

## **The Third Council of Experts on the Stewardship Code**

1. Date and Time: March 22, 2017 (Wednesday) 13:00-15:00
2. Venue: 13F, Central Government Building No. 7, Meeting Room No. 1

[Kansaku, Chairman] It is 13:00. I would like to start the third meeting of the Council of Experts on the Stewardship Code. I thank you very much for taking the time from your busy schedule to attend this meeting.

Then, let me move straightly on to the agenda. The secretariat has put together a draft revision of the Stewardship Code based on our past discussions. Today, I would like you to discuss the draft. After we close the discussions today, we will have Ms. Aoyama, the observer from the Ministry of Health, Labour and Welfare (MHLW), introduce us to the report of the council of experts of MHLW and Pension Fund Association on the stewardship code, which was publicized on March 17.

[Tahara, Director of the Corporate Accounting and Disclosure Division, FSA] First, I would like to proceed with my explanation following “Principles for Responsible Institutional Investors” <<Japan’s Stewardship Code>> (Draft),” which was distributed to you.

In revising the Stewardship Code this time around, we prepared a preamble in the first two pages. Paragraphs 1 to 3 discuss the history from the formulation of the Stewardship Code to the establishment of this Council. Paragraph 4 introduces five main proposals that were made in the Opinion Statement published in November 2016. As I understand that we have discussed so far that these five proposals should be included in the Code, these proposals are included in the draft revision which I am laying out.

Next, Paragraph 5 which follows describes three other issues that have been discussed here apart from the five proposals. The first issue addresses proxy advisors. The current Code stipulates that the principles, such as management of conflicts of interest, are applicable to such advisors. I understand that it has been pointed out in the Council that, in addition to the current requirement, it is important for proxy advisors to dedicate sufficient management resources in providing their services.

Then, the issue of collective engagement was also addressed. Some argued that the option of such engagement should be included in the Code. On the other hand, we have heard many voices saying that when carrying out collective engagement, it may be necessary to pay attention sufficient enough to prevent dialogs from becoming mechanical.

Regarding the third issue concerning so-called ESG factors, it has been mentioned that ESG factors, which are considered important under each investee company's specific circumstances, may affect medium- to long-term corporate value in terms of both business risks and opportunities. In respect of the three issues, we have incorporated them in this draft revision of the Code.

Next comes Paragraph 6. First, we would like you to discuss it. Then, we will have one month or so to invite public comments on the draft revision of the Code. Subsequently, we will finalize a revised Code. After that, we will have institutional investors start to respond to any issues they may have with the revised Code. Of course, we would like to ask institutional investors to comply as soon as possible if they are already prepared to do so. However, expecting institutional investors to comply within six months at the latest, we took the liberty of setting down the contents of Paragraph 6.

Pages 3 to 7 constitute a preamble when the Stewardship Code was formulated through cooperation with you. Some alterations were made in this portion as well, which I would like to explain to you. Apart from descriptions including the timing to which we made adjustments, first comes Page 5. There are some changes in terminology. We formerly used the terms, "institutional investors as asset managers" and "institutional investors as asset owners." It was said that such terms were too long. Considering the deliberations of the Council and sufficient discussions at the Follow-up Council("The Council of Experts Concerning the Follow-up of Japan's Stewardship Code and Japan's Corporate Governance Code"), we expect you to agree to the change of these terms to "asset managers" and "asset owners."

I will now move on to Page 6. Paragraph 12 deals with the concept of "comply or explain." When formulating the Stewardship Code, we spent a great deal of time elaborating on the incorporation of the idea of "comply or explain." However, during recent discussions at the Follow-up Council or the Council, we have arrived at the understanding as it was pointed out that "comply and explain" would be also important. Therefore, we added that idea to the last

part of Paragraph 12.

About Pages 6 to 7, the coverage of “comply or explain” has been the principles including Guidance since the time discussions took place on the formulation of the Stewardship Code. As the number of Guidance has not been so high relative to that of the principles until now, complying with the principles in actual practice is deemed to establish full compliance. However, as we are making a revision by adding Guidance this time around, we are thinking that it would be better to clarify that the principles including Guidance are subject to “comply or explain.”

In this regard, Footnote 4 reads that some Guidance may not necessarily specify that certain actions should be taken and states that certain matters are “important” among others. These Guidance do not necessarily seek an explanation of non-adaption. Accordingly, we consider that they are not necessarily included in “comply or explain.”

As I have mentioned, the preamble ends on Page 7. Page 8 onwards discusses the principles and Guidance. As a result of considerations at the secretariat, we have concluded that the principles themselves need no modification, taking recent discussions at the Council in particular into account. Therefore, I would like to explain changes in the Guidance from Page 9 onwards. Paragraphs 1-3 to 1-5 deal with asset owners. Paragraph 1-3 describes that asset owners should engage in stewardship activities themselves as much as possible to secure the interests of ultimate beneficiaries. The paragraph also reads that when asset owners do not directly engage in stewardship activities, they should, as a matter of course, request that their asset managers be engaged in effective stewardship activities on their behalf.

Paragraph 1-4 discusses that, when selecting or issuing mandates to asset managers, asset owners should clearly specify issues and principles to be required in conducting stewardship activities to ensure effective stewardship activities. In addition, large asset owners in particular should proactively consider and clearly specify issues and principles to be required when asset managers conduct stewardship activities.

Paragraph 1-5 refers to monitoring, stating that asset owners should effectively monitor whether their asset managers conduct stewardship activities in line with asset owners’ policies, making use of methods including asset managers’ self-evaluations.

In Principle 2 on Page 11, we specify a draft revision to the matter related to conflicts of

interest.

Paragraph 2-2 concerns how to manage conflicts of interest. We describe that asset managers should identify specific circumstances that may give rise to conflicts of interest which may significantly influence the exercise of voting rights and/or dialogue with companies, and set out and disclose specific measures for avoiding such conflicts of interest and effectively eliminating their influence.

Paragraph 2-3 prescribes that asset managers should establish governance structures to ensure that the above actions are taken without fail. In Paragraph 2-4, we describe that the management of asset managers have important roles and responsibilities for the aforementioned matters.

We wrote the above paragraphs almost completely along the lines of matters that were also pointed out at the Follow-up Council.

Paragraph 3-3 on Page 12 includes one of three additions that I touched on before. Currently, social and environmental matters are exemplified with “risks included” and described with a focus on risk factors. Since they are examples, business opportunities would be appropriately included if they are relevant. We have understood that, during discussions at the Council, ESG became a recent topic, and the view that this issue should be addressed with a focus placed on both risk and business opportunities was raised. We clearly specify business opportunities, and as we are aware that it was pointed out that Japan’s stewardship code does not refer to ESG. In this regard, we have clearly specified in the footnote that certain matters are called ESG factors to highlight that ESG is referred to unequivocally.

Page 13 includes Paragraph 4-2, which refers to passive management about which we heard several remarks since the Follow-up Council. We have written that, because passive management provides limited options to sell investee companies’ shares, and the need to promote their medium- to long-term increase of corporate value is great, institutional investors should actively take charge of engagement and voting from a medium- and long-term perspective.

Paragraph 4-4 refers to the second of the three additions that I mentioned above, describing collective engagement. Whereas it does not mean that collective engagement cannot be carried out under the current Code and legal systems at all, a comment was raised that, with no

wording of collective engagement formally found in the Code, such an action does not seem to be permitted. To revise the Code this time around, we have included the wording of collective engagement so as to eliminate that doubt.

Moreover, in formulating the stewardship code, we summarized legal issues to facilitate such an action. This matter is again referred to in footnotes.

On Page 15, the guidance for disclosure of voting records is summarized.

In respect of Paragraph 5-3, institutional investors should aggregate voting records into each major type of proposal and publicly disclose them under the current Code. However, our understanding is that the Council discussed this time around that, in principle, institutional investors should disclose voting records for each investee company on an individual agenda item basis. Thus, we have described that process accordingly.

On the other hand, we clearly specify that if there is a reason to believe that it would be inappropriate to disclose such company-specific voting records on an individual agenda item basis owing to a specific reason an investor may have, an option is provided whereby the investor should proactively explain that reason.

Also, since the Follow-up Council, the opinion was voiced that, at the time of their voting records disclosures, it is also considered beneficial in enhancing the visibility for institutional investors for them to explicitly explain the reasons why they voted for or against a specific agenda item. Accordingly, we incorporated this matter in the description.

As I explained before, please note that such expressions as “is considered” are not necessarily included in “comply or explain,” as stated in Footnote 4. Based on that line of thinking, this portion falls outside of “comply or explain.”

I move on to Page 16, which discusses the third point of the three additions. We describe matters related to proxy advisors in Paragraph 5-5. We wrote that proxy advisors should dedicate sufficient management resources to ensure sound judgment in the evaluation of companies and furnish their services appropriately, bearing in mind that the principles of the Code apply to them.

In Paragraph 7-2, on Page 18, we describe that the management of asset managers should possess appropriate capabilities and experience to effectively fulfill their stewardship responsibilities. In addition, in light of the remark since the Follow-up Council that the

management should also recognize that they themselves have important roles and responsibilities to carry out stewardship activities and implement activity-facilitation measures such as structuring their organizations and developing human resources, and push forward with measures for issues related to them, we accordingly incorporated this matter in the description.

Paragraph 7-4 refers to asset managers' review of and self-evaluations on the status of their implementation of the Code. We added this matter to the current description, writing that asset managers should regularly conduct self-evaluations with respect to the status of their implementation of each principle and disclose the results with a view to continually improving their governance structures, conflicts of interest management and stewardship activities, and so forth.

As stated in Footnote 18, following the description of the aforementioned asset owners, we also expect that the disclosure of the results of such self-evaluations will help asset owners select and evaluate asset managers.

I am closing my explanation on the draft revision of the Code. We look forward to your discussing it. Thank you in advance for your cooperation.

[Kansaku, Chairman] Thank you for your explanation.

Next, we would like to hear whatever opinions or comments you may have. By the way, Mr. Kawada, Mr. Wataru Tanaka, Mr. Horie and Ms. Waring, who are all absent today, all have informed us that they agree to this draft revision.

Please express your opinions.

Mr. Ueyanagi, please.

[Ueyanagi, member] Thank you, Chairman. I agree to the draft on the whole, but allow me to add a little. In terms of the Guidance, specifically in regard to the results of executing voting rights in 5-3, I am certain that this portion including Footnote 15 was written in an ingenious manner that reflects the contents of our discussions. However, talking about the future, I hope that the first two sentences in 5-3 will be deleted and Footnote 15 made a bit more concise.

In addition, as another hope of mine, Guidance 3-3, which refers to the so-called ESG factors, was reorganized with a focus put on risk and business opportunities, as I surmise. However, basing the thinking on a long-term perspective or on the notion that companies are social beings is important to the Stewardship Code taken as a whole. I have also found this

point important because it shows the direction of impending changes.

Another hope of mine, which may be related to the long term, is about Guidance 4-4 on Page 13. As matters regarding to collective engagement, Page 2 of the material currently reads that sufficient attention should be paid so that dialogue does not become mechanical in conducting collective engagement. I have found that this is a noteworthy point. Nevertheless, if I think a little ahead, I personally have come to believe, through our discussions, that collective engagement can be useful in some cases because joint efforts among institutional investors can change the behavior of a company if an investment project or investee company encounters a problem.

That is all I have to say. Thank you.

[Kansaku, Chairman] Thank you very much.

Does anyone have other opinions? Or something about what he pointed out?

Then, Mr. Masuda, please.

[Masuda, member] I am interested in Guidance 5 on Page 15. In principle, I am fully in favor of disclosing the results of executing voting rights broadly. In this regard, I have an opinion. “At the time of their voting record disclosures” is followed by “enhancing the visibility for institutional investors to explicitly explain the reasons why they voted for or against an agenda item.” I found that to be completely true. However, I also understand that that sentence does not mean that all the actions should be taken for the moment. As we discussed this issue, I have concluded that there are both advantages and disadvantages in not only disclosing the voting records but also publicizing all the reasons for voting for or against at the same time.

We are conducting engagement activities with companies. For instance, though we are basically against an agenda for election of directors in a company pursuant to our internal criteria for executing voting rights, through engagement activities, we can determine that the board is functioning well when we discuss the company’s business performance and model. Therefore, if we have to clearly write the reasons for being for or against an individual agenda item, that means that we will in effect write our engagement activities ourselves. Furthermore, the reasons for being for or against may include investment judgments. Therefore, I would say that in the future we need to fully discuss whether broad disclosures should include the reasons

for being for or against. As it was explained that this is not included in “comply or explain” in any circumstances, I accept that this wording will stay.

That is all I have to say.

[Kansaku, Chairman] Thank you very much.

Does the secretariat have any comments on that point? All right?

Are there any other views?

Mr. Kato, please.

[Kato, member] Thank you. I would like to comment on Guidance 2-2 and 2-3 in Principle 2. Though it may have already been explained, I take 2-2 and 2-3 as a pair. Because the situation of conflicts of interest that institutional investors, especially asset managers, face varies from company to company considerably a perspective from which a governance structure, suitable to such situations, should be built after identifying the state of such conflicts of interest needs to be incorporated.

Another related point that I found important is the meaning of citing an independent board of directors in 2-3 as an instance of a governance structure intended to prevent conflicts of interest. When I look back at the discussions up to now, it was also pointed out at the Follow-up Council that this independent board of directors is important to asset managers that belong to a financial group; however, an asset manager that belongs to a financial group is a 100% subsidiary. For example, even if directors of the 100% subsidiary satisfy the requirements of independence to comply with the definitions of the Tokyo Stock Exchange, it would be extremely difficult for them to act somehow while ignoring the intent of their 100% parent company. Therefore, though I find it important for an asset manager as a fully-held subsidiary to install an independent board of directors as a governance structure against conflicts of interest, I understand that the wording in 2-3 includes the intention of not only establishing an independent board of directors but also building a mechanism that supports such directors in taking actions based on their independent status, that is, without being interfered with by the full parent company at the same time.

That is all from me.

[Kansaku, Chairman] Thank you very much.

Are there any other opinions?



Ms. Shimada, please.

[Shimada, member] I too agree with this draft, but there is one point that I want to confirm. Regarding 2-1 and 2-2, the term “asset owners” is often found in the Guidance in other parts. 2-1 and 2-2 naturally include asset owners in the ranks of institutional investors, but compared to the following sentence that starts with “In particular, asset managers,” I have found that the portion of raising the awareness of asset owners to manage conflicts of interest carries slightly less weight. In the case of corporate pensions especially, I have heard that the staff in charge receives various requests from their parent company or their company’s stakeholders because such staff belongs to the company. I would like to pose a question why the term “asset owners” is not found here.

[Kansaku, Chairman] We have just had a question. Secretariat, please answer the question.

[Tahara] As you pointed out, 2-1 and the first sentences of 2-2 naturally include asset owners. The question is why the term was replaced with asset managers after the latter part of 2-2. We put our thinking in writing this way in light of the fact that the discussions so far have been made mainly about the issues faced by asset managers. Though I think that arguments will be raised about asset owners, we understand that the members are aware that matters related to asset managers have basically been a point at issue since the Follow-up Council last year, which ended up without placing emphasis on this issue. That background made us start with the phrase, “In particular.”

In any event, 2-1 and the first sentences of 2-2 are connected. From that perspective, we hope that asset owners will take action bearing such matters in mind.

[Kansaku, Chairman] Is it all right?

[Shimada, member] Yes. Thank you very much.

[Kansaku, Chairman] Mr. Oba, please.

[Oba, member] My comment is also connected with Ms. Shimada’s question. The Follow-up Council confirmed the perspective that effective check by asset owners is important to begin with, did it not? In this context, though my comment may be the same as Ms. Shimada’s, it would be logical to think that Principle 7 especially places assets owners in an important position as well. Without the requisite skills, they would be unable to check. Therefore, I would say that asset managers should be equipped with the ability to make proper

judgments accompanying stewardship activities. Next, regarding 7-1 and 7-2. 7-1 covers both, does it not? 7-2 says “In particular, the management of asset managers....” In my view, such matters as human resource development and establishment of organization should be also applicable to asset owners. What do you think of this point?

[Kansaku, Chairman] I invite the secretariat to respond to the question.

[Tahara] We are discussing the same thing again. As Mr. Oba has now pointed out, 7-1 naturally covers asset owners, and 7-2 has been deemed to discuss the management of asset owners since the Follow-up Council. That is why we put the idea in writing this way. Talking about the background of having this kind of argument, in our view this thinking applies not only to asset managers but also to asset owners; however, regarding asset owners, the contents of discussions so far are to stipulate in the Code that asset owners should fulfill their responsibilities mainly in terms of the three points that are described in Principle 1. Therefore, I found a little difference in this regard. If, however, you say what should be done in actual practice is the same, I think that it can be interpreted in that way.

[Kansaku, Chairman] Mr. Oba, is it fine with you?

Thank you.

Are there any other opinions?

Next, Member Masaaki Tanaka, please.

[M. Tanaka, member] I will change the subject. My comment is about 5-5 on Page 16. I reviewed the materials that I have been given in the previous meetings. In the material about proxy advisors distributed at the last meeting, we discussed that matter a great deal. There I found examples in the U.S. and Europe. The influences of proxy advisors were also analyzed, and it was explained that their influences were gradually becoming stronger. Then, a report says that, against that backdrop, the U.S. subjects proxy advisors to a registration system and obliges them to fulfill various duties including disclosure of evidence that shows they own sufficient fiscal management resources, and establishment of that structure. Also, the EU is considering revising the law to oblige proxy advisors to disclose their procedures for securing the capacity of staff and any manner of things. With that trend in mind, I read 5-5 and found that it said only, “Proxy advisors should dedicate sufficient management resources to ensure sound judgments in the situation of companies.” It does not stipulate that proxy advisors

should make certain to disclose their actual efforts. Amid the influences of proxy advisors considerably mounting, if proxy advisors are obliged to make disclosures following the examples of the U.S. and Europe, can the disclosures be sufficiently reliable to the people who use them? Will any issues arise from that? I have the sense that clarifying such questions will remain as a disputed point.

My comment is about this point alone. I am pleased to find everything else put together quite satisfactorily. Thank you very much.

[Kansaku, Chairman] Thank you.

Does the secretariat have any comments on that point?

[Tahara] Your comment is that the Code should stipulate, for instance, that proxy advisors should disclose or publicize their efforts toward operational systems, management of conflicts of interests and the like. Is my understanding correct?

[M. Tanaka, member] That is right.

[Kansaku, Chairman] Does anyone else have any comments on this point?

Mr. Oguchi, Please.

[Oguchi, member] Sorry but this is not about that point. Before that, I want to confirm one thing. In this draft, in the last part of the preamble, the wording that the Code will be revised periodically, around once every three years, remains unchanged from the previous time. I guess that was done on purpose. I mean, a revision will be made this time, and three years later, the Code will be changed again in light of various circumstances in the same way that this revision is being made to the previous one. I conjecture that the wording remains here according to that intent. Is my understanding correct?

[Tahara] Regarding the matter that you pointed out, we simply did not change what was provided for initially. If the draft is accepted, the wording that the Code will be revised periodically, about once every three years, will remain as is.

[Oguchi, member] Here is the reason that I brought this up just now. We have heard a number of opinions today, but the draft incorporates improvements in various aspects, compared to the last time the Code was formulated. I have found this acceptable as it is for the moment. Having said that, as time passes, what we have just discussed, for instance, what applies only to asset managers may become applicable to asset owners. Or, the stance may

arise that we will be able to improve the issue of disclosure, as pointed out before, when it comes to make more sense later. In that sense, given the current situation, I personally understand that the draft incorporates as high demands as practically possible, based on discussions from the Follow-up Council to the Council. Of course, if we were to split hairs, there would be more issues; however, if we take the stance that we will have discussions like this in another three years to revise the Code again, I think that these contents will remain acceptable as they are.

That is all from me.

[Kansaku, Chairman] Thank you for your opinion,

Mr. Toyama, please.

[Toyama, member] I have no bombshell up my sleeve today. I found what Mr. Tanaka pointed out completely right. Since I was a victim in a sense, I have kept saying that they can do better. On the whole, I have found that our discussions were put together excellently. Generally speaking, to put it bluntly, as corporate governance had been extremely poor until now, issues of institutional investors did not manifest themselves so visibly. In a sense, thanks to advances in corporate governance reform, companies are trying to do their best. In turn, it is reasonable to expect that those who have voting rights are asked whether they are doing the right thing as we live in a capitalist democracy. From that perspective, I have sort of thought that both sides are at fault. At the conference in the presence of the prime minister, the remark that idiots knew only two things attracted lots of attention. As I said here before, stupid institutional investors say nothing but “More dividends,” and “Repurchase and abolish.” Often in the past, I have felt that they should have said something more intelligent. Japanese institutional investors, especially, tend to have this problem. I dare say, professionals from foreign firms, the so-called vulture funds, do not say anything like that so often. In fact, they can communicate better through much more decent engagement.

Then, arguments going forward will be about how high the Japanese level can rise in the future. The other day, Nikkei carried an article saying the same thing I wrote previously. Being on the side of a company, that is, in the capacity of an outsider of a company, I sometimes talk with institutional investors or analysts in IR engagement. Though I said before, to put it bluntly, regrettably, foreign firms are at a higher level. When U.S. or European major companies, that

is, professionals who hold meaningful volumes of Japanese stocks for long-term investment, visit Japan, I talk with them and find the quality of their arguments relatively high. Regrettably, being hit from all sides, all one can do is to start imitating engagement. Some youngsters from Japanese firms – who knows what they're thinking – they come up with the kind of questions that they just pick up from textbooks. And they call that engagement. Lots of idiots pose questions mechanically and go back. They can find these answers when they read disclosed documents.

The key is whether that level can rise in two or three years. We have to be sure to monitor it. Then about 5-3, to put it straightforwardly, life insurance companies and the like must have found it difficult. Of that I am certain. Let me put it straight. I am not good at mincing words. Looking about my personal experience, the most expensive financial product that I bought when I was young was probably a life insurance policy from the largest life insurance company in Japan. Almost 30 years have passed since then. If the life insurance company has up until now failed to perform what was written in the Stewardship Code by any chance when executing their voting rights that would be downright absurd. I have paid a considerable sum of money, and I have to tell them to take care of my money responsibly. For my part, since I believe it is a mutual company, I am a shareholder. Yes, as a policyholder, I am indeed a shareholder. That is, I am one of the owners of the mutual company. Therefore, I want to believe that they must be doing such things without fail. Therefore, if we feel reluctant about that, it would not make any sense to me. Generally, this issue is similar to that of asset owners that we touched upon before. We are talking about asset owners. According to the recognition that I got from my experience, they are people who are kind of charged for corporate pension funds. They are often at the terminal stage of their careers in the company's administrative department. They are willy-nilly assigned to this job. There are lots of amateurs who know neither CAPM nor portfolio theories. This industry is in such a state. Such people should not be involved in this business. That is the root of the argument. They are entrusted with precious post-retirement funds for former employees in their company. This must be a job not for such amateurs but for professionals. In my view, that is why basic matters are questioned. This is a problem at the bottom of this issue.

What I mean is that this argument will not end here. In the coming two or three years, since I

have been blessed to work as an outside expert for various companies, I will be in contact with a variety of people from investment mutual trusts or life insurance companies on the occasion of IR. In such cases, I'm sorry but I will size them up squarely. Will their quality improve or not? If not, I will shout again in three years' time. I will drop a bombshell. To avoid such a scene, if there are people from institutional investors here today, please do your best to hone your skills. Please become equipped with skills that are globally competitive. If that happens, we will no longer need the Code. That is where the problem lies.

Furthermore, it is another long story. The issue of executing voting rights. They say that it is difficult because they have plenty of investment destinations. They whine that if they have to disclose individual cases, it will be a huge burden. I say, shut up. They are talking about no more than 3,000 companies. They are making money from them. If they cannot do that, to put it bluntly, they must close shop. They will have to merge with someone if they don't have such skills. That is why I call them amateurs. I am repeating myself, but in this industry, frankly speaking, corporate governance is a professional job of company management. The job of institutional investors from here on out is a profession just like that of medical doctors. This is a professional job. If professionals say that they cannot do their job because there are too many companies, stop whining. In this discussion, they say that the Code would prompt asset managers to execute voting rights only for formality's sake. They are whining again. To put it bluntly, they are pushed around, then they are forced to do it just for formality? Give me a break. They are just revealing that they are amateurs. They are saying that they are amateurs so they cannot respond to such an argument, and someone should help them. This argument is, perhaps, if it ever helps promote a shift to formality, what should be truly questioned is the professionalism of those doing so. But that is not the problem. They are completely clueless. They are in effect saying that they are green and are not confident so that they are affected by such things. If so, then those guys must change places. So, in this argument, there remain a lot of deplorable points to discuss. Will these deplorable points be eliminated in two or three years' time? I cannot wait to see. Anyway, I repeat over and over. I think that that we have people from various fields here today. I expect you to grow into first-class professionals who can compete on the world stage in two to three years.

That is all from me.

[Kansaku, Chairman] Thank you very much.

Now, I have found that three points were raised. First, on the opinion of Mr. Masaaki Tanaka that Mr. Toyama supports. I would like you to go back to that point. If you have an opinion about proxy advisors, please let us know.

Yes, Mr. Ueyanagi.

[Ueyanagi, member] In respect of 5-5, I also consider Mr. Tanaka's opinion correct. Even if the Code does not mention anywhere that disclosure is required, we can think of it in a way similar to comply and explain. In any case, stakeholders are obliged to be "explained" to, but broadly speaking, it is society at large which is, and in my view the Code includes disclosure. However, it says that other bodies or people should disclose. Therefore, I have found that not mentioning proxy advisors is inconsistent here.

Next, I am sorry that it may sound that I may be seeking to restore a part that has been deleted, but about 7-2 that Mr. Oba just referred to, I find it better to limit the responsibility not to asset managers but to the management of institutional investors. I think that Principle 7 is a chapter for summary in a sense and is an important item as a comprehensive remark.

[Kansaku, Chairman] Thank you very much.

Mr. Oba, please.

[Oba, member] I will follow up on what Member Uesugi just mentioned. I suggest that the second half of 7-2 should relate especially to both asset owners and asset managers. Since the term "affiliated financial groups" is used above that, the term "asset managers" may be a better fit here. Developing human resources and the organizations, which is written below, is in general a sort of infrastructure. As Mr. Toyama pointed out, I think that how to develop human resources is crucial. So, I am certain that it makes sense that the term should be related to institutional investors as a whole.

[Kansaku, Chairman] Thank you.

Are there any opinions? I invite you to comment on how to describe the issue of proxy advisors in particular in the Guidance.

Next. Ms. Takayama, please.

[Takayama, member] Regarding proxy advisors, I am also in favor of promoting disclosure, because they have enough resources to do so, and disclosure will not become such a heavy

burden on proxy advisors, and would rather give them a good opportunity to clearly demonstrate their structures. It seems to me that capable proxy advisors would rather welcome such a code. This is my view on that point.

Besides that, I would like to comment on two other matters. As a premise, I support this draft Stewardship Code. My comment is based on that stance. I am talking about ESG in Principle 3-3, which Mr. Ueyanagi mentioned. Looking at the global trend, the consensus is that non-financial key factors, such as ESG, are closely connected with the long-term economic value and financial performance of companies. Given such a consensus, both companies and investors have responded to prevailing circumstances. When the time comes to revise the Code in three years, I expect that the description here will have become more significant.

Another comment concerns dialogues between companies and investors. My comment overlaps with Mr. Toyama's remarks. Owing to the nature of my work, I often find myself attending dialogues between companies and investors or hearing about the circumstances of such dialogues. Talking about changes after the Stewardship Code and the Governance Code took effect, more dialogues are made from a standpoint that is longer-term than before. I have observed that, on such occasions, with an interest in corporate governance and ES rising alongside financial information, as I have already mentioned, people have been discussing those matters more often. On the other hand, as is often pointed out, the quality of investors' dialogues varies considerably. Some dialogues are substantial, based on a deep understanding of companies, from which the management and directors can learn a lot, but I have often heard it said that other dialogues are extremely mechanical. Though I do not mean to defend Japanese investors, I cannot categorically state that whereas Western investors are good, Japanese ones are poor. Since investors in the U.S. and Europe have been involved in engagement from a long-term perspective for the past 20 or 30 years, they are naturally ahead in that regard. However, on the part of Japanese investors, some of them have also treated such matters properly for a long time and conducted engagement, based on reliable analysis. At the same time, a considerable number of investors have not done so. Companies find this situation is highly frustrating. They have been told to improve the quality of management and the quality of governance that supervises that management under the corporate governance code. In addition, they are asked to make a self-evaluation of whether such matters are correctly



performed through methods including board evaluation. Such high demands are imposed on companies. Under such circumstances, it makes sense that companies expect investors to upgrade the quality of their dialogues, and to make a self-assessment of whether they are fulfilling their responsibilities.

From this standpoint, this draft Stewardship Code describes those matters very clearly. Therefore, I strongly hope that this Code will catalyze a positive spiral between companies and investors; that is, taking this opportunity, investors will further raise the quality of their dialogues, and that effect will be brought to bear on companies.

That is all from me.

[Kansaku, Chairman] Thank you very much.

Who else would like to share comments?

Dr. Ueda, please go ahead.

[Ueda, member] Thank you. First, let me say that I really appreciate that the draft revision of the Stewardship Code was compiled in such a short span of time from the end of last year. The results of the substantial discussions at the Follow-up Council were reflected in the draft revision of the Code. I also heard that there were additional discussions on collective engagement and proxy advisors among other matters during the previous meeting. Therefore, I have no objection to the overall contents of this draft revision. Maybe there will be some amendments made to the details, but I'm in agreement with the direction of the draft revision of the Code.

I also agree with Mr. Tanaka's earlier comments. Considering in particular that proxy advisors are required to register with Securities and Exchange Commission (SEC) in the U.S., I believe that requiring them to disclose their approach to providing services is in line with the policies or the principle of the Stewardship Code. Also, there is an issue of conflict of interest as was pointed out by Mr. Tsukuda during the previous meeting. I hear that some proxy advisors give advice to investors, while providing consulting services to companies. This looks like the case in which proxy advisors are earning revenue through conflicts of interest. Therefore, accountability, or transparency, will become all the more important.

Let me make some comments on general issues. Based on the discussion and the draft revision of the Code, I think that the discussion on asset managers has already shifted from

fulfilling the formality to improving the substance or quality. Meanwhile, I feel that it has taken the first step for asset owners. In particular, while the draft revision of the Stewardship Code stipulates that the most important role of asset owners is to “engage in stewardship activities as much as possible”, I think that their activities are to focus on monitoring in most cases. I believe both private and public pension funds are making efforts to strengthen the monitoring function with hiring staffs or enhancing disclosure. To achieve this, cooperation with asset managers is essential. In connection to that, the draft revision includes a stipulation about self-evaluation of asset managers, and I think that this is very important. While the Corporate Governance Code stipulates the evaluation of the effectiveness of the Board of Directors, such evaluation is very difficult to implement. Perhaps it is easy to understand what is required but it is difficult to know what to do in practice. I think that information provided through this self-evaluation should include both figures and description to improve the quality of the engagement. I’m not sure what the right word is in English, but I think *review* is a word that adequately conveys the meaning.

The Ministry of Health, Labour and Welfare (MHLW) recently released a set of materials for corporate pension funds to adopt the code. I will introduce it as I believe it will serve as a reference for coming up with concrete efforts. Looking at the UK Stewardship Code, self-evaluation includes a kind of framework for conducting evaluation by which engagement activities are quantified based on something like check points listed in MHLW’s materials. Maybe I should not make reference to a set of materials not introduced yet, but I think some framework for evaluation, something like the check points shown on page 10, the last page of the materials, will enable visualization and help to compare.

Secondly, I think there should be a reporting of stewardship activities. Public pension funds, such as the GPIF and Pension Fund Association for Local Government Officials, have already disclosed reports on their stewardship activities. As for engagement activities, sorry for citing a specific investor name but Nippon Life Insurance Company (NISSAY) publishes a very detailed engagement activity report. By organically integrating such a report with the results of the proxy voting, policies to manage the conflicts of interest and any other related information disclosed separately now, we can create an “annual report” of the stewardship activities. This will help asset owners to evaluate asset managers. I imagine that it is difficult for asset

managers to prepare customized reports for each client. With more and more private pension funds adopting the Stewardship Code, asset managers can use this report to potential clients.

The stewardship activity report will also serve as a tool for asset managers to provide information to individual investors, who are behind the asset owners and, for investment trust companies, are their direct clients. I hope that such practice will develop.

Thank you very much.

[Kansaku, Chairman] Thank you very much, Dr. Ueda.

Mr. Tsukuda, please go ahead.

[Tsukuda, member] Thank you. I have three comments to make.

First, I agree with Mr. Tanaka's comment on Guidance 5-5 on page 16. It is not enough for proxy advisors to dedicate sufficient management resources; it is also important for them to properly disclose their efforts of doing so.

Secondly, turning back to page 6, Mr. Tahara earlier explained the importance of the "comply and explain" approach. As I pointed out during the previous meeting, the expression at the bottom of page 6, "In order for institutional investors to earn sufficient understanding from their clients and beneficiaries, in the process of complying with the principles, it is considered beneficial for institutional investors to proactively explain their specific implementation activities," is overly soft. I think that a stricter and more specific expression should be adopted when the Code is revised in three years.

Thirdly, I think that what Mr. Toyama pointed out earlier is an essential issue. He said that he was not going to drop a bombshell today, but it certainly sounded like he did. I envied the fact that he was excusable regardless of what he said. As I was listening to his comments, I remembered that the Stewardship Code and the Corporate Governance Code are like two wheels of a cart. I believe he mentioned earlier that the Stewardship Code was introduced just three years ago. The Code is currently undergoing revision three years after its adoption. On the other hand, the Corporate Governance Code was introduced in June 2015, and its three years will come in another year and a half. There is no specification that the Corporate Governance Code should be revised once every three years. Meanwhile, this revision of the Stewardship Code will bring about changes in actions of institutional investors, which will naturally place positive pressure on companies and promote sufficient constructive dialogue

between the two. As a result, there will be a discussion this time next year that the Corporate Governance Code may need to be revised. That would be an ideal situation.

The U.K. is called a leading country in governance, but I heard from a colleague of mine there that when they introduced their corporate governance code over 20 years ago, it was more of the same as the current Corporate Governance Code in Japan. They have revised their code over a period of decades, about every three years. My colleague said that there is no end to revising the stewardship code and the corporate governance code. In my opinion, both the Japan's Stewardship Code and the Corporate Governance Code are still, if I may an analogy from climbing Mt. Fuji, whose summit is called the tenth station, at the first or second station. We have long way to go to get to the top of the mountain. I think that it is important that we should remain aware of that.

Finally, thank you very much for your efforts for preparing the draft revision. I am one-hundred percent in agreement with this draft.

[Kansaku, Chairman] Thank you very much.

Who else would like to express their opinions?

Mr. Shimizu, please.

[Shimizu, member] I will express my opinion as a representative of the Life Insurance Association of Japan. Life insurance companies are long-term institutional investors and as such have been conducting engagement activities before the Stewardship Code was introduced, and we are working to conduct stewardship activities with emphasis on dialogue with investee companies. We have already expressed concerns about this repeatedly, but I'd like to again express concern over voting record disclosure on individual agenda items as described in the footnote on page 15. Except for this point, I have no objection to the draft revision of the Code.

I believe that there will be discussions on the revision of the Code continuously every few years, and would like to make two comments which I hope will be reflected in those discussions.

First, about voting record disclosure on individual agenda items, I wish to request a review on the effects and issues arising from it and implementation of the PDCA cycle. Ms. Kerrie Waring commented during the first meeting that voting records on individual agenda items are disclosed in the U.K. but no one sees the content of the individual agenda items. That comment

has been on my mind ever since then.

Secondly, I hope that discussions for revision of the Code should not be focused only on the exercise of voting rights; rather, substantial discussions should be held from such perspectives as improving the process of the overall stewardship activities and raising the quality of dialogue. If my memory is correct, there was a comment in the Follow-up Council that discussions on raising the quality of dialogue should be left to each institutional investor. I wonder if that is sufficient. Various opinions were presented on the quality of dialogue with investee companies during this meeting. To improve the quality of dialogue based on such opinions, I believe that the Stewardship Code has a role to play. Therefore, I hope that discussions will be held continuously to improve quality of dialogue and that revisions will reflect the results of those discussions on the Code.

That is all I have to say.

[Kansaku, Chairman] Thank you very much.

Any other opinions?

Mr. Oguchi, please go ahead.

[Oguchi, member] I said earlier that I basically agree with the draft revision. However, many members have requested the disclosure of approach by proxy advisors under 5-5, and I would like to make a comment assuming that that disclosure will be made. Proxy advisors, or proxy service companies, are basically overseas companies with global coverage, which includes a small percentage of investment in Japanese stocks as it now stands. Principle 4 states only “investee Japanese companies,” meaning that the target of the Stewardship Code is basically investee Japanese companies, which is the implicit assumption of the Code. If Guidance 5-5, which is applicable only to proxy advisors, is translated in English, and proxy advisors make disclosure based on it, there is a concern that they will disclose just their global framework (personnel and systems) without making disclosure with a focus on their investments in Japanese stocks unless the disclosure target is made clear. If the aim of the Code is to require efforts on Japanese stocks and the disclosure of such efforts by proxy advisors, I think the Code should include a clear specification on that point. I know that this is a practical issue, but thought that I should comment on it during this meeting.

[Kansaku, Chairman] Thank you very much for your comment. Any other opinions?

Mr. Toyama, please go ahead.

[Toyama, member] Let me talk about the future. Mr. Tsukuda mentioned about the discussion on the Corporate Governance Code earlier, and I will make some comments in that context. I personally think there are two major issues for the Corporate Governance Code. First, as Prime Minister Shinzo Abe mentioned in the Council on Investments for the Future the other day, there is an issue of the so-called OB-centered Governance. My point is, there seem to be retired executives, maybe advisors or those in similar positions, who are not company presidents but wield influence on corporate management nevertheless. Or, there are similar cases everywhere. In my opinion, the situation is the same with companies and institutional investors. They both have the same problem. I will examine if engagement activities are conducted properly. The point is, I'm not going to name specific company names, but I will perhaps say no to all resolutions and agenda items of companies in which there are those who maintain their offices at their companies even though they serve as presidents of some other companies. I believe that that constitutes reasonable action and engagement in a real sense. In my opinion, we shouldn't overlook that issue. So, I think Nippon Life Insurance Company should criticize the problem. They really should.

The other point I would like to make is in line with what I've been talking about and is a long-term issue for top management, namely, selection of top managers. Fortunately, the issue of the so-called OB-centered Governance has come under public scrutiny. However, this issue has originally stemmed from another problem, that is, Japanese companies have not paid serious enough attention to the selection process of their top managers. This is the conclusion I have reached. You might wonder why I am so sure about this. I can say this for sure because I have handled more top leader selection matters for Japanese companies than has anyone else in the country. I am sure that I have handled the largest number of president selection jobs in Japan. I have been involved in the president selection process of Japan's listed companies as well, more often than anyone else. To be frank, there are just too many cases in which I can't see the reason why they chose their ex-presidents. Why is that? Because, honestly speaking, they failed to make serious enough efforts to select the right people for top management jobs. I wanted to pursue this issue further in our previous meeting when we talked about Japan's Corporate Governance Code but I ended up not doing so, or let that topic go in

other words, because in certain places some people really did not want me to do that. Now, look at what has happened since then. Problems related to top management have become rampant. There have been so many cases that made us wonder why these companies chose such people as their leaders. We have seen such cases happen one after the other. What I want to point out is that the two major issues of the so-called OB-centered Governance and the selection of top management related to the next Corporate Governance Code will be like two sides of the same coin. These issues cannot be separated because OBs (retired corporate executives) generally meddle with their companies' top management selection process. We need to address these issues seriously. Putting this the other way around, after the Stewardship Code is finalized today, and when we want to check whether the relevant parties are seriously committed to promoting engagements, we just have to see if they will point out such issues and ask for explanation. I want them to ask, "Why are you taking the helm of the company as president?" If they can do that, that would be true engagement. If they cannot, it would not be real engagement. It would be merely superficial. That's what I will check on. I want you to keep up the good work.

Thank you.

[Kansaku, Chairman] Thank you for sharing your opinion.

Any other comments?

No? All right. We looked at the proposal made by the Secretariat today and you suggested points we need to consider when putting the proposal into practice as well as issues to address for the next revision and for medium- to long-term revisions. I also remember that some of you suggested that we review the contents of the proposal submitted by the Secretariat.

One of them is related to Guidance 5-5 which stipulates that proxy advisors should dedicate sufficient management resources to furnish their services appropriately. Many of the council members suggested that the proxy advisors be required to disclose information to prove that the sufficient management resources have been dedicated, and so on. Can we hear the Secretariat views on this suggestion?

[Tahara] Yes, certainly. About the suggestion related to proxy advisors, if there are no objections, we can add a sentence to Guidance 5.5, "Proxy advisors should disclose their approach to providing the services including the operational structure, the management of

conflicts of interest, and procedures for developing voting recommendations.”

This revision may not directly address the issue pointed out by Mr. Oguchi. However, the proposed sentence will basically be included in the Code and the sentence can be interpreted as Mr. Oguchi’s suggestions.

[Kansaku, Chairman] The Secretariat has just proposed to make an amendment to Guidance 5.5. Do you agree with his proposal?

(The members said, “No objection.”)

[Kansaku, Chairman] So, his proposal is fine with you. Thank you. We will go ahead and add the sentence, “Proxy advisors should disclose their approach to providing the services including the operational structure, the management of conflicts of interest and procedures of developing voting recommendations.”

I want to make another point. This one is related to Guidance 7-2. The stipulation is currently addressed solely to asset managers, but some of you suggested that the stipulation specify that it is addressed to asset owners as well, especially in the second sentence that begins with “The management of institutional investors...” Does the Secretariat have any suggestions for amendment or revision regarding this point?

[Tahara] Regarding this point, Guidance 7-1 provides for institutional investors to have the necessary internal structure to have appropriate engagements and make proper judgements. We think that this part addresses that concern. If we are to rewrite the stipulation, we would need to change the structure of the paragraph by, for example, changing the placement of some sentences, because the first three lines include rather specific information, as Mr. Oba pointed out. If you insist that the paragraph be amended, we will consider how we can do so. However, if you agree with what I suggested, namely, that the matter is already addressed in Guidance 7.1, we will just leave that Guidance as is.

[Member Oba] You may need to consider technical details, as Mr. Tahara just said, such as changing the subjects and predicates around. This work may be a bit complicated but the thing is, this is partly related to what Mr. Toyama said, that structurally speaking, if asset owners are committed, asset managers will have to get their acts together. When consumers are clear about what they are after, companies have no choice but to strive to meet their needs. So basically, asset managers need to do a better job, as is pointed out by the Guidance. However, the same



can be said of asset owners. They have to share the same kind of awareness with asset managers. We are wondering what words we can use to express this. That's what we are talking about. The point is how we should put this into words.

[Kansaku, Chairman] Mr. Kato, please.

[Kato, member] I agree with what Mr. Oba said about Guidance 7-2. To be specific, the wording can be changed around by, for example, switching the order of the paragraph that starts with "In particular" with the one that begins with "The management of institutional investors." That way, it would read that the institutional investors' management needs to develop human resources and the asset managers' management, in particular, should have.... This way, the flow of the paragraph and connection between the sentences will become natural and can also reflect Mr. Oba's suggestions rather clearly.

[Tahara] All right. I will take this matter back to the Secretariat for discussion and inform you later of what we have decided.

[Kansaku, Chairman] Thank you.

Does anybody else want to comment on this? If not, as we agreed, we will add one sentence to the end of the current text of Guidance 5-5, and also for 7-2, the Secretariat will make necessary amendments, based on the points made today concerning the revised draft. The amendments may include changing the wording. The Secretariat will send us their draft text through email or other means, compile our suggestions, have them reflected in the text and finalize the draft. How does that sound? Is that fine with you?

(The members said, "No objection.")

[Kansaku, Chairman] Thank you.

Regarding the final scrutiny of the text in terms of consistency of expressions and other matters, please leave it up to me. I will take care of that. Is it all right with you?

(The members said, "No objection.")

[Kansaku, Chairman] Thank you.

Now, let's hear about specific steps to take going forward from the Secretariat, including how to call for public comments.

[Tahara] Thank you for sharing your opinions. As I said at the beginning of this session, we will draw up the revised draft by incorporating your suggestions from this meeting and invite

public comment on the draft for a month or so. We look forward to receiving comments from various stakeholders.

Following this, we are planning to publicize the English translation of the revised Code and start calling for public comments. Again, please allow us some time for the work to be done.

[Kansaku, Chairman] Thank you.

So, we will incorporate views submitted as public comments in finalizing the Stewardship Code and publicize the final Code. We may have to convene another meeting, which you will need to attend. In that case, we appreciate your kind cooperation.

Now, let's move on to the last item of the day. Ms. Aoyama, Observer, will talk about the report issued the other day by the Stewardship Council of the Ministry of Health, Labour and Welfare (MHLW) and Pension Fund Association. Ms. Aoyama, please.

[Aoyama, observer] Thank you very much. My name is Aoyama and I am from the Private Pension Division, Pension Bureau, Ministry of Health, Labour and Welfare. Thank you for sparing your precious time for me.

As Mr. Kansaku said, I will talk about efforts being made to promote corporate pension funds' acceptance of the Stewardship Code. Please turn the cover page that says Ministry of Health, Labour and Welfare to the next page. You will see the text describing the Code's historical background. All of you are fully aware of the benefits of stewardship activities for corporate pension funds, so I will not repeat them here. Bearing such benefits in mind, however, Japan Revitalization strategies, including the one formulated last year, have emphasized the importance of promoting acceptance of the Stewardship Code by corporate pension funds. Yet, the number of corporate pension funds that have declared their acceptance of the Code is still small. We also received feedback from some corporate pension funds that they could not envision what to do with the Code. Thus, we inaugurated the Stewardship Council in the Pension Fund Association, an association of corporate funds, last September. The Council has cooperated with our Ministry (MHLW), and invited specialists from the Financial Services Agency as observers, and has held a series of discussions on matters such as the significance of carrying out stewardship activities by corporate pension funds and examples of behaviors that corporate funds should adopt when accepting the Code.

Please turn to the next page. What this page says partly overlaps with what I have already

explained but I will go over it anyway. This council has held about five meetings which were attended by some people involved in corporate pension funds, academics, and asset managers. In December, we released an interim summary of issues, calling for public comments and holding a seminar, and compiled the report on March 17. The schedule here says March and it was actually done last week. The text of the report is quite long. You can find the outline from page 5 but, in the interest of time, I will just briefly go over the content of the report based on the points made on page 3.

There, three points are marked. The first one is to summarize the significance of stewardship activities for corporate pension funds. As you all know, corporate pension funds entrust asset management companies to manage stocks. In line with today's discussion, corporate pension funds are classified as asset owners. This report has concluded that, even as asset owners, it is meaningful for corporate pension funds to accept the Code themselves because doing so will enable them to encourage asset management companies to take further initiatives and thus to better perform their fiduciary duties of working for the benefit of pension subscribers.

Next, we considered various advisable behaviors when accepting the Code. By referring to the principles of the Stewardship Code, we have presented items and principles such as the ones you see here that require asset management companies to perform various activities, have conducted monitoring activities such as asking asset management companies to provide reports and informing of the status of asset managers' activities to the Board of Representatives, an organization of pension subscribers, to which the corporate pension funds owe fiduciary duties, and have presented examples of behaviors to demonstrate their fiduciary duties. All of that may be so familiar to you that you do not need any explanation but we listed them anyway to give readers an idea of what accepting the Code would entail.

Again, as Dr. Ueda pointed out, adopting those behaviors will require cooperation from asset managers in particular, and as such, we will have to make many requests to them, hold meetings with them, and monitor their activities. For those purposes, we developed a checklist with items to check. Please open to page 10, the last page of this document. There, you will see some examples of our checklist items to give readers some idea what specifically we need to check in a meeting with asset managers. Those examples are the items to be checked in a meeting but we also developed checklist items to confirm what conditions we require asset

managers to meet in the first place and to check on other matters, together with sample questions, so as to show the ways in an easy-to-understand manner. Also, because the number of asset managers is rather limited and they often overlap among pension funds, we suggested in the material that corporate pension funds with the same asset managers get together to receive a briefing at once in the form of a joint information meeting. We also suggested that relevant organizations provide assistance in the form of offering opportunities for collective engagement with asset managers.

As I have explained, this material was organized in a way that allows corporate pension funds to fully understand the significance of accepting the Code and to envision specific activities and actions. Going forward, we will publicize this report to deepen corporate pension funds' understanding and help them carry out substantive stewardship activities in a manner that is both efficient and effective. We have just compiled this material and still have a lot to do, but keeping the aims of the Stewardship Code in mind, we will strive to promote its acceptance.

Thank you.

[Kansaku, Chairman] Thank you very much.

Any questions or comments for Ms. Aoyama?

Mr. Toyama, please go ahead.

[Toyama, member] I have a question related to what Mr. Oba said. In short, the Stewardship Code aims to make everyone act like a full-fledged professional. A professional, in my opinion, needs to have two elements. One is related to ethical principles that professionals of some kind should uphold, including morals and managing conflicts of interest. The other is professional competencies and skills which, I think, are of the utmost importance. Yet, there are some people who seem to lack literacy skills as professionals. To be frank, there are those who make me want to ask, "Are you okay?" What makes you a professional is, first of all, basic skills required for working as a professional or what I call literacy skills as a professional. So, I want to ask if you discussed ways to improve such literacy skills. If you did not, that would constitute a problem. If you did, it would be critical to improve levels of representatives of the relevant asset owners.

As you may already know, university endowments in the U.S. are asset owners. For example,

those in the top management of Stanford Management Company are top-notch professionals. They are at the front of the pack, like the real kings of the industry. They are the ones who will be immediately offered an annual salary of few hundred million yen to work at any asset management company. They are alumni of Stanford University Business School, my alma mater. These real professionals evaluate funds. They are tough evaluators. The ultimate professionals at the front of the pack evaluate other professionals. Japan's Government Pension Investment Fund (GPIF) is gradually turning in this direction. Yet, if corporate pension funds, the essential elements of the game, cannot catch up, they will just remain entangled in the same old chain of events. In short, if asset owners who can exercise governance do not know any better, institutional investors will think. "Why are these amateurs telling us what to do?" How do you feel about that?

[Aoyama, observer] We discussed again and again the possibility that the current structures and responsibilities would hinder corporate pension funds from accepting the Code. You are right in that, if appropriate structures are not in place, the funds will find it difficult to accept the Code. We are always concerned with that possibility. The scale, structure, and format of the fund, whether it is run by a foundation or a company itself, whether the fund is managed by a single entity or co-managed... We are also discussing that, depending on these factors, some funds may find it much easier to accept the Code than others. Thus, we have come to the conclusion that we should start with the corporate pension funds that have acceptance-conducive structures. For cases in which the structures are incompetent in the first place, or the funds lack necessary competencies and skills, we haven't come up with clear and effective solutions. Yet, the corporate pension funds are managed by entrusted asset managers and as such, they have to have competencies and skills to manage and evaluate these asset managers. To that end, the report is telling them that corporate pension funds need to develop such competencies. To such an extent though, we have been aware of the issue.

Thank you.

[Toyama, member] In the context, and going back to the discussion we just had, we'd better include some wording directed to asset owners. Once they sign the Code, they will have to commit themselves to its provisions, so we need to include that just in case. It will invite the conclusion that asset owners need to develop professional skills. I realized again that this has

to be done. Mr. Tahara, Sorry for making more work for you but that is how I feel.

[Kansaku, Chairman] Any other questions on Ms. Aoyama's comments?

Mr. Kato, please go ahead.

[Kato, member] Thank you. I am not an expert on corporate pension funds but one thing I can point out as a characteristic of such funds is that there is little competition among them. I mean, even if they do not make any efforts, money keeps coming in to them in the form of premiums. Because there is no competition among corporate pension funds who are asset owners, what kinds of mindset their parent companies take on will be critically important. For example, corporate pension funds are important to their parent companies not only because the corporate pension scheme is a part of their employees' benefit packages, but also because the funds play an important part in fulfilling the parent companies' pension obligations if the pension plan is defined. Therefore, if you want to change the mindset of corporate pension funds as asset owners, you have to start changing their parent companies' mindsets towards the corporate pension funds. If corporate pension funds become too close to their parent companies, that would certainly be problematic, but if a fund cannot get rid of the mechanism of receiving personnel who will take charge of fund operations from its parent company, it will be critically important to change the mindset of its personnel supplier, a parent company in this case, to make sure that it supplies more competent personnel. I wonder if you had any discussion on this matter.

[Kansaku, Chairman] Ms. Aoyama, please go ahead.

[Aoyama, observer] Thank you. As for the issue of competition, corporate pension funds are uniquely positioned in that their beneficiaries are their pension subscribers, including their employees and ex-employees, and also in that they manage the funds in collaboration with their parent companies. Being in such a position, corporate pension funds focus on fulfilling responsibilities to their beneficiaries more than competing with other funds. Thus, they place a priority on managing their funds in a safe and secure manner so as to pay their subscribers defined pension benefits. Meanwhile, related to the funds' relationships with their parent companies, I agree with what you said about the important issue of conflicts of interests, that corporate pension funds are faced with the same issue. To address this issue, we wrote in our report that funds should be managed in compliance with Principles of Fiduciary Duty. I also

agree with the point you made about the necessity to gain understanding and cooperation from parent companies, and our report encourages readers to do just that. So, in sum, we discussed and concluded that the funds need not only to understand by themselves but to explain the significance of the Stewardship Code in an easy-to-understand manner to their parent companies.

[Kansaku, Chairman] Thank you. Do you have any more comments, Mr. Kato? Does anyone else have a question?

Mr. Oguchi, please go ahead.

[Oguchi, member] Let me take this opportunity to ask you some questions. The first one is related to incentives for corporate pension funds. This is not just about corporate pension funds but also has to do with a topic discussed in the Follow-up Council and the one concerning Corporate Governance Code. I am talking about medium- to long-term incentives that contribute to the enhancement of asset values of corporate pension funds, not of their corporate values in this case. Specifically, I want to know what sorts of reward systems are widely used by corporate pension funds. And how are those reward systems connected to boosting the asset values of corporate pension funds?

The second question concerns a report entitled “Status of the amount of funds for domestic stock investment by Institutional Investors” that I received from the Financial Services Agency at the end of this January. The report says the value of domestic stocks managed by public pension funds is 40 trillion yen, of which 30 trillion yen is managed by Government Pension Investment Funds and 10 trillion by corporate pension funds. Looking at how many Defined-Benefit Corporate Pension Plans there are, we have some 13 thousand contract-type plans and some 600 fund-type plans. That’s quite a lot. It might sound a little harsh, but so many pension plans are managing just tiny amounts of stocks. Looking at this situation from the viewpoint of an outsider, I can’t help but wonder if there’s any better way to operate the pension plans more effectively. Referring to the issues we have discussed, like those of future human resources, incentives, and limited opportunities for HR training, I wonder if they are making efforts to address the issues related to limited management resources by, for example, jointly managing the funds to make better use of the limited human resources and so on.

What Ms. Aoyama reported today is probably premised on the current system. What she said

is still a step forward compared with the previous discussions but if we look ahead to the future, we will have to think about other matters that I talked about, such as incentives and the possibility of joint management of funds. Please let me know how you are dealing with these issues.

[Kansaku, Chairman] Ms. Aoyama, please go ahead.

[Aoyama, observer] The first question you asked was about how the significance of corporate pension funds is understood, right?

[Oguchi, member] No, it was about incentives or, to be more specific, reward systems. I asked what sort of reward systems are in place for top managers of corporate pension funds.

[Aoyama, observer] Sorry, I don't have actual figures at hand. What sort of reward system to adopt is determined by each corporate pension fund and we cannot be completely sure, but as a rule, pension funds are required to appoint a director in charge of asset management as part of their organization. They make efforts to build their organizations in a way that fulfills at least our minimum requirements. The requirements do not specify the details of reward systems but I imagine, as the basic requirements are being met, the fund managers must be receiving rewards and other benefits that are suitable for their jobs.

About the joint management of funds, many funds are already managed jointly. Many of the corporate pension funds are small-scale enterprises, which makes it convenient for them to manage their funds jointly, so they are already opting for joint management of funds. We have also started discussing the possibility of corporate pension funds using the same asset management company to get together to have a forum, like I said earlier, so as to seek more effective ways to carry out business activities.

That's all I can say for now. I am sorry that I might have not answered your questions well enough.

[Kansaku, Chairman] Mr. Toyama, please go ahead.

[Toyama, member] The thing I want you to really look into is what kind of people are managing corporate pension funds, like what kinds of career they have in asset management business with how many years of experience. You need to grasp the situation accurately. The image I have of these people is the ones who have worked in fields such as HR, labor relations, or general affairs of some company but could not make it to executive directors, are sent to



their companies' pension funds and automatically assigned as managers, replaced by similar successors in every four or five years. That's not the way to go. These people work on fixed salaries in their second career life, so to speak, just hoping major events, like the collapse of Lehman Brothers, will not happen during their tenure of four or five years. They are the ones who often think about their golfing trips on weekend during work hours. These people can never do a good job as fund managers.

The actual situation may be different from how I described it, but it is important to grasp the situation as it is. As Mr. Oguchi just said, there are over 10,000 pension plans, and if all of them want to hire real professionals as their managers, they will never find them. That's just too many. Thus, they need to think seriously about managing their funds jointly or merging funds to establish large-scale funds in a smaller number so that each of them can hire a full-fledged professional as their manager. However, in a Japanese *salaryman*-centered company structure, it is probably more important to keep such after-retirement posts for its employees. They can say all politically-correct things but the truth is Japanese companies think it is much more important to provide some posts to their senior employees than managing their pension assets safely but with high yields. In Japanese companies with their lifetime and seniority employment system, there are so many senior employees waiting in line for after-retirement positions and it's so much more important in a company structure to come up with posts for these people every four years or so. The situation we face today has resulted from this structure. To be honest with you, I recommend that you investigate the situation, like what kind of people are working as asset managers at corporate pension funds. After investigating the situation and judging from its results, if you conclude that the managers do not seem like real professionals, you really should start promoting joint management or de-facto merger of funds. Unless you do that, the situation will likely remain unchanged. Please begin working on this issue.

[Kansaku, Chairman] Ms. Aoyama.

[Aoyama, observer] We will strive to grasp the situation from many angles. I know that corporate pension funds tend to be small-scale entities with a small number of employees. Bearing that and what you said in mind, we will make sure to consider their organizational structures and other issues. Thank you so much.

[Kansaku, Chairman] Mr. Hamaguchi, please go ahead.

[Hamaguchi, member] The expressions Mr. Toyama used are rather extreme. The Pension Fund Association to which I belong is carrying out its duties in a truly professional manner. However, among our members, there are some funds that are managed by people who are not regarded as professionals in asset management like Mr. Toyama said, but nevertheless his expressions were a bit too harsh. Yet, in the past five or ten years, things have changed a great deal. For example, pension funds of so-called major companies started hiring an executive director in charge of asset management separately from other executive directors. The executive directors for asset management are from the financial affairs department of their sponsor company, or are seconded to the funds from major asset management companies. So, my impression is that more and more managers of corporate pension funds can be regarded as professionals as competent as those of the relevant asset management companies. I feel that the mindsets of the funds' sponsor companies as well as their actions have changed quite a bit.

Also, to deal with the issue of corporate pension funds being small in scale, we have just started a project to promote collective management of funds. This project is for small pension funds, including those who have scaled back their operation after returning a substitutional part of their Employees' Pension Fund to the Japanese government. These funds collaborate with the Pension Fund Association in managing their assets. As we just started this project, there are not so many participants at present but we are hoping that more members will join and the project will grow gradually.

Also, about the mindsets of the funds' sponsor companies towards the Stewardship Code, the topic was often discussed in the meeting that Ms. Aoyama talked about. This is an important topic and for example, corporate pension funds of which sponsors where Mr. Toyama serves as a director, have not signed to accept the Code. They all signed up for the Corporate Governance Code and say that they agree that engaging with investors is important and will promote it with all their might. These things are declared by their presidents or directors in charge of general affairs. These same leaders generally serve as chairpersons of corporate pension funds as well but they do not usually care much about whether their pension funds have accepted the Stewardship Code. I do not know if they overlook this fact intentionally or unintentionally, but at any rate they seem to take little interest. So, I believe

that we need to promote an awareness of the Code among the funds' sponsor companies. As it happens, we have a chairperson of corporate funds who is also an executive of sponsor companies and are thus well-positioned to do so.

This is just a thought about the discussion we had today. We talked about how asset owners should have competent personnel and an appropriate structure in place, but I wonder if this will work. As far as I know, sponsor companies seem happy with accepting the Corporate Governance Code and that's the end of the story for them. I hear that many even seem unaware of the existence of the Stewardship Code. So, I think if we can add some wordings to the Preamble that indicate the necessity to promote awareness of the corporate pension funds' sponsor companies because their influence is rather huge. If we can do that, our message will get across to them.

To be frank with you, people working on the frontlines of corporate pension funds are facing many difficulties. I believe that Japanese corporate pension funds are doing a good job on the finance front, too. They have accumulated large amounts of premiums, and survived the financial crisis unleashed by the collapse of Lehman Brothers. And their average ratio of funded status is around 120 or 130 percent. No other countries have corporate pension funds with such good conditions. They are working really hard and feel the results demonstrate their efforts. Apart from these financial matters, corporate pension funds manage stocks as a part of their portfolios, though the percentage of Japanese shares is declining yet we still have them. Thus they, as investors in Japanese stocks or as asset owners behind those investors, have to be aware of the obligations they should fulfill. Therefore, if some wording or message to call for the attention of the sponsor companies to that effect, it will make things easier for people who are working on the frontlines of corporate pension fund management.

Thank you.

[Kansaku, Chairman] Thank you very much.

Any other comments?

No? Okay then, this is it for today's meeting. Thank you very much for your participation.

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