

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

- 1. Date and Time: December 11, 2019 (Wednesday) 10:00 - 12:00**
- 2. Venue: The Central Common Government Offices No.7, 13F Meeting Room No.1**

**[KANSAKU Hiroyuki, Chair]**

Momentarily, we will begin the 3rd 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.

Based on the discussions we have had until now, the Secretariat has put together a draft revision of the Stewardship Code, which we would like you to discuss today. Furthermore, once the draft is finalized, it will be presented for public consultation. But in the course of the discussions that have taken place until now, we have received a large number of opinions concerning various issues from Council Members. So for the public consultation, we are also considering preparing a questionnaire concerning these issues in order to hear a wide range of opinions.

So with regard to the revision of the Stewardship Code, I would like you to discuss Material 1, "Principles for Responsible Institutional Investors <Japan's Stewardship Code> (Draft)," and Material 2, "Revision of the Stewardship Code."

We have prepared paper versions of each of these materials to facilitate discussion of the draft today. You can find them in front of you, so please take a look at them.

To start with, I'd like the Secretariat to give an explanation of Material 1 and Material 2. Mr. Sampei and Mr. Toyama, who are absent today, have submitted written opinions today, so I would also like the Secretariat to provide explanations of these.

So without further ado, please go ahead.

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

Thank you very much. I am INOUE Toshitake, Director of the Corporate Accounting and Disclosure Division, and I'd like to speak for about 20 minutes. I'll begin with an explanation based on Material 1 "Principles for Responsible Institutional Investors" <Japan's Stewardship Code>. Basically, the changes are shown in red ink. It's based on the current Code, and the proposed revisions are marked in red. I'll omit explaining minor changes in wording, and just explain the substantial changes.

I'll begin with the preamble. At the top of the first page, in the framed area, there is a definition of stewardship responsibilities. Stewardship responsibilities are defined here as responsibilities to enhance the medium- to long-term investment return for clients and beneficiaries by improving and fostering the investee companies' corporate value and sustainable growth through constructive engagement, etc. But by the previous meeting, we received numerous opinions concerning sustainability, including ESG factors. In light of this, we have added a description that expect the consideration of sustainability corresponding to their investment strategies in constructive dialogue. Regarding the phrase "corresponding to their investment strategies," since investment timelines, policies, and so on differ from entity to entity with respect to the consideration of sustainability, we added it to express that the nature of the consideration of sustainability will differ depending on investment timelines and, policies, and so on.

Note that with respect to the purpose of the Code, "improving and fostering the investee companies' corporate value and sustainable growth," we have made no changes from the previous version.

Next, and this is paragraph 4 on the second page, we have added a brief summary of the background leading up to this revision of the Code.

Let's move on to paragraph 9 of page 4 of the preamble. Until now, regarding entities that

were discussed as being so-called service providers, we have made the name service providers for institutional investors, and provided a definition of them. Basically, we're thinking about proxy advisors and investment consultants for pensions, but in the course of the discussions by the Council, the opinion has been expressed that there may be cases that entities other than these two should also manage conflicts of interest. So we have adopted a definition that is not limited to these two, but instead focuses on their functions, by stating that service providers for institutional investors are "the parties which provide services to contribute to institutional investors in carrying out effective stewardship activities in accordance with requests for services by institutional investors, etc."

Though I will explain this later, this time we have added a new principle, Principle 8. This principle applies only to service providers for institutional investors, but paragraph 9 of the preamble explains that the other principles are also applied to them as far as the principles are not inconsistent with Principle 8.

Next is paragraph 10. This contains information about the application of the Code to assets other than Japanese listed shares, such as bonds. By the previous meeting, we received various opinions, such as the opinion that, the existence of a gap between listed shares and other assets in Stewardship Code has no consistency from the perspective of fiduciary responsibility, and the opinion that if dialogue aimed at securing retained earnings takes place, there is a danger of a conflict of interest with shareholders emerging. Based on these discussions, the draft basically continues to be based on the assumption of investment of Japanese listed shares, but after that sentence, we have inserted the expression, "The Code may also apply to other asset classes as far as it contributes to fulfilling the 'stewardship responsibilities' mentioned in the heading of this Code. In other words, in cases where it contributes to medium- to long-term increases in corporate value and the sustainable growth of companies, each entity can, based on its own judgement, apply the Code to assets other than listed shares and can engage in stewardship activities.

And those are the main changes proposed for the preamble.

Moving on, I'll discuss the body of the Code, starting with Principle 1 on page 8.

In my explanation of the preamble just now, I explained the purpose, and in Guidance 1-1 this time, we have stated that sustainability is defined as "medium- to long-term sustainability, including ESG factors."

Next, Guidance 1-2. This guidance concerns the formulation of a policy for fulfilling stewardship responsibilities, and since the sustainability has been discussed at previous meetings of the Council, in the second paragraph we have included the expression, "Institutional investors should clearly specify whether they take the issues of sustainability, and how they take them into consideration in their policy, corresponding to their investment strategies." As I mentioned earlier, we have therefore stated that there are various ways of taking sustainability into account, which differ depending on the investment strategies of entities.

Next, page 9. Guidance 1-3 concerns asset owners, and one thing that has been pointed out and discussed is that corporate pension funds, etc. do not understand adequately the scope of stewardship activities. In response to this, while keeping a principles-based approach, we have also included a statement aimed at making the scope of stewardship activities of asset owners clear. We have proposed this revision to make it clear that the Code demands that asset owners, which do not manage funds directly, promote asset managers to engage in effective stewardship activities, and that this does not mean that they must engage in dialogue with companies or exercise voting rights themselves.

We have also made proposals for the same purpose in Guidance 1-4 and at the beginning of Guidance 1-5 and in footnote 11 below.

In footnote 9 at the bottom of page 9, we have made it clear that not only fund-type corporate pensions but also contract-type corporate pensions are assumed to accept the

Code.

In footnote 10, since support from sponsor companies is extremely important for effective stewardship activities by corporate pensions, we have referred to Principle 2-6 of the Corporate Governance Code, which expresses this and was added in the Code in the last year's revision.

We have added Footnote 12 based on the opinion that it is important for asset owners to confirm whether asset managers are conducting effective stewardship activities, and that they do not necessarily need to give detailed instructions to asset managers.

Next, Principle 2 on page 10. Regarding Guidance 2-3, Principle 2 assumes to disclose the items in this Guidance to the general public as part of a policy on how they manage conflicts of interest. So we added a statement to make it clear that Guidance 2-3 also requires disclosure to public, aligned with Guidance 2-2.

Next, Principle 3 on page 11. We have proposed revising Guidance 3-3 to replace "investment policy" with the phrase "investment strategy" to match the expression used in first part of the preamble.

Moving on, please look at Principle 4 on page 12. The opinion statement from Follow-up Council in April 2019 also discusses the dialogue regarding sustainability, and in Guidance 4-2, we have proposed adding the guidance that when engaging in dialogue concerning issues related to sustainability, attention should be given to ensuring that it is consistent with investment strategy and will lead to the sustainable growth of the company and the medium- to long-term increase of corporate value.

Footnote 15 on the same page also relates to an opinion we have received, and we've added that if institutional investors have the engagement team dedicated to the dialogue with investee companies, internal communication with other teams is important.

Let's move on to footnote 14, which also relates to dialogue. There was an opinion that regarding the priority issues of the management policy including governance structure, it is also beneficial for asset managers to engage in dialogue with the company's independent outside directors and *kansayaku*, and we have therefore added a footnote in line with that.

Next, in Guidance 4-5 on page 13 there's a change in terminology. Until now we have used the term collective engagement, but the U.K. Code has replaced "collective engagement" with "collaborative engagement," so to reflect that we have also switched to the term collaborative engagement.

Let's move on to Principle 5 on page 14. Guidance 5-3 concerns the results of voting. One of the issues this time has been the explanation of reasons why they voted "for" or "against," and we got opinions such as that the reason of votes on the agenda of investee companies which suspected to have conflicts of interests should be disclosed. So in the draft, and this is in red, we have added a sentence to the effect that institutional investors should disclose the reasons of votes, either "for" or "against," which are considered important from the standpoint of constructive dialogue. In particular, these include those suspected to have conflicts of interest or those voted contrary to their voting policy.

Next is Guidance 5-4 on page 15. This concerns cases of use by institutional investors of proxy advisors. It states that in such cases, it is important to use such service based on an understanding of the voting recommendation process, and that when they are used, institutional investors should disclose the name of the advisor and how they utilize the service specifically.

We have moved Guidance 5-5 to the newly-established Principle 8.

Moving on, please look at Guidance 7-4 on page 18. This is for asset managers, and in addition to requiring them to perform self-evaluations, it also calls for them to disclose the

results of their stewardship activities. It states that when doing these, they should be conscious that these will lead to the medium- to long-term increase of corporate value and the sustainable growth of companies. It encourages them to be conscious of the aims of the Code.

Moving on, and this is page 19, we have established a new principle, Principle 8. This principle applies only to service providers for institutional investors. During meetings of the Council, we have heard the opinion that service providers for institutional investors should act in accordance with the aims of the Code. In the square at the top, it states that service providers for institutional investors should endeavor to contribute to the enhancement of the functions of the entire investment chain by providing services appropriately for institutional investors to fulfill their stewardship responsibilities.

Below that, Guidance 8-1, which applies to all service providers for institutional investors, states that structures for conflicts of interest management should be developed, and these measures should be disclosed. In connection with this, footnote 26, which is at the bottom, once again makes it clear that because service providers for institutional investors are defined with a focus on their functions, if they fall under the definition in paragraph 9 of the preamble, which we looked at earlier, institutional investors themselves could be included in service providers for institutional investors.

The next two guidance items, 8-2 and 8-3, are exclusively for proxy advisors.

Regarding Guidance 8-2, to ensure that proxy advisors provide recommendations based on accurate information, it states that they should develop appropriate and sufficient human and operational resources, including setting up a business establishment in Japan, and in order to assure transparency, that they should specifically disclose the voting recommendation process, including descriptions of such resources. Regarding this voting recommendation process, we have added footnote 27, in which we say that it is not expected to disclose the content of dialogue concerning each individual recommendation,

but instead to just disclose the major information sources generally relied on when formulating recommendation, whether they have dialogue with companies, the nature of such dialogues, and so on. Footnote 28, meanwhile, states that when putting in place a policy for voting recommendations, which constitutes one part of the voting recommendation process I have been discussing, the policy should be made as clear as possible and should not be comprised of a mechanical checklist. Rather, the policy should be designed so as to contribute to the sustainable growth of subject companies.

Finally, Guidance 8-3 states that advisors should not only rely on information disclosed by companies, but should also actively exchange opinions with them. The last paragraph states that if so requested by companies, it could be beneficial to give companies opportunities to confirm the information on which the recommendations is based, and to also provide opinions received from companies to clients.

And that concludes my explanation of the draft.

Moving on, please take a look at Material 2 "Revision of the Stewardship Code."

As Mr. Kansaku mentioned earlier, in public consultation of the draft revision, we are thinking about obtaining a wide range of opinions based on the questions beginning on the fourth page of Material 2. This material provides a draft explanation on public consultation.

To begin with, the first page provides background information. It describes what has led up to this revision, and in the third point, we have explained that we are going to obtain a wide range of opinions based on the issues for consultation items beginning on the fourth page.

Next, and this is the second page, please look at "II. Major issues of the Revision Draft and their viewpoints." Regarding the first point, we have provided brief explanations of the opinion statement of the Follow-up Council in April this year. In the second point, we

highlight issues that were not mentioned in the opinion statement of the Follow-up Council but were newly pointed out in this Council or were discussed in more detail than in the opinion statement.

Furthermore, the third page includes some of the opinions that were not incorporated into the draft revision of the Code we looked at earlier, but that we have marked as issues for further study. Specifically, it describes the improvement of engagement as passive investing becomes increasingly widespread and the clarification of the scope of collaborative engagement.

The issues for consultation begin on the fourth page. We have determined five main questions for public consultation, from Question 1 to Question 5, in accordance with the issues in the draft revision.

In addition, at the end, in Question 6, we have asked for a wide range of opinions concerning issues other than those dealt with in the previous five questions.

And that concludes my explanation of Material 2, "Revision of the Stewardship Code."

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

First, we have a written opinion from Mr. Sampei. The opinion relates to the wording of "consideration of sustainability corresponding to their investment strategy. This is in the preamble of the Code, which I discussed earlier. He suggests that the term investment management strategy could be used instead so as to make it clear that investment strategy assumes to consider dialogues conducted at the level of entities, and that improvements could be made to where and how to define it. Furthermore, with regard to setting up a business establishment in Japan pursuant to Principle 8, he argues that given recent circumstances concerning matters such as changes of working style, there is still room for

discussion. And regarding Guidance 8-3, he stated that because this could be difficult to achieve unless the disclosure of corporate convocation notices takes place earlier, further changes to the process of shareholders meetings should be considered.

Next, we also received an opinion from Mr. Toyama, which concerns the details of the current revisions to the Stewardship Code. He stated that the revisions are clear, and that he supports all of them. Regarding the next challenge for the Corporate Governance Code, he said that the Corporate Governance Code should include a provision that controlling shareholders are obliged to protect minority shareholders. He also added that, with the aim of substantially strengthening the functions of Audit & Supervisory Board, Audit Committee, and so on, kansayaku (audit and supervisory board members) and audit committee members, and especially internal full-time kansayaku and audit committee members, who are directly responsible for all shareholders and stakeholders, should act with a sense of mission and exercise internal influence in a manner consistent with their professional responsibilities. He also said that there should be a direct report line from internal audit departments, and that the independent financial foundation needed for that should be secured.

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

**[KANSAKU Hiroyuki, Chair]**

Thank you very much. In light of the explanation we've just received from the Secretariat, 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 discuss both Material 1, the draft of the revised version of the Code, and Material 2, "Revision of the Stewardship Code."

And as was the case last time, in order to ensure that as many council members as possible have an opportunity to speak, once certain period of time has elapsed since a

council member began speaking, a guideline figure for the time remaining will be displayed on the screens, so I hope you will keep an eye on your time remaining as you speak.

Because we have limited time available, I'd like each person to keep their remarks at under five minutes. So are you ready? Who would like to go first?

Okay, Mr. Ogai, please go ahead.

**[OGAI Taro, Council Member]**

Thank you very much. Regarding the revisions of the Code, I think all of them are moving us in the right direction, so in that sense, when I look at them as a whole, I'm in agreement. However, I'd like to make two comments.

Principle 8 has been added in this time, and I have no objection to that. And I think it's natural that it has been clearly stated that pension investment consultants like my firm constitute service providers for institutional investors.

However, I also think that master trustees, which exert a greater influence on the investments made by asset owners such as corporate pensions than consultants like ourselves do, should perhaps also be clearly stated as constituting service providers. Having said that, though, I don't believe that the essence of this problem should be discussed in the context of the Stewardship Code. I think that the people involved have the best understanding of the actual circumstances, so ultimately, I don't care whether there should be a clear statement or not in the Code. But one thing I'd like to say is that given that the original purpose of these meetings was to improve the earning ability of Japanese companies, if asset managers, including master trustees, that are group firms of large financial institutions are undertaking elements of investment that do not in themselves constitute asset management, a question is whether this will contribute over the long term to truly improving the investment capabilities of asset managers and growing business going forward. Another question is whether investing assets entrusted in this way in

Japanese companies can be persuasively claimed as leading to long-term constructive dialogue and increases Japanese companies' corporate value. These are questions that I think should be put to the people involved.

My second comment concerns sustainability and ESG. At our firm, we recognize that sustainability is extremely important in investments. We therefore believe that we should include such elements in all our investment processes, and we have included them in all our investment processes. So I think it's good that sustainability has been clearly included in the Code this time. Many components of stewardship relate to sustainability, and even though this is an extremely important point, it has not always been given sufficient attention in the past, so I view the move to clearly state it in the Code as a positive one.

Furthermore, given that the goal of stewardship is to make better investments, I think that it's natural that it should be expanded to cover other asset classes besides Japanese listed shares. Of course, when investing in bonds or other assets, I think that a different approach to that used for domestic shares may be required, but I still feel that the spirit should be applied in the same way.

That concludes my remarks.

**[KANSAKU Hiroyuki, Chair]**

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

**[MATSUYAMA Akihiro, Council Member]**

This relates to Principle 8, which concerns service providers, and regarding the points I made at the meetings until now and at the Follow-up Council, and particularly those with respect to proxy advisors, I would like to express my gratitude that this draft has incorporated them in the form of a new principle. I think that this will make the aspects of the Code concerning service providers clearer.

My second comment concerns disclosure of the reasons for voting that has also been added in Guidance 5-3, but I think that care needs to be taken to ensure that stating the reasons doesn't actually have the effect of facilitating formalistic voting.

That's all.

**[KANSAKU Hiroyuki, Chair]**

Thank you very much. Now over to Mr. Haruta. Please go ahead.

**[HARUTA Yuichi, Council Member]**

With various opinions being expressed, and following consideration after consideration, I would like to express my gratitude to the Secretariat for putting together this draft. While I agree with the overall direction, I'd like to express a few of my opinions.

The first is that I think it's highly significant that the phrase "consideration of sustainability" has been newly added at the beginning of the first page and to Principle 1.

Evaluations of companies should not be based solely on short-term profitability or efficiency. ESG elements and other aspects of sustainability must also be taken into account, and I think this is an important standpoint to adopt. With regard to public pensions and corporate pensions, in particular, given that they comprise workers' capital contributed by workers, and that workers and labor unions like ourselves are one of the most important stakeholders and assets for companies, I hope that during dialogue with investee companies, consideration will also be given to the fact that more attention should be paid to factors such as working environments, health and safety, dialogue with workers and labor unions, human resources development, work-life balance, and the offering of "decent work."

The second is that I'm a bit concerned about the addition of the phrase "corresponding to their investment strategies" just before the part about the consideration of sustainability.

I'm not asking for it to be changed, but when you say, "corresponding to their investment strategies," it makes me think of the fairly specific investment strategy that each company has, but I think perhaps that the importance of ESG elements in stewardship activities should be positioned as an even higher-level concept than the investment strategies of individual companies. So in that sense, I feel that this "corresponding to their investment strategies" is a bit odd, and I'd just like to register that as an opinion.

And I'd like to make just one more final point, which concerns the expansion of application beyond shares to include bonds and such, which is stated in number 10 on the fourth page. As I also said at the previous meeting, I hope that attention will be paid to ensuring that expanding the scope of application to bonds and so on will not lead to dialogue that goes against the original purpose of the Code, which is to increase corporate value and ensure sustainable growth. And regarding corporate pensions and the like, I recognize that there has been an increase in alternative investments in addition to shares and bonds, and I think an important point going forward will be how dialogue with respect to this should be conducted, so I hope that things like this will also be given consideration. That's all I have to say.

**[KANSAKU Hiroyuki, Chair]**

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

**[OGUCHI Toshiaki, Council Member]**

Thank you very much. Before I begin, I'd like to thank the Secretariat for all their hard work in compiling such a wide range of opinions in a consistent way.

In that sense, my overall view is one of agreement. But I'd just like to say one thing. This time around, Principle 8, which will be applied to service providers for institutional investors, has been newly established. Its objective, as explained earlier, is described in 9 of the preamble which expects to enhance the functions of the entire investment chain running from their clients and beneficiaries to the investee companies. I believe that

Principle 8 has been proposed this time from such background.

When considering that objective, or put another way, when considering things from the standpoint of improving the function of the investment chain as a whole, I think that there may be some areas that haven't been adequately referred to. As for the whereabouts of these, and as stated in the Opinion Statement of the Follow-up Council, they are the first part of investment chain, which is from the ultimate beneficiaries toward asset owners, which are located closest to the ultimate beneficiaries and encourage and monitor the asset managers who are the direct dialogue counterparts to companies. Regarding this first part of investment chain, and Principle 6 of the UK Stewardship Code 2020, which was distributed as Appendix at the previous meeting, requires signatories to explain how and where they have sought beneficiaries' views, how they have taken into account those views of beneficiaries, and what action they have taken as a result. To enable the investment chain to function properly, the source, or the starting point is the flow from ultimate beneficiaries, and I don't think anyone would question the importance of that, but I feel that the statements about that in Japan's Code might be insufficient. So my concrete proposal is that in addition to various changes in Guidance 1-3, which describes that its objective is to be secure the interests of ultimate beneficiaries, the expression, and this is just an idea, "seek and reflect the views of ultimate beneficiaries" could be added with respect to asset owners in the Code. I think that this would make it clear that asset owners should actively incorporate the views of ultimate beneficiaries. I think that doing that might lead to a proper securing of the line along which the investment chain flows from the ultimate beneficiaries as the source of it.

That's all.

**[KANSAKU Hiroyuki, Chair]**

Thank you very much. Now over to Mr. Hokugo. Please go ahead.

**[HOKUGO Ken, Council Member]**

Thank you very much. I'm going to talk based on what I can see from my standpoint as an asset owner, so my viewpoint may be a little different from all of yours.

I wasn't here last time as I was really busy preparing for a business trip. I apologize for my absence. That business trip, though, had something to do with our discussion, so I'd like to talk about it. I traveled to speak with asset owners in North America who have large asset like 20 or 30 trillion, and major asset managers. Most of the conversations were disappointing, as the asset owners almost unanimously said that Japan was underweight, that they aren't investing in Japan, or that it's not that they have no interest in Japan but they don't know much about it. I heard views like this a lot. So although I appreciate all of your making tremendous efforts for and about this Code as well as other capital market related initiatives, I came back with the feeling that the attractiveness of Japan's stock market may still not be adequately conveyed to or understood or appreciated by overseas investors. It was that sort of trip.

I have two points to make today. First one is about "other asset classes" in 10 on the page 4, which someone else also discussed earlier. Looking at things from my standpoint, it appears see that corporate governance in Japan has got out of the "bank governance" and then the "cross-shareholding governance or status-quo-protecting governance" to finally enter the realm of global-standard shareholder governance. Overseas investors also have the same view. That means, for the lack of better words, we're still like a kindergarten children. Therefore, I feel that the debate about making the Stewardship Code cover not only shares but also bonds in Japan just because the U.K. or Europe have done that, is a bit like getting a kindergarten child to take a university entrance examination. So I think that there are probably still other things that we have to do right now. Normally, you can't go on to the second stage until you've cleared the first one, so I think that we should think about going to the next stage when that time comes. Therefore, my view is that for asset owners it is meaningless or rather waste of time to make assets other than shares subject to coverage at the present time.

Next, I mentioned it in the first Council so I'll keep it short, but it's about the target signatories of the Stewardship Code. Various aspects of the U.K. Code have been copied and pasted into it, and there's obviously nothing wrong with that. I think it's good to include good aspects, but in the U.K. the composition of shareholders completely differs from that of Japan. For example, apparently ordinary industrial companies usually hold less than 2% of shares in U.K listed companies. In Japan, though, the figure is around 25% including banks. So even if no effort is spared in revising the Stewardship Code, if these huge bulk holdings are disregarded, how powerful will the Code be? I've been wondering about this for a long time. In my impression one key role of the Stewardship Code is for the responsible investors to improve corporate governance in Japan along with the Corporate Governance Code. If that's the case, I would really like you to consider expanding the target signatories to include general corporate shareholders, as this would also convey the seriousness of both Codes.

That's all.

**[KANSAKU Hiroyuki, Chair]**

Thank you very much. Moving on, let's hear from Mr. Okada. Please go ahead.

**[OKADA Joji, Council Member]**

I think these revisions to the Stewardship Code are extremely far reaching. Thank you very much.

I'd like to make two points.

The first concerns footnote 14 on page 12. Thank you very much for including as a footnote here what I said on the other Council about proactive dialogue with outside directors, kansayaku, and so on. I'd like a bit more of what I said to be added. Specifically, I'd like "governance structure" to be added as "governance structure (use of independent officers, etc.)" then "review of business portfolio ... in order to arrive at a common

understanding with an investee company” which follows. I think this would make things clearer.

In addition, though it is a minor matter, but please change “independent outside directors and kansayaku of the company” to “kansayaku, etc.” as it also includes audit committee members.

The second concerns what Mr. Sampei stated in his opinion statement with regard to Guidance 8-3. While I certainly think that the nature of the shareholders meeting process is an important issue, at the Guidance 8-3 it says “not only rely on the disclosed information of companies.” As this indicates, I think opinions can be exchanged on many matters such as the company’s governance and its approach to ESG, and not only just before the shareholders meeting. Therefore I don’t feel that there are any problems with the content of Guidance 8-3.

That’s all.

**[KANSAKU Hiroyuki, Chair]**

Thank you very much. Moving on, let’s hear from Council Member Takayama.

**[TAKAYAMA Yoshiko, Council Member]**

I think it’s great that the draft we’ve received places a greater emphasis on the importance of sustainability than the previous version. With regard to that, I’d like to make two comments.

This overlaps with Mr. Sampei’s opinion, but as Mr. Sampei said, I feel that the expression “consideration of sustainability corresponding to their investment strategies” is a little limited. The sense of the phrase “investment strategies” itself is limited, and the entire sentence can be read as sustainability doesn’t need to be taken into account if sustainability isn’t important in individual investment strategy. So I think the phrase

“investment strategies” should be replaced with a higher-level phrase or expression.

As for my second comment, as Mr. Sampei has also pointed this out, I agree that the definition of sustainability should be made clearer. This would obviously benefit the investors who are subject to the application of the Code, but is also essential for companies. It is extremely important for companies to understand the codes of conduct that investors follow. Making the meaning of sustainability more specific would enable companies to behave appropriately, so I think the definition of sustainability could be made a little more extensive.

That’s all.

**[KANSAKU Hiroyuki, Chair]**

Thank you very much. Next, Mr. Takei. Please go ahead.

**[TAKEI Kazuhiro, Council Member]**

Thank you very much. I’d like to start by thanking everyone at the Secretariat for their hard work putting together a really balanced draft. I also think the content is well-drafted.

Among others, the issues of expanding asset classes and ESG integration are somewhat difficult, but because the current draft present various viewpoints in a balanced fashion, I think the current wording is fine. I think just the right amount of information has been included.

I’d just like to raise a few other points. First, though it probably relates to Principle 4 and also has to do with the ownership issue that Mr. Mizuno touched on the 2nd Council. Basically, when conducting constructive dialogue, I think it’s good manner and natural that the institutional investors at least explain to the companies about their shareholdings, including whether it actually owns any shares. It’s a form of greeting, much like professional people exchange business cards with each other. I think that almost all of

them already do this, but among certain institutional investors, there exist examples of them not doing it. From the company's side, they won't be able to know how the institutional investor has its shares unless they ask. So, my first point is that including a message like "it is desirable that institutional investors explain something to investee companies." in the Code even as a footnote, might be a good idea.

Next, my second point concerns the changes with regard to the disclosure of reasons in Guidance 5-3 of the draft. What I'm a bit concerned about is the expression "contrary to" in the phrase "those voted contrary to their voting policy." This is likely to create a motive not to vote contrary to their policy, or conversely, create a motive to just follow their policy superficially. As the description, "important from the standpoint of constructive dialogue with investee companies," is comprehensive, so can this point be read into that? Or if this statement is going to be retained after all, I would like the purpose to be written with avoidance of the expression "contrary to," such as by writing "those which need explanation in light of their voting policy." I'm just worried about side-effects.

My third point concerns footnote 28 of the draft, which is about proxy advisors. This is somewhat similar to the point I raised earlier, and I don't think it has an especially deep meaning, but it says "should endeavor to articulate the policy as much as possible." I don't think the statement is incorrect, but I think it might be a good idea to ensure that this is not overemphasized, which would make the standards for advisors formal and uniform. I'd like to ask that steps be taken to prevent them just becoming formalities, either by cautioning that they don't become formal and uniform, or by deleting this part if it can be.

Finally, my fourth point is about Material 2, which is not in the Stewardship Code itself. It regards the statement about collaborative engagement at the bottom of page 2. If this point is going to be considered, it's not going to reduce certain types of disclosure, such as by changing the scope of what does not constitute Act of Making Important Suggestions or by narrowing the scope within which a normal large shareholding report should be made. Instead, as can be seen from the various discussions taken place recently in U.S.

and E.U., it should be going to strengthen disclosure to enable scrutiny as to whether they aren't making profits in a way such as insider trading, from the viewpoint of fair treatment with other shareholders. Rather than having discussions about retreating from disclosure, I think it would be better to ensure that the issue of reinforcing disclosure should be discussed.

As often discussed, in connection with collaborative proposals, there's the issue of whether the disclosure of collaboration might be inadequate with regard to wolf-pack-type activities utilizing derivatives. Rather than talking about retreating from disclosure, including with regard to such problems and issues, I think there could be an argument for moving forward with disclosure. So if something is going to be discussed about this issue of collaborative proposals, this viewpoint should be taken into account.

That's all.

**[KANSAKU Hiroyuki, Chair]**

Thank you very much. Moving on, Mr. Tsukuda, please go ahead.

**[TSUKUDA Hideaki, Council Member]**

Thank you very much. I feel that the draft of revisions of the Stewardship Code are highly appropriate, given that they strengthen the functions of the investment chain and also serve the ultimate beneficiaries. I would like to start by thanking the Secretariat for skillfully putting together a draft that covers a wide range of issues by, for example, making changes with regard to so-called ESG integration and asset owners and newly establishing Principle 8, which concerns service providers for institutional investors. I agree with these revisions, but I'd just like to make two comments.

My first point concerns financial institutions, including banks, and industrial companies, and was also made by Mr. Hokugo earlier. As things stand now, there's an argument about whether they should be handled by the Stewardship Code, which targets institutional

investors, or approached from the Corporate Governance Code, but ultimately, I think the most important thing is that voting is appropriate overall. In that sense, I think there is still huge room for improvement.

Second, I think that we need to reconfirm what the objectives of the Stewardship Code are. In the paragraph 5 of Aims of the Code, on page 2 of Material 1, there is the phrase “the responsibilities of institutional investors to enhance the medium- to long-term investment return for their clients and beneficiaries.” Can this objective be achieved with this draft? Regarding matters like this, I would like the FSA to perform proper monitoring. Some have expressed the concern that corporate executives could use SDGs and ESG as excuses, and that their discipline to increase corporate value could slacken, or is already loose. I would therefore really appreciate it if you would take steps to ensure that this does not occur.

That’s all I have to say.

**[KANSAKU Hiroyuki, Chair]**

Thank you very much. Is there anyone else? Mr. Callon, please go ahead.

**[Scott CALLON, Council Member]**

Thank you very much. I’d like to express my gratitude for the excellent draft revision. In particular, I think that explicitly calling out the importance of sustainability is a huge step. Japan is a country with a culture deeply committed to ESG, and considering not just returns, but also what is good for society, is one of the hallmarks of Japan. This manifests itself in Japanese ESG activities that, relative to the US and Europe, can challenge the notion of shareholder supremacy. My view is that company management and investment that emphasizes socially-contributing value creation to the benefit of those less well-off is extremely important, and therefore it’s wonderful that a sustainability mandate has been incorporated into the Code.

If I may, I would like to ask for three revisions to be made to the draft. The first concerns sustainability on page 8, as discussed earlier by Mr. Haruta and Ms. Takayama. I agree with Ms. Takayama that the phrase “corresponding to their investment strategy” is too limited. Also, as Mr. Sampei wrote in his submitted statement, the wording used here should be “asset management strategy” rather than “investment strategy.” The key is to be consistent in wording, so I would recommend using the phrase “consistent with their asset management strategy” throughout the Code.

My second proposed revision is with respect to page 4. In our last meeting, I recommended the application of the Code to all assets, not just equities. With apologies to Mr. Hokugo, as I don’t want to clash directly with him, I think this issue is extremely important. Fiduciaries’ stewardship responsibilities are not limited to equity investments. And because stewardship responsibilities need to be exercised irrespective of the asset class (and fully recognizing that I may be accused of going too quickly on this), I think we need to set a direction on this for going forward. The current proposed wording is that asset managers “may” apply the Code to assets other than equities, but I would suggest alternative wording such as the Code “should be applied” or “it is desirable” to apply the Code to assets other than equities.

My third suggested revision concerns the language on service providers on page 19. In line with Mr. Sampei, I don’t agree with the call for “setting up a business establishment in Japan” in 8-2. Mr. Sampei talked about this not being consistent with Japan’s work reforms. Issues with respect to Japan’s Foreign Exchange and Foreign Trade Act also come into play here. I’m concerned that Japan will be seen as exclusionary, with global investors believing that they cannot fully participate in Japan’s equity market and capital markets. I therefore think that the phrase “including setting up a business establishment in Japan” should be deleted. The expression “adequate and appropriate human resources” is sufficient here.

Apologies, I spoke for a bit longer than I intended to. Many thanks.

**[KANSAKU Hiroyuki, Chair]**

Thank you very much. Next we'll hear from Mr. Yonehana. Please go ahead.

**[YONEHANA Tetsuya, Council Member]**

I am YONEHANA Tetsuya of Mitsubishi UFJ Trust and Banking Corporation. Thank you very much for accurately reflecting various issues in the draft. I don't have any particular objection to the draft that I have received as a whole, and with that said, I'd like to make two comments.

Firstly, and this has already been mentioned, but in the objectives of this draft of the Code, this statement has been added: "The Code may also apply to other asset classes as far as it contributes to carrying out the stewardship responsibilities." I believe that this implies the expansion of application of the Stewardship Code to assets other than domestic listed shares, and that this will lead to increased sophistication along the entire investment chain. And I think that as a direction, this approach is appropriate. However, when I think about actually putting it into practice, as an asset manager we have been involved in deep discussions about the Stewardship Code on the assumption that it would be applied to domestic shares, so at the moment I think that it's also a fact that there are assets for which it would be difficult to abide by the Code at the same level as for domestic shares. So I feel that the expression "may" used in the draft is appropriate. Going forward, in light of perspectives like the one I have just raised, I think that an issue will be how each asset manager should abide by the Code with respect to other assets, but I think that this may mean that each asset manager will, in view of their own investment strategy, steadily broaden their adherence step-by step to the extent that is possible for them.

That was my first point, and my second point concerns the issue of providing an impetus to stewardship activities by asset owners, such as corporate pension funds, which was one of the issues of this revision of the Code. In this draft, a detailed description of the stewardship responsibilities of asset owners has been added, and I feel that this is an appropriate response.

We, as the trust sector, have walked in lockstep with asset owners through the history of the corporate pension system, and while our view may be one-sided, we would like to continue providing assistance to corporate pension funds with their stewardship activities. So I hope that these revisions to the Code will serve as an impetus for that.

That's all I have to say.

**[KANSAKU Hiroyuki, Chair]**

Thank you very much. Are there any other opinions? Ms. Ueda, please go ahead.

**[UEDA Ryoko, Council Member]**

Thank you very much. To start with, thank you very much for putting together the draft today, as well as the written opinions from the follow-up meeting, in such a short space of time. I'm in agreement with the draft as a whole, and I think it's going to turn into a good revised version once the public comments have been taken into account. However, please let me ask one question and make a number of comments.

I'll begin with my question. In paragraph 9 on page 4 of the draft, which is Material 1, it says "other principles" in the second line from the bottom in the section about "service providers for institutional investors." Does this also include the guidance? If possible, I'd like this to be made clearer.

I also have several comments. First, in paragraph 10 below, there are various opinions, and regarding the expansion of assets subject to the Code, I am, as I said before, in agreement, and because this is basically a Code and does not impose an obligation, I think that institutional investors that are able to can expand the assets they apply the Code to, while those that aren't yet capable, and those that don't invest in the assets concerned, can provide explanations based on their individual circumstances. Regarding bonds, in particular, I think that one probable concern is that it could be a factor that causes them to

hoard cash to an even greater extent than now, given that earning power is weak and consciousness of ROE and capital efficiency is low. If descriptions or explanations of some sort are provided in the future, I think that this could be prevented by making it clear that dialogue focused on the ideal situation for sound companies that procure funds should be conducted.

My next comment concerns 5-3. It calls for disclosure of the specific reasons in the case of conflicts of interest, but I feel that the expression is a bit weak. Earlier, Mr. Takei said that there might be a tendency to avoid referring to decisions that differ from voting policy, so with regard to matters like this, I think it is important to properly explain, for example, that this was a case that reflected the dialogue. Also, regarding the part that says "those suspected to have conflicts of interest," I think that this probably relates to group companies, transactional relationships, and so on, so if examples of these were presented, I think it would be easier to understand. And in the second paragraph from the bottom, I think that "the agenda of the companies which are considered important " could be changed to "agenda of the companies which are considered important from the standpoint of constructive dialogue with companies etc.," as it's better for lots of disclosures to be made, even if they are not deemed to be important.

Finally, and this concerns 7-4, which I guess is envisaging something like the stewardship activity reports that overseas institutional investors, asset owners, and asset managers have been increasingly putting out recently. I conducted various types of analysis, and I found that they are almost all similar to the annual reports produced by Japanese issuers. However, while Japanese institutional investors are providing fairly detailed information as part of their public disclosures, I feel that compared with that, these reports are sometimes like the brief IR reports of old, and that they are still inadequate in terms of both quality and quantity. Reports like this don't really allow people to see the action that Japanese institutional investors are taking. They also need to be put out in English. I understand that the FSA has also been analyzing best practices for corporate disclosure, and I feel that if the same were done for these stewardship activity reports, it could serve as a foundation

for boosting disclosure.

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

**[KANSAKU Hiroyuki, Chair]**

Thank you very much. Ms. Ueda asked a question about whether guidance is included in "other principles," which I think is in the second line from the bottom of section 9, which is set to be established on page 4 of Material 1. If the Secretariat could give us an answer, please go ahead.

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

My understanding is that it's included. And I also understand that the current signatories of the Code, such as proxy advisors, are already following like that.

**[UEDA Ryoko, Council Member]**

Thank you very much.

**[KANSAKU Hiroyuki, Chair]**

Is that okay? And do you have any other opinions? Mr. Oba, please go ahead.

**[OBA Akiyoshi, Council Member]**

I am in agreement with the draft as a whole, so I don't have anything to say about the overall document, but I'd like to make two points concerning expressions, as I think they could be improved a little to convey the purpose better.

First, and this point has been made by others, but it concerns Guidance 1-3, encouraging corporate pension funds or asset managers to accept the Code. It's been added in 1-3, 1-4, and 1-5, but what concerns me a little is that in each of them it says "corresponding to their size and ability, etc." I guess this demands entities to declare acceptance within a scope that is possible for them, but because the Code itself is based on principles, when

only this phrase is emphasized, I wonder how asset owners would feel. As the Code is principles-based, I think in the first place it is based on the premise that asset owners understand the Code and make specific adaptations corresponding to their own situation. If that's the case, will it really encourage asset owners? My concern is that they will only declare their acceptance and stop pursuing best practices. It's always important to aim for best practices, but I'm concerned that it could send that sort of message. Because all economic entities in the investment chain will accept this principles-based Code, and then adapt it to their respective situations, when only asset owners are emphasized, I'm concerned that they will just respond in a formalistic fashion.

Another point, and this concerns the expression in the section about sustainability on page 8, which others have also mentioned. I think this section, including the part of investment strategy, could be revised a little bit. Specifically, the phrase "whether they take the issues of sustainability" can be interpreted that not taking such issues into account is also permissible. And I feel that this is probably inconsistent with the original purpose of the Stewardship Code. In other words, it's based on the "consideration of sustainability corresponding to their investment strategies," which is in the second line of "Stewardship responsibilities' and the role of the Code" on the first page. As for what specifically should be done, it concerns "how they take the issues of sustainability into consideration," so I think the expression "whether they take the issues of sustainability" doesn't need to be there. I think that removing it would make things consistent overall. For example, the Aims of the Code and preamble 5, which are on the second page, all say "constructive engagement ...based on consideration of sustainability," so I think an expression consistent with that would probably be easier to understand.

That's all.

**[KANSAKU Hiroyuki, Chair]**

Thank you very much. Next, over to Mr. Matsunaga.

**[MATSUNAGA Yosuke, Council Member]**

I'd like to talk about the draft presented today. First, I'd like to discuss the expansion of application to other assets and the application of ESG. With both of these, the text states that the institutional investors that undertake the tasks of investors should think independently, make decisions in accordance with their policy, and disclose information. Entities of various sizes and ways of thinking can therefore take action that is aligned with their own situation and the stage they are at. I feel that the expression is balanced and pays attention to the impact on actual practices.

Next, I'd like to talk about disclosure of the reasons of votes either "For" or "Against". Imposing the obligation to make detailed disclosures about each case could affect the content of dialogue, and I've expressed concern about this in the past. My understanding of this is that it leaves the specifics up to the institutional investors. I hope that continuous efforts will be made to provide easy-to-understand disclosures.

And regarding the work of master trustees, it is, as I've stated in the past, different to asset investment business, and as the primary entities for supporting the corporate pension system, we intend to contribute to the maintenance and expansion of Japan's pension system. And naturally, we are committed to further ensuring customer-oriented business conduct.

At any rate, as an institutional investor, I am strongly in agreement with the purpose of the Stewardship Code, which aims to increase the value of Japanese companies and promote the sustainable growth of companies. As I said at the previous meeting of the Council, changes are gradually starting to occur on the corporate side, and I feel especially that attitudes toward governance structures, information disclosure, and shareholder returns are beginning to change.

Going forward, I intend to continue properly fulfilling my role with the aim of developing the entire investment chain, including through the promotion of understanding of the

stewardship activities of corporate pension funds.

That's all I have to say.

**[KANSAKU Hiroyuki, Chair]**

Thank you very much. Let's now hear from Ms. Okina. Please go ahead.

**[OKINA Yuri, Council Member]**

The expressions in this draft are extremely balanced, and new initiatives are described, so I agree with it on the whole.

I actually agreed with what Mr. Oba said earlier about the expression of Guidance 1-2 being somewhat of a concern. I felt that the expression is being used because Guidance 1-1, which calls on entities to comply or explain, suggests that there are situations in which entities will explain, but taken as a whole, and as Mr. Oba said earlier, my impression was that it would be better to write as how issues of sustainability should be considered, so as to cover the entirety.

In addition, on page 12 it says that entities should endeavor to share awareness and address problems through purposeful dialogue with institutional investors. However, and Mr. Toyama has raised this issue, but I think that these sorts of group governance problems, and the issue of parents and subsidiaries both being listed, are also extremely important, and in footnote 16 there's a statement that seems to be about governance structures. I'm not asking that the wording be changed, but I do hope that dialogue will be encouraged with regard to matters like this, including with respect to important issues such as group governance.

**[KANSAKU Hiroyuki, Chair]**

Thank you very much. Does anyone else have anything to say? Yes, Mr. Takei.

**[TAKEI Kazuhiro, Council Member]**

The mention in Guidance 8-2 of the establishment of an office in Japan, which was discussed earlier, is I think just stating what's obvious and natural, so I don't think it should be deleted. Moreover, and if the choice has been made to provide services to Japanese listed companies, and the choice has been made to sign up to the Stewardship Code, then this is a matter of voluntary choice, so I don't think the expression should be deleted.

That's all.

**[KANSAKU Hiroyuki, Chair]**

Thank you very much. Does anyone else wish to speak? Mr. Shibasaki, please go ahead.

**[SHIBASAKI Toshio, Council Member]**

I submitted an opinion statement last time, and speaking from the standpoint of a small-sized asset owner, I am incredibly grateful that the fact that we don't have a lot of personnel with high levels of financial literacy has been taken into account, and that the expression "corresponding to their size and capacity, etc." has been included in the first part about asset owners.

My first point is that if the aim of these revisions to the Code is to expand the scope of stewardship activities, it would be better to include the phrase "corresponding to their size and capacity, etc.," as this will encourage more asset owners to participate, and will therefore expand the scope.

My second point concerns the scope of assets covered, and as you know, with returns being difficult to secure, corporate pension funds are working hard to secure returns by looking for them amongst a wide range of assets, so as you have said, corporate pension funds are investing not only in Japanese shares, but also overseas shares and domestic and overseas bonds, and on occasion, are investing in debt instruments by, for example, conducting private, unlisted direct lending. Depending on the nature of the instrument,

some assets are easy to perform direct ESG assessments upon, while other assets are not. So if we're told to take ESG into account in every case, then given that ESG investments account for only around 20% of all our assets, if we take the example of investing in infrastructure such as renewable energy, it is easy to see they are extremely beneficial for ESG, but in the case of private debt products such as direct lending, it is sometimes impossible for those of us on the asset owner side to determine how they serve ESG. Regarding the wording used this time, which provides a degree of breadth, it is obviously essential for funds that are of a sufficient size and capacity, to apply ESG factors to bond investments. And in the case of vehicles such as private equity, entities that are able to adopt an investment approach which factors in ESG considerations need to move in that direction, and for those funds that are not able to perform such assessments and analysis on their own - who therefore rely upon opinions from third parties, it is difficult to obtain ESG assessment and analysis services from these external parties beyond the realm of equities. In light of this, I feel that the wording proposed is good.

That's all.

**[KANSAKU Hiroyuki, Chair]**

Thank you very much. Would anyone else like to say anything? Ms. Ueda, please go ahead.

**[UEDA Ryoko, Council Member]**

Thank you very much. Seeing as we still seem to have some time, please let me make one additional point that I omitted when I spoke earlier.

Regarding the part in Guidance 1-2 about whether ESG is taken into account or not, which Mr. Oba talked about earlier, I also don't think it's necessary, so if possible, one thing that I'd like to be included is how, after taking ESG into account, this is integrated into the investment or the asset management process. I think that all investors would probably say that they are taking it into account, but we want to know how they are actually integrating that into their processes. Looking at the situation overseas recently, this integration seems

to have become more important aspect, so if there's space, I'd like you to consider whether integration could also be referred to in policies.

That's all. Thank you very much.

**[KANSAKU Hiroyuki, Chair]**

Thank you very much. Does anyone else wish to speak? Is that all?

Regarding Material 1 and Material 2, we've heard various opinions today, but my understanding is that there is overall support. We've had suggestions for specific changes in wording, and after reconciling the opinions we've received today via email, for example, we plan to rework the draft and make it available for public comment, but does the Secretariat have any comments to make concerning the opinions, criticisms, and so on we've received so far?

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

We in the Secretariat intend to move in the direction of reflecting as many of the opinions as possible, provided that they are not in conflict with each other.

**[KANSAKU Hiroyuki, Chair]**

So in light of the various remarks that have been made today, I'll be asking the Secretariat to make revisions once again, and after reconciling them via such means as email, we intend to put them forward for public comment. Is everyone okay with that? Regarding the public comment phase, we intend to gather a wide range of opinions from various sectors based on the questions presented from the fourth page onwards of Material 2.

(Verbal confirmation of "no objections")

**[KANSAKU Hiroyuki, Chair]**

Thank you very much. Regarding the scrutinization of matters such as consistency of

expression, I would really appreciate it if you would leave this to me, but I should ask, so is this okay with you?

(Verbal confirmation of "no objections")

**[KANSAKU Hiroyuki, Chair]**

Thank you very much. So now I'd like the Secretariat to brief you on the procedure for the upcoming public comment phase.

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

Regarding the draft that was put together for this meeting, as the Chair has just explained, we will be making adjustments to ensure consistency of expression, for example, after which we will publish it on the FSA website for a period of about one month, make it available for public comment, and ask for opinions from a wide range from people.

And as we did with the previous version, and with the first version for that matter, we will also be making an English version available for public comment, so as to get opinions from a broad spectrum of people overseas.

**[KANSAKU Hiroyuki, Chair]**

Thank you very much. In light of the opinions we receive during the public comment phase, we will produce and publish the final version of the Stewardship Code. Depending on what happens, we may call another meeting of the Council so the members can have more discussions, so I ask for your cooperation in advance.

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

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

Thank you very much. As the Chair has just said, if we need to hold another meeting after the public comment phase, we'll decide on a day and time after taking into account

everyone's schedules. I therefore ask for your cooperation at that time.

That's all from the Secretariat.

**[KANSAKU Hiroyuki, Chair]**

Thank you very much. Although it's still well before the schedule time for the end of the meeting, I'd like to bring today's meeting to a close. Thank you all very much.

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