

**The Second Council of Experts on the Stewardship Code (FY2019)**

- 1. Date and Time: November 08, 2019 (Friday) 16:30 - 18:30**
- 2. Venue: The Central Common Government Offices No.7, 13F Meeting Room No.1**

**[KANSAKU Hiroyuki, Chair]**

Momentarily, we will begin the 2nd meeting of the Council of Experts on the Stewardship Code. I wish to thank you all very much for taking time out of your busy schedules to be here. In the same vein as last time, I would like to engage in discussions on revisions to the Stewardship Code.

Today we will start with a presentation from the Secretariat concerning the final version of the U.K.'s revised Stewardship Code, which was published on October 24, and U.S. regulatory proposals concerning proxy advisors, which were published on November 5.

After that, there will be two sessions for hearing from council members and a guest speaker. The first session will feature a presentation from Mr. Matsuyama, a director of Mitsubishi Electric Corporation, while the second session will feature consecutive presentations from Ms. Waring of the International Corporate Governance Network and Mr. MIZUNO Hiromichi, Executive Managing Director and Chief Investment Officer of the Government Pension Investment Fund (GPIF). Mr. Mizuno is expected to arrive later.

Starting with this meeting, we have installed six screens inside the tables. The purpose of this is to ensure that more members have an opportunity to speak, and once certain period of time has elapsed since a presenter or member began speaking, for reference, the time remaining will be displayed on the screens. I hope you will keep an eye on the screens as you speak.

Today, Ms. Waring will be speaking in English, but simultaneous interpretation will be provided. You will all find a receiver in front of you. The channel for Japanese is 1.

So without any further ado, let's move on to the agenda. As I mentioned earlier, on October 24 a revised version of the U.K. Stewardship Code was published by the country's Financial Reporting Council. Furthermore, on November 5 the U.S. Securities and Exchange Commission (SEC) issued new regulatory proposals concerning proxy advisors. So now I would like to call on the Secretariat to provide us with an explanation of both.

Mr. Shibasaki and Mr. Toyama have also submitted written opinions today, so I would also like the Secretariat to provide explanations of these.

**[INOUE Toshitake, Director, Corporate Accounting and Disclosure Division]**

Thank you very much. I am INOUE Toshitake, Director of the Corporate Accounting and Disclosure Division.

I'd like to begin with an explanation based on Document 1 of the explanatory materials from the Secretariat. Please take a look at the first page. I'll start by giving you the key points from the final version of the revised U.K. Stewardship Code.

As I explained at the 1st Council, in the U.K. a draft for a revised version of the Stewardship Code was published on January 30 this year to make it available for public consultation. Then, after the 1st Council, the final version was published on October 24. As the document states, the new code is scheduled to take effect from January 1, 2020.

Let me explain some of the major changes with regard to the composition of the revised version. The term "reporting expectations" is used to describe matters that are generally expected to be reported, and this is one of two levels, the other being "principles." In addition, the wording for principles has been changed from "comply or explain" in the previous code to "apply and explain," meaning that application is now a requirement.

Furthermore, a separate chapter has been established for principles for service providers,

and there are 12 principles for asset managers and asset owners and six principles for service providers.

Next I'll describe key points concerning the content of the revised version. They are on the second page, and make clear that all financial assets, including bonds, are subject to the code.

There is also a clear requirement to take into account ESG factors when making investment decisions. In addition, the definition of stewardship in the introduction, which you can see the excerpts from the English version here includes clear references to environmental and social factors.

In addition, the code requires reports detailing the results of activities to be submitted to the U.K. Financial Reporting Council (FRC) once a year. The FRC reviews the content of the reports, and only those entities that have met the FRC's expectations are included in the list of signatories.

The next page, which is the third page, illustrates the changes in the U.K. Stewardship Code. In the middle is the draft of the revised code, and it includes the principle of constructive engagement, but the principles in the final revised version, which are on the right side, touch on the concept of escalation in the chapter on engagement in the same way as the current code, which is currently being applied.

Moving on, regarding proxy advisors, there have been some new developments in the U.S. recently, so I'd like to tell you about them. The information is on page four of the materials. On the 5th of this month, the U.S. Securities and Exchange Commission (SEC) put forward draft revisions to the SEC rules on proxy solicitation with the aim of enhancing the accuracy and transparency of advice from proxy advisors.

The draft revisions were only released three days ago, and I have to admit that I'm still in the

process of scrutinizing them, but as you can see from the summary of the draft revisions contained in the materials, for a proxy advisor to demand an exemption from application of the proxy solicitation rules, it must, and this is the blue part, disclose important conflicts of interest, provide opportunities for review and feedback to issuing companies before giving advice, and if requested, include in the advice a link to the opinion of the issuing company concerning the advice.

And that concludes the explanation from the Secretariat of Document 1.

Moving on, I'd like to share the opinions we've received from council members who are absent today.

First, we have an opinion from Mr. Shibasaki. The written opinion from Mr. Shibasaki states that small and medium-sized private corporate pensions have an inadequate understanding of their roles and scope of involvement, and that to increase uptake of the Stewardship Code, it will probably be important going forward to assign personnel with financial literacy to investment execution at small and medium-sized private corporate pensions.

Next I'll share the opinion from Mr. Toyama, who said that with passive investment becoming increasingly dominant, there are concerns that engagement could be weakened as the investor side could have less motivation to engage and there could be a decline in the number of high-quality engagement personnel. As a result, he said, there is a risk of a weakening in corporate governance and of asset building by citizens and the achievement of ESG through sustained increases in corporate value being impeded. He therefore argued that there needs to be a discussion on ways of securing, in terms of both quality and quantity, personnel who can perform high-quality engagement functions, including collective engagement, which can be said to be public functions.

Although it was brief, that concludes the presentation by the Secretariat.

**[KANSAKU Hiroyuki, Chair]**

Thank you very much.

Now I'd like to move on to the presentations from council members. First of all, I'd like Mr. Matsuyama, who is a director of Mitsubishi Electric Corporation, to talk from a corporate standpoint for around ten minutes about issues with asset managers, asset owners, and service providers. Mr. Matsuyama has provided us with Document 3.

So, over to you, Mr. Matsuyama.

**[MATSUYAMA Akihiro, Council Member]**

I am MATSUYAMA Akihiro of Mitsubishi Electric Corporation, and I also serve as chairman of the capital markets working group of Keidanren's Committee on Financial and Capital Markets. Thank you very much for giving me the opportunity to speak today. I'm going to be discussing a number of issues, most notably with respect to the current status of and issues with initiatives by Japanese companies to further promote constructive engagement between issuing companies and institutional investors.

The first page is the contents.

I'd like you to look at both the third and fourth pages. I'm going to start by talking about progress with dialogue and future challenges. This was discussed at the previous Council, but following the publishment of the two codes in Japan, dialogue between issuing companies and institutional investors is being promoted. As you can see from the graph, both issuing companies and institutional investors are acutely aware of this.

I'd like you to now turn to page five. At Keidanren, we've been exchanging opinions on an ongoing basis with domestic and overseas issuing companies, institutional investors, related organizations, regulatory authorities, and so on. And based on our findings, I'd like to tell you about some issues facing both issuing companies and institutional investors that need to be

tackled if constructive engagement is to be deepened further.

I'll begin with issuing companies. First, it was pointed out that stories for long-term value creation should be concretely articulated. These could include the connection between the long-term vision the company has established for improving dialogue and its income.

The second concerns corporate information relating to ESG. Rather than just disclosing everything, it is essential to clarify points that should be emphasized and disclose them in an easy-to-understand fashion.

The third concerns changes in corporate behavior based on the results of dialogue. It is regarded as important to proactively provide feedback to institutional investors, and also to improve the reporting of the content of dialogue to management and employees and to further improve the effectiveness of dialogue.

Please turn to page six. These are issues on the institutional investor side. The first finding is the importance of initiatives to improve the effectiveness of dialogue, including the enhancement of information disclosure and the provision of feedback to issuing companies. It is vital to present the positioning of dialogue in the process leading up to investment as clearly as possible to issuing companies, and also to be proactive in providing feedback to issuing companies concerning things like what investment decisions the results of dialogue led to or how many shares are being held.

Furthermore, to discharge fiduciary responsibilities, it is hoped that institutional investors will not exercise their voting rights in a uniform fashion after implementing advice from proxy advisors or applying superficial internal criteria, but instead will make decisions based on the content of dialogue. Asset owners, too, must not base their assessments of asset managers' exercise of voting rights on superficial criteria, but rather perform their assessments from substantial perspectives.

Second, to make engagement constructive, and ensure that the results of dialogue are adequately reflected in the subsequent conduct of institutional investors, it is necessary for interdepartmental cooperation among asset management departments, voting-right exercise departments, ESG assessment departments, and so on to be stepped up. With the number of institutional investors establishing dedicated sections for performing ESG analysis on the rise, internal cooperation can be said to be crucial for ensuring that such initiatives function effectively.

Third, another thing that was pointed out was that to promote sustainable growth of issuing companies, it is important to not pursue short-term profit, but to instead conduct dialogue and investment from medium- to long-term perspectives.

Please turn to page seven. Among the other findings were, firstly, the nature of activities of proxy advisors. I'll talk about that a little later.

The second concerns the promotion of infrastructure utilization. Although issuing companies are taking steps such as early disclosure of shareholders meeting convocation notices on their websites, the number of investors making use of electronic voting platforms remains small, so it is hoped that the utilization of infrastructure will be promoted so as to further deepen dialogue.

Third, a unified method for assessing ESG needs to be established. Recently, with regard to ESG and SDGs, several sets of guidelines have been put together, both domestically and internationally, to serve as frameworks for the disclosure of nonfinancial information by issuing companies and for dialogue between issuing companies and investors. But a result of various different guidelines having been prepared, the guidelines employed by companies differ. Going forward, it will be important to establish a more unified assessment method so that issuing companies taking action in the area of ESG and SDGs receive appropriate funding.

Please look at page eight. Keidanren's goal is for there not to be negative screening of companies that are striving for sustainable growth, but rather, for such companies to be evaluated positively, and for money targeted at sustainability to be directed to such companies. We have therefore been working with the GPIF and the University of Tokyo recently to conduct joint research with the aim of connecting sustainability-oriented funding with corporate initiatives to bring about Society 5.0, a concept that Keidanren has put forward for achieving the SDGs. Through activities like these, we believe we can contribute to the establishment of more appropriate assessment methods.

Moving on, and this is on page 10, I'd like to talk about the activities of proxy advisors. All entities that sign the Stewardship Code are required to take action to promote the companies' sustainable growth through investment and engagement. And with regard to the activities of proxy advisors, we believe that three new points should be incorporated into the code.

The first concerns the number of issuing companies with regard to which advice on proposed resolutions is provided, the structure for considering them, the number of times dialogue has occurred with issuers or proposers regarding specific important proposals, and the main information sources relied on when preparing advice should be disclosed.

The second is that issuing companies should be supplied with the proposed advice at least before the deadline for the exercise of voting rights and opportunities should be provided to issuing companies for communication with proxy advisors and asset managers concerning the advice. Furthermore, if an issuing company has commented on the advice, the comments and the response to them should be provided to asset managers.

Third, although public consultation is held when proxy voting guidelines are formulated, the views of proxy advisors concerning these opinions should be disclosed to the public.

Besides these points, it will also be important for those on the asset manager side to implement the action stated in the opinion statement from the Council of Experts Concerning

the Follow-up of Japan's Stewardship Code and Japan's Corporate Governance Code (hereafter, the Follow-up Council), such as promoting further disclosure of the use of proxy advisors. At the same time, I believe it will also be necessary to consider establishing a system that will enable actual shareholders to be identified so that issuing companies can approach actual shareholders.

Now turn to page 12. Finally, I'm going to talk about stewardship activities by corporate pensions, and strengthening stewardship activities by corporate pensions will not only contribute to improving the corporate governance of all Japanese companies, but will also have a positive influence on stable asset accumulation by employees and the financial condition of the companies themselves.

This was also featured in the materials for the 18th Follow-up Council in March this year, in December last year Keidanren sent a letter to relevant companies concerning the stewardship activities of corporate pensions, and in conjunction with this Keidanren invited the Financial Services Agency and corporate pensions that had signed the Stewardship Codes to a briefing that it organized.

That concludes my presentation. Thank you very much.

**[KANSAKU Hiroyuki, Chair]**

Thank you very much.

Now I'd like to allocate some time for discussion, during which I'd like to hear opinions from all of you. I'd like you to comment on a range of issues, including, but not limited to, the issues touched on in the presentations from the Secretariat and Mr. Matsuyama. I'd also like to hear your opinions, of which I'm sure there are a great variety, about the wording of the Stewardship Code. For example, should the volume be minimized to just cover the principles, or should more detailed descriptions be provided.

In your tablets we've saved, as Document 2, a compilation of opinions concerning each of the issues, including opinions we received from you at the 1st Council, so please refer to it.

In addition, from 5:15 p.m. today we're planning to hear from Ms. Waring and Mr. MIZUNO Hiromichi, so we'll suspend the debate at 5:15 and then resume it once they have finished with their presentations. Because we have limited time available, I'd like each person to keep their remarks at under five minutes.

So please go ahead. We'll start with Mr. Ishida, who's already signaling.

**[ISHIDA Takeyuki, Council Member]**

Thank you very much. I'd like to say something not about proxy advisors, but about the definition of a term.

The Stewardship Code's stated objective is to increase corporate value. If corporate value increases, that's great, but I think the problem here is that there is no definition of what corporate value is. Without a definition, confusion will emerge, and I am concerned that the efforts of stakeholder will prove fruitless.

In other words, it could be that from the standpoint of companies, action aimed at increasing corporate value, seems, from the viewpoint of investors, to actually be action that reduces corporate value. As I mentioned at the previous Council, ISS will, in the event of a shareholder proposal or a proxy fight, listen to the opinions of both the company and the shareholders. The company and the shareholders will be in opposition to each other, but neither side will be able to deny the expression "increase in corporate value" itself. The two will clash because they have different perceptions of what corporate value is and how it can be increased.

So the more the two sides engage in dialogue while declaring that they are going to increase corporate value, the more strained the relationship will become, and the less productive the outcome will be. So I think what's needed is an easy-to-understand definition. And it should

make sense not only within Japan, but also globally. I think it needs to be easy to understand from the viewpoint of global investors and to be measurable.

So, and this is just an example, how about the present value of future cash flow? And because what shareholders ultimately gain is dividends and share price appreciation, the total of those, which is known as the total shareholder return, or TSR, could also be used, I think. A stock price cannot be controlled by the company itself, so perhaps the TSR relative to the market could be employed. And if there is resistance to the short-term TSR, I think that the medium- to long-term TSR would probably also see less resistance from companies.

The total of stock price appreciation and dividends might seem too direct, but because that is the ultimate purpose of investing in stocks, I think it's important to make it clear. In short, when considering a definition, the important thing is clarity. I think the language should be understood by global investors.

Another point, and this also relates to words, is that with the expression "constructive engagement," for example, different people will have different interpretations of what constructive means. Activist shareholders, for example, might feel that making some sort of proposal to a company constitutes constructive engagement, but companies, on the other hand, might interpret activists making proposals to companies as unconstructive behavior that harms trust between the two sides. Without a definition for increasing corporate value, even if there's a discussion of what corporate value is, it'll just be word play. But even in cases like this, if there is a definition of corporate value that can be measured, I think steps can be taken in that direction, and the discussions will be smooth and easy to understand.

So my conclusion is that I think there's no need to consider an elaborate the text of the Stewardship Code. Rather than that, I think that corporate value should be defined using a clear definition that anyone can understand, and that by doing that, the revised Stewardship Code can serve as a set of easy-to-use practical guidelines for the stewardship activities of investors.

That's all I have to say. Thank you very much.

**[KANSAKU Hiroyuki, Chair]**

Thank you very much. Moving on, let's hear from Mr. Matsunaga.

**[MATSUNAGA Yosuke, Council Member]**

I am MATSUNAGA Yosuke of Nippon Life Insurance Company. I'd like to make two points.

First, at the previous Council the opinion was expressed that we should look back on the five years since the publishment of the Code and assess what sorts of outcomes it has led to. I'm therefore going to talk about the initiatives of investors and the changes on the corporate side.

I'll start with the initiatives of investors. The approach of the Code, which is to increase corporate value and promote sustainable growth through constructive engagement, is consistent with the stance of life insurance companies, which invest with a focus on long-term stability. We adhere to these philosophy, and are taking action in line with them,

Specifically, we have made our standards concerning the exercise of voting rights more rigorous and expanded the number of criteria included. We have also reinforced our structures, and are increasing the number of constructive engagement sessions year by year. We have also been working to expand information disclosure. For example, we are including information about the dialogue we have engaged in, how we exercised voting rights, and the reasons for our agreement or disagreement when exercising these voting rights in our stewardship activity report. And since fiscal 2017, 10 life insurance companies that belong to The Life Insurance Association of Japan have been performing collaborative engagement on the topics of returning value to shareholders and ESG information disclosure. In this way, I believe institutional investors have demonstrated creativity and innovativeness and made ongoing efforts to strengthen initiatives, and that the corporate side is also seeing positive

changes.

I guess it will take some time to increase ROE, which is difficult to improve immediately based on corporate decision making alone, but I believe that matters that can be improved through corporate decision making, such as reinforcing governance through the appointment of independent outside directors, disclosing information through integrated reporting, and boosting shareholder returns through higher payout ratios, are showing steady improvement, both in terms of performance and attitudes on the corporate side. As a life insurance company, we will be continuing to work on engaging in higher-level dialogue to achieve the underlying objectives of the Code.

Second, Document 1 shows the main points of the U.K. Stewardship Code 2020. Regarding ESG, I talked about that last time so I'll leave it out today. Instead, I'll discuss the expansion in the range of assets covered by the code.

When the code was created, the goal was to promote increases in corporate value and sustainable growth through constructive engagement between institutional investors and companies, and I understand that the only assets covered were Japanese listed shares. But Principle 1 of the revised U.K. Stewardship Code includes an additional expression of stewardship as delivering "sustainable benefits for the economy, the environment, and society." And based on this, I understand that assets such as bonds have been added to those covered by the code.

Going forward, when the range of assets covered in Japan is expanded, I feel that there should be further discussions on issues such as whether to change the objectives and goals of the Stewardship Code, and that after that there should be a proper debate on how to proceed in a smooth and effective way.

That concludes my remarks.

**[KANSAKU Hiroyuki, Chair]**

Thank you very much. Next I'd like to hear from Mr. Ogai. Please go ahead.

**[OGAI Taro, Council Member]**

I'd like to make one point. During the presentation we've just heard, the speaker ended by saying that because they have the role as asset owners, it will be important for corporate pensions to strengthen their stewardship activities, and I completely agree. Unfortunately, however, from what I've seen this probably isn't possible right now. So continuing on from last time, I'd like to make one point.

Last time, I stated that corporate pensions might not be in a position to decide on various things independently, due, for example, to the master-trustee system or their relationship with their sponsoring companies. I think some expressed the view that asset management is not included in the remit of master trustees, and that they are completely separate, and that it's not the case that the master trustee will automatically undertake the task of asset management just because they are the master trustee, but this was a bit different to my view, so I actually went away and collected some data.

I gathered actual data on several dozen funds, which is a limited sample as they are all our clients, and I found that when the master trustee is doing asset management, they're undertaking 42% of it on average. I excluded funds where the master trustee isn't doing asset management, as they aren't undertaking any asset management at all, and the figure is zero, so I excluded them. At non-master-trustee funds, the share is 12%. So it's 30% lower, which makes me feel, at least looking at it from this figure, that it's not the case that master trustees have hardly any involvement.

So on that point, I would like to reiterate that I think that it will probably be important in some cases for master trustees, including service providers such as consultants like ourselves, to make improvements in some way or another with respect to the undertaking of asset management.

Specifically, and I think everyone is operating or have made announcements in accordance with Principles for Customer-first Business Practices, I think it will be important to ensure implementation of not only Principle 2, Pursue customers' best interest, and Principle 3, Appropriately manage conflicts of interest, but also for example Principle 4, Clarify commissions and fees, and Principle 5, Provide important information in an easy-to-understand manner.

Specifically, can master trustees, for example, assess the nature of services such as management operations and quantitative operations and how much the costs are, and can they outsource each of these operations separately? Funds need to be clearly informed of matters such as whether asset management is completely separate. In fact, on the fund side, I think it would be difficult to obligate them to decide on who to outsource to after comparing and considering multiple companies, so I think it would be enough to just recommend that they do that.

Going further, I think it would be difficult to periodically review the effectiveness of the measures and to make such reviews obligatory. But a review could be performed once every three years, for example. It would of course be fine to continue outsourcing to the same place as a result of this review, but I think it's probably important to do such things.

Based on what I've actually seen, I cannot recall any case of a Japanese company changing its master trustee in the 15 or more years that I've been working in this area. It happens occasionally at foreign companies, and in that sense, there may be cases in which such fixed long-term relationships are serving in an unhealthy way.

Finally, when corporate pensions are deciding which such service providers to use, and particularly when outsourcing to the same place for a long period of time, or when various places are fixed by the same group, the reasons should be clarified, and this should be encouraged in some way, or it should be actually looked at in the process of audit or

supervision. I believe that this could serve as an impetus for corporate pensions to actually engage in these sorts of stewardship activities and tackle other tasks as asset owners.

That's all I have to say.

**[KANSAKU Hiroyuki, Chair]**

Thank you very much. Moving on, let's hear from Mr. Haruta. Over to you.

**[HARUTA Yuichi, Council Member]**

I am HARUTA Yuichi of the Japanese Trade Union Confederation. I'd like to say something regarding the content of the revised U.K. Stewardship Code, which the Secretariat told us about earlier.

As the Secretariat explained, regarding the recent U.K. revised version, I see the major point being that regarding the assets covered. It states that all assets, including bonds, will now be covered. Regarding this, I recognize that it will at least have some impact on the debate concerning the revision of Japan's Stewardship Code.

As I also said at the previous Council, we have been campaigning, from the position of labor unions, for the popularization and implementation of ESG investment. I keenly sense the importance of ESG elements in stewardship activities, and I feel that the recently-revised U.K. Stewardship Code's requirement to take into account ESG elements will also affect us.

Regarding the assets covered, which I mentioned earlier, not only are there numerous bonds relating to ESG, but corporate bonds are deeply connected with the finances of investee companies, and also with corporate value, so I understand that there are already cases of dialogue with companies from which bonds are purchased. Going forward, when considering revisions to Japan's Stewardship Code, I believe that this issue will probably also be included in the discussions.

On the other hand, though, and this is an extreme example, if there is too much fear of default or nonperformance, and amassing retained earnings becomes the top item on the dialogue agenda, there is a danger that the dialogue will go against the purpose of the Code, namely to increase corporate value and promote sustainable growth.

Speaking from the standpoint of labor unions, I believe it is important to appropriately allocate funds for growth, which includes corporate earnings and their proper distribution to workers. And because this is likely to have various effects with respect to the assets covered going forward, as I said earlier, I believe that there must be a proper debate on the objectives and goals of Japan's Stewardship Code.

That's all.

**[KANSAKU Hiroyuki, Chair]**

Thank you very much. Moving on, I'd like to hear from Mr. Sampei.

**[SAMPEI Hiroki, Council Member]**

Thank you very much. Earlier, the Chairman talked about the writing style of the Code, so I'd like to start by talking about that. Put simply, I think we should avoid making it too detailed and establishing it as a uniform direction. In relation to that, and in light of today's explanation from the Secretariat concerning the U.K. 2020 code and the presentation from Mr. Matsuyama, I would like to share two points that are likely to be important.

First, as stated in Principle 1 of the U.K. Stewardship Code, I believe that having asset managers consider their stewardship responsibilities based on their investment beliefs, strategy and culture would allow stewardship activities to be integrated into the investment process without any discomfort or waste. This would likely result in maximum benefits, so I think it is the most important starting point. I understand that this is why it has been included in Principle 1 of the U.K. code.

Conversely speaking, if uniform stewardship activities or reporting that do not reflect the investment beliefs, strategy and culture of each asset manager are required, I believe it would lead to be more distortion or waste in investment processes and approaches, and the outcomes hoped for would be less likely to be achieved. Fundamentally, capital markets are based on freely and legitimately available public information, and work because assets are sold and bought at the same price. The reason that a sale and a purchase, or in other words completely opposite investment decisions, can occur simultaneously is that there are different investment strategies and approaches. Even with the same public information, the fact that rational decisions that are consistent with oneself are made as a result of investment philosophy and analytical approach, is, I believe, the source of competitive strength.

The U.K. code is careful not to harm the competitive strength that constitutes the source of individuality among asset managers. Specifically, I think a Japanese translation is provided in Reference Document 2, and on page 4 of the U.K. code there's an introduction. It starts where it says "The Code" in the third paragraph from the top. And it clearly states: "The Code does not prescribe a single approach to effective stewardship. Instead, it allows organizations to meet the expectations in a manner that is aligned with their own business model and strategy". Furthermore, the fifth paragraph on the sixth page, which starts with "The Code recognises" also contains this statement: "The Code recognises that signatories ... do not exercise stewardship in an identical way".

A similar opinion has been expressed by the Forum of Investors Japan. The Forum of Investors Japan is a voluntary body comprising a broad range of institutional investors both from Japan and overseas. The Forum's 23rd report, which is dated October 30 and is publicly available on the Forum's website, discusses this matter in detail.

My second point concerns the disclosure of voting rationale for agreeing or disagreeing when exercising voting rights. This is on page one of Document 2, and relates to Principle 12 of the U.K. code. It's on page 22, in the "Activity" section, and rationale for agreement or disagreement are not stated. Instead, there are three specific examples under "particularly

where.” These are rationale for decisions to oppose corporate proposals, rationale for decisions to oppose shareholder proposals, and rationale for decisions to withhold/abstain voting rights. I think this can serve as an incredibly useful reference. My interpretation is that regardless of whether it’s a corporate proposal or a shareholder proposal, the convocation notice contains the reason for the proposal and information required for making a decision about it, so when a proposal is supported, the reason for supporting it can be easily inferred. On the other hand, if a proposal is opposed, only the people involved know why the decision was made to oppose it, so I think the rationale should be disclosed, even if the explanation is brief.

However, I believe that the second of the “other opinions” presented on Page 1 of Document 2 will serve to enhance trust by promoting conditional dialogue “in cases of agreement with an investee with which there is a conflict of interest.”

That’s all I have to say.

**[KANSAKU Hiroyuki, Chair]**

Thank you very much. Next, let’s hear from Mr. Matsutani. Over to you.

**[MATSUTANI Hiroshi, Council Member]**

I am MATSUTANI Hiroshi of the Investment Trusts Association of Japan. Even though this isn’t directly related to the discussion about the Code, I’m going to provide a report.

As Mr. Matsuyama mentioned earlier, regarding the operations of investment management organizations, a huge number of opinions have emerged regarding the promotion of IT adoption and infrastructure deployment. As you know, in Japan around 70% of shareholders meetings are held in June, and among them, there are still some for which communications are based on faxes or emails. Investment asset managers will be actively pursuing stewardship activities in line with the investment beliefs of each company, but there are frequent complaints about being forced into extremely inefficient practices. Specifically, I

think a crucial point will be to get all companies, if possible, to participate in a voting-right exercise platform.

In addition, regarding activity reporting to asset owners, and this is included in the Secretariat materials under “Summary of opinions concerning each issue,” by establishing a common reporting framework through the adoption of smart forms, I think it will be possible to assess various activities in a unified fashion. I mentioned infrastructure development, and if this occurs, I think that the administrative burden of stewardship activities, of the like that is being discussed here, will be alleviated, efficiency will be increased, and more capability for effective disclosure will be created.

And that concludes my report.

**[KANSAKU Hiroyuki, Chair]**

Thank very much. Moving on, Mr. Okada. Please go ahead.

**[OKADA Joji, Council Member]**

I am OKADA Joji of the Japan Audit & Supervisory Board Members Association. I'd like to raise one point with regard to proxy advisors, which were included in the report from Mr. Matsuyama earlier.

Developments in the U.S. were presented earlier, and I think it would be premature to introduce such measures immediately, but I feel that it would probably be a good idea to include some form of “soft law” for advisors in the Stewardship Code.

That aside, my personal feeling about proxy advisors is that I want them to engage in more dialogue with companies. There are voting-exercise guidelines for advisors, and these constitute uniform judgement criteria. However, because each issuing company faces specific circumstances that are unique to them, I hope that cautious voting advice that reflects such factors will be provided.

A specific and easy example concerns the independence of outside officers. Each company has established and is following their own standards with regard to independence, and these standards are disclosed in their corporate governance reports. On the other hand, there are also cases where advisors give advice on whether to vote for or against proposals based on their own uniform standards, or where comments are attached that cast doubts on independence. I think it's good for advisors to have their own exacting indicators and to articulate their views on independence, but I feel it might be going too far to apply these standards in a uniform way to all companies. So I'd like them to engage in deeper dialogue concerning the independence standards established by each company.

Regarding individual proposals, I think it must be hard work making decisions on whether to vote for or against and providing advice when shareholders meetings are fast approaching, and it must be a challenge in terms of human resources, but as I said earlier, I truly believe that with regard to dialogue concerning the independence standards formulated by each company, it should be possible to engage in such dialogue adequately and in a relaxed fashion as part of normal activities, without the need to do it right before the shareholders meeting.

That's all I have to say.

**[KANSAKU Hiroyuki, Chair]**

Thank you very much. Would anyone else like to say anything?

In that case, we're almost out of time, so as I explained earlier, it's now time for today's second presentation session.

On October 14 the International Corporate Governance Network (ICGN) put forward proposed revisions to its Global Stewardship Principles for public comment. So now I'd like Ms. Waring, who's the CEO of the ICGN, to speak for about 10 minutes on matters including

the content of the proposed revisions. Ms. Waring has submitted Document 4-1, and Document 4-2 provides a summary Japanese translation of that.

So Ms. Waring, please go ahead.

**[Kerrie Waring, Council Member]**

Today, I would like to focus on a number of areas drawing on my letter to the council regarding possible amendments to the stewardship code for your consideration.

Firstly, in terms of voting rationale, ICGN agrees with FSA that investors should be encouraged to improve their disclosures around the vote decision-making process. In fact, in ICGN's own principles, include four points for consideration:

- Firstly, we encourage investors to publish their voting policies, including conflicts of interest.
- Secondly, we ask that investors disclose how voting judgments are reached including accountability for the decision and whether this differs depending on resolution, geography or scale of holdings.
- Thirdly, we encourage, where possible, investors to explain to companies the reasons underlying the voting decisions preferably before the shareholder meeting. (The UK stewardship code now specifies that signatories should explain their rationale, particularly where there was a vote against the board, there were votes against shareholder resolutions, a vote was withheld or the vote was not in line with their own voting policies.)
- And fourthly, we encourage investors to publish their voting records with limited delay from the date of the vote itself. An impressive example of this is Allianz Global Investors who publish their votes in real time on their website.

In terms of Proxy Advisors, ICGN supports the FSA proposal for better disclosure around organizational structures and decision making. I think this is already made fairly clear in recommendation 5.4 of the Japan stewardship code. We encourage you to take a look at

what the UK have done, where they have separated out a whole new section for proxy advisors or perhaps look at the European Best Practice Principles published in July.

Investors are responsible for voting thousands of resolutions, and this is efficiently facilitated by Proxy Advisors. While there is a perception by some that investors blindly defer to proxy advice, we believe that this is not the case for the majority of ICGN members. In fact, we surveyed them on this question last year and around 40% responded based in 14 countries representing around USD\$11 trillion assets. Sixty percent said that they take their own voting decisions and never rely on proxy advice. A further 20% said they take their own voting decisions on a majority of resolutions in key markets, but that elsewhere they instruct their Proxy Advisers to vote in alignment with their in-house voting policies.

ICGN encourages constructive engagement between Proxy Advisors and companies, particularly when concerns are raised that there may be factual inaccuracies in reports. Noting, of course, some disputes arise from differences in analytical approach, which may then result in an alternative outcome. There is no doubt that where there is a factual error, the report should be corrected, however, ICGN does not advocate that Proxy Advisors should be required to mandatorily share advance copies of their report with companies for regular review as has been proposed this week by the US Securities and Exchange Commission.

ICGN's own Global Stewardship Principles focus on the responsibility of investors to ensure that votes are cast in an informed and responsible manner consistent with their own voting policies. And we recommend that investors should disclose the extent to which they use advisory services including the identity of the provider and the degree to which their advice has influenced the ultimate vote outcome.

My next point is that I would encourage you to include a recommendation in your code regarding the application of stewardship across all asset classes, not just equities.

This concept has been included in the ICGN principles for many years and we were very

pleased to see it now included in the UK Stewardship Code. Fixed income investors, in particular, are prioritized given the size of the global bond market. And in the UK's case where the largest proportion of pension assets are investors. It is fairly easy to visualize the application of stewardship from an equity perspective, shareholders who use their ownership rights to influence corporate governance by voting at annual general meetings. But bondholders also have the opportunity to influence corporate governance, for example, when setting covenants before an investment is made or when amending terms in indenture agreements.

Of course, many argue that conflicts of interest between the two rules diminish alignment of interests, bondholders tend to prefer financial prudence and be risk averse while shareholders have a greater risk appetite to generate returns on equity. Differences of opinion can arise, for example, around corporate restructuring. But in many respects, many respects, bondholders and shareholders have a common interest in healthy companies. They both want sustainable financial performance to generate cash flows to service debt as well as earnings growth. And this is particularly true for ESG related risks that have the potential to threaten both credit quality and the generation of shareholder returns.

So, let's think about what are the mutual priorities that both bondholders and shareholders share when they are engaging with companies. Well, first off, a big subject within this council, capital allocation including the use of debt and financial leverage. Remuneration structures that discourage risk taking to achieve bonus awards, risk management with an increasing focus on systemic risks and, of course, robust accounting policies and audit processes to ensure the accurate reporting and guard against financial risks.

Ultimately, companies should seek to satisfy the needs of bondholders and shareholders who both play critical role in financing long-term growth for sustainable value creation. I should just say that ICGN's Policy Director, George Dallas, has produced a viewpoint on this subject, so please take a look on our website.

Next, very briefly, I'd like to emphasize the importance of integrating ESG factors in stewardship activities in the code. For ICGN, we dedicate an entire principle to ESG integration. We ask that investors analyze, monitor and integrate ESG factors in investment decision making, voting and engagement. We ask that they encourage reporting by companies to link ESG factors more clearly with long-term company strategy. And we ask that they understand long-term systemic threats including factors relating to overall economic development, financial market quality and stability. For example, ICGN members increasingly engage with companies on how they embed the effects of climate change in their business models and risk management systems to ensure they are properly identified, measured and monitored.

Finally, I would suggest that you emphasize the importance of disclosure around stewardship 'activities', as well as policies. This would be consistent with amendments to ICGN's own Principles and the new approach that the UK stewardship code has taken. The UK Code now also requires that reports from investors be reviewed and approved by the signatories governing body and signed by the chair, chief executive or chief investment officer, and this aims to ensure that disclosures are accurate and balanced.

**[KANSAKU Hiroyuki, Chair]**

Thank you very much.

Moving on, in light of increasing developments in such fields as sustainability recently, Mr. MIZUNO Hiromichi, Executive Managing Director and CIO of the Government Pension Investment Fund (GPIF) is going to speak for around 10 minutes from the standpoint of an asset owner. Mr. Mizuno has submitted Document 5.

So, Mr. Mizuno, please go ahead.

**[MIZUNO Hiromichi, GPIF Executive Managing Director and CIO]**

I am MIZUNO Hiromichi of the GPIF. First of all, as a representative of the GPIF, I would like

to thank you for giving me this opportunity today. Because this is the Council of Experts on the Stewardship Code, today I would like to talk about the action that the GPIF, as an asset owner, has been taking with regard to the Stewardship Code, and also convey to you all my hopes concerning the upcoming revision of the Code.

When I've taken part in discussions overseas concerning stewardship, I always declare that Japan's Stewardship Code goes beyond the U.K. code, which was the original one. This is because it (Japan's Code) contains references to the ESG-related concepts before the U.K. code did. But looking at the recent revisions to the U.K. Stewardship Code, I'd say that the situation might be reversed again. There are two main points in their revisions to their code; they have expanded the scope of stewardship responsibility to cover not just equities, but also bonds, and they have quite clearly stated the importance of ESG integration. If these points aren't also included in Japan's Code, I will no longer be able to say that Japan is further ahead.

I'd like to use the example of ourselves to explain our view on these two points. The first materials present our view concerning our stewardship responsibilities in response to the Stewardship Code, which we call our Policy to Fulfill Stewardship Responsibilities. Furthermore, the year before last, we included in the GPIF's investment principles clear references to ESG and the need to fulfill stewardship responsibilities with respect to all asset classes, including bonds, rather than just equities.

I feel that in Japan, the Stewardship Code was introduced as one approach to improving corporate governance. However, the origin of stewardship responsibilities calls for us asset owners and fiduciary investors to whom we entrust our assets, to act in a fiduciary capacity for the best interest of our beneficiaries. Given that origin, I feel that it is inconsistent that there are differences between asset classes. So based on the view that we should exercise required stewardship responsibilities with respect to all asset classes in order to fulfill our stewardship responsibilities, the year before last we made this clear by removing the wording "in the case of equity investment ..." from our investment principles and adding "ESG" Instead.

Regarding the next point, in our Policy to Fulfill Stewardship Responsibilities, I would like to include clearer references to long-term orientation, which we are currently working on it. Since medium-term, long-term, and short-term are vague concepts, it's difficult for us to define time horizons. Regarding ESG, the longer the horizon for such activities, the debate about what financial information should look like will be resolved, I believe as well. GPIF is therefore intending to incorporate a clear long-termism into all our policies.

Next, regarding the positioning of ESG, we have also defined materiality. At page 7, you'll see that we demand that asset managers integrate ESG, and also provide a clear definition of ESG integration. This definition is in accordance with that of PRI, which we are a signatory to, and we clearly define ESG integration as "the explicit and systematic incorporation of ESG issues in investment analysis and investment decisions." This integration is essential for enabling GPIF, a universal owner and cross-generational investor, to fulfill its fiduciary duties. In that sense, I believe that the longer the investment period is, the more likely improvements are to be seen in risk-adjusted returns. Currently we include this ESG integration in our assessments of both active and passive asset managers. As a quite recent development, in an assessment as a part of investment process of asset managers, we are endeavoring to clearly position ESG integration as an assessment item.

As a part of our stewardship activity principles, we also require our external asset managers to conduct engagement concerning material ESG issues. At present, these ESG and other stewardship activities accounts 30% of the assessment for passive and 10% for active.

We have made it clear that we are in the direction of positive screening and positive engagement, not adopting the divestment of certain industries, which is often discussed in the same breath as ESG investment. This can be said to be two sides of the same coin with ESG integration into our investment process. Positive screening and positive engagement involve integrating risks and returns and pursuing engagement over the long term.

Going back a little, I'd like to mention how we articulate a long-term orientation. Last year, GPIF had introduced a fairly balanced performance-linked fee structure for active asset managers. Apparently the only thing people in the industry were talking about is that our base fee is low. However, actually, the most important thing is that, we have introduced multi-year contracts in order to enable external asset managers to achieve long-term investment objectives, as well as to remove incentives to pursue short-term investments or short-termism, which I've highlighted here in red.

This year we hired an HR consulting firm to conduct research on the compensation structures of asset management company executives, fund managers, and staff in charge of Stewardship activities, in order to evaluate them with a particular focus on whether incentive structures promote short-termism. We are currently incorporating this as a part of the assessment of asset managers.

Finally, as I mentioned earlier, two years ago we conducted a study with the World Bank on bond investments and ESG. This report mentioned the significance of ESG as an investment factor, which means that ESG investment becomes a general part of the investment process for bond investors, as well as the significance of engagement by bond investors. This study also served as an impetus for us to make bonds subject to stewardship.

I have two minutes left, so I guess I can talk for a bit longer. What GPIF currently regards as important in stewardship discussions with asset managers is to ensure long-term horizons and long-termism, and to provide incentives for eliminating short-termism. However, because short-termism isn't just found in human investors, we believe that one of the reasons for the sharp decline in average holding periods in the market is algorithmic trading.

We are also currently conducting various studies on AI. I have just received a commissioned research report on AI from Sony Computer Science Laboratories before I rushed over here. I think that it is likely that the more these algorithmic trades occur, the more the importance of human investors investing and engaging with a long-term perspective and an ESG-based

approach will be highlighted.

Finally, for the last minute I'm going to talk about disclosure. While GPIF naturally asks for information about matters such as the exercise of voting rights to be disclosed these days, we are also doing whatever we can do to enhance transparency in the market as a whole.

One issue is that we think it is really critical to know where our shares are, and we are aware that because of things like stock lending, the whereabouts of shares is often unclear. When our asset managers engage with companies, we want them to be conscious of ownership, and to secure assert ownership beforehand. And finally, we have been publishing ESG activity reports since last year. This year, for the first time, we disclosed climate risks aligned with the TCFD recommendations. It means that we will be asking our asset managers to analyze and disclose ESG risks in the same way as we did going forward since GPIF could do this year. We see this as a part of their fiduciary duty towards us, and we would like to ask our asset managers to analyze long-term systemic risks like this.

Thank you very much.

**[KANSAKU Hiroyuki, Chair]**

Thank you very much.

Now we'll have another discussion session. Besides the issues raised at the beginning, I'd also like you to discuss other matters, including the issues just raised by Ms. Waring and Mr. Mizuno. Because we have limited time available, I'd like each person to keep their remarks at under five minutes. We'll start with Ms. Takayama. Please go ahead.

**[TAKAYAMA Yoshihiko, Council Member]**

I'd like to make two comments in relation to what Ms. Waring was just talking about.

The first concerns having a global viewpoint. What we're discussing right now is Japan's

Stewardship Code, and it may be that we consider the bearers of such responsibility to be mainly Japanese investors and the targets of their investments to be Japanese companies, but even if that's the case, Japanese companies and Japanese investors cannot be separated from their activities in global markets, and believe that they are incorporated into these markets. So when discussing the Stewardship Code, I think that we must always adopt the viewpoint of asking ourselves what views are being shared in global capital markets.

On that point, I understand that the matters pointed out in the written opinion stated by Ms. Waring have been discussed among global investors for the past ten years, and that they reflect shared views. Because of this, when revising our Stewardship Code, I think that we should also consider the matters pointed out by Ms. Waring.

Next I'll discuss the second point, which concerns what form that will be reflected in activities. I think a phased approach would be best. This relates to the matters pointed out by Ms. Waring, and also to those pointed out just now by Mr. Mizuno, but ESG factors are extremely closely connected with the medium- to long-term economic value and financial value of companies, so I think they're incredibly important. Looking at how they have been reflected in the Stewardship Code over the years, we see that the very first Stewardship Code focused on ESG risks. But at the time of the previous revision to the Code, earning opportunities were added as a new factor, and ESG is stated as being important from the standpoints of risk and earnings opportunities.

And the written opinion statement presented at this year's Follow-up Council also made clear mention of ESG factors. In light of this, I considered what sort of expression would be good for the new revised version of the Stewardship Code, and I feel that the expression written by Ms. Waring would be appropriate.

Specifically, on page 7 of Document 4-2 there's a section about the integration of ESG factors into stewardship activities. It's the fifth item. First, it says, "Investors should have awareness of ESG factors that may influence risks and opportunities affecting a company's long term

performance and sustainable value.” I think this is a really good expression. This is because it clearly states that ESG factors are connected to the long-term economic value and performance of companies.

I also think that the second expression should be incorporated into the Code. It says, “Investors should consider ways to analyze, monitor, assess and integrate ESG-related risks and opportunities into investment processes across asset classes in alignment with their investment decision-making, voting and engagement practices.” Looking at the original English text, it says, “Investors ... should consider ways,” so the details are left to the discretion of investors. No uniform demands to do this or that are made, so there’s a degree of freedom. The Stewardship Code has changed little by little since the initial version, through the previous revision, and the current revision work. And I guess it’ll probably change again three years from now when it’s revised again. And I feel that during revision processes and changeover periods like these, it is a good idea to word things in such a way that allows for some degree of freedom.

That’s all.

**[KANSAKU Hiroyuki, Chair]**

Thank you very much. Moving on, let’s hear from Mr. Yonehana.

**[YONEHANA Tetsuya, Council Member]**

Thank you very much. I am YONEHANA Tetsuya of Mitsubishi UFJ Trust and Banking Corporation. I’d like to make two comments from the viewpoint of an asset manager about the revisions to the U.K. code and the earlier presentations from Ms. Waring and GPIF CIO Mr. Mizuno.

The first point concerns the notion that the Stewardship Code should not only cover shares, but instead should be expanded to cover all assets, including bonds, and I think the underlying purpose of the Stewardship Code will involve, through constructive engagement

with investee companies, promoting medium- to long-term increases of corporate value and sustainable growth with the companies concerned, and at the same time increasing medium- to long-term investment returns for the ultimate beneficiaries. So in light of this purpose of the Stewardship Code, I think that it should cover more than just shares, and that expanding coverage to include other asset classes would lead to enhanced sophistication along the entire investment chain.

Nevertheless, unlike equity investment, which targets increase corporate value, bond investment eyes the maintenance and expansion of creditworthiness, and the concept of exercise of voting rights does not exist. For reasons like this, I feel that it will probably be necessary to consider specific methodologies such as how to apply the content of the Stewardship Code. That's my first point.

My second point concerns ESG. I think that ESG initiatives have become increasingly important for companies, too, as we strive to establish a sustainable society, and I believe that at our company, our stewardship activities as an asset manager and our efforts to tackle ESG issues have already been integrated.

However, the current Stewardship Code contains only a scant reference to ESG in Principle 3, which concerns the monitoring of investee companies, so as part of the current revision of the Code, I think it would be worth expanding the text on ESG by, for example, making clear that dialogue with companies from an ESG perspective is encouraged.

That being said, while I feel that awareness among companies of ESG has been increasing recently, it will take time for corporate efforts in the area of ESG to produce visible results, and I think that the benefits of these returns have not necessarily been fully investigated as of now. So if I were to state the minimum requirements for asset managers at the present time, I would say that with regard to ESG, they should strive to increase corporate value over the medium- to long-term by continuing to engage in targeted dialogue with companies.

That's all I have to say.

**[KANSAKU Hiroyuki, Chair]**

Thank you very much. Moving on, let's hear from Mr. Tsukuda.

**[TSUKUDA Hideaki, Council Member]**

Thank you very much. I'd like to make just one point.

During the presentation from Ms. Kerrie Waring just now, I personally felt that the most important thing was number seven, which is down at the bottom on page 8 of Document 4-2, which is the Japanese version, and calls for the escalation of engagement toward investee companies. I feel that this is probably the most important.

The wording is "engagement escalation." If corporate performance is strong, and managers are doing well, then constructive engagement is comparatively effective and everyone's happy. But it becomes a problem when corporate performance isn't all that great, and institutional investors aren't all that satisfied. Under such circumstances, how can you pursue constructive engagement? I think this is a key topic for a lot of Japanese companies.

And as it says here in Ms. Waring's materials, Japan's Stewardship Code makes no mention of how, when no progress with dialogue is being seen, investors should escalate engagement. Obviously, in Japan until now, engagement activities were not enough. So it's probably been premature to start talking about escalation, but as we've heard in various explanations, engagement activities are more common in Japan. And if, as a consequence of this, constructive discussions between institutional investors and companies are now possible, then I think that our stance should be to mention escalation of engagement in Japan's Stewardship Code, maybe next time if not this time.

That's all.

**[KANSAKU Hiroyuki, Chair]**

Thank you very much. Next, let's hear from Mr. Oguchi.

**[OGUCHI Toshiaki, Council Member]**

Thank you very much. Today, besides learning about the revisions to the U.K. Stewardship Code, I've obtained a lot of insights from Mr. Matsuyama, Ms. Waring, and Mr. Mizuno, so thank you very much. I think it's really important to consider these sorts of global developments.

And at today's meeting we're thinking about revisions to Japan's Stewardship Code, and I think that we mustn't forget that in Japan governance reform was originally positioned as part of growth strategy, and that's how things got started.

I asked about this last time, too, and the Corporate Governance Code and the Stewardship Code are like the two wheels of a cart. They trace their origins to the shared goal of contributing to the development and growth of the economy as a whole, and we are moving toward that goal, and concepts such as the cost of capital that relate to capital efficiency, which contributes to the development and growth of the economy as a whole, were included in the previous revisions to the Corporate Governance Code, and while progress is being made in these areas, I think that we perhaps ought to confirm that we are still only half way there from the perspective of global standards.

Amid such circumstances, and this also goes for corporate management, I feel that to achieve objectives the concept of select and concentration will be required. I think this is something that we need to think about in Japan.

From that viewpoint, what I was interested in with the revised version of the U.K. Stewardship Code, which is today's hot topic, is the fact that with regard to reporting under the Stewardship Code, the direction for reporting has been shifted to reporting for the purpose of verifying activities and outcomes. In Japan, too, a key task is to deepen substance, and I

feel that there are numerous points we can refer to.

At the beginning, Mr. Ishida argued that the definitions should be easy to understand, on the grounds that unless definitions are clear, gaps between companies and investors will emerge even if they are engaging. And if you look at Reference Document 1 today, which is the English version, and Reference Document 2, which is the Japanese translation, it shows the activities and outcomes that should be disclosed for each principle. I think that such techniques might be able to avert gaps between companies and investors of the like pointed out earlier, namely differences in interpretation, and in that sense, I think that adopting such a viewpoint will probably be important.

On the other hand, the new U.K. Stewardship Code has also seen an expansion in conceptual scope. While I'm not rejecting that, as I said earlier, what we need to think about right now is how to deepen substance through both codes. A number of things have already been pointed out at the Follow-up Council, and if we prioritized, I think that starting with those and then having various discussions with an eye on the future would be the correct direction to take.

That's all.

**[KANSAKU Hiroyuki, Chair]**

Thank you very much. Moving on, over to Mr. Tanaka.

**[TANAKA Wataru, Council Member]**

I'd like to present my opinions concerning ESG from my standpoint as a company law scholar.

When considering ESG theoretically, we are faced with the choice of only promoting ESG when it will contribute to corporate value, or promoting ESG even when it won't contribute to corporate value or could even be detrimental to that. From the perspective of benefits for society as a whole, it would obviously be possible to argue for the promotion of ESG even

when it won't contribute to or could even be detrimental to corporate value. This is because corporate value and benefits for society as a whole are often not aligned, and can sometimes even be in opposition to each other.

When I talk about corporate value here, I'm using the standard definition from the academic field of finance, which was mentioned by Mr. Ishida at the beginning. In other words, I'm defining corporate value as the present value, calculated by discounting, of future cash flows generated by the company, with the cash flows being those belonging to shareholders and financial creditors. According to this definition, the beneficiaries of corporate value would be shareholders and financial creditors.

However, those affected by corporate activities are obviously not limited to shareholders and financial creditors. They also include employees and consumers, as well as members of society at large, such as the people around the world affected by the CO<sub>2</sub> being emitted by companies. So they include people who will be unable to enjoy the benefits of corporate value in the future. In the language of economics, these are referred to as externalities. Because of such externalities, if an attempt is made to provide a definition of corporate value over the long term, it will not necessarily match the benefits for society as a whole. This leads to the possibility that management based on the maximization of corporate value is not necessarily desirable from the standpoint of benefitting society as a whole.

To tackle this problem, it may be necessary to introduce policies that do not necessarily contribute to increases in corporate value in the theoretical sense, such as policies that curb CO<sub>2</sub> emissions or protect the environment and resources even while sacrificing profitability.

However, regarding the pursuit of ESG in that sense by individual companies, as University of Tokyo professor TAKEUCHI Akio pointed out when corporate social responsibility came to be emphasized in the 1970s, there was a strong backlash, with critics arguing that if taken to extremes, corporate social responsibility could result in managers becoming irresponsible. Demanding that individual companies pursue broad objectives beyond just maximizing

corporate value will ultimately give managers unlimited freedom to do whatever they want under the pretext of serving various stakeholders. Demanding ESG in a broad sense that goes beyond corporate value brings with it major problems like these.

On that point, I think that the same sorts of problems could occur if there are requirements to pursue ESG in a broad sense within a framework, like the Stewardship Code, that targets institutional investors. I am worried that by demanding that institutional investors pursue broad objectives rather than just maximizing returns, or in other words, maximizing income for the ultimate beneficiaries, the objectives of institutional investors could become unclear.

From this perspective, I think it would be preferable to consider ESG, from the choices I presented at the beginning, as being limited to the pursuit of increases in corporate value. Even from this sort of perspective, it would still be possible, for example, to demand that corporate management pay heed to environmental risks. This is because if management that doesn't pay attention to environmental risks continues, the company could see a drop in its returns as a result of causing an accident that leads to huge losses. Alternatively, it could result in a drop in returns as a consequence of a fall in profitability stemming from a substantial decline in the company's reputation. Furthermore, the risks to such a company would increase, which would raise the discount rate, and thus lead to a decline in its corporate value.

Therefore, from perspectives like these, namely future returns and the impact on risk, I wouldn't be against a Stewardship Code that articulates such objectives as a policy that clearly states the importance of ESG and calls for ESG factors to be taken into account within the scope of contributing to increases in corporate value.

But finally, if I can say one more thing, I am in complete agreement with Mr. Oguchi that it should be emphasized that original purpose of establishing the Stewardship Code was to increase the profitability of companies. I hope that ESG factors are not overstressed to the point that corporate profitability and efficiency are sacrificed to an excessive degree and that

the original purpose of establishing the Stewardship Code becomes blurred.

My apologies for talking for so long. That's all I have to say.

**[KANSAKU Hiroyuki, Chair]**

Thank you very much, moving on, let's hear from Ms. Ueda.

**[UEDA Ryoko, Council Member]**

Thank you very much. I was absent last time, so please let me also include some more general comments.

My first point concerns integration. Until very recently I was working in London, and a lot of the people visiting on business from Japan said that there has been a bipolarization of investors.

When I asked what they meant, they said that among investors, there are ones who make investment decisions and ones who don't. In other words, when they meet people who call themselves investors, they ask for a range of opinions but the investors say the exact opposite. Some investors say they are interested in financial matters, while others say they have specialized in ESG. And with regard to stewardship, they say there's a polarization, with some saying they like it and some saying they hate it.

So even though they might call themselves investors, the number of those who don't make investment decisions, in particular, has been increasing recently. I think the same sort of trend is also occurring in Japan, and I feel it bit awkward saying this today in front of Mr. Mizuno, but basically, to obtain the GPIF mandate, there are actually asset managers who say they have appointed such people. I wonder whether the cost of such personnel is included in operating costs, but on the other hand, if these people are also in charge of exercising voting rights, they are presence that companies cannot ignore. In fact, their activities are also important in the context of considering sustainability factors, so I think that

properly incorporating that into the investment process will be really significant not just for investors but also during dialogue from companies.

Regarding ESG, until a few years ago I used to think that the main goal was to reduce long-term risk, but recently various aspects of the business environment have been changing fairly drastically, and this also presents business opportunities, so in the sense of viewing opportunities from that side of things, I believe that incorporation into the investment process will probably lead to increases of corporate value. Therefore, when I talk about this integration with European investors, it's an extremely important factor, so I hope that there will be discussions of some sort about it this time.

Next, regarding the expansion in the range of assets covered, and Ms. Waring also said this earlier, but my view is that stewardship responsibilities are borne not so much toward assets as by investors, so I feel it's a bit peculiar to talk about bearing or not bearing responsibilities depending on the asset.

But I think the approach to stewardship activities differs depending on the asset, so I suspect that differences will emerge, particularly in terms of methods of IR and engagement, depending on whether the assets are shares, which carry voting rights, or assets that do not carry voting rights.

In the U.K., I think the origins of the Stewardship Code can be traced to the restoration of soundness to the U.K. stock market following the financial crisis, and the way I see it is that during the process, investors increasingly and spontaneously expanded their range of assets to include not just U.K. shares but also bonds and other assets, and that's why the expansion occurred. If that's the case, in Japan, too, this tendency might occur spontaneously, and this also seems to match the opinions we've heard today from investors.

Also, financing means are expanding recently, and with, for example, green bonds increasingly being issued, I see that not many Japanese companies, though they seem to be

interested, have gone as far as actually issuing such bonds. I think that one of the factors behind this is the supply-and-demand balance on the investor side, so I think that expanding the assets covered could be one way to encourage things like this.

My last point is about strengthening disclosure. In the U.K. code the expression used is “reporting expectations,” which has been translated into Japanese by the Secretariat as *kitai sareru kaiji* [expected disclosure], but I understand that “expectations” has a fairly powerful nuance, and is not the same as *kitai*. I think it’s closer what’s called voluntary disclosure in Japan. So I think that this strengthening of disclosure will, in Japan, mean the disclosure of reasons for voting for or against, but I think there is still room for discussions in the case of Japan’s Code. I hear there are moves to only disclose reasons for opposition, but when there’s a conflict of interest, in particular, the reason for giving support is important, so in light of that, I feel that disclosure should probably be strengthened overall.

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

**[KANSAKU Hiroyuki, Chair]**

Thank you very much. Moving on, let’s hear from Mr. Sampei.

**[SAMPEI Hiroki, Council Member]**

Regarding the application of the Stewardship Code to all assets, I’d also like to present my opinion on how it relates to ESG integration.

First of all, I support the expansion of the range of assets subject to stewardship responsibilities to include assets such as bonds and real estate. I think that from the E and S perspectives of ESG, and also from the perspective of sustainability, this is a natural move.

For example, when I was engaging with a certain company the other day, at which time I was doing so from the standpoint of a shareholder, I asked why, when procuring funds for a large project that would eliminate carbon usage, the company had done so in the usual way rather

than considering green bonds. I also asked them to consider issuing them the next time a similar project arises in the future.

When promoting ESG integration at companies, I believe a balance of stakeholders to be important for sustainability. Because of that, even though we naturally conduct engagement from an equity standpoint, the consideration of other assets also occurs naturally.

However, there is one point that needs to be kept in mind. Regarding interests with respect to shares and bonds, because they provide a final risk buffer, shareholder rights such as voting rights are given to shareholders. So I believe that shareholders should get involved primarily in governance. In Japan, in particular, we have finally seen a shift from debt governance by main banks to equity governance by shareholders. In light of that, matters such as consciousness of the cost of equity capital and improving capital productivity need to be retained and propagated within the discipline of equity governance, so I think this should be made clear.

Linking this with what Mr. Tanaka said earlier, I think it can be said to be so-called ESG that is limited to contributing to corporate value, but I think that we should go beyond the current scope of contribution to expand and interpret what can be done.

But if this is overdone, I don't think it will be sustainable, so I think there are limitations like that. Put really simply, a company, for example, can theoretically achieve a 100% capacity utilization rate for one of its plants. That being said, a plant is hardly ever operating at 100% all the time, right? This is because if it keeps operating 100%, concerns about sustainability will arise. But it's actually sustainable if it's given a bit of elbow room, with, say, a rate of 95%. So I feel that talking about "maximizing" corporate value is a bit wide of the mark.

I'm not recommending going as far as harming corporate value, but I think ESG integration will probably happen not by "maximizing" corporate value, but by searching for just the right balance, placing greater priority on sustainability, and expanding the scope of what can be

accomplished. There are already lots of examples of companies that are doing this well. So I feel that this sort of engagement will become necessary.

That's all.

**[KANSAKU Hiroyuki, Chair]**

Thank you very much. Moving on, let's hear from Mr. Oba. Over to you.

**[OBA Akiyoshi, Council Member]**

I'm OBA Akiyoshi of the Japan Investment Advisers Association. Regarding the upcoming revisions to the Code, I think that it's necessary to move forward with this debate after clarifying a perspective for that. And that perspective is, I believe, that we must revise the Code to turn it into effective action.

And what I mean by effective action is, as has been pointed out by the council members, increasing corporate value in a sustainable fashion. Ideas that will make this possible must be translated into effective action. I think that this is the perspective that should serve as the first premise. Based on that, I would like to propose two specific points to follow for the revisions.

To start with, the first point is that when working on the revisions to the Code, and Mr. Sampei also expressed an opinion about this earlier, but because there has been no discussion of altering the basic principle of "comply or explain," I don't think things should be made too detailed.

What I think is particularly important is, in connection with effective action, for entities to self-assess their own stewardship activities, and make these assessments visible by disclosing them in detail. Regardless of what the current Code says about that, I don't feel that it's become firmly established, so I think that it might need to be focused on once again.

The other point is that we should not take our eyes off inconvenient facts that are only seen in Japan or at least extremely characteristic of Japan. What I mean by that, and Mr. Ogai also pointed this out at the previous Council, is that the need for investment in Japanese stocks is extremely limited. In other words, the weight of Japanese stocks as investment targets has fallen. So the question is how to view facts like this. It could be that people wonder whether there's any point in even discussing the Code if Japan isn't an investment target.

Another inconvenient fact is that it is extremely rare for questions concerning ESG to be received from the asset owners, as shown in the results of the questionnaire survey. Today, Mr. Mizuno spoke of his enthusiasm for ESG, but such asset owners are exceedingly unusual. So the question is how to view this reality.

In other words, I think the same problem forms the undercurrent. They aren't considered investment targets. There aren't many people who regard ESG factors as extremely important. And in the background to this is the fact that they don't bring medium- to long-term returns. This is a huge issue that is only seen in Japan.

So regarding effective action, and I'm repeating myself here, when going back to this starting point, when the meaning of "effective" is regarded as being increasing corporate value in a sustained fashion, I think that the Code needs to be revised from the standpoint of how to drive a wedge into this reality.

That's all.

**[KANSAKU Hiroyuki, Chair]**

Thank you very much. Next let's hear from Mr. Takei. Please go ahead.

**[TAKEI Kazuhiro, Council Member]**

We don't have much time so I'll keep it brief. My first point concerns conflicts of interest with regards to proxy advisors. As has been pointed out during the recent series of developments

in the U.S., the conflict of interest between the consulting services of advisors and listed companies is often paid attention. In addition, a conflict of interest with institutional investors needs to be pointed out. For example, if an institutional investor making a shareholder proposal has a conflict of interest stemming from the fact that it is an important client of the advisor, a conflict of interest with such institutional investor will also become the issue. I think proper advice needs to be given with regard to this point. That's my first point.

Second, and this concerns the series of developments in the U.S., these developments are important with regard to ensuring the accuracy, transparency, and integrity for proxy advisors. While the timing of the current developments in Japan is similar, I think that Japan shouldn't put this off for, say, another three years, but rather should take a proper look at outside progress this time around. That's my second point.

And finally, my third point concerns escalation. I am opposed to incorporating this in writing into Japan's Code this time. By including something about escalation in writing in the Code, some or many tend to read that institutional investors "should" escalate or that they "should" collectively confront companies. I think it would be premature to include such writing this time. In this connection, among the various revisions being made in the U.K., as explained earlier, "apply and explain" principle under the U.K. code can be viewed as close to this "should" approach. But, I think the background of the U.K. revisions is different from that of the Japan code. The declared objective of Japan's Code is to bring about sustainable growth for listed companies, On the other hand, the background of the "should" approach of the revision of the U.K. Code includes, for example, necessity to enhance ESG issues and/or pressure to reduce social disparities arising from such as short-termism and high executive compensation, and therefore these issues tend to direct to take "should" approach to the institutional investors. These background is different from that in Japan, so "should" direction taken in the U.K. code does not lead to the conclusion that the Japan Code also takes the "should" approach. Anyhow, I don't think that escalation should be included.

Those are my three points.

**[KANSAKU Hiroyuki, Chair]**

Thank you very much. And now let's hear from Mr. Callon. Please go ahead.

**[Scott CALLON, Council Member]**

Thank you very much. Regarding the question of whether the Code's coverage should be expanded to all assets, I agree that it should. To state my position more strongly, I believe we absolutely have to do this. Mr. Mizuno and many of the other council members have already spoken to this issue, but responsible institutional investors invest in assets other than equities. It is true that when the Code was introduced, it was targeted at equities, but expanding coverage to encompass all assets would be a meaningful innovation. It would be consistent with Principle 1 of the Code, which calls on institutional investors to properly execute their fiduciary responsibilities, and with Principle 2's language to properly manage conflicts of interest and consider ESG factors, which would also apply to debt and other investors.

This is more of an administrative issue, but given the current schedule, I am concerned that our next meeting will only mark the beginning of the process of putting together this proposed revision to extend the Code's coverage to all assets. Because of the tight schedule, we may not be able to enact this revision, or alternatively, the revision itself will be insufficiently thought out, and if that happens, we will be putting the cart before the horse. If the Code revision is going to call on institutional investors to conduct responsible investment with respect to all assets, there needs to be a review, sooner rather than later, of what revision will be made. And depending on the outcome of that review, I think our discussions with respect to this issue will need to occur not only at our next meeting, but potentially at a preliminary one in December.

Of course, another approach would be to include debt and other assets the next time the Code is revised, but revisions to the Stewardship Code take place on a three-year cycle, which means the revision will be made in 2023. In short, I believe this matter needs to be investigated immediately with a view to including it in this round of revisions to the Code, and

in a way that does not burden the Secretariat personnel and the council members. Addressing all assets in stewardship codes is already the global standard, so I hope we can consider adopting this best practice for Japan. We should seek to make ours the world's leading stewardship code.

Thank you very much.

**[KANSAKU Hiroyuki, Chair]**

Thank you very much. Now over to Mr. Okada. Over to you.

**[OKADA Joji, Council Member]**

At the previous Council, I said that I really wanted investors to engage in more dialogue with outside officers. Regarding the background to this view, recently, when an investigation into wrongdoings is performed by a third-party committee, it's incredibly common for outside officers to be given immunity by saying, "The report didn't reach me." Actually, I've also heard rumors of outside officers saying, "If I get a bad report, I'm going to have to assume responsibility, so don't let me know." So in that sense, too, it's extremely important to see, among outside officers, an attitude of being conscious of whether information is reaching them or an attitude of actively going to get information, so I said I wanted them to engage in dialogue.

Conversely, when I looked at the ICGN code recently, I noticed that investors are described as the main characters in stewardship codes, but it also says that companies bear, in a sense, a responsibility to make an effort, and should be willing to engage in dialogue, and in that section it goes as far as saying "including non-executive directors" in its discussion of directors.

In that sense, then, I think that in Japan there's recognition of the problem of whether outside directors are really functioning properly, so I think a statement that non-executive directors (which in Japan also include kansayaku (audit and supervisory board members) ) are obliged

to make an effort to engage in dialogue with investors concerning, mainly whether they are prepared to supervise execution, should probably be included in the wording.

And if I were to add one more point, ESG issues are coming up a lot, but ESG, at least from my experience when I was working at a company, should be based on the company's philosophy itself, or on the company's code of conduct.

I think that each company needs to be willing to properly disclose what ESG factors it has incorporated into its corporate philosophy or its corporate code of conduct, so I would like investors to engage in dialogue from this sort of perspective.

That's all.

**[KANSAKU Hiroyuki, Chair]**

Thank you very much. Over to you, Mr. Haruta.

**[HARUTA Yuichi, Council Member]**

I am HARUTA Yuichi of the Japanese Trade Union Confederation. I'd just like to briefly make one point. I'd like to say something about the activities of the GPIF.

Regarding ESG investment, we also think it's only natural that the importance of working to create sustainability for society has been increasing, and last time, too, I felt that there was an imbalance within ESG. Among initiatives, I don't feel that there's been much progress made with the S component, and there's also the matter of workers' rights and employment.

And in the GPIF's activity report, when I look at the materials, I feel that it is extremely effective, in the context of corporate activities, too, to produce these sorts of indicators, including indicators of the promotion of the advancement of women, in the form of a set that also includes corporate information disclosure.

Going forward, in the context of how to consider sustainability, with the birth rate declining, the population aging, and labor shortages increasing in Japan, in the area of employment, too, what sort of action should we take next? And if the GPIF is considering something internally, I hope they will provide us with some suggestions.

That's all.

**[KANSAKU Hiroyuki, Chair]**

Thank you very much. Are there any other opinions? Is that all? Ah, Mr. Mizuno, please go ahead.

**[MIZUNO Hiromichi, GPIF Executive Managing Director and CIO]**

Thank you very much. What everyone has said today will serve as a useful reference for our activities.

During the five minutes I spoke for earlier, I forgot to comment about something that states in the written opinion from Council Member Toyama, who happens to be absent today. We demand engagement from passive managers. However, resources such as analysts are skewed to the active side, and are absent on the passive side, which is particularly true for Japanese asset managers. And regarding actual fees, while the best passive managers have focused on the lowest tracking errors and the lowest cost, it's been pointed out that they may not be suited to the type of engagement we are calling for. GPIF is fully aware of that, and starting two years ago, we have been also been clearly thinking about the added value of passive in separate terms. It's our job to choose indexes. Then in addition to tracking indexes, which is originally the job of the asset managers, we think it is important for passive managers to demonstrate active ownership and stewardship, by which passive managers can stand out. Last year, we have newly appointed two passive asset managers, as they propose a passive business model that enhances their stewardship activities. Their fees are also structured slightly differently to the standard passive fees.

Regarding the question from Mr. Haruta, while we are fully aware of the skewedness within ESG, we consider G to be a platform, and not an objective in and of itself. In other words, for company's sustainable growth, we regard G as essential for ensuring to resolve issues beyond the current terms of directors and representative directors and to maintain company's value. I believe that one of the objectives of G is to resolve issues that relate to Social.

As Mr. Tanaka mentioned earlier, we believe that unless a company steadily pursues E and S over the long term, it will probably difficult for the company to preserve its long-term corporate value, as we discuss with investors. In that sense, as investors we feel that our approach has been gradually changing from the manner described by Milton Friedman.

That's all.

**[KANSAKU Hiroyuki, Chair]**

Thank you very much. Ms. Waring, over to you.

**[Kerrie Waring, Council Member]**

I was struck by the discussion around fiduciary duties earlier because the modern-day concept of the role of the investor is to preserve and enhance value on behalf of the ultimate beneficiary. That beneficiary can be both short and long term in nature. For example, in GPIF's case, many beneficiaries have liabilities extending 60-80 years out, surely that is long term. So, particularly in Europe, investors accept that ESG factors should be explicitly considered in order to take a long-term view. It's no longer ambiguous. This is part of an investor's fiduciary duty.

On the point about escalation, perhaps this is just an issue of terminology. Why don't we change the word 'escalation' and to 'alternative'? The word escalation infers some kind of escalating tension.....but actually what we are talking about is what investors do all the time - utilizing a number of engagement tools. Reference to 'escalation' is made in almost every other stewardship code around the world today so Japan seems to be an outlier in this regard.

The reason it's important is that investors in their engagement policies can specify how they will engage with companies. This is very clear and then companies will be aware then of what the next steps might be, if there was to be any failure in dialogue.

And then thirdly, I just want to emphasize again the importance of incorporating ESG factors into your Code. Malaysia, was one of the first countries to include ESG as a standalone principle, before ICGN did it. So, or would be helpful for the FSA to consider whether you hardwire ESG thinking throughout all of the principles or as a standalone section.

**[KANSAKU Hiroyuki, Chair]** Thank you very much. Does anyone else have anything to say? Is that all.

Thank you very much for the incredibly enthusiastic discussions today. Regarding the wording of the Stewardship Code, many people have expressed the opinion that it should continue to be based on principles. There were differences of opinion about such issues as focusing more on ESG factors and expanding the range of asset classes covered, but I would say that there were positive opinions more common than negative ones. And with regard to proxy advisors, I feel that many people expressed the opinion that a lot of what is happening in the U.S., for example, could serve as a reference and be added to the Code in some form or another.

In light of today's discussions, next time I would like you to discuss proposed revisions to the Stewardship Code. Because the time available for debate by this Council is limited, if you have any opinions, including about superficial matters such as ways of making the wording of the current Code easier to understand, please don't hesitate to convey them to the Secretariat.

Finally, I'd like to ask the Secretariat if they have anything to say.

**[INOUE Toshitake, Director, Corporate Accounting and Disclosure Division]**

Regarding the schedule for the next Council, we would like you to discuss the proposed revisions of the Stewardship Code, so I hope you will give us some of your time for that. We

will make a final decision after considering everyone's circumstances, so we'd appreciate it if you could wait awhile.

I also have a request for all of you, including the observers. Please do not take your receiver for simultaneous interpretation away with you. Instead, please leave it on the table or on your seat.

Also, because today's meeting was held at a fairly late time, the elevators are expected to be crowded. It's the time when people leave the building, so, and I apologize for this, I'd like to ask the council members and the guest speakers to use the elevators on the 13th floor, while I'd like the general observers, and I apologize for the inconvenience, to go to down to the 12th floor and take one of the elevators from there, if possible. There are lots of them, so I hope you will cooperate in using one of the elevators on the 12th floor.

That concludes the remarks from the Secretariat.

**[KANSAKU Hiroyuki, Chair]**

Thank you very much. And with that, I'd like to bring this meeting to a close. Thank you very much for your enthusiastic discussions.

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