reforms in Japan in such a short time. I would also like to acknowledge from the outset that there are many ICGN members in the room. We have a former ICGN board

member, Takayama-san, and a member Ueda-san over here and a current board member Iguchi-san behind me.

So thank you again for the opportunity to present to you today and my remarks will draw on ICGN principles, latest developments taking place in Europe and anecdotal evidence from ICGN members. I will focus on the four areas that Tahara-san has suggested is of interest to you, that is the governance of investors, vote disclosure, company engagement and the role of asset owners.

By way of background, the ICGN was established over 20 years ago in response to the globalization of capital. Investors wanted to understand more about the corporate governance practices in the countries where they were sending their money to, so they created the ICGN to provide a network to promote best practices. Today our members are based in 47 countries and our investor members represent assets under management in excess of \$26 trillion. So we have a substantial voice and engaging in the world on policy matters. Our membership is open to anyone with an interest in corporate governance particularly companies. For example, some of our company members include BP, Pfizer, Coca-Cola and more recently Eisai from Japan. We believe that both companies and investors alike have a mutual responsibility to protect and enhance company value for the benefit of its members and society as a whole.

Please refer to slide number 1, 'The Governance of Investors'. This is a very topical issue in the UK right now. Our new Prime Minister, Theresa May, has initiated a review of the UK corporate governance system. In part this was in response to a recent high profile company collapse, BHS, a private company, but there is also a growing sense of wealth inequality in the UK with public dissatisfaction around levels of executive pay in comparison with ordinary people.

I gave evidence to UK parliament late last year and I was called to talk about ICGN's perception on the role of corporate directors and how they are effectively fulfilling the director's duties to promote the success of the company, for the benefits of members, i.e., shareholders whilst having regard to a whole host of other stakeholders.

However when I arrived, the questions were not about board directors. They were about the degree to which investors are effectively holding the board directors to account. The focus very

much was on the governance of investment institutions and whether or not they are properly equipped to fulfill the stewardship obligations.

This is not just an issue in the UK. The revised European Shareholder Rights Directive will be signed in March and must be enacted within 2 years. It will require asset owners to mandatorily report publicly on how their investment strategy contributes to the long-term performance of their assets and requires asset managers to report to their clients on the same.

This is why stewardship codes are so vitally important because they provide us with a framework for investors to understand how to conduct stewardship effectively.

This is also why the ICGN global stewardship principles begin from the perspective that investors must have the right internal governance arrangements in place from the outset in order to be truly effective stewards. In this regard I would like to draw your attention to slide one and in particular to the topics of independent oversight, capacity and conflicts of interest.

So slide 1.1 is the ICGN position on independent oversight.

In particular, we believe that the governance body should act independently and without bias. In particular, we urge against government representatives or employers dominating decision-making. We want to avoid investment strategies being developed that might favor public policy objectives over and above the interests of beneficiaries.

We also believe that the governance body should be subject to regular self-evaluation but also periodic external evaluations perhaps every 3 years. There should also be a clearly disclosed appointment process and criteria.

Slide 1.2 refers to the importance of investors having the appropriate capacity and experience to conduct stewardship, particularly in terms of investing company, monitoring voting and engagement. This includes training and fund manager coordination and integration.

For example, for many ICGN members, the voting responsibility sits within the governance team who has regular dialogue with fund managers. This often starts at the analysis stage so that any governance deficiencies, risks or opportunities can be mutually identified and prioritized as part of an ongoing engagement strategy.

But resourcing stewardship efficiently can be challenging particularly given the large number of companies in investment portfolios. Many ICGN members have significantly

increased their stewardship resources over the last few years particularly over the last 6 months, you will see Vanguard, BlackRock, State Street in the news this week.

Slide 1.2 gives you an anecdotal sound bite from Mike McCauley, from the US-based Florida State Board of Administration. Now, this is a fund with 10,000 companies in their equity portfolio and it has around \$190 billion worth of assets under management and you can see in Mike's company, his screening process is by ranking global markets by the SBA size of investment, individual company performance and also by governance factors.

I refer you to slide 1.2 because another way to deal with limited resources is for investors to collaborate. This is a common recommendation in stewardship codes around the world and the lack of reference in the Japan code is a concern for global investors.

They are keen to understand that as long as they do not collude to vote in the same way on items related to the control and direction of the company such as board elections, their collective engagement efforts will not breach rules regarding collective holding thresholds above which they would be obliged to report to the FSA.

It might therefore be useful for you to look at the guidance from the European Securities Markets Association or the UK Financial Conduct Authority, it was then the FSA, and I provide annexes in the slide deck. The ICGN's position on collaboration stresses the importance of leveraging the voice of minority investors to exert influence where required with investee companies.

Please refer to slide 1.3 where we talk about conflicts of interest. ICGN's guidance called for investors to have robust policies to minimize or avoid conflicts of interest. Investors should review their investment activities and client interest to identify and manage real or potential conflicts and such conflicts should be disclosed along with the remedies to mitigate them.

The UK Financial Reporting Council which is the body responsible for overseeing the UK stewardship code have identified that more work in the UK is needed around the disclosure of conflicts of interest.

I would like to give you some examples of what we might consider to be good practice and what we might consider to be not so good practice.

Please refer to slide 1.3A regarding Legal and General Investment Management (LGIM) which is one of the most active funds in the UK. What is interesting here is they provide a lot

of detail around where conflicts of interest possibly arise. LGIM categorize their conflicts into three ways; conflicts with clients, conflicts with the parent or group or conflicts internally say between the portfolio manager and the CG team. So I think it's helpful to think of conflicts in those three ways but every fund is different, so I think it's also important that every conflict disclosure is unique to that fund.

And then the next slide shows you how they mitigate such conflicts. So the team is structured and supported to minimize conflicts, activities are monitored and supported by two nonexecutive directors who sit on a corporate governance committee and meet quarterly. They treat confidential material appropriately, they train staff, there is a conflicts register and so on.

In contrast the following slide shows a conflicts of interest statement which is clearly too short and does not really explain how they deal with conflicts of interest.

I would now like to refer to vote disclosure and I have been asked to think about the ICGN's position around whether it is by aggregate or by individual company. ICGN supports the disclosure of actual voting records and that is to say voting results at a company level as well as by aggregate. We believe that more company specific disclosure helps to ensure transparency and avoid conflicts of interest and our position is written in 2.1.

By way of example, we can look at the voting decisions by BMO Asset Management in relation to the Schroder AGM last year on slide 2.2. This was quite a contentious AGM on a number of issues.

Firstly, there is a vote against the remuneration because of the quantum of annual bonus awards made during the year. Secondly, there is a vote against Michael Dobson, who was the retiring CEO, who succeeded to chairman which is a big corporate governance no-no, and thirdly, not a vote against but you can see the system allows for a note. Thirdly, there are recommendations that the reappointment of PWC as the auditor be considered due to tenure limits and therefore also a note about their remuneration.

I would now like to move to the subject of passive funds and company engagement and refer you to slide 3.1. Firstly, I should say that I do not think reference to longtime capital as passive is particularly helpful. It can have a negative connotation and infer that such funds are not engaging with companies. While not all index funds are active, some of our most engaged

members like Legal and General, BlackRock and State Street are some of the most serious stewardship advocates because they cannot divest.

And we can think of engagement in two ways. There is usually a proactive approach and a reactive approach. In a proactive approach many investors have a formal planning process using sophisticated spreadsheets that show the size of holdings, geography, investment rankings and any voting concerns as shown in the note from Florida SBA

There is more of a challenge in a reactive situation. For example, if there is a sudden change in the company, if the chairman resigns, the company makes a big acquisition which seems a bit out of line with its strategy, there is an accounting problem and so on, investors need to grapple very quickly with the problem and engage with the company to try and understand what is going on.

In the UK, we have established what we call the Investor Forum which really helps address dealing with reactive situations. It enables a collaborative group of investors to come together under one forum which welcomes both local and global investors to engage with companies and it may be advantageous for there to be such a network here in Japan.

I would like to ask you to look at slide 4.1 regarding the role of asset owners.

Asset owners cannot delegate their fiduciary duty to protect and generate value on behalf of beneficiaries. I have also added in a quote on fiduciary duties from the 2012 Kay report which I think is quite nice because it refers to the importance of conflicts of interest too.

So, slide 4.2, once you recognize your fiduciary duties, we believe strongly that asset owners should clearly incorporate their expectations regarding the stewardship practices in the awarding of investment management agreements and in selecting asset managers.

Please look at 4.2A. One of the most popular pieces of ICGN guidance is called the Model Mandate and it sets out contractual terms between asset owners and managers. It is really important in aligning asset owner investment strategies with the profile and duration of beneficiary liabilities, particularly long-term liabilities.

So we suggest that asset owners consider a whole range of subjects including risk management, how to integrate environmental, social and governance factors, adherence to the highest standards of stewardship and so on.

Finally, slide 4.3, we believe it is crucial to have proper accountability and oversight. Many asset owners include stewardship as a selection criteria but probably could do a little bit more in terms of monitoring and overseeing asset manager performance. We must recognize however the resource implications that this has.

Regular review of stewardship code reporting here in Japan might be helpful in ensuring the quality, not only of signatory reporting, but of stewardship activities undertaken.

This was recently undertaken by the UK FRC who reviewed the quality of signatory disclosures. They have put in place a Tier system to help raise the ball in terms of disclosures. And on that point, I will conclude my remarks but happy to take questions.

[Kansaku, Chairman] Thank you very much, Ms. Waring.

Now I'd like to open the discussion. Please express your opinions about the explanation by the secretariat and the presentation by Ms. Waring.

Today is the first meeting of the Council, so I'd like to hear your thoughts about how to proceed with this Council as well.

If you have questions to Ms. Waring, you may ask questions either in Japanese or English. Questions in Japanese will be interpreted into English. If you ask questions in English, please note that there will be consecutive interpretation into Japanese so that questions and answers are shared by the entire audience. Please understand this procedure.

Who would like to start?

Mr. Ueyanagi, please go ahead.

[Ueyanagi, member] Thank you very much. I'll ask a question in Japanese.

It is very important to disclose proxy voting results to the public. I heard that in the UK or in the world, some argue that it is sufficient to disclose voting results at the company level only to their clients, not to the public, or that disclosures to clients should be given priority. How common are such opinions? What do you think about such opinions, Ms. Waring?

[Waring, member] So in the UK, almost all investors disclose at company level. In fact, right now there is a consultation by the government considering to make it mandatory by law. ICGN does not think it needs to be mandatory because the market already does it. The European Shareholder Rights Directive will also require disclosure of voting. So it is very common. It is not controversial at all.

[Kansaku, Chairman] Mr. Ueyanagi.

[Ueyanagi, member] My questions may not have been clear enough. I wanted to ask about discrimination between disclosure to the public and disclosure to their own clients. Are there arguments that either of the two should be sufficient, or either of the two should be given priority?

[Waring, member] Reporting to the client is a given and must be done and reporting to the market has also become very customary and not controversial. The only problem is nobody really looks at it, is a problem, but because in the UK everybody is mad about CEO pay and investors maybe will be having annual vote on pay, then we will see people looking at vote disclosure may be more, but I think in the UK we will be strengthening the stewardship code and we will be recommending the stewardship code is strengthened.

[Kansaku, Chairman] Anybody else? Mr. Hamaguchi, please.

[Hamaguchi, member] I did not attend the Follow-up Council, so I'd like to express my view on the Opinion Statement overall, including the point just raised. I prepared a presentation material, and would like to talk in accordance with that.

I agree with many parts of the Opinion Statement, but would like to share my opinions on certain points. Since it was just mentioned, first I'd like to talk about disclosure of proxy voting results on page 3 – the page number is written in the upper right corner.

Disclosure to clients should be a matter of course. The Pension Fund Association, for which I work, is reported to by all of its asset managers and we naturally respond to inquiries from investee companies. However, I disagree with company-level disclosures to the public at this stage. To put the conclusion first, I consider that it is still too early to go for such disclosures, and they may not necessarily lead to constructive dialogue between investors and companies.

I'm telling you the reasons. As you know, dates of annual general shareholders meetings are still concentrated in a certain period, and that causes a situation where – I venture to say – we, institutional investors, have no choice but to mechanically exercise voting rights, while sacrificing the appropriateness of voting right exercise to a certain degree. It would be necessary to take into account such a situation at the practical level.

Furthermore, while the number of voting rights of cross-shareholders is 2 to 3 times more

than that of ordinary institutional investors, as I'll show you the actual figures later, such cross-shareholders do not disclose their voting results, thus lacking transparency. Therefore, it may not make much sense to require only ordinary institutional investors to make costly excessive disclosure and question their appropriateness.

Finally, for investors, exercising influence through proxy voting should be the last measure to be taken. Before that, they should solve problems through constructive dialogue with companies. That's how it should be. We should thoroughly consider whether there might be a concern that placing an extra emphasis on proxy voting by requiring company-level disclosures to the public may encourage responses for form's sake, thus only deteriorating the quality of stewardship activities.

Now I'm moving on to other points. Please turn back to page 2. As Ms. Waring mentioned, it is necessary to consider collective engagement at this opportunity of reviewing the Code, although the Follow-up Council may not have discussed it. Let me explain.

In the first place, the practice where many investors individually have dialogue with a company is not efficient for the company as well. Especially in case of passive portfolio which invests in a large number of companies, it is reasonable for institutional investors to collectively work on dialogue. As I mentioned earlier, the percentage of cross-shareholders is large in Japan, so in order to secure the influence of institutional investors as well, it is necessary to establish a framework of collective engagement. It has a role to complement or reinforce individual engagement activities of institutional investors, and it is indispensable to increase the effectiveness of their stewardship activities. Therefore, as Ms. Waring mentioned earlier, collective engagement is widely adopted globally.

I'd like to emphasize again that the UK's Stewardship Code, the ICGN Global Stewardship Principles which were introduced earlier, the UN Principles for Responsible Investment, and most of other related codes clearly stipulate that "investors should engage with companies collectively" as one of key principles of action. Therefore, in reviewing the Code, I do believe it is essential to incorporate a similar principle in Japan's Stewardship Code.

Even if collective engagement is not incorporated this time for certain reasons, taking into account that foreign asset managers have already had collective dialogue in Japan and the Financial Services Agency has no objection to such collective dialogue in my understanding,

as Ms. Waring suggested, I will have a talk about whether Japanese institutional investors can make similar effort in the future.

Please turn to page 4. As the Opinion Statement refers to corporate pension funds, I'd like to briefly explain the current situation.

As explained earlier, the number of corporate pension funds in Japan is very large. Although the number is large, most of such funds are small-sized and have only limited resources. So proper monitoring and overseeing asset managers' activities will pose a heavy burden on them, and the administrative cost will significantly increase.

Under such a circumstance, if you ask wide-ranged corporate pension funds to sign up to the Code, I'm afraid that their acceptance of the Code may be just for form's sake. Therefore, a realistic scenario would be to encourage certain sized corporate pension funds, which have the necessary organizational structure and human resources, and are prepared to bear the cost, at the beginning. So the Pension Fund Association and the Ministry of Health, Labour and Welfare are now creating an environment to facilitate corporate pension funds to sign up to the Code, by holding study sessions and seminars.

Please turn to page 5. This is not directly related to the Stewardship Code, but I believe this is extremely important in terms of its effectiveness, so I added the data at the end.

As I referred to several times, in Japan's stock market, cross-shareholders account for a large percentage of shareholders as shown on the last page, and influence of ordinary institutional investors is limited. Thus, I think Japan does not necessarily have in place an environment where stewardship activities work effectively. In order to increase the effectiveness of the Code, it is necessary to significantly reduce cross-shareholdings. As for policy efforts including the revision of the Corporate Governance Code, the government needs to address this issue even more actively in the future.

Please refer to the last page. This chart shows estimate percentages of cross-shareholders. Dr. Ueda from the Japan Investor Relations and Investor Support, who is also a member of this Council, estimated these figures based on publicly available data including securities report, and this data is consistent with the data of TSE and the Bank of Japan. I'll skip a detailed explanation due to the time constraint. Among companies listed on the TSE's First Section, on average, cross-shareholders account for at least 35%. Since this is an average ratio, it is

expected that a half of the companies have a larger percentage of cross-shareholders, implying that cross-shareholders still virtually control a significant number of voting rights. Unlike pure investments by institutional investors including us, cross-shareholders hold shares for the purpose of maintaining or enhancing various business relationships. I heard that recently, an increasing number of issuing companies request counterparties to hold their shares as a condition for continuing business transactions. It means that the issuing companies themselves can control voting rights, and thus pose a problem which affects the basis of the stock market functions. On the other hand, each company faces intense competition for transactions, and it is difficult to solve such a problem through individual dialogue as a part of our stewardship activities. Accordingly, I believe that the government's policy response is needed, as shown in examples of other countries.

That's all.

[Kansaku, Chairman] Thank you very much. Does anybody else want to share their opinions?

Mr. Oguchi, please.

[Oguchi, member] Thank you. As I participated in the Follow-up Council as well, I'd like to express my view on company-level disclosure of voting results, which we are discussing today, as well as what was discussed in the Follow-up Council. Material 3 summarized opinions shared at the Follow-up Council. As shown on page 20 – in the second bullet point from the bottom, the comment from a North American fund, in some ways, represents the entire picture. As described there, securing transparency is the best solution for addressing concerns about conflicts of interest; accordingly, voting disclosure needs to be as transparent as possible and aggregated disclosure is insufficient. In essence, the issue of voting disclosure is inextricably linked to the issue of conflicts of interest, and these two issues should be discussed together.

As explained earlier, page 12 also refers to both Principle 2 and Principle 5. I feel it is symbolic that proxy voting and conflicts of interest are discussed on the same page. Under the assumption that outsiders have a doubt that there may be any conflicts of interest, but that they cannot judge it from the outside, in order to dispel such a doubt, transparency is required. To that end, company-level disclosure of voting results is a powerful tool, and it is empirically proven in other countries that such disclosure provides physical evidence in a certain sense.

Kerrie earlier mentioned that there is no need to make company-level disclosure mandatory by law in the world, because the market already does it. In my understanding, it demonstrates the fact that company-level disclosure of voting results is deemed to be the best or one of the best solutions, or at least a valid way for addressing conflicts of interest.

Our organization provides services to a UK pension fund client in the network, which Kerrie belongs to. That pension fund has disclosed its voting results at the company level for many years. I suppose that the fund is included in those pension funds, which have disclosed voting results at the company/proposal level, on page 19. Frankly speaking, we have never seen any situation where its company-level disclosure got in the way of dialogue in the last 10 years. Some argue that company-level disclosure would impede dialogue, or they should not disclose at the company level in order to facilitate dialogue. Speaking from our experience, if investors say these two are in a trade-off relation, it will be interpreted that voting exercise is an exchange for dialogue. If they would like to prove that there is no conflict of interest and dispel concerns, the principle of company-level disclosure of voting results should be a good opportunity to do so. For investors which would like to thoroughly consider conflicts of interest as stipulated in Principle 2, this will be a good opportunity to face proxy voting squarely. And I believe that company-level disclosure should be a natural consequence.

In the Follow-up Council, there was an argument that it may be too early to go for it. However, those who participated in the Council of Experts concerning the Corporate Governance Code remember that almost all matters stipulated in the Corporate Governance Code had been initially considered to be too early to implement. I believe that we could overcome the situation owing to the 'Comply or Explain' principle. If companies consider that it is better to choose Explain instead of Comply, they should explain. Such an approach contributed to overcoming the challenge and achieving progress. Similarly, concerning the Stewardship Code, that institutional investors should also take a step forward under the 'Comply or Explain' approach.

Now I'd like to talk about collective engagement, which Kerrie mentioned earlier and another member just referred to. Kerrie mentioned that the Stewardship Code does not refer to collective engagement. Actually, in response to a public comment from a foreign investor at the time of developing the Stewardship Code, the Council replied that even though the Code

does not include a principle concerning collective engagement, Guidance 7-3 stipulates that exchanging views with other investors and having a forum for the purpose may help institutional investors conduct better engagement with investee companies. Certainly, the Code does not recommend collective engagement, but does not preclude a possibility of collective engagement, either. Therefore, if there is a misunderstanding among foreign investors that collective engagement is hampered in Japan, it will be better to add a similar explanation to the response to the public comment, which I just mentioned.

Beyond that, whether or not to encourage collective engagement should be judged after considering specific cases. While listening to Kerrie's presentation, specifically concerning "3.1 Company Engagement: Proactive and Reactive" in the ICGN's Material, I felt that collective engagement may be necessary in case of reactive approach: specifically, when they need to respond to something which cannot easily be addressed within a limited timeframe, investors can work together to deal with the issue. If that is the case, we should first share specific examples in the last 3 years since the establishment of the Code, and then have a discussion.

Meanwhile, as mentioned earlier, the UN Principles for Responsible Investment also encourages collective or collaborative engagement. I brought its brochure "Introductory Guide to Collaborative Engagement", which I have read to gain more knowledge. Certainly, there are benefits of collective engagement, but not always. This brochure also pointed out some challenges. For example, when an investor already has a good relationship with the management of an investee company, or when an investor does not want to share knowledge or information, which should be their competitive advantage, with peer investors, the investor tends to prefer to engage with the company on an individual basis, instead of collective engagement. And collective engagement may allow for less in-depth and more formal discussions. Actually, I have participated in dialogues led by other institutional investors several times, and felt similar challenges. Concerning stewardship responsibilities, when engagement is defined as constructive, purposeful dialogue based on in-depth knowledge of investee companies and their business environment, etc., and when we talk about in-depth knowledge or constructive dialogue, it should be based on an assumption that an institutional investor, which is familiar with an investee company, engages with the company on an

individual basis.

On the other hand, if so-called collective engagement allows for “free riders” who rely on other investors, it will contradict the intent of stewardship responsibilities, as well as our consistent message for shifting from ‘Form’ to ‘Substance’. I’m concerned about a possibility that collective engagement may encourage the formalism, and may be used as an excuse, “We conduct engagement activities” for form’s sake. I understand the benefits of collective engagement very well, and I have no intention to deny the fact. Nonetheless, in case collective engagement is to be utilized, we should also stipulate governance of collective engagement, in order not to encourage collective engagement for form’s sake.

Under Principle 5 of the Stewardship Code, Guidance 5-4 describes the relationship between institutional investors and proxy advisors. Thinking about institutional investors which participate in collective engagement, this relationship may be close to a relationship with an institutional investor or service provider which leads collective engagement. For example, to use the expression of Guidance 5-4, institutional investors should not mechanically depend on a lead investor or coordinator – as explained earlier that fiduciary duties cannot be delegated – but should participate in collective engagement at their own responsibility and judgment and based on the results of monitoring of the investee companies and dialogue with them. Such Guidance should be included. In case institutional investors use such engagement-related service, they should publicly disclose the fact and how they utilize the service. I only modified Guidance 5-4 about proxy advisors. Anyway, if the governance of collective engagement is also stipulated, and if they share information on what cases collective engagement is used in, it will be worth giving thought to collective engagement, which has its benefits.

That’s all.

[Kansaku, Chairman] Thank you very much.

Now I’ll give the floor to Ms. Takayama, Mr. Fukumoto, and Dr. Ueda.

[Takayama, member] I’d like to share my opinion about company-level disclosures of voting results, which was just mentioned.

Also in the Follow-up Council, pros and cons of company-level disclosures were discussed from various angles. In order to minimize the cons, a necessary framework must be established.

One is governance structures of investors – to strengthen the management of conflicts of interest. I believe this point will be sufficiently discussed by this Council for revising the Stewardship Code, and thus the framework for company-level disclosures will be developed.

Another point is concerning the concentration of general shareholders meeting dates of Japanese companies, which Mr. Hamaguchi mentioned earlier. It is true that the concentration of the dates does not allow investors to take sufficient time for making proxy voting decisions. For investors which invest in Japanese stocks, regardless of whether they are Japanese or foreign investors, this is a big problem. In response to this situation, global investors, many of which are ICGN members, expressed their concerns. ACGA, another organization of investors, also expressed their concerns. However, I understand that companies and such ministries as the Financial Services Agency and the Ministry of Economy, Trade and Industry are currently addressing this issue in various ways. Efforts toward the diversification of general meeting dates include: exploring the concept of a record date, reviewing the corporate tax system, and promoting electronic proxy voting in order to secure sufficient time for making voting decisions. Results from such efforts will not be materialized overnight, but the framework enabling company-level disclosures will be gradually developed.

Taking such a situation into account, when we consider company-level disclosures, instead of arguing that such disclosures are not feasible because there are such major challenges, it would be better to make efforts to get rid of those challenges and create an environment where players can enjoy the maximum benefits from company-level disclosures, and then realize company-level disclosures as the next phase.

[Kansaku, Chairman] Thank you very much.

Mr. Fukumoto, please go ahead.

[Fukumoto, observer from the Ministry of Economy, Trade and Industry] As I'm here in the capacity of an observer, I'd like to make some brief comments. Let me share information, or make two points related to today's discussion.

The first point is about what investors look at when considering environmental, social and governance (ESG) factors or long-term investment, as Ms. Waring mentioned in her presentation, or how companies should perceive it. Currently, a study group under the Ministry of Economy, Trade and Industry (METI) is discussing this topic, inviting a representative from

the Financial Services Agency as an observer. I'm not sure whether this discussion is directly related to how to revise the Stewardship Code, but I believe it is very relevant to this Council. So if there is an opportunity, I'd like to share the progress of the study group's discussion.

The second point is related to disclosures of voting results, which Ms. Takayama just mentioned, or increasing the efficiency. Collaborating with the Ministry of Justice and the Financial Services Agency, the METI established a study group on promoting electronification of processes for shareholder meetings. This group has discussed how to facilitate electronic provision of materials necessary for proxy voting, as well as an electronic voting system. I'd appreciate it, if you were aware of such a move. I'd like to share the discussion of this study group as needed.

[Kansaku, Chairman] Thank you very much.

Dr. Ueda, please go ahead.

[Ueda, member] Thank you. I think there are several points to be discussed. In the past year, I have participated in various discussions at the Follow-up Council, Working Group on Financial Markets, etc. and felt that the issue of internal governance of institutional investors or conflicts of interest is central to all issues. Because many asset managers in Japan belong to financial groups, this issue seems to draw particular attention. Personally, I don't think that asset managers have not managed conflicts of interest. Owing to the Financial Services Agency's supervision, each financial institution has properly worked on compliance measures. So I cannot imagine that asset managers have not managed conflicts of interest. However, if there is a concern about that, it will be necessary to send a strong message externally to dispel the concern.

As a means to that end, as I already mentioned it at another meeting, each asset manager needs to establish a robust governance structure in a visible way. As written in the Opinion Statement of the Follow-up Council, it is necessary to establish a third-party committee or appoint outside directors. The second means would be company-level disclosures of the voting result to enhance transparency, making it visible that there is no conflict of interest; even if there is, such a conflict of interest has no effect; and if there is any conflict of interest within a financial group which affects the corporate business department, it does not affect the asset management department. Such governance and company-level disclosures of the voting result

would be important means to make an assertion.

I think we will discuss it to revise the Stewardship Code: looking at financial institutions' policies for managing conflicts of interest included in the material prepared by Kerrie, for example, Legal & General Investment Management provides 3 possible scenarios where conflicts of interest may arise in detail. On the contrary, in Japan, they generally specify their parent company and affiliated companies within the same group, and describe possible conflicts of interest with such companies. Instead, conflict of interest could be defined more vaguely: as written on page 12 of Material 3, instead of limiting the scope to specific circumstances that may give rise to conflicts of interest, the scope should be expanded in a way to include "grey areas" by providing examples instead of specific names, etc. I believe that such a wider definition is necessary.

When an institutional investor widens the definition, there would be two possible scenarios to be included. One is a possible conflict of interest between its corporate business department's client and an investee company to which it has fiduciary duties. Another is a possible conflict of interest between two clients, to both of which the institutional investors have fiduciary duties. When we expect that more corporate pension funds will sign up to the Code in the future, these are related to the independence of corporate pension funds and conflicts of interest facing them. Including these points, I think we need to consider several possible scenarios.

Globally, it is required to take necessary measures to control conflicts of interest, as stipulated in the ICGN's Principles which Kerrie introduced earlier, and G20/OECD's Governance Principles. I believe this is a global trend. Meanwhile, Principles Concerning Customer-Oriented Business Conduct are also being established, following the same track. So I think this should be a core issue.

That's all. Thank you very much.

[Kansaku, Chairman] Thank you very much.

I'll give the floor to Mr. Matsushima, Mr. Kawada, and then Ms. Shimada.

Mr. Matsushima, please go ahead.

[Matsushima, member] First of all, I welcome this initiative for reviewing and revising the Stewardship Code in response to the opinions from the Follow-up Council. Of course, asset

managers themselves are expected to implement principles of the Stewardship Code under the 'Comply or Explain' approach according to their specific circumstances. Anyway, the proposed revisions fit in our efforts for enhancing credibility of investment trusts, so I feel this is a welcome step.

I'd like to express my views in this context. Currently, the Investment Trust Association, Japan is discussing governance of investment trusts, in order to enhance credibility of investment trusts and reflect investors' perspectives in product designs and operations. Let me share some of our discussions. While each company has been making their own efforts, including the appointment of independent directors, and establishing an advisory board or a committee for monitoring and supervising funds, we are also discussing how we, as the entire sector, can clearly show investors such efforts for improving credibility of investment trusts, including the examples which I just mentioned. Especially in case of publicly offered investment trusts where asset owners are a large number of ordinary investors, it is essential to operate businesses by incorporating such views.

Next, I'd like to briefly talk about enhanced disclosures of voting results. This is also something that each company should make decisions on, taking into account their specific circumstances, but I believe that enhancing the transparency of their efforts significantly contributes to improving confidence in investment trust management companies. At the same time, asset management companies are expected to make efforts for operating as efficiently as possible for the interests of beneficiaries, so it would be necessary to go for disclosures at the company/proposal level, while adequately controlling the cost. As a feasible way, probably the Code could refer to disclosures on websites, etc. as an illustrative example.

As you know, in case of investment trusts, each company has various funds. Because of the multitude of funds, disclosures at the fund level will require tremendous efforts. Each asset management company established its own proxy voting policy and exercises its voting rights in accordance with the policy; and it is very unusual that different voting decisions are made by different funds within a company. Therefore, as public disclosure, if each asset management company posts, on its website, voting results at the investee company's proposal level, it will be relatively easier to gain support from the industry.

That's all.

[Kansaku, Chairman] Thank you very much.

Mr. Kawada, please go ahead.

[Kawada, member] Thank you. As a member on the companies' side, and as an IR/SR practitioner, I'd like to make a few points.

The first point is concerning enhanced disclosure of proxy voting results. At the end of last year, I conducted SR activities for Japanese and foreign institutional investors. What I was struck by was the fact that even though we, as a company, tried to have constructive dialogue, institutional investors stuck to their own proxy voting standards, and had a tendency to be very reluctant to make voting decisions deviating from the standards. Although we communicated our views, what we consider about governance, and future plans through dialogue, if our proposal did not conform to their proxy voting standards even to the slightest extent, institutional investors would hardly support the proposal. That is the reality.

The point is as follows: if constructive dialogue convinced an institutional investor to make a voting decision, which differs from a decision in case of formally applying their proxy voting standards, when disclosing the voting result, the institutional investor will be required to explain why they made such a voting decision that does not conform to their proxy voting standards. Accordingly, I assume that institutional investors are reluctant to make voting decisions based on dialogue. I'm worried that, as a result, institutional investors will act in accordance with formal standards, being obsessed with the formality, thus impeding constructive dialogue. Institutional investors are expected to make their own decisions simply based on constructive dialogue and exercise their voting rights, but I got an impression that delicate problem regarding their correspondence to the proxy voting standards would occur.

I'd like to refer to proxy advisors as well. As Mr. Hamaguchi mentioned, in case of proxy voting, especially proxy voting at a general shareholders meeting, the period from the arrival of convening notice to the general meeting is very short, so a large number of institutional investors rely on services of proxy advisors. Last year, our company held an extraordinary general shareholders meeting, and managed to have prior face-to-face meetings with institutional investors to explain our proposals. At that time, some institutional investors – both Japanese and foreign – mentioned that they would refer opinions of proxy advisors, or that they usually vote in accordance with proxy advisors' voting guidelines. On page 12 of Material

3, under “Effective Stewardship Activities of Asset Managers”, it is pointed out that “it is important for institutional investors to make careful judgments by taking note of the particular circumstances of individual companies, instead of mechanically applying formal criteria depending on proxy advisors.” However, on the contrary, if institutional investors tend to mechanically depend on services of proxy advisors, proxy advisors’ governance and process of developing appropriate proxy voting guidelines, etc. will be key issues to be discussed. Concerning our extraordinary general shareholders meeting, as mentioned earlier, some investors stated that they refer to proxy advisors’ opinions, or it is easier to provide external explanations by using their opinions as the basis for proxy decisions. This would be the reality, and that’s why I wanted to share this information.

That’s all.

[Kansaku, Chairman] Thank you very much.

Ms. Shimada, please.

[Shimada, member] As I publish an investment trust-monthly magazine, I’d like to make some comments from the standpoint of handling publicly offered investment trusts, representing individual investors who use investment trusts for one’s financial independence by steady periodic investment with the long-term perspective. As I have not participated in the Follow-up Council, I’m afraid if I talk about something obvious.

First of all, a publicly offered investment trust is a collective investment scheme where funds collected from many and unspecified individuals are managed. Unlike a pension fund, there is no visible asset owner. Under this scheme, each individual investor is, so to speak, an ultimate beneficiary and an asset owner. Therefore, it is considered that such ultimate beneficiaries entrust to an investment trust management company as an institutional investor, not only their money, but also their voting rights attached to the assets as well as having dialogue with companies, etc. Investment trust management companies have duties to properly carry out proxy voting or have dialogue on behalf of ultimate investors.

In case of investment trusts, there is no professional asset owner who takes an initiative to conduct stewardship activities. It means that an asset management company is required to be aware of its stewardship responsibilities to the same extent as in case of pension funds or even more strongly. At the moment, it is difficult for individual investors to effectively monitor asset

management companies. Therefore, I think it is desirable that on behalf of individual investors, third-party bodies – for instance, fund rating companies or proxy advisors – monitor behavior and action on stewardship responsibilities of asset management companies. To that end, public disclosure of various kind of effectual information concerning stewardship action is needed.

Now I'd like to talk about enhanced governance and management of conflicts of interest. On the page numbered II-4-③ of Material 3, circumstances that may give rise to conflicts of interest are illustrated. As pointed out on the next page, in case of investment trusts, investment trust management company is often controlled or influenced by its parent financial institution which is its largest fund sales company (financial institution) at the same time. It is common for the member of Japanese financial group an investment trust management company have CEO from its parent company. Furthermore, in case of investment trusts for defined contribution (DC) pension funds, the presence of a DC provider and its parent financial institution may give rise to a conflict of interest, because the financial institution is often a large stock holder or main financing bank for a DC plan sponsor.

Taking such a background into account, as Dr. Ueda also mentioned, it would be necessary to consider effective governance, which helps convince individual investors that asset managers work on adequately controlling or avoiding conflicts of interest.

As for passive managers' proxy voting, opinions are different among individual investors, which I found very interesting. For instance, considering characteristics of passive management, some argue that passive managers may vote 'for' all company proposals, except for limited types of proposals, typically concerning anti-takeover measures. Actually, there are some individual investors who assert that if company-level disclosures are costly, passive managers should rather focus on reducing costs. On the other hand, some express their opinion that, because passive managers have to maintain portfolio, they should make efforts to increase corporate value over the mid- to long-term through engagement and proxy voting.

Personally, I believe it is desirable that passive managers also exercise their voting rights properly. However, passive managers tend to hold shares of so many companies, so I believe the priority of their engagement from the mid- to long-term perspective should be given to large-cap investee companies which have defined problems.

When passive funds exercise their voting rights, this may be a little too harsh, but it will

have little value, if they merely vote in accordance with proxy advisors' guidance. The point is not whether or not they should vote. Depending on what actions they take to fulfill stewardship responsibilities, characteristics of each passive fund will be revealed. I think it is desirable that disclosures are made in a way allowing investors to select products, taking such characteristics into account.

Next, I'd like to discuss disclosures of proxy voting results. First of all, I suggest that they should specify their proxy voting policies in their prospectus or fund information websites. Looking at the current disclosures by publicly offered investment trusts concerning proxy voting policies and voting results, most asset managers merely disclose, on their website, policies describing general matters and aggregated voting results (i.e. numbers of 'for' and 'against' votes) by category of proposals. From the investors' viewpoint, such disclosures are insufficient and merely formal. Some of them provide explanations about voting, but such explanations tend to be too general. On the other hand, a certain asset manager has taken one step further by clearly stating their proxy voting policy, and explaining examples of engagement without providing specific names of counterparties. In their disclosure, instead of merely informing investors of the fact that they had dialogue, they explain specific results of the dialogue.

Concerning public disclosures on the 'Comply or Explain' basis, I don't think that typical or formal disclosures are meaningful. They are required to explain in a manner that is easy to be understood by ordinary shareholders. However, although company-level disclosures would be a natural course of action for company-type investment trusts in the US, I'm afraid it would be difficult to require contract-type investment trusts in Japan to make company-level disclosures at the moment.

Actually, what individual investors are most interested in is asset managers' engagement. Asset managers are expected to use creativity to present more specific policies, and communicate what they are doing in an easy-to-understand way in their disclosure documents. Specifically, in disclosing voting results, they are not expected to inform investors of the mere fact that they vote for or against proposals. They are expected to communicate their thoughts behind the action – for instance, by explaining reasons why they cast 'against' votes.

Concerning asset managers to which individual investors entrusted their money, they want

to know how the asset managers fulfilled their responsibilities on their behalf – by taking what action with what view of which aspect, instead of merely formal information like the numbers of ‘for’ and ‘against’ votes. In that sense, we could naturally expect them to disclose in their annual reports what stewardship responsibilities they fulfilled, and what actions they took for engagement or proxy voting, at the fund level. However, if it was difficult to do so due to space limitation or cost constraints, they could make disclosures on their websites, and provide the link to the website in the annual reports. They could use creativity in this way.

I’d like each asset manager to communicate to investors about examples of their actual engagement without disclosing names of companies – objectives of dialogue, and what responses or actions they got from the companies as a result, etc. – in their own words. This is because investors can use such disclosures as a guide for selecting asset managers to which they entrust their own money.

Meanwhile, in case of investment trusts advocating ESG, CSR, SRI and the Stewardship Code, I believe that it is desirable to move toward company-level disclosures. It is important to have responsible and purposeful dialogue for the benefit of investors; and communicating the substance of dialogue to investors, or making it visible to investors should be stewardship responsibilities of investment trusts.

[Kansaku, Chairman] Thank you very much.

I’ll give the floor to Mr. Shimizu, Mr. Nagashima, and then Mr. Kato.

Mr. Shimizu, please go ahead.

[Shimizu, member] I’d like to share my views from the standpoint of a life insurance company, which makes investments from the long-term perspective.

Each life insurance company has been carrying out stewardship activities centered around dialogue with companies by using their creativity. And they support the objectives for revising the Code, specifically, direction toward making stewardship activities more effective through more in-depth dialogue. In that context, we’d like to request this Council to consider the revision of the Code from the following 3 viewpoints.

First, we hope that the revision will be made to strengthen overall stewardship activities, not focusing merely on proxy voting.

Second, to ensure that stewardship activities will be more effective and enriched, not being

for form's sake, we hope that wide-ranged options are to be stipulated, instead of limiting the scope of compliance.

Third, consideration should be given to actual practices.

On that basis, I'd like to make two points, specifically about company-level disclosure and enhancement of governance.

I'd like to share my view of disclosure first. The Opinion Statement suggests that, as a principle, voting results should be disclosed at the company level. We should not make company-level disclosure the only option for complying with the Code: instead, the Code should provide additional options other than company-level disclosure. There are two reasons. First, for the purpose of managing conflicts of interest, I believe that the purpose can be achieved through other methods than company-level disclosure. For example, to enhance governance, a new body including outside members will be established this time. By disclosing what was discussed by this body, in other words, by a method other than company-level disclosure, I believe that asset managers can provide sufficient explanations of how they manage conflicts of interest, and obtain adequate understanding.

Now I'll tell you the second reason. If company-level disclosure is stipulated as the only option to comply with the Code, the focus of stewardship activities and concern of interested parties will be overly inclined to proxy voting, I'm afraid. In stewardship activities, proxy voting is an important element, but that is not the only element. The current Code stipulates that stewardship activities are wide-ranged activities, including constructive dialogue with companies. Seen in that light, in case it is considered that they can more easily obtain investors' understanding by explaining the entire picture of stewardship activities, including process of dialogue, content of dialogue, voting results, outcome of dialogue, it would be possible to recognize such a comprehensive explanation of overall stewardship activities as an alternative to company-level disclosure under the Code.

The second point is about enhancement of governance. The Opinion Statement calls for developing governance structures, with the awareness of outsiders' perspectives. It would lead to improving reliability of each asset manager. However, since governance structures vary among asset managers, the Code should ensure that each asset manager can have an optimum governance structure in place, by allowing for their autonomy and diversity in terms of their

board composition consisting of both outside and inside members, content and number of agenda for deliberation, etc.

That's all from me.

[Kansaku, Chairman] Thank you.

Mr. Nagashima, please go ahead.

[Nagashima, member] I'd like to briefly make some points.

I think the current Code is very well-written as a whole. While listening to the ICGN's presentation, I was thinking that there would be no need to change the framework of the Code. Accordingly, what we need to do is updating the Code by incorporating outcomes of our discussion in a manner to meet the needs of the times. Particularly, I suppose Guidance needs to be updated.

As for governance, although trust banks have been making much efforts, it seems there remain room for further improvements. I think trust banks are expected to improve them. So we'd like to work further on enhancing our governance, and ensuring the transparency.

As for proxy voting, there are many points to be discussed concerning company-level disclosure. In short, I personally consider that we should move toward that direction, as I heard from people in charge that company-level disclosure may contribute to securing and improving the transparency of the Japanese market, or facilitate dialogue.

Finally, I'd like to refer to collective engagement. Opinions may vary depending on the type of funds. Especially, in case of active funds, dialogue serves as a source of value. So if they have dialogue as a collaborative group, each fund or asset manager cannot maintain its uniqueness. Accordingly, I think it is difficult to stipulate collective engagement in the Code.

That's all.

[Kansaku, Chairman] Thank you very much.

Mr. Kato, please.

[Kato, member] Thank you. There are some overlaps with other members' comments, but I'd like to express my opinions.

First of all, when we consider the revision of the Stewardship Code, we need to consider stewardship responsibilities and a mechanism to fulfill such responsibilities separately.

I'll tell you the reason. What was impressive in Ms. Waring's presentation is the

importance of asset owners. Specifically, since it is asset owners who select asset managers, when asset owners select asset managers, an important point is whether or not asset owners ensure to make the selection, giving consideration to stewardship responsibilities. Meanwhile, as shown in the example of investment trusts which was introduced earlier, in the case of asset owners which consist of many different individuals, we cannot expect such asset owners to check whether asset managers are fulfilling their stewardship responsibilities. Accordingly, it is necessary to establish a mechanism for ensuring that asset managers fulfill their stewardship responsibilities. We need to discuss this issue, taking into account the fact that there should be various mechanisms for ensuring that asset owners and asset managers fulfill their stewardship responsibilities, depending on how they are connected within the investment chain.

In this connection, the second point is about disclosures under the ‘Comply or Explain’ approach. It would be all right to say that the ‘Comply or Explain’ approach itself has already taken root in Japan. The issue should be whether or not meaningful disclosures are made. In the explanation from the secretariat, it was implied that there are issues to be discussed concerning how to make disclosures. I’m not sure if we can present examples of good disclosure and bad disclosure as in Ms. Waring’s presentation, but we need to consider and discuss specific case examples as best practices of disclosure.

As the third point, I found that the FRS’s approach introduced in Section 5 of Ms. Waring’s presentation material is very interesting, while the UK is an advanced country in terms of ‘Comply or Explain’. The fundamental objective of ‘Comply or Explain’ is to disseminate best practices among practitioners through the market mechanism, I think. However, according to the above-mentioned slide, it seems the FRC considers that at least as far as stewardship responsibilities are concerned, the FRC cannot rely merely on the market mechanism, and makes aggressive intervention to correct undesirable disclosures.

The UK’s Stewardship Code and Japan’s Stewardship Code are different in terms of legal position and framework in the first place, so the Financial Services Agency may not be able to make responses similar to those made by the FRC. Nonetheless, as a mechanism for facilitating desirable disclosures relating to the Stewardship Code, I believe we also need to consider what measures the Financial Services Agency can take under various legal constraints in Japan.

That's all.

[Kansaku, Chairman] Thank you very much.

Does anybody else want to express their opinions? This is our first meeting, so...Mr. Masuda, please.

[Masuda, member] While the members actively share their opinions, I'd like to sort out points to be discussed for the purposes of enhancing the effectiveness of the Stewardship Code and shifting the focus of efforts from 'Form' to 'Substance'.

First of all, I basically agree with the already-mentioned points at issue. Having expressed my support, I'd like to talk about how to enhance the effectiveness from the standpoint of asset managers.

Concerning the first point about governance of asset managers and conflicts of interest, asset managers, including our company, have been making earnest efforts, but there inevitably remain market and client concerns. In order to dispel such concerns while making the said efforts, as Dr. Ueda also mentioned, I believe it is a must to make company-level disclosures.

However, as for the way to do so, it should be noted that some clients expect asset managers to exercise their voting rights in accordance with their own proxy voting standards, and thus we need to thoroughly address the issue of diverse exercise of voting rights. Meanwhile, in case of publicly offered investment trusts and the like, they act in accordance with asset managers' proxy voting standards, so there should be no problem with disclosing voting results all together.

Next, I'd like to refer to engagement of passive managers. Our company was established last October, and has implemented engagement activities, by trial and error, for both active and passive management, where we need to focus on different aspects. Naturally, in case of engagement of passive management, we place an emphasis on increasing corporate value, which is the common benefit for the market participants. ESG is also included. Depending on agenda-setting, as Mr. Hamaguchi mentioned, it would be feasible to go for collective engagement.

Let me tell you cases where collective engagement is more effective than individual engagement. There are some topics, to which both companies and investors pay attention during dialogue, and concerning which the Corporate Governance Code requires companies to

provide sufficient explanations and requires asset managers to ask questions. Such topics are common issues, so focusing on such topics as agenda of collective engagement would be a possible approach to enhance the effectiveness of engagement.

Furthermore, as a problem with engagement of passive managers, as the Follow-up Council also discussed, there is a cost issue. Naturally, an increasing number of passive managers, which have no experience in engagement, will start engagement activities in the future. Then, on the premise that passive managers engage with companies in a responsible way, we need to discuss how asset owners and asset managers share the cost necessary for increasing corporate value of investee companies.

Lastly, again as Mr. Hamaguchi mentioned, I understand such an argument that it is too early for corporate pension funds to sign up to the Stewardship Code due to the cost issue as well as the balance of various things. However, speaking from the standpoint of asset managers, we have been discussing ways to create an environment where small and medium-sized corporate pension funds can broadly sign up to the Stewardship Code. The focus of our discussion is how corporate pension funds and asset managers communicate, and how asset owners can effectively check asset managers. We are thinking about establishing common guidelines by sorting out what was deemed desirable for dialogue between asset managers and corporate pension funds. Depending on the content, it may encourage the formality or superficial responses, but we believe that there is a possibility for reducing costs and enhancing the effectiveness.

That's all from me.

[Kansaku, Chairman] Thank you very much.

Mr. Tanaka, please.

[W. Tanaka, member] I learned a lot from other members' arguments.

I'd like to make two points. The first point is about the concept of 'Comply or Explain'. The 'Comply or Explain' approach allows for choosing to comply or explain reasons for non-compliance, and the mere fact that a company chose to explain does not result in negative evaluation. I think that is the rule. Although this is not about the Stewardship Code, according to a research conducted in Canada, compared to companies which reported their compliance with Canada's Corporate Governance Code, companies which chose to explain convincing

reasons for non-compliance saw more positive effects on market values of their stocks (Luo, Y., and S. E. Salterio, 2014, Governance Quality in a "Comply or Explain" Governance Disclosure Regime, *Corporate Governance - an International Review* 22(6), 460-481). This finding implies that investors appreciate "mixed" responses, so to speak. If established rules are something all players comply with, there will be no difference among information disclosed by all players. Then such information is of little use. Therefore, it is meaningful to establish rules where a company which takes a different standpoint from other companies can squarely explain reasons for non-compliance.

My second point is about company-level disclosure of proxy voting results. I agree with the point Dr. Ueda raised. In Japan, the circumstances that may give rise to conflicts of interest are not really the obvious case involving controlling shareholders. Rather, conflicts of interest may arise in the circumstances where various transaction relationships exist. Minor conflicts sometimes become serious. To address this issue, reinforcing governance structures is an obvious option, but securing the transparency is also a powerful option.

The 'Comply or Explain' approach does not force all players to comply with specific rules. Therefore, we can incorporate rules that would have been too early to implement as mandatory rules. This is a big advantage. So I believe that a principle of company-level disclosure is established under the 'Comply or Explain' approach.

That's all from me.

[Kansaku, Chairman] Thank you very much.

Does anyone want to share opinions?

Ms. Aoyama, please.

[Aoyama, observer from the Ministry of Health, Labour and Welfare] I'll make a brief comment as an observer. I'm Director, Private Pension Division, Pension Bureau of the Ministry of Health, Labour and Welfare.

I appreciate what Mr. Masuda mentioned earlier. The Opinion Statement also stated that asset owners should effectively oversee asset managers' stewardship activities. I agree with that. However, when they are just told to carry out effective oversight, or to comply or explain, they have difficulties to figure out exactly what to do. So I believe that efforts to fill such a gap or create an enabling environment are essential. As Mr. Hamaguchi mentioned earlier, the

Ministry of Health, Labour and Welfare has established a study group, and has been considering a specific way of creating such an environment for asset managers. I wanted to share this information with you.

That's all.

[Kansaku, Chairman] Thank you very much.

Although we still have plenty to say, it's already past the schedule closing time, so I'd like to close today's discussion.

Finally, I'd like to hand it over to the secretariat for housekeeping announcements.

[Tahara] Thank you very much. As for the next meeting date, I'll let you know the date soon. We hope to have the next meeting in February. Thank you.

[Kansaku, Chairman] Thank you very much for your participation. I'm sorry that we had to extend the meeting time due to my poor facilitation.

Now I declare this meeting adjourned. Thank you very much.

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