(Provisional translation)

The Second Council of Experts on the Stewardship Code

1. Date and Time: February 17, 2017 (Friday) 9:00-11:00
2. Venue: 13F, Central Government Building No. 7, Meeting Room No. 1

[Kansaku, Chairman] Good morning. I would like to open the Council of Experts on the Stewardship Code.

Thank you very much for taking the time from your busy schedule.

There are some members who did not attend the last council, so we would like to continue to receive comments from every member this council.

Now, we would like to proceed with the Council.

In the last Council, we received comments from members regarding matters which were not taken up in the Opinion Statements of the Council of Experts on the Follow-up of Japan's Stewardship Code and Japan's Corporate Governance Code, namely, the issue of proxy advisors and the issue of collective engagement. Today, prior to receiving comments from the members, we would like the secretariat to explain the current status of these matters in order to supplement the materials from the previous Council.

Now I'd like to hand it over to the secretariat to explain the materials.

[Tahara, Director of the Corporate Accounting and Disclosure Division, FSA] I would like to give a supplementary explanation regarding the status of proxy advisors and collective engagement in accordance with the materials at your hand.

Please turn to page 3 of the materials. We have received comments from several members regarding proxy advisors in the previous Council. The Stewardship Code states that the Code applies to proxy advisors as well as institutional investors. Preamble 8 of the Code states as follows: "The Code also applies to proxy advisors commissioned by the institutional investors."

For example, Principle 5 of the code states "Institutional investors should have a clear policy on voting and disclosure of voting activity. The policy on voting should not be comprised only of a mechanical checklist: it should be designed to contribute to sustainable growth of the investee companies." The principals, therefore, apply to proxy advisors as well.

Additionally, I would like to refer to Guidance 5-4 of Principle 5. It states that when institutional advisors use the service of proxy advisors, they should not mechanically depend on the advisors' recommendations but should exercise their voting rights at their own responsibility and judgment and based on the results of the monitoring of the investee companies and dialogue with them. The guidance also states that when disclosing their voting activities, institutional investors using the service of proxy advisors should publicly disclose the fact and how they utilize the service in making voting judgments. I would like to firstly bring your attention to how the current Code addresses the issue of proxy advisors.

The influence of proxy advisors has increased noticeably in the Japanese market. Recently, the Japan Investment Advisors Association conducted a survey on its member companies. Of the 126 companies who responded to a question related to proxy advisors, we checked the results of 92 companies with exposure of Japanese equities in Japanese equity in order to assess the influence of proxy advisors, and noted that about half of the institutional investors utilize proxy advisors.

Also, in order to respond to points raised in the previous Council, we are presenting the results of our research regarding the status of proxy advisors in Europe and the U.S. Due to a limited time period, our preparation of the research may not be adequate, but we would like to present the results. In the U.S, a bill known as the "Financial CHOICE Act of 2016" is under discussion and has been submitted to the Congress. It adopts a registration system of proxy advisory firms and requires them to establish a system, etc., including policies to manage conflicts of interest, having sufficient staff, and forming procedures to give companies an opportunity to comment on the draft recommendations.

In short, the purpose of this bill is to improve the quality of proxy advisors by mandating a registration which requires a certification that they have adequate financial and managerial resources, as well as providing information on the procedures and methodologies that they use in the services, their organizational structure, whether or not they have a code of ethics, and any potential conflicts of interest relating to the provision of the services. Such information must be filed to the SEC and the information shall be publicly available on the SEC's website.

The bill also mandates the duty to establish certain systems. The duty includes the establishment and enforcement of written policies to manage conflicts of interest, having staff

sufficient to produce proxy voting recommendations that are based on accurate and current information, forming procedures to give companies an opportunity to comment on the draft recommendations, employing an ombudsman to receive complaints about the accuracy of information used in making recommendations and resolving those complaints in any event prior to voting on the matter, and the designation of a compliance officer.

In regard to EU, as presented on page 6, we understand that there has been discussion on proxy advisors for several years, and that the proposal on amending the Shareholder Rights Directive is approaching the final stages of discussion.

The amendment mandates proxy advisors to disclose information, including procedures to ensure qualifications of the staff, how they take company-specific conditions into account and have dialogues with the companies, and take actions against conflicts of interest. In summary, Member States shall ensure that proxy advisors publicly disclose reference to a code of conduct which they apply and report on the application of this code of conduct, on their websites annually. Member States shall also ensure that proxy advisors publicly disclose on an annual basis at least all of the following information in relation to the preparation of their research, advice and voting recommendations in order to adequately inform their clients about the accuracy and reliability of their activities. Similar to the requirement in the U.S, such information includes the essential features of the methodologies and models they apply, the main information sources they use, procedures put in place to ensure quality of the service and qualifications of the staff involved, whether they have dialogues with the companies and stakeholders of the company, and if so, the extent and nature thereof, and the policy regarding prevention and management of potential conflicts of interests. Such is our understanding of the disclosure requirement of this directive.

This ends our explanation on the status of proxy advisors.

Now, I would also like to explain about collective engagement.

Collective engagement was discussed in the Council of Experts on the Japanese Version of the Stewardship Code, resulting in Principle 7 of the Stewardship Code. Guidance 7-3 of Principle 7 states that exchanging views with other investors and having a forum for the purpose may help institutional investors conduct better engagement with investee companies and make better judgments. This is a positive assessment on collective engagement.

In the process of developing the Stewardship Code, we received a question regarding the disclosure requirement under the Financial Instruments and Exchange Act. We prepared a summary at that time, which we is presenting again from page 9 and thereafter.

As discussed while developing the Stewardship Code, under the large shareholder reporting system, shareholders are required to calculate their shareholding percentage by including the shareholding of a "Joint Holder". Subsequently, in a situation where an institutional investor takes action against an individual investee company in a joint effort with other investors and such investors are considered as "Joint Holders," such an investor is required to take into account the ownership of the other investors in complying with the large shareholding system. This is the first point.

Secondly, in regard to financial instruments business operators, etc., who repeatedly and continuously execute buy/sell transactions in their daily operations, etc., there is a special reporting system which relaxes the requirement regarding the frequency and due date of the large shareholding report and the change report. However, a holder of shares, etc., may not use the special reporting system if it commits to the "Act of Making Important Suggestions". Therefore, the report must be submitted within five business days from the day the cause of the submission occurs, rather than judge whether to assume reporting obligations on the pre-registered semimonthly reference date. A point was raised that the special reporting system may not be utilized in the case of collective engagements, and that it may be necessary to further clarify and specify the interpretation of the regulation.

We clarified the interpretation of these legal issues in February 2014 by publishing "Clarification of Legal Issues Related to the Development of the Japan's Stewardship Code", as discussed below.

Please refer to pages 10 and 11 of the materials which present the easy-to-follow Q&A of the published clarification. First of all, we would like to respond to the question, "If a holder of shares, etc., exchanges opinions with another investor about exercising voting rights in terms of a specific investee company, or agrees with other investor to jointly request the investee company to set up a dialogue, will the other investor be considered a Joint Holder under the reporting requirements for large shareholdings?" The answer is that the concept of a Joint Holder applies when an investor agrees with another investor to "execute voting rights and

other shareholder rights jointly". The "voting rights and other shareholder rights" most likely include the legal rights of shareholders to propose, and other rights listed herein. Therefore, basically, as long as the agreement between an investor and another investor remains within the scope of shareholders' general activities that are unrelated to the exercise of legal rights, the other investor will unlikely be considered a Joint Holder.

Next I would like to refer to the question in the lower half of page 10, "When a holder of shares, etc., communicates to another investor its plan for the exercise of voting rights, and such plan matches with that of the other investor, will the other investor be considered a Joint Holder?" The answer is that the concept of a Joint Holder applies when an investor "agrees to jointly execute voting rights and other shareholder rights". The agreement referred hereto means an agreement containing the element of a mutual or unilateral promise to act in future, and differs from a mere exchange of views. Therefore, basically, in the situation where an investor, in the discussions, etc. with another investor, communicates their plan for the exercise of voting rights and finds that the plan is the same as the other investor, the other investor will unlikely be considered a Joint Holder.

Now, in regard to the Act of Making Important Suggestions, as you can see at the top of page 11, we prepared seven model actions. Acts such as request for an explanation regarding the investee company's management policy, explanation regarding their own policy for exercising voting rights, request for an explanation of the investee company's stance given the afore-mentioned shareholder explanation, asking questions at a general shareholders' meeting, etc., are highly unlikely to be classified as an Act of Making Important Suggestion.

On the other hand, (5) to (7) are actions requesting specific resolutions at general shareholders meetings. Basically, as long as the contents of these actions are as listed under Article 14-8-2 of the Order for Enforcement of Financial Instruments and Exchange Act, it is highly likely that they will be deemed as "suggestions" that are "intended to cause material changes or materially influence the issuer's business activities", and be classified as the Act of Making Important Suggestions. It should be noted, however, that depending on an individual situation, some actions are less likely to be identified as the Act of Making Important Suggestions, such as in the cases of (6) and (7) which are requests for the investee company to change their business policy etc. Specific examples include cases where a shareholder provides

its own opinion in response to an issuer's request. Such cases are less likely to be regarded as an Act of Making Important Suggestions. So the determination will be made case by case.

Therefore, under the current regulation, it is substantially possible to hold discussions with the investee company on a collective basis, as members have discussed on various occasions in previous Councils.

That's all for the explanation from the secretariat. Thank you very much.

[Kansaku, Chairman] Thank you very much.

Now we would like to start our discussion and receive comments from members.

We have received opinion statements from Ms. Waring and Mr. Toyama who are absent today. We would like to ask the secretariat to briefly go over their opinion statements prior to starting the discussions. Could the secretariat please go ahead?

[Tahara] I would now like to explain the opinion statements of Ms. Waring and Mr. Toyama, which you have on hand.

Mr. Waring's opinion statement is in regard to proxy advisors. To summarize the contents briefly, her opinion is that it is understandable that proxy advisors provide formal standard advice to a certain extent, considering the voting protocols of the investors, and corporate governance best practices followed worldwide,.

Ms. Waring also states that the codes of best practice are more appropriate to address any concerns relating to proxy policy transparency, conflicts of interest and research quality, rather than a regulatory approach to the oversight of the proxy advisory industry.

Now, in regard to Mr. Toyama's opinion, he has raised six points. The first point is "efforts should be made so that effective dialogue will not be obstructed by the presence of stable shareholders." If stable shareholders unconditionally act in the stance of supporting the investee company management, the effectiveness of the dialogue will decline. Therefore, the Stewardship Code should include a clause on joint engagement.

The second is "governance that focuses on the actual state of conflicts of interest of institutional investors should be strengthened." The third is "investment of resources for the purpose of raising the 'quality' of the content of dialogue should be strongly encouraged". The fourth is "the ideal way of evaluating stewardship activities should be "made visible" with a focus on the substantial aspects." We believe that points two to four are endorsements of the

Opinion Statements of the Follow-up Council.

The fifth emphasizes “joint engagement should be promoted.”

The sixth is his opinion on the quality of the advice of proxy advisors. He states that there is a concern that advice is not provided appropriately, as he also mentioned in a discussion at a previous Follow-up Council. Mr. Toyama also introduces an example from his personal experience. As explained earlier, the current Stewardship Code states that it applies to proxy advisors. Mr. Toyama is of the opinion that Guidance 5-4., for example, should specifically state that proxy advisors should invest sufficient management resources and provide services appropriately by embracing each individual and specific situation precisely.

This ends the brief explanation of the opinion statements of Mr. Waring and Mr. Toyama. Thank you very much.

[Kansaku, Chairman] Thank you very much.

As mentioned at the beginning of the Council, today we would like those members who had no opportunity in the previous Council, to voice their opinions before others.

I would also like to introduce to you at this time that we have received an opinion from Mr. Callon, who is absent today, that he is in favor of revising the Stewardship Code in accordance with the Opinion Statements of the Follow-up Council.

Now, could we please start from a member who did not have an opportunity in the previous Council? Mr. Horie, please.

[Horie, member] Similarly to Mr. Toyama’s second, third and fourth points as well as Mr. Callon’s comment, I also think that the Code could be revised in accordance with the Opinion Statement of the Follow-up Council.

I’ll tell you the reason. As written in the Preamble, the objective of stewardship responsibilities is to continuously increase corporate value by appropriately evaluating companies through discussions from various angles. The fundamental cause of a decrease in corporate value of Japanese companies is nothing but low capital productivity – the cause is already identified through preceding discussions. In order to improve corporate value, discussions should focus on mid to long-term business strategies, for example, what to do with business portfolio, or what to do with capital policy.

The basic idea is that investors are supposed to check whether the board is capable of

having such discussions in terms of its quality as a whole. Accordingly, the Stewardship Code should be revised, upon confirming whether the stipulations of the current Code are sufficient for checking such matters.

As stated at the Follow-up Council, long-term foreign institutional investors especially criticize Japanese institutional investors for not taking a shareholders' standpoint similar to theirs. It is true that there is a strong criticism against Japanese institutional investors for insufficient management of conflicts of interest and weak governance – they need to have governance in place before providing directions to investee companies. In this regard, the Code should be revised as stated in the Opinion Statement of the Follow-up Council. With the assumption that the said point is to be revised, I believe that company-level disclosure of voting results is a part of such efforts, and should be included as a matter of course.

Therefore, although we could discuss the matter at this Council again, I believe that the Follow-up Council has already covered almost all useful points. So I would suggest that we should use the Opinion Statement of the Follow-up Council as a basis, and change the wording.

That's all.

[Kansaku, Chairman] Thank you very much.

Mr. Oba, please go ahead.

[Oba, member] Because I did not have an opportunity to talk during the last meeting, I'd like to make an overall comment and raise a point.

Overall, as Mr. Horie just mentioned, the Follow-up Council has pretty much clarified issues to be discussed, so we could work along the lines, and focus our discussion on specifics.

As for issues to be discussed, as explained by FSA Director Tahara at the last meeting, there would be three key themes. The first one is asset managers' governance. The second one is company-level disclosure of proxy voting. The third one is effective proxy voting by passive managers. In addition to these three themes, there is room for discussing the issues explained [by the secretariat] today. I sorted out issues this way.

Among those issues, I consider that we still need to thoroughly examine passive managers' exercise of voting rights. As FSA Director-General Ikeda mentioned at the beginning, while institutional investors have been increasingly engaging with listed companies, their

engagement efforts should not be merely formal. We need to enhance the effectiveness of their engagement. That is the objective of this Council in the first place. In this light, I think there are two factors that impede the effectiveness of passive managers' exercise of voting rights.

One factor, Mr. Hamaguchi also pointed out now, is the situation where they have no choice but to exercise their voting rights in a formal manner, due to the concentration of the dates [of general shareholders' meetings].

Another one is the fact that the number [of investee companies] is too large. I don't know why, but many index funds use TOPIX as their benchmark. Such funds have voting rights in 2,000 companies. Realistically speaking, it would be very difficult to exercise all voting rights effectively. Nonetheless, the number of outstanding TOPIX shares held by such index funds is extremely large. Such a situation causes formal responses, I assume.

Consequently, this may rather be a request to asset owners, but I'm wondering whether they can narrow down the scope of the benchmark. I'm not saying that using TOPIX as a benchmark index is wrong, but I believe that they should more thoroughly consider problems caused by using it.

Let me tell you why I insist on this point. In the first place, Principle 3 of the Stewardship Code stipulates that institutional investors should monitor investee companies so that they can appropriately fulfill their stewardship responsibilities. I think they cannot monitor and properly understand the situation of investee companies without adequately researching the companies' culture, history, and set of values.

If they conduct voting-related activities without doing so, as Mr. Kawada also pointed out, it will cause trouble for companies because dialogue with them is merely formal or does not contribute to awareness-raising.

Therefore, for the purpose of making dialogue contribute to increasing sustainable corporate value, unless they narrow down the number of companies with which they have dialogue, it will be very difficult to secure the effectiveness of such efforts. That's my view.

That's all.

[Kansaku, Chairman] Thank you very much.

Mr. Masaaki Tanaka, please go ahead.

[M. Tanaka, member] At the last meeting, Chairman Kansaku and FSA Director-General

Ikeda explained the objectives and mission of this Council. The basic mission is the revision of the Stewardship Code, taking into account the Opinion Statement of the Follow-up Council. As I was a member of the Follow-up Council, I have no objection to what the secretariat explained at the first meeting as issues to be discussed.

Last time, Ms. Waring from ICGN made the presentation. I found it was very useful to have a deep understanding of best practices of investors' stewardship activities. It was great in that sense.

In particular, she stated, "both companies and investors are likely to have a mutual responsibility to protect and enhance company value for the benefit of society as a whole," and a similar point was described on page 9 of the Material for the last meeting, which is redistributed today. I've been thinking this point of view – in other words, the concept of the investment chain – is very important. In the entire picture of the investment chain, each player, including institutional investors and asset owners, needs to reconsider their roles. I think this view fits with what was mentioned in the Opinion Statement of the Follow-up Council.

Since the last meeting, the media has reported that Mitsubishi UFJ Trust and Banking announced its policy stating that, concerning results of voting for or against proposals of investee companies at their general shareholders' meetings, the bank will disclose voting results at the company/proposal level.

There was another notable media reporting about the Dai-Ichi Life Insurance Company. In order to enhance the transparency of their voting activities at general shareholders' meetings of its investee companies, they will establish the responsible investment committee in April, and three outside Audit & Supervisory Board members will conduct ex-post review of voting activities. It was reported this insurer will make a new effort to involve third-parties instead of internal decision-making.

The revision of the Stewardship Code means writing sentences. In doing so, I think we should keep in mind that the Code will be revised in a way to encourage such efforts of front-runners.

The last meeting was very thought-provoking, with various inputs from each member. It was a great discussion. Particularly, Mr. Oguchi and Professor Tanaka referred to the 'Comply or Explain' principle. I believe that we need to revisit the principle, and their comments

concerning the functions of this approach were very useful.

Especially, Professor Tanaka introduced a case example of a research in Canada, which found that, compared to companies reporting their compliance [with Canada's Corporate Governance Code], companies choosing to explain convincing reasons for non-compliance saw more positive effects on their shareholder value.

This time, the revision of the Code is to be made under the 'Comply or Explain' approach. In accordance with the recommendations in the Opinion Statement, basically, I believe that the Code should incorporate best practices as principles; and when institutional investors take different approaches from those best practices, the Code should require them to provide convincing explanations.

If the Code easily broadens the range of options for compliance, or provides more options than those specified in the Opinion Statement, institutional investors, etc. may take mechanical response to the Code, for example, by merely ticking checkboxes, thus nullifying the purpose of revising the Code.

Speaking from the fundamental perspective, institutional investors are also financial intermediaries. They do not manage their own money, so they need to keep firmly in mind that they have accountability to ultimate beneficiaries in the investment chain as in the chart on page 9.

I understand that the Financial Services Agency (FSA) is currently studying its administrative policy in many ways. Considering the fact that the FSA has a basic policy, which focuses on best practices, and encourages responses and dialogue in line with such best practices, I assume the future policy will be consistent with that.

Accordingly, when the FSA proceeds with drafting the revised Code, please keep in mind that such a task does not focus merely on rhetoric, or cast a spotlight on the most lagging part as in a convoy approach. That is my request.

Concerning today's topic about proxy advisor, page 4 of today's material shows they have certain influence. Considering the results of researches on the U.S. and Europe, I think we could think about a certain revision.

With regard to proxy advisors, for example, as Mr. Toyama also discussed in his opinion statement, the Code may as well require proxy advisors to make some sort of disclosures

concerning whether they have sufficient management resources, how they manage conflicts of interest, how they formulate their advice, etc.

Especially, the actor of Principle 5 is institutional investors, not proxy advisors. Therefore, the Code could include stipulations specifically for proxy advisors.

Finally, I'd like to talk about collective engagement. This may be partly because the use of the special reporting system is delayed. Last time, Ms. Waring mentioned that ICGN members are concerned about the fact that Japan's Stewardship Code does not refer to collective engagement.

In fact, despite considerable efforts as explained by Mr. Tahara, we still need to keep in mind that there is such a perception.

Under this circumstance, in the recent issue of "Capital Market Research", Dr. Ueda contributed a report titled "Issues of Collective Engagement". I believe this is an excellent report. In this report, she raised an issue: when considering collective engagement, while paying attention to stipulations of the Financial Instruments and Exchange Act, instead of stating that collective engagement cannot be done because of the legal stipulations, it is necessary to consider how to carry out collective engagement within the scope of the current stipulations. I hope that the Code will be revised, specifically focusing on this point. In addition, as Mr. Toyama argued, in his opinion statement, that "joint engagement should be promoted", we could think about some sort of edition.

That's all.

[Kansaku, Chairman] Thank you very much.

Mr. Matsushima, would you like to share your opinions?

[Matsushima, member] I have a question, not an opinion. Specific details of collective engagement are not provided in the Code. It is not clear to practitioners, including our company, specifically what recommended collective engagement looks like. I'd appreciate it if you could tell me about it.

Mr. Tanaka, what forms do you have in mind?

[M. Tanaka, member] Dr. Ueda may have more expertise, but I'll try to answer the question. As Mr. Hamaguchi mentioned at the last meeting, partly because institutional investors have only limited resources, actual forms [of collective engagement] vary. I assume that a group of

investors share common awareness of issues, and have dialogue or engage with each company. This is a possible form.

However, in other countries, there are quite a few organizations of institutional investors, who formulate basic policies of engagement, etc. and have dialogue with companies. I heard that such an approach has increasingly been adopted, while such organizations are yet to develop in Japan. I think this is another form.

[Kansaku, Chairman] Thank you.

Mr. Tsukuda, you didn't have an opportunity to express your view during the last meeting. Would you like to share your opinion?

[Tsukuda, member] Thank you for the opportunity to speak.

I'd like to raise two points. The first point overlaps with Mr. Tanaka's comment about the concept of 'Comply or Explain'. Looking at their reports filed to the TSE, the compliance ratio is very high. However, when I talk with companies, many of them say that, in a real sense, they have not been able to comply. When pursuing substance, the limitation of the concept of 'Comply or Explain' inevitably creates such a gap, I assume.

In that sense, if we further promote the best practice approach which Mr. Tanaka mentioned, it will become necessary to ensure that the concept of 'Comply AND explain' is widely accepted.

In my opinion, only after providing explanations about why they complied and on what basis they can say they complied, their assertion of compliance will become legitimate. Therefore, it is necessary to change the state of affairs which does not require any explanation for compliance.

The second point. As I was also a member of the Follow-up Council, I don't see any problem with direction of the Opinion Statement. Basically, I'm in a position to support the revision in this direction. Having said that, I'd like this Council to discuss the issue of proxy advisors' management of conflicting interests. There was a media report about a proxy advisor recently. While providing proxy advisory services to institutional investors, they also provide board evaluation services to companies.

There are various circumstances that may give rise to conflicts of interest. Because an entity provides various services to a certain client company, it is not surprising that there arises

a conflict of interest between such services.

For instance, trust banks and life insurance companies may face the circumstances that give rise to conflicts of interest between multiple transactions with a certain client company. Then the situation where proxy advisors provide services to institutional investors and also provide different services to companies which the investors evaluate, requires more sophisticated management of conflicts of interest, in my opinion.

Such proxy advisors are naturally expected to create a firewall between the departments dealing with institutional investors and companies, and announce that they are properly managing conflicts of interest. However, I'm wondering whether that is sufficient. Ultimately, we need to ask proxy advisors who services they would like to choose to maintain. Upon understanding the fact that such conflicts of interest actually arise in the investment chain, I'd like you to incorporate necessary matters in the revision.

These are the two points I wanted to make.

[Kansaku, Chairman] Thank you very much.

Now everyone already had an opportunity to speak in the first round, so anyone can feel free to express their view. Mr. Hamaguchi, please.

[Hamaguchi, member] First of all, concerning today's topic about proxy advisors, in general, I have no objection to imposing a certain discipline on proxy advisors. However, as I mentioned at the last meeting, and as stated in the ICGN's comment, general shareholders' meeting dates in Japan are still concentrated in a certain period, and thus, there is no choice but to exercise voting rights at the expense of the appropriateness of voting decisions to a certain degree. To avoid mechanical exercise of voting rights, they need tens or hundreds of staff members, but that is not realistic. Accordingly, considering the balance with practical issues, if the prohibition of such mechanical responses leads to the result where they cannot exercise their voting rights, it will create an adverse effect, so we need to thoroughly think about this issue.

Mr. Matsushima asked what collective engagement is like. It is difficult to give a concise answer. Explaining only a certain aspect is likely to cause misunderstanding, so we need to be cautious about that. As a specific example, an organization named Investor Forum in the UK, which 30 to 40 asset managers participate in, has publicly disclosed that they have undertaken

collective engagement activities, including specifically what they are doing. Our organization is currently consulting with other institutional investors about what we should do, by referring to the said example.

I would say it is not so difficult. As a typical example, concerning such matters as governance, environmental issues, and scandals, which many institutional investors commonly consider problematic, compared to the situation where tens of institutional investors separately meet with a company to discuss the same matters, it would be better if a collaborative group of such investors worked together to form a consensus opinion, and representatives of the group had dialogue with the company. That is the idea [of collective engagement]. In this sense, I believe it offers a great benefit to companies as well.

Concerning more complicated and difficult issues, investors basically have dialogue with companies on an individual basis, and collective engagement is supposed to complement or reinforce such individual engagement: in case there is any difficult issue which can hardly be solved on an individual basis, investors will collaborate with their peers and have in-depth dialogue with the company in question. I think it will enhance their influence in a good sense.

Such collective engagement is widely adopted in the world, and is clearly stipulated as one of key principles of action in the stewardship codes of most countries. That is because it is important for institutional investors to collaborate with peer investors, where necessary, to achieve results, instead of merely providing explanations in fine words or making an excuse that they are minority shareholders. This is essential for increasing the effectiveness of the stewardship code, and I assume that is the reason why other countries have adopted [collective engagement].

Accordingly, as for legal issues which were explained earlier, European and American supervisory authorities not only have provided explanations, but also have taken a further step by setting up provisions that encourage collective engagement.

Looking at actual examples of such engagement in the market, as far as I found, [collective engagement] has played a certain role on important occasions, thus forming the foundation that supports market functions.

This time, the Code is reviewed for the purpose of effective stewardship activities, taking into account international discussions and trends, so [collective engagement] should be

adopted as one of the principles. Even if that does not happen for any reason, at the minimum, it should be incorporated in Guidance under a certain Principle: for instance, it could stipulate, "Institutional investors may come together to engage in dialogue with companies, as needed." We could consider such a revision at the minimum.

I'm not sure what other members are thinking, and some members may not feel like this, but I consider that Japan is being tested as to how serious about stewardship we are, so we need to respond in a manner that will not give rise to concerns among foreign investors.

Finally, I'd like to respond to Mr. Oba's question about index funds: why are they using an index with 2,000 constituents? I talked about it three years ago at the first meeting of this Council. It is not a difficult thing. They could use TOPIX 300, 400, or 500. Global investors are using MSCI Japan index with roughly 300 constituents. Unfortunately, JPX-Nikkei 400 was launched after that. As you know, its constituent selection criteria focus on ROE and governance, not simply based on a share of market capitalization, and the calculation method is not completely market-capitalization-weighted. As you know, currently, the performance of JPX-Nikkei 400 is far below that of TOPIX. A movement in the market results in such a difference. Accordingly, for global institutional investors using benchmarks for the entire market on the market capitalization basis, this index cannot be used.

Another index, Nikkei 225, is not on a market capitalization basis, so it cannot be used. Then you might say TOPIX 400 or 500 could be used. However, a very important point is futures. This is also applicable to ETF. Large institutional investors first trade futures: they buy futures and sell futures. This is the basics of their large-volume trading. Accordingly, unless futures are liquid, they cannot make investments.

Consequently, it is necessary to establish TOPIX 400 index, for example, and secure the liquidity of the futures of 400 constituents. I'd like to discuss a possibility of launching a new index with 400, 500 or 300 constituents on a simple market capitalization basis, with other institutional investors, securities companies, and the Stock Exchange as their cooperation is indispensable – I'd like to discuss whether such an index can be used by investors and securities companies in the future.

[Kansaku, Chairman] Thank you.

Mr. Tanaka, please.

[M. Tanaka, member] Let me make a supplementary comment. We should also give consideration to the corporate perspective. Actually, I have approx. 8-year experience in IR. After announcing their financial results, large Japanese companies still work on IR, which is dialogue with investors. In doing so, we already have a forum for dialogue with a group of investors. Such a forum for collective dialogue is routinely used.

As a common practice, companies undertake overseas road shows. In that case, in London, Edinburgh, or New York, it is very common that the companies have dialogue with a group of institutional investors.

In the conversation on such occasions, they actually discuss such topics that are deemed suitable for collective engagement. For example, they naturally talk about CEO and the existing governance structure. I rather consider that companies already have "groundwork" for accepting collective engagement to a certain extent.

I assume that companies are rather bothered by a large number of visits by investors on an individual basis. Large Japanese companies have conducted such IR activities for the past 30 years, so I suggest that we should discuss this issue on the premise that the "groundwork" is in place.

[Kansaku, Chairman] Thank you very much.

Mr. Ueyanagi, please go ahead.

[Ueyanagi, member] First of all, this may overlap with what was discussed last time, but I believe that company-level disclosure of voting results should be realized. This is related to Principle 5 and Guidance 5-3.

Second, I'd like to talk about proxy advisors, which is today's topic. Currently, as the secretariat representative pointed out, Preamble 8 clarifies that while the Code primarily targets institutional investors, the Code also applies to proxy advisors. This may be sufficient in theory, but I suggest that the revised Code should incorporate important issues with respect to proxy advisors, specifically, for instance, the issue of conflicts of interest involving their consulting services which was discussed today, and the issue of whether proxy advisors have sufficient human resources in the context of the concentration of Japanese AGMs on a single day. I'm not sure whether the said U.S. bill will be passed and implemented, but there is an initiative which requires the registration of proxy advisors. So I believe we need to address this issue.

Third, I believe that consideration of environmental, social and governance (ESG) issues or sustainable investment should be emphasized in the future. Today, the Ministry of Economy, Trade and Industry prepared a reference material, and informed us of its study group [on long-term investment (investment evaluating ESG factors and intangible assets)]. I believe that such problem awareness is very important.

In this connection, at the moment, while Principle 3 – I mean Guidance 3-3 – refers to "social and environmental matters", I got an impression that it refers only to a risk-related aspect, although my interpretation may be wrong. While Principle 3 requires institutional investors to monitor investee companies by considering various factors, I believe that such factors should include corporate attitude toward social and environmental issues, or sustainable development or long-term vision of social and environmental issues.

That's all.

[Kansaku, Chairman] Thank you very much.

Mr. Oguchi, please.

[Oguchi, member] Thank you. As all members already expressed their opinions in the first round, I'd like to make some comments.

Basically, when we consider the Stewardship Code, the most important point is what stewardship responsibilities are, as stipulated in the box at the beginning of the Stewardship Code. As Mr. Oba also mentioned, the basic premise is to enhance the mid- to long-term investment return through constructive engagement, based on in-depth knowledge of investee companies and their business environment, and the Code exists for ensuring that institutional investors fulfill such responsibilities. In other words, I consider that the principles themselves are merely a means for fulfilling such responsibilities.

This time, we are supposed to revise the means. Needless to say, the revision must reinforce the original principles for fulfilling stewardship responsibilities. As Mr. Tanaka also mentioned, this is not about just editing sentences. We need to look at the Code from the perspective of increasing the effectiveness.

From that perspective, while today's material focuses on proxy advisors and collective engagement, there always is a criticism against proxy advisors for their superficial judgment. Since they are providing advice on so many voting proposals, that may be unavoidable in a

certain sense, but people are concerned about that.

Actually, I have a similar concern over collective engagement. Mr. Matsushima earlier mentioned that specifics are not clearly laid out. Speaking from our practical experience, after all, we understand that so-called collective engagement is not such a forum for discussing various matters as Mr. Tanaka mentioned, but a forum where institutional investors work together to identify visible agenda and negotiate with investee companies in line with such agenda. This is what collective engagement is in the world of investors.

Therefore, while someone referred to the Investor Forum, I understand that the Forum is an organization leading collective engagement, where companies with certain problems are selected, and a collaborative group of institutional investors intensively negotiates with such companies. Probably, this is different from what Mr. Tanaka mentioned. Unless we have proper understanding of the concept, I'm afraid that our discussion may head in a wrong direction.

When we think about collective engagement, it is important to understand the current situation. What needs to be done? What are the current shortcomings? What is missing in the current stipulation of the Code which was explained earlier? Starting from answering those questions, we need to discuss specifically what should be done. Otherwise, we will not be able to have meaningful discussion.

Nonetheless, I believe that we need to think about the point raised by Ms. Waring last time. It is not desirable for Japan to be considered against [collective engagement] because there is no Japanese term to describe it. Accordingly, the keyword would be "collaboration". For example, page 8 of this Material refers to Guidance 7-3. Let me try to change the wording just for the sake of discussion. Where it currently states, "Exchanging views with other investors and having a forum for the purpose," it can be changed as follows: "Exchanging views with other investors and setting up a forum for collaborative work for that purpose." I'm not sure whether we should use the term "collective" or "collaborative", but adding the term "collaboration" or the equivalent will give a very different impression, although its actual nature may remain unchanged. As I mentioned last time, it is better to use easy-to-understand expressions.

Finally, there has been a change in the situation since the last series of meetings. It is about fair disclosure to be introduced in the future. Today, we are discussing "act of making

important suggestions" and "joint holder" from the standpoint of institutional investors. I assume that the fair disclosure rule will be applied to both individual and collective engagement. However, from the standpoint of companies, if so-called collective engagement relies on the number of participating investors, a company will be vastly outnumbered. I mean that a company surrounded by a large number of institutional investors may get off the track of fair disclosure. To avoid such a situation, if collective engagement is becoming increasingly utilized, companies will need to be more cautious about that. Although it is too early to discuss it, I wanted to raise this issue for our future consideration.

That's all.

[Kansaku, Chairman] Thank you very much.

Mr. Masuda, please go ahead.

[Masuda, member] In addition to my comment at the last meeting, I'd like to express my opinions on proxy advisors, which is today's topic, and engagement of passive managers.

As for relationships between proxy advisors and asset managers, as far as Japanese stocks are concerned, I understand that large asset managers exercise their voting rights by themselves, but that may not be the case with smaller asset managers.

In case of large asset managers, to address the issue of conflicts of interest, in case they exercise their voting rights at their parent company or other companies, with which there is a concern over possible conflicts of interest, they use proxy advisors to a limited extent. I think this is the current actual situation.

Taking our case for example, we first delegate decision-making on proposals of the parent company, etc. to a proxy advisor, and then thoroughly analyze their judgment, comparing with our own judgment. Their judgment is made for the purpose of avoiding any conflicts of interest, so we basically vote in accordance with their advice. However, I believe that asset managers also have a role in checking proxy advisors' judgments.

In addition, within the framework of stewardship, I assume that large asset managers are also responsible for improving the quality of the judgement of proxy advisors, so I believe that asset managers have a responsibility to require proxy advisors to improve their governance or the quality [of their judgment]. This is my first point.

The second point is about engagement of passive managers, as Mr. Oba also mentioned.

The reasons why we need to focus on engagement of passive managers this time would be because the world of equity investment management in Japan remains unchanged since before the implementation of the Stewardship Code. The current framework is like this: If an asset manager reduced tracking errors, and their index funds efficiently tracked a specific index, the asset manager would be deemed to have fulfilled their responsibilities.

In the new era of stewardship, this issue is to be discussed at this Council. Whether or not asset managers do that [i.e. engage with companies] is up to them. They may choose either to comply or explain. However, asset managers with a certain level of passively managed assets should take responsibility [for conducting engagement activities].

They cannot use such excuses as "We have no choice because the index is problematic" or "It is the fault of the asset owner who adopted this index." A change is demanded in this era, so Mr. Hamaguchi's initiative to establish a new index would be one right option. However, given that the outstanding balance of passively managed funds that track TOPIX, etc. has been increasing, what can asset managers do? That is a challenge. For example, in the context of engagement of passive managers, they could take an approach of removing companies which are not worth engaging with from their investment portfolio. Furthermore, there would be another approach where they conduct screening from the viewpoint of passive management, and actively engage with companies in whose corporate value they can expect a significant increase. I consider that they can fulfill their responsibilities as asset managers by taking such approaches.

That's all.

[Kansaku, Chairman] Thank you very much.

Ms. Takayama, please.

[Takayama, member] Following our discussion so far, I'd like to express my views on the 'Comply or Explain' approach as well as ESG.

As for 'Comply or Explain', the consensus among global companies and investors is, as Mr. Tsukuda mentioned earlier, 'Comply and Explain; or Do Not Comply and Explain'. In other words, regardless of whether or not they complied, they are responsible for providing explanations.

In the Preamble of the Code, the interpretation of 'Comply or Explain' is provided as

follows: “comply with the principles or explain why they are not complied with.” This may be literally correct, but I would suggest that the Code should clarify that institutional investors are expected to provide explanations, even in case they complied.

As for ESG, especially environmental and social issues, as Mr. Ueyanagi pointed out earlier, significant matters concerning not only governance, but also social and environmental issues – not all but significant matters – are deeply connected to the long-term economic value of a company and financial returns in terms of both risks and opportunities. This is also a consensus among global companies and investors.

Under this consensus view, they actually have various dialogue concerning E and S, in addition to G [in ESG]. Taking such a situation into account, I believe that we could enhance the explanation or view on social and environmental matters in Guidance 3-3 under Principle 3.

That’s all.

[Kansaku, Chairman] Thank you very much.

Would anybody else like to share their opinions? Dr. Ueda, please.

[Ueda, member] Thank you. Let me share some examples concerning ‘Comply or Explain’ first.

I visited some European investors at the end of last year. Among them, I heard from multiple large asset managers in well-known large financial groups, which probably have offices in Japan, that they had signed up to both the UK and Japan’s Stewardship Codes. At that time, the English version of the Opinion Statement [of the Follow-up Council] was not yet published, so I explained its concepts to them. Concerning company-level disclosure of the voting record, many of them voiced an opinion that while the UK’s Code does not incorporate such disclosure in its principles, Japan’s Code is going one step ahead, but it is a tough requirement.

Then they told me, “but we could explain reasons for not making company-level disclosure.” They said they would provide explanations in a responsible way, referring to how they make disclosures in their own country. If they do not comply, they will explain the reasons in their own words in a thoughtful manner. I found this process would be important.

However, in case institutional investors do not make company-level disclosure, and if

investee companies inquire about how they voted, I'd like to request such investors to provide answers. I believe this is the basics of dialogue. If it is established as a best practice in providing explanations – if company/proposal-level disclosure is made to the investee company in question, even though not publicly disclosed, it will serve as a foundation for dialogue. I hope the Code will be revised, taking account of this point.

Now I'd like to talk about collective engagement, which is today's topic. Thank you very much for referring to my article. My view on collective engagement is simple: it is feasible in Japan as well. Some argue that it is not possible under the current laws, but I do believe that it is possible.

However, as another member pointed out earlier, the term "collective" or "collaboration" is not used in the current Code. That's why people think it may be impossible. After Japan's Stewardship Code was established, Malaysia, Hong Kong, and Thailand also established the codes, and they incorporated collective engagement in the codes. They describe such an expression as "collectively". Compared with these countries, Japan seems to be incapable of adopting it, and that is a disadvantage. Therefore, as Mr. Oguchi mentioned, I think it would be better to write about it in the footnote, not in the main text, stating this is called collective engagement. If significant amendments are made to the main text, Japan will be deemed to have changed its policy, and that's not what it should be.

In general, I support collective engagement, but I think we should give it due consideration first. As Mr. Tanaka also mentioned, there already exists something like collective engagement in Japan. We need to consider that point.

It is a given fact that collective engagement complements engagement on an individual basis. Then what is engagement? Level 1 is discussion on general issues: for example, how the independence of outside directors should be ensured. Level 2 is general discussion with an individual company. Level 3 is discussion or exchange of opinions on certain issues with an individual company. Finally, level 4 is making significant proposals to a specific company.

Probably, the first three levels are already done in the current framework of IR/SR. The issue here should be level 4, where investors make significant and specific proposals. This may be classified as "act of making important proposals" by law. So such engagement activities need to be conducted on a step-by-step basis. You cannot jump into level 4 from the start.

Speaking from the corporate viewpoint, the starting point should be dialogue. In order to create a necessary environment, they could set up a forum for collective dialogue: for example, in case there is any significant matter, such a forum allows a company to have dialogue with multiple investors at all once, instead of having one-on-one meetings. While continuing such engagement, both sides might find the right time to move into level 4, or maybe not.

In the UK, they are very cautious about level 4 engagement. The Investors Forum has been making level 4 proposals by employing lawyers to check laws and regulations in the UK, Europe, the U.S, and other countries, and ensuring good information management. I'm wondering to what extent a collaborative group in Japan can do such things. Maybe they can take a step-by-step approach. It would be necessary to sort out such issues in order to implement collective engagement.

Now, I have talked long enough. Thank you.

[Kansaku, Chairman] Thank you very much.

Mr. Fukumoto, would you like to speak?

[Fukumoto, observer] I'm Fukumoto from the Ministry of Economy, Trade and Industry. In connection with the points raised by Mr. Ueyanagi, Ms. Takayama, and Mr. Oba, I prepared two presentation materials today. May I give a presentation now?

[Tahara] If it is short… If it takes time, could you please provide the presentation later?

[Fukumoto, observer] OK, I'll do it later.

[Kansaku, Chairman] Mr. Tsukuda, please.

[Tsukuda, member] My previous comment was about the topics for the last meeting, which I could not attend. Now I'd like to talk about today's topics.

At the beginning of the meeting, Mr. Oba mentioned that it is important to focus on Substance, not Form. Under both the Corporate Governance Code and the Stewardship Code, the focus of reforms is shifting from Form to Substance, so I'd like to talk about proxy advisors from the substantive perspective.

In the first place, when shareholders exercise their voting rights, what do they vote for? Looking at proposals at general shareholders' meetings of Japanese companies, there are various proposals, including the appropriation of surplus, amendment of the Article of Incorporation, and issuance of subscription rights to shares as stock options. However, the key

proposal would be the election of directors.

Then, concerning proposals for electing directors, what is important when exercising voting rights? For example, in case of re-appointment of directors, the most important factor would be whether the directors in question have contributed to the board so far. In case of new director candidates, the most important factor would be whether they are qualified for contributing to the board. Of course, it should be a given fact that they fulfill formal qualifications, including no conflict of interest, or attendance of the board meetings. Such formal criteria are merely necessary prerequisites, and the most important part is how they satisfy sufficient conditions in terms of Substance.

When considering such Substance, it has been pointed out that advice from proxy advisors is extremely formal or superficial.

The issue here is whether such superficial things can be changed to be substantive. Personally, I don't think it is possible. As someone commented earlier, institutional investors have no choice but to use proxy advisors to a limited extent, for example, in case there is any conflict of interest.

Then what is the most important consideration after all? There is no alternative for institutional investors but to increase opportunities to have dialogue with directors, directly observe such directors, and make voting decisions based on their own findings through such engagement.

In that sense, while we have been discussing joint engagement or collective engagement – of course, it is important, who carries out IR activities of companies? In most companies, executives, including President, CFO, or other corporate officers or division managers, are in charge.

I heard from some institutional investors that they would like to meet with outside directors as well. Yet companies hesitate to create such opportunities, and institutional investors can hardly communicate with outside directors.

I think that the concept of "outside directors and inside directors" is specific to Japanese. In that sense, in order to enhance the substance of the exercise of voting rights, actually, this issue and engagement issue are connected, and there is no alternative but to enhance engagement. For that purpose, I believe that it would be extremely important to encourage communication

between outside directors and institutional investors.

Some companies have already been actively making such efforts. I'm not sure whether this should be incorporated in the Stewardship Code or the Corporate Governance Code, but I'd like to request the Financial Services Agency to promote such engagement.

That's all.

[Kansaku, Chairman] Thank you very much.

Mr. Nagashima, please.

[Nagashima, member] Thank you. I'd like to talk about collective engagement. From the perspective of people engaged in fund management, I believe it is important that market transparency, the initiative of asset managers and related parties, and market mechanisms should be maintained even after the Code is revised.

As a fund manager, I think that most asset management companies don't think to do collective engagement with regards to active fund management, because this is often the focus of our business and the source of our value.

However, with regards to passive fund management, our participation in collective engagement is decided on a case-by-case basis. For example, we are more likely to do collective engagement in case of a corporate scandal. I hope these facts are taken into consideration when the Code is revised.

[Kansaku, Chairman] Thank you very much.

Mr. Hamaguchi, is your comment related to this point?

[Hamaguchi, member] No.

[Kansaku, Chairman] Then, Mr. Kato, please go ahead.

[Kato, member] Thank you. I'd like to make some comments from the perspective of making the 'Comply or Explain' approach more effective.

First of all, it was pointed out today that we should consider the 'Comply or Explain' approach as 'Comply and Explain; or Not Comply and Explain'. I think this is a very important point. This is applicable not only to the Stewardship Code, but also to all cases using the 'Comply or Explain' approach.

From that perspective, the important point is what information is disclosed in what manner. These points may be very different between disclosures under the Corporate Governance Code

and the Stewardship Code.

In case of the Corporate Governance Code, the Tokyo Stock Exchange serves as a hub, and provides various kinds of information in the format of Corporate Governance Reports, which are accessible for investors. On the other hand, in case of the Stewardship Code, there is no such mechanism. The Financial Services Agency uploaded, on its website, a list of institutional investors with links to their websites in the format of PDF file using a very small font, and that's it. Is this acceptable? This is my first comment.

Next, in reviewing the mechanism of disclosures, we need to be conscious of why we require institutional investors to explain under the Stewardship Code. Is it based on the assumption that asset owners use such disclosure documents for selecting asset managers? Or is it sufficient that each institutional investor give consideration to the Code? Depending on the reason, the necessary mechanism of disclosures may change.

In that sense, I'm interested to know whether asset owners are reading existing disclosure documents related to the Stewardship Code. Furthermore, if they are not happy with the current disclosures, it means there are areas to be improved.

[Kansaku, Chairman] Thank you.

Now I'd like hand it over to you, Mr. Hamaguchi.

[Hamaguchi, member] Concerning company-level disclosure of voting results, I'd like to make a comment in addition to what I said last time. After listening to other members' opinions and reading the Opinion Statement once again, I'm fully aware that the purpose of disclosure is to avoid possible conflicts of interest, so disclosure should allow ultimate beneficiaries to judge it.

Then, I'd like to raise a question, in addition to what I said last time. The Opinion Statement suggests that both asset managers and asset owners should make it a principle that they disclose company-level voting results to the public. In light of the said purpose, this statement is rather slipshod. In case of investment trusts for example, since ultimate beneficiaries are the general public, it would be all right to require public disclosure.

Taking a typical example, beneficiaries of corporate pension funds are not the general public. If we follow what is written in the Opinion Statement and set a principle of public disclosure of company-level voting results, a question will arise: why do they need to make

disclosure to unrelated third parties? The Code should make such disclosure a principle only in case ultimate beneficiaries are the general public. Otherwise, unnecessary explanations for not making such disclosure will increase, and that is a waste.

[Kansaku, Chairman] Thank you very much.

Mr. Tanaka, please go ahead.

[W. Tanaka, member] I'd like to share my opinion about collective engagement.

First, as Dr. Ueda mentioned, collective engagement is feasible under the current legislation. Certainly, there are some cases with legal risks, but legal risks exist in every country in a certain sense. Generally speaking, I believe that various things can be done [through collective engagement] in Japan as well.

What is expected from the term "collective engagement"? As Mr. Oguchi pointed out, a collaborative group of investors are expected to point out problems with certain companies, or I would even say that they are expected to press the issues and demand improvement. That way, they could work on a wide variety of matters.

In doing so, there are certain legal restraints as explained earlier today. One is "act of making important suggestions". If investors conduct an act that falls under the category of "act of making important suggestions", they will not be able to use the special reporting system. The regulation concerning "act of making important suggestions" currently covers a wide range of conducts. Accordingly, in case an institutional investor, who holds more than 5% of voting rights on its own, makes a request concerning the company's capital policy or business policy, it is highly likely to fall under the category of "act of making important suggestions".

However, if an investor holding more than 5% of voting rights conducted such an act, the investor could disclose to ordinary investors the fact of conducting such activities. This is a possible option, and such investors are not prohibited to conduct "act of making important suggestions".

Now let's think about a case of collective engagement where multiple institutional investors collaborate and make a certain request to a company. In this case, no single investor holds more than 5% voting rights on its own. Therefore, according to the current legislation, only when they have agreed to jointly exercise their shareholder rights, this 5% rule is applied. If they are outside the scope of the 5% rule, they will not be subject to regulation under the

large shareholding reporting system, so we do not have to think about the issue of "act of making important suggestions" in this case.

Furthermore, even if aggregate voting rights exceed 5%, unless they have agreed to jointly exercise their shareholder rights, they will be outside the scope. Companies can implement most policies, for which collective engagement is conducted, without resolution of general shareholder meetings (AGMs). For example, companies can conduct most activities, including a capital increase, M&A which may not necessarily result in capital improvement or increased returns, or individual investment, without resolution of AGMs. Accordingly, even if a collaborative group of investors are against such acts of the companies, generally it will not be considered that they have agreed to jointly exercise their shareholder rights.

Certainly, there are capital policies or business policies which require resolutions of AGMs. For example, in case of a capital increase which additionally needs to be authorized by the Articles of Incorporation, the company cannot increase capital without resolution of the AGM. Accordingly, if investors are against such a business policy, it is considered that they will vote against the proposal, and therefore, it is associated with the exercise of shareholder rights. Furthermore, in case of M&A, if investors are against any reorganization which requires a resolution of the AGM, it will be associated with the exercise of shareholder rights.

However, even in such circumstances, unless investors in the group have agreed to jointly exercise their shareholder rights, the regulation does not apply to them. As clarified when we sorted out legal issues at the time of establishing the Stewardship Code, agreement should have a nature that one party makes a promise with another party, or both parties make a firm promise with each other, concerning one's behavior [in the futre]

Institutional investors have fiduciary duties to their own clients. Even if an institutional investor found common ground with other investors and said "That proposal is not acceptable. Let's vote against it," the investor gives further consideration to the proposal until the date of the AGM, and may judge that casting a 'for' vote will be the benefit of their clients. Then they will vote for the proposal without hesitation. In doing so, they never consider that they violate the promise to other investors. It's obvious that other investors also regard the investor's statement to the same effect.

Accordingly, in general, even if institutional investors express collaborative opposition to a

company's capital policy or business policy which is associated with a certain proposal to its AGM, the investors who expressed the opposition will not be considered to have made a mutual agreement to exercise their voting rights jointly at the AGM in most actual cases, I think.

In addition, I believe that legal risks over this issue can be controlled to a certain extent. For example, there are cases where institutional investors opposing a certain company's policy write a letter in their joint names to the company. In doing so, by clearly describing that the letter in their joint names does not constitute an agreement among the investors concerning the exercise of their voting rights, they can probably mitigate legal risks.

As I just mentioned, there is room to consider the regulations under the current legislation in many ways, but even with the current regulations, I believe that collective engagement is quite possible.

At the last meeting, Ms. Waring pointed out a concern about Japan's stance to collective engagement, specifically the fact that it is not stipulated in the Stewardship Code. I think we should take it seriously. As I just mentioned, the regulations generally do not prohibit collective engagement. However, if investors feel it is difficult to do so, are afraid of legal risks, or have a perception that the authorities deem it undesirable setting aside the details of the regulations, they will not actually conduct collective engagement, I assume. If so, I suggest that the Code should include descriptions concerning collective engagement.

The UK's Stewardship Code certainly includes a principle on collective engagement, and stipulates that institutional investors should be willing to act collectively with other investors where appropriate. It uses the expression "be willing to". It does not state that institutional investors should collectively engage with companies on a routine basis. It simply states that they should "be willing to" do so "where appropriate".

Therefore, even institutional investors, who have never conducted collective engagement in the past, can comply with this principle. I believe this principle clearly presents such an intention. In case Japan's Stewardship Code incorporates a principle on collective engagement, I think it will and should be similar to the said [UK's] principle.

In case such a description is to be included in the Code, it does not necessary have to be written in a Principle. Instead, it can be described in Guidance under Principle. However, I'd

like to make a comment to the explanation provided by the secretariat concerning Guidance 7-3 under Principle 7. It refers to the exchange of opinions among investors, and thus, it is not reasonable to consider that the said Guidance refers to collective engagement. While collective engagement means dialogue between a collaborative group of investors and a company, exchanging opinions among investors is sort of preparation for that, and we cannot call such activities collective engagement, in my opinion.

Accordingly, if descriptions about collective engagement are to be incorporated in the Code, it will be desirable to provide such descriptions in Guidance under Principle 4, which stipulates dialogue between companies and investors. In doing so, it could be described, for instance, as follows: institutional investors may have dialogue with companies on an individual basis, but may take collective action with other investors to have such dialogue with companies, where appropriate. The Code could also refer to the fact that some investors have already done that.

Even in the UK, it is stipulated that collective engagement should be conducted as appropriate, not on a routine basis. So if Japan's Code refers to collective engagement in the manner I just described, it will not make an unreasonable demand to investors in light of the current legislation, and will successfully fix a misperception that Japan is reluctant to encourage engagement. If so, I believe that such a description should be included in Guidance.

I'm afraid that I have used a long time. That's all.

[Kansaku, Chairman] Thank you for concrete suggestions. Mr. Matsushima, please.

[Matsushima, member] I couldn't agree more with what he just mentioned.

We consider we are ready for collective engagement, but if the Code includes descriptions which encourage collective engagement on a routine basis, it will be likely to cause an adverse effect. That is because reaching an agreement [when investors in a group have different perspectives] may require us to alter our perspective.

Therefore, we need to consider whether making such a compromise is good for us. When we need to fulfill our responsibilities to investors, it is better to make it a principle to collaborate to the extent we can do so. If the Code recommends collaboration, it will mess up priorities. So I think he offered an easy-to-understand and great suggestion.

[Kansaku, Chairman] Thank you very much.

Well, Mr. Kawada, please go ahead.

[Kawada, member] Thank you. I'd like to speak from the standpoint of a person in charge of AGMs of a company with long experience, for your reference.

I'd like to talk about relationships between proxy advisors and institutional investors, as well as collective engagement. When our company held a AGM last year, we submitted a proposal for electing directors. Actually, our company incurred a loss for the second consecutive year.

There were several reasons for the loss. Private oil companies including us have a legal obligation to have crude oil stockpiles to cover 70 days of usage. Accordingly, extreme fluctuations in crude oil prices incurred valuation loss on inventory for the purpose of accounting, and we had to report a loss of hundreds of billions of yen, while securing effective ordinary income excluding such valuation loss on inventory. However, in case an average return on equity (ROE) in the past five years is below 5% and a company has failed to improve its ROE, proxy advisors recommend, in principle, to vote against proposals to elect directors as executive chairperson or president.

Our company explained our special circumstances to proxy advisors many times. However, they said, "If we hear circumstances of an individual company, we will have to hear from all companies. Therefore, we will make a judgement based on formal criteria, and recommend to vote against the proposal." Consequently, they announced that they recommended to vote against our proposal.

We found ourselves with a problem, so we wrote a letter to domestic and foreign institutional investors. In that letter, we wrote that Japanese oil companies like us have a legal obligation to stock crude oil for 70 days of usage, and are materially affected by price fluctuations; our company, therefore, had to report a loss, but we effectively secured this much in earnings. As a result, many foreign institutional investors, who exercised their voting rights via the Internet, had initially voted against the proposal, but finally they voted for the proposal. Probably, they initially followed advice from proxy advisors, and voted against the proposal of electing directors who served as president and executive chairperson. However, after we sent this letter, their voting decisions changed from 'against' to 'for'.

This experience left us an impression that dialogue is extremely important. At the same time, we found that more than the expected number of institutional investors exercised their

voting rights in accordance with recommendations from proxy advisors. Accordingly, dialogue is very important, and if we gain investors' understanding, their investment behaviors will also change. I wanted to share such an experience of ours for reference.

That's all.

[Kansaku, Chairman] Thank you for your valuable input.

Would anybody else like to share their views? Mr. Shimizu, please.

[Shimizu, member] I'd like to talk about collective engagement, and also make a comment, which is not directly related to governance of proxy advisors. If it is all right, I'll talk now. If it is better to talk later, I'll do so.

[Shimizu, member] May I? Thank you.

I'd like to talk about what I felt while listening to other members' opinions on today's topics - collective engagement and governance of proxy advisors.

Today's topics are collective engagement and governance of proxy advisors. In a broad sense, I think the point of these issues is what is necessary to increase the quality of overall engagement. In other words, it is necessary to consider how to improve the quality of dialogue not only in case of collective engagement, but also in case of engagement on an individual basis. I understand today's discussion is a part of such broad discussion. It also corresponds to Mr. Toyama's opinion in his paper stating that it is necessary to improve the quality of dialogue.

Life insurance companies make investments from the long-term perspective, and place an emphasis on dialogue. Speaking from that standpoint, I believe that improving the amount and quality of dialogue is our challenge, as well as an important matter for all institutional investors.

Consequently, it is important to have broad, active, and continuous discussion for improving the amount and quality of dialogue, so that it leads to a better revision of the Stewardship Code. I think it is important that such a cycle continues without interruption.

Upon participating in this Council of Experts, I reviewed what was discussed at the Follow-up Council. Its members argued that [the Code] needs to include discussion for improving the quality of dialogue. In my understanding, it should be each asset management company that considers necessary measures. I don't think that the Code should go into too

much detail on this. Instead, it is important for investors to provide broad explanations and be evaluated by the public. Therefore, we have discussed that it will not be reflected in the revised Code.

The important point here is how [the Code] can facilitate the process where the investors provide broad explanations and get evaluated. I think this point overlaps with the concept of 'Comply and Explain', which Mr. Tsukuda, Ms. Takayama and Mr. Kato discussed earlier.

In order to improve the quality of dialogue, for example, 'Explain' would be one necessary thing. Taking the importance of dialogue into account, in disclosing their stewardship activities, it is important to further enhance explanations on engagement activities. Investors should provide more appropriate explanations as to the number of opportunities for dialogue, examples of dialogue, outcome from dialogue, and how they achieve further improvement through PDCA (Plan-Do-Check-Act) cycle, thus improving the quality of dialogue. Disclosure is just one example. I hope that this Council will have discussion for continuously improving the amount and quality of dialogue, thus contributing to better revision of the Code.

That's all.

[Kansaku, Chairman] Thank you very much.

Anybody else? Mr. Ueyanagi, please go ahead.

[Ueyanagi, member] I'll try to make it as short as possible. As for collective engagement, at this stage, we can take a stance that intended collective engagement is feasible under the current legislation, as many members discussed. As a future challenge, although Dr. Ueda stated that it is too early to go for level 4 as in the UK, I think we need to think about it in the future.

I'll tell you the reasons. The basic assumption is that each institutional investor reflects its direct asset owners' intention in the market. To that end, an institutional investor needs to collaborate with other investors, where appropriate, to make suggestions to the company in question, or to change the company's behavior. The number of very influential institutional investors, including pension funds among others, has been increasing. The general public entrust them with a large amount of money. In case a company commits an act that is not necessarily desirable, instead of merely voting against the company's proposal even if it ends up to be a minority opinion, institutional investors are somewhat expected to take positive

action, including – I dare to say – attracting many voters from the opposite side. Or I would say that such an era will come. Since it is necessary to be aligned with the legislation, I thought I should study the matter.

That's all.

[Kansaku, Chairman] Thank you very much.

Dr. Ueda, please.

[Ueda, member] As my name was mentioned, I'd like to respond to the comment.

What I meant by saying it is too early to go for an act of making proposals is that they are not ready for it. Institutional investors are not ready, and companies are not ready, either. However, forums for discussion as a preliminary step toward that level are still necessary. I think they already exist in some way or other. I didn't mean that they cannot conduct such activities. In some cases, something like an act of making proposals, or something that falls under the category of "act of making important proposals" defined by law is feasible under the current legislation. We could make this point clear in the discussion.

While we have discussed active management and passive management, except for cases that bring the significant public benefit and have an impact of facilitating a change of the entire market, even though institutional investors conduct an "act of making important proposals" to individual companies, I doubt about whether it will be reflected in beta. I wonder if they can generate appropriate returns for costs of hiring lawyers. Rather, in these cases, active strategies have room for better performance. Although I talked about nice things, in reality, it would be case by case. However, I consider it is necessary to make it a practice.

Thank you.

[Kansaku, Chairman] Thank you very much.

Mr. Oguchi, please.

[Oguchi, member] Let me make a brief comment in response to Mr. Ueyanagi. The current legislation does not prohibit "act of making important suggestions". As Professor Tanaka provided a detailed explanation earlier, if large holders conducted "act of making important suggestions", they cannot use the special reporting system. Conversely, large holders could conduct such acts with appropriate reporting.

At the moment, there are some asset managers who have more than 5% of voting rights

and conduct “act of making important suggestions”. They are not doing something wrong. However, if they conduct such an act, they should disclose the fact, which is necessary information for other market participants. That is the underlying concept of the system, I think. If they make appropriate disclosures, I think they should go for it. Nonetheless, when it comes to collective engagement, there always is a misunderstanding that it is prohibited. Taking this opportunity, I’d like to emphasize once again that it is all about disclosure.

[Kansaku, Chairman] Thank you very much.

Mr. Fukumoto, I’m sorry to have kept you waiting. Now I’d like to hand it over to you.

[Fukumoto, observer] I’d like to make a comment before making the presentation, because we often receive inquiries from foreign investors and various people. Foreign investors generally tend to raise a question to any system that is different from their system. Therefore, when we explain this Code, we need to explain that this can be substantially covered under the existing Code and issues are to clarify the text, etc.. Under such a circumstance, when we change a general expression to clarify what it means in practice, we should make sure either the fact we changed means that it cannot be done without the change or not.

The material prepared by the Ministry of Economy, Trade and Industry consists of two parts, summarizing the first meeting of two Study Groups. These Study Groups discuss wide-ranged issues. For your reference, this material summarizes discussions related to Principle 3 and Principle 4 of the Stewardship Code. Guidance 3-1 states “with the aim of enhancing the medium- to long-term corporate value and capital efficiency and supporting the sustainable growth of the companies” by placing an emphasis on mid- to long-term perspective. For that purpose, Guidance 3-3 stipulates that investors need to capture information on investee companies’ governance, strategy, performance, capital structure, and risk management. This part is related to my presentation.

Under Principle 4, Guidance 4-1 similarly stipulates that institutional investors should have constructive dialogue with the aim of enhancing investee companies’ medium- to long-term value and capital efficiency, and promoting their sustainable growth. This is also related to my presentation.

I’ll briefly explain about the “Study Group on Long-term Investment (Investment evaluating ESG Factors and Intangible Assets) toward Sustainable Growth.”

Page 2 shows the member list. Some members of this Council are also included.

Please take a look at page 3. The objectives of the Study Group are summarized in the box. As measures for improvement of sustainable corporate value and promotion of mid- to long-term investment – for enabling both institutional investors and individual investors to make investments and gain appropriate returns, what should we think about ESG and investment in intangible assets? Both ESG and investment in intangible assets have various factors to consider. According to the objectives as mentioned earlier, the Study Group has been discussing how the long-term corporate value can be steadily increased.

Please turn to page 4. As the objectives of the Study Group, issues to be discussed are indicated in the chart. I think the aim of discussion is in line with that of this Council concerning the Stewardship Code. Issues on the side of companies are shown on the left, and issues on the side of investors and capital market practitioners are shown on the right. What are ideal approaches to judging and evaluating long-term investments? What ideal approaches to make long-term investment decisions and evaluate investments of the companies should be? As written below, for that purpose, what are ideal actions, dialogue and communication overall? The Study Group has been discussing such issues.

There has been a significant progress in the discussion. Please take a look at Material 7 on the next page. This material was prepared for the meeting of the Study Group on January 10th, and clarified issues to be discussed concerning policy responses. For example, the first point is about formulating guidelines on disclosure and dialogue for promoting long-term investment - investment in intangible assets and investment evaluating ESG factors. The Group will also discuss the following points: comprehending the current state of investments in intangible assets properly; making evaluations of such investments visible; and promoting such investments.

Please turn to the next page. As the fifth point, the Group will also discuss ideal approaches for promoting overall long-term investment. This point is related to the issue of institutional investors' decisions on investment and exercise of voting rights, which are also discussed by this Council. The Group will discuss how such factors work in a way to promote long-term investment.

The sixth point refers to market indexes. The seventh point is about creating an

environment that promotes long-term investments. I assume that it is closely related to how the Stewardship Code will be revised, and in what way the implementation of the Code will change, which are discussed by this Council.

Now I'm moving on to Material 5 on the next page. Formulating guidelines for promoting long-term investments is one of key issues, as I just explained. The Group is currently working on it. Naturally, we take into account principles stipulated in the Stewardship Code, and invited investors, representatives from companies, and experts as the Group members.

As I mentioned at the beginning, there are various international frameworks, which we consider very important for communicating with the global invesotrs' community, but we also asked the Study Group to discuss necessary matters to formulate guidelines that are convincing to Japanese business managers and investors, and are widely accepted among them. That's all for my presentation on this Study Group.

Now I'd like to introduce the "Study Group on Promoting Electronification of Processes for Shareholder Meetings". Mr. Kawada and Mr. Oba also referred to this topic. This Study Group discusses the processes for shareholder meetings, especially how we can facilitate dialogue, including the exercise of voting rights, and address the issue of the concentration of meeting dates or peak period, and time constraints, focusing on the keyword "electronification".

You can find subjects to be discussed by the Group on page 2. To create a world-class environment for dialogue, the Group has discussed what should be done to ensure appropriate information provision and secure the period for shareholders to deliberate agenda, focusing on issues described on page 3 of the material.

Such issues include promoting electronic provision of notices of shareholder meetings and other materials, and introducing an electronic voting process, which is described as recommendation No. 2 on page 4. The latter is related to this Council. These recommendations were published last April, and the follow-up meetings will be held from next Wednesday. Promoting such an electronic voting process is related to Principle 5 of the Stewardship Code, which refers to a policy on voting.

It is, however, said that some parts of the electronic voting process achieved a progress, and other parts did not for various reasons. One focus area of our current efforts is the linkage

between two electronic voting platforms, namely ICJ and ISS. Some argue that it is necessary to obtain approvals of asset owners.

As a potential solution, a number of people mention that it is essential to clarify the stance of asset owners who delegate their voting rights toward such electronic voting. When the Stewardship Code is to be revised to create an environment that allows easier conduct of stewardship activities by institutional investors, I'd appreciate it, if you could give consideration to our discussions.

In addition, I'm aware that this Council addresses the concentration of AGM dates. Since our Study Group is also discussing this issue, I'd like to proceed with the discussion in tandem with this Council.

That's all from me.

[Kansaku, Chairman] Thank you very much.

Does anybody have questions or comments concerning Mr. Fukumoto's presentation? Mr. Hamaguchi, please.

[Hamaguchi, member] You referred to asset owners' approvals. Although I've been monitoring this discussion at the Study Group and heard about the remark, I still do not understand why their approvals are required. Basically, asset owners delegate their voting rights to asset managers under discretionary investment contracts, thus leaving voting decisions to the discretion of the asset managers. If such an arrangement is efficient, we will have nothing left to say but, "Please go ahead with that arrangement." However, it is often argued that such an arrangement is an obstacle to get the process going. I'd like you to understand that asset owners are not in a position to be asked for approval.

[Fukumoto, observer] That's exactly the point. Everyone in the investment chain tends to lay the blame on others. We are trying to bring everyone to the same table, and find out the actual situation vis-à-vis what was argued. As Mr. Hamaguchi pointed out, if asset owners clarify that they concluded discretionary investment contracts [that leave everything to the discretion of asset managers] and express their intention to support electronic voting, there will be no room for other players to make excuses, and electronic voting will become possible. Nonetheless, they are currently using such an excuse. Therefore, the Study Group is discussing ways to get rid of it. I'd appreciate it, if Mr. Hamaguchi clarified that point, or confirmed that

there is no problem with that at this Council.

[Kansaku, Chairman] Thank you very much.

Mr. Tanaka, please go ahead.

[M. Tanaka, member] That argument is familiar to me, and I'd like to introduce something – it's GPIF's annual report. I think this is probably the first report of this kind, which GPIF published.

In this report, its view on the exercise of voting rights is described as follows: "The GPIF itself does not exercise voting rights and instead entrusts the external asset managers with the exercise of voting rights so as not to give rise to a concern that the GPIF could have a direct influence over corporate management. The GPIF will also suggest to the external managers that they should recognize the importance of corporate governance and that the voting rights should be exercised to maximize the long-term interest of shareholders. The GPIF will ask each external asset manager to establish a detailed proxy voting policy (guideline) and to report the voting results to the GPIF."

Specifically, "external managers submit the guideline for voting and annually report voting results to the GPIF. The GPIF holds meetings with the managers on the results, and in the annual evaluation process of each manager by the GPIF, the way a manager exercises voting rights is considered in the qualitative part of evaluation."

As described in the material for the first meeting, the fact that GPIF, which accounts for a large share among asset owners, has taken such an approach would have some positive influence.

Looking at the member list of the Study Group of the Ministry of Economy, Trade and Industry, I found Mr. Mizuno [of GPIF] is also a member, so I'd like the Study Group to have discussion including such a point.

That's all.

[Kansaku, Chairman] Thank you.

Mr. Oba, please.

[Oba, member] Due to time constraints, I'd like to make only two points, focusing on the perspective of increasing the effectiveness.

First of all, Professor Tanaka suggested that it should be better to include descriptions on

collective engagement in Principle 4, making it easier to understand the intent. In a similar sense, the current Opinion Statement of the Follow-up Council refers to self-evaluation of asset managers: they should regularly conduct self-evaluations and disclose the results to the public. The Corporate Governance Code refers to board evaluations, and I think these are in pairs.

Principle 6 stipulates that institutional investors in principle should report periodically on how they fulfill their stewardship responsibilities. This cannot be achieved without self-evaluations. Therefore, I believe that the term "self-evaluation" should be included in Guidance under Principle 6, so that it will be easier to understand, thus securing the effectiveness. This is my first point.

Another point is related to what I pointed out earlier. The Opinion Statement of the Follow-up Council states that, from the perspective of enhancing effectiveness of passive management, passive managers are expected, for example, to remove stocks which are deemed obviously inappropriate for investment from their passive index.

I think this is important. Mr. Kawada's opinion is symbolic. Index fund managers make investments by looking at indicators, not companies, so it may be difficult for them to have dialogue with companies.

Looking at companies well and having more in-depth and effective dialogue – that should be the basic spirit of the Stewardship Code, so I believe it is essential to emphasize the significance of this spirit once again.

That's all.

[Kansaku, Chairman] Thank you very much.

Anybody else? Although we still have plenty to say, it's already the scheduled 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 for your active discussion today.

As for the next meeting date, we'll find the date convenient for the most of you, and let you know the date.

That's all from the secretariat.

[Kansaku, Chairman] Thank you. Now I declare this meeting adjourned. Thank you very much for your participation.

END