

Issues for Consideration for Further Promotion of Corporate Governance Reform

March 5, 2019

Financial Services Agency, Policy and Markets Bureau

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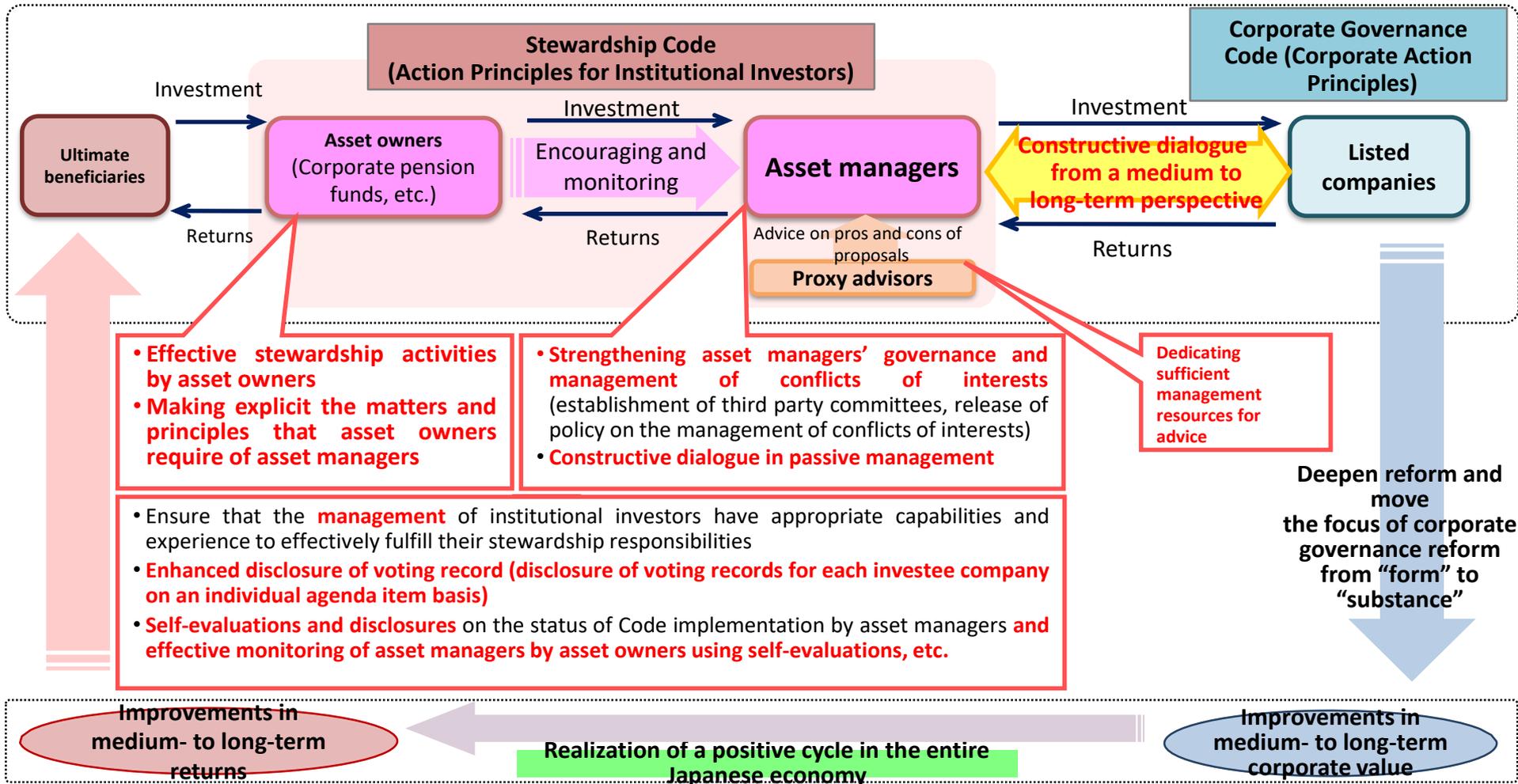
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I. Stewardship

(1) Overview

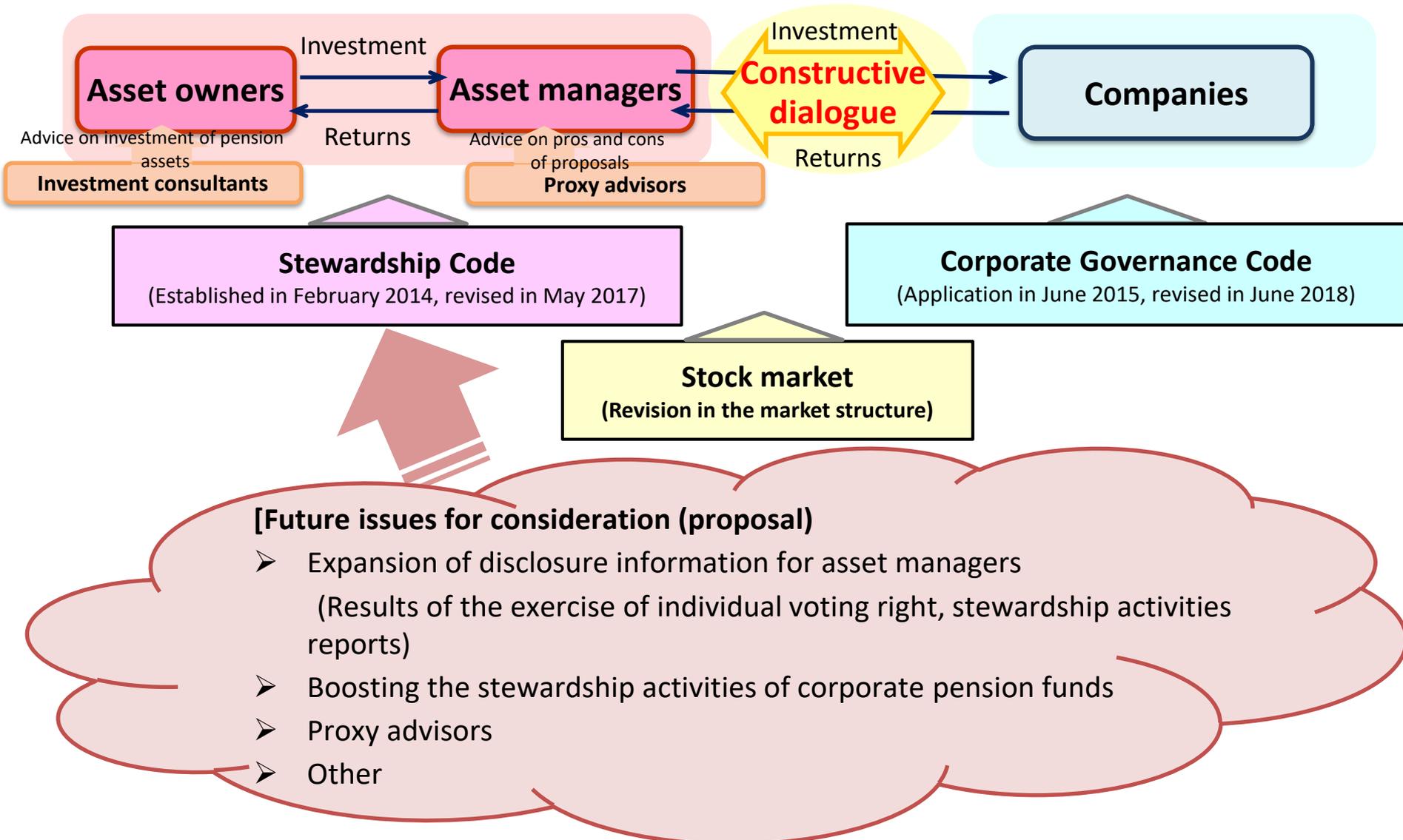
I.(1) Overview (1): Revision of Stewardship Code (May 2017)

- ❑ In order to deepen reform and move the focus of corporate governance reform from “form” to “substance”, it is important for institutional investors to have effective and constructive dialogue with companies.
- ❑ To this end, the strengthening of asset managers’ governance and management of their conflicts of interests were promoted, and the roles of corporate pension funds and other asset owners were clarified.



I.(1) Overview (2): Main issues to be considered related to stewardship activity issues

- What matters need to be considered going forward so asset managers and corporate pension funds and other asset owners can work to **enhance constructive dialogue with investors and companies and further fulfill their stewardship responsibilities?**



I.(1) Overview (3): Proposed revision to the UK Stewardship Code

❑ **In the UK**, a proposed revision to the UK Stewardship Code was released in response to recent changes in the global investment environment on January 30, 2019. Public comments will be accepted until March 29, and the revision will be finalized this summer.

Structure of the proposed revision

○ The structure will be changed from the two levels of principles and guidance to the **three levels of principles, provisions, and guidance**.

*The structure will be changed to follow a similar structure to the UK Corporate Governance Code (revised in July 2018)

○ **Common principles will be set for asset managers and asset owners, and provisions and guidances will be set respectively. Separate principles, provisions, and guidance will be set for service providers (including investment consultants and proxy advisors).**

[Chapter structure of the proposed revision]

Chapter 1	Purpose, objectives and governance
Chapter 2	Investment decision-making
Chapter 3	Active monitoring
Chapter 4	Constructive engagement and clear communication
Chapter 5	Exercise rights and responsibilities

Principles are to be followed on an 'apply and explain' basis.

Main points of the proposed revision

○ Stewardship is defined as **"the responsible allocation and management of capital across the institutional investment community, to create sustainable value for beneficiaries, the economy and society"**, and signatories are asked to establish an organizational purpose and provide disclosures on matters such as their stewardship objectives and governance structures.

○ Suggested to apply the principles **even for investment in assets other than listed equity, such as bonds.**

○ **Clearly requires consideration to ESG factors.**

○ Requires submission and disclosure of **annual report on activities and results.**

○ Requires higher levels of disclosures in light of the revised EU Shareholder Rights Directive.

I. Stewardship

(2) Asset managers

I.(2) Asset managers (1): Disclosure of status of stewardship activities (restated from Material 1 for the Sixteenth Council)

There are significant differences in the contents of disclosures on the status of stewardship activities among institutional investors. **While there are some institutions that provide detailed disclosures that include engagement themes and results, in some cases the disclosures are not necessarily specific and some even have no disclosures at all on the status of activities.**

Overseas asset manager A

Engagement for i

Number of companies that conducted engagement and cases of engagement

Themes engagement conducted on

Name of company that conducted engagement

Examples of exercising voting rights in consideration of engagement

Company	Country	Resolutions	Vote	Text
Softbank	Japan	<ul style="list-style-type: none"> Independence Auditors' compensation 	<ul style="list-style-type: none"> then 	<p>We dialogued with the Chairman on many sensitive governance issues, notably their independence criteria for Directors and external auditors, but also the requirements of their compensation policy.</p> <p>The company's willingness to move towards meeting our main voting policy criteria led us to vote for all of the resolutions.</p>
Crédit Suisse	Switzerland	<ul style="list-style-type: none"> Binding approval of compensation elements Compensation policy (advisory) 	<ul style="list-style-type: none"> then 	<p>After having dialogued with the company on our questions in terms of transparency and standards for fixed and variable remuneration, a public statement by the Chairman responding in part to our wishes led us to vote for the "binding" resolutions.</p> <p>On the other hand, we maintained our opposition to the resolution (merely advisory) on the overall compensation policy.</p>
Continental AG	Germany	<ul style="list-style-type: none"> Compensation policy 	<ul style="list-style-type: none"> then 	<p>After having accepted the compensation policy in 2014 following dialogue with the company, an amendment in 2017 increased the remuneration potential without any explanation, notwithstanding our previous comments. Despite further dialogue, we finally rejected this change, along with around 20% of the shareholders who spoke at the General Meeting.</p>
Mitsubishi Heavy Industries Group	Japan	<ul style="list-style-type: none"> Independence Directors' attendance rate Remuneration report 	<ul style="list-style-type: none"> then 	<p>Our dialogue addressed an improvement in the Board's rate of independence, but also greater transparency in terms of director attendance and variable compensation components.</p> <p>After sharing our views, we approved all the proposals tabled at the General Meeting.</p>

● For ● Abstention ● Against

Japanese asset manager B

Engagement structure

Analysis of engagement

Examples of engagement (industries, themes, and results)

Self-evaluation

Japanese asset manager C

スチュワードシップ活動に関する当社の体制・取組の評価について

当社は、受託者責任を果たすため、議決権(当社が裁量権を有する場合、以下同様)を保有している企業に対し、当社の「議決権行使の考え方」に基づき適切に議決権を行使することにより、当該企業の企業価値の向上や持続的成長への寄与を図っております。

今回、スチュワードシップ活動を行うにあたり当社の体制や自らの取組の評価を実施し、現時点において、当社対応方針に従いスチュワードシップ活動を行っており、当社の体制、取組については適切なものと考えております。

当社は引き続き、議決権行使を中心としたスチュワードシップ活動に取組んでまいります。

以上

I.(2) Asset managers (2): Overview of ICGN “Guidance on Key Disclosure Elements”

- ❑ The international institutional investor organization ICGN (International Corporate Governance Network) established the “Guidance on Key Disclosure Elements” for institutional investors (December 2018).

[Key disclosure elements]

- 1. Engagement is conducted strategically to identify and narrow down the scope of engagement.**
- 2. A clear engagement policy has been established.**
- 3. There is a uniform point of view within the company, and engagement activities are consistent.**
- 4. All available measures are being considered to strengthen engagement as necessary.**
- 5. Measures have been prepared to collaborate with other investors in order to enhance the effectiveness of engagement.**
- 6. Engagement methods, including the effectiveness of engagement, are being reviewed on a regular basis**

Source: ICGN Model Disclosure on Engagement “Guidance on Key Disclosure Elements”

Note: Summary by the Financial Services Agency

I.(2) Asset managers (3): Tiering of stewardships reports in the UK

- ❑ **The UK Financial Reporting Council conducts tiering** on the approximately 300 organizations (of which, approximately 200 asset managers) that are signatories to the Code for objectives including improving the transparency of markets and maintaining confidence in the Code.
- ❑ In the process of tiering, the FRC provides feedback to signatories **and encourages improvements through engagement with FRC.** The tiering results were released for the first time in November 2016. Going forward, signatories to the revised Code will be tiered and the results will be released in 2021.

(The number of institutions is as of February 2019)

Tier	Details	Asset managers	Asset owners	Service providers
1	Signatories provide a good quality and transparent description of their approach to stewardship and explanations of an alternative approach where necessary.	116	75	12
2	Signatories meet many of the reporting expectations but report less transparently on their approach to stewardship or do not provide explanations where they depart from provisions of the Code.	55	22	0

*At the time of release in November 2016, there was a Tier 3 category (“Significant reporting improvements need to be made to ensure the approach is more transparent. Signatories have not engaged with the process of improving their statements and their statements continue to be generic and provide no, or poor, explanations where they depart from provisions of the Code.”),

and approximately 40 asset managers were classified as Tier 3.

⇒Tier 3 asset managers were told that they would be removed from the list of signatories if there was no improvement within six months.

⇒While about half of these asset managers improved to Tier 1 or Tier 2 within half a year, the other half chose to remove themselves from the list of signatories (currently, there is no Tier 3 category).

In July 2018, the FRC released a Feedback Statement indicating that **the majority of opinions were positive and called for the ongoing implementation of tiering.**



It was also pointed out it was only a checklist of issues and did not focus on actual effectiveness and results (December 2018, Kingman Review). There were also concerns that the tiering process had been devalued by having too many signatories in Tier 1.

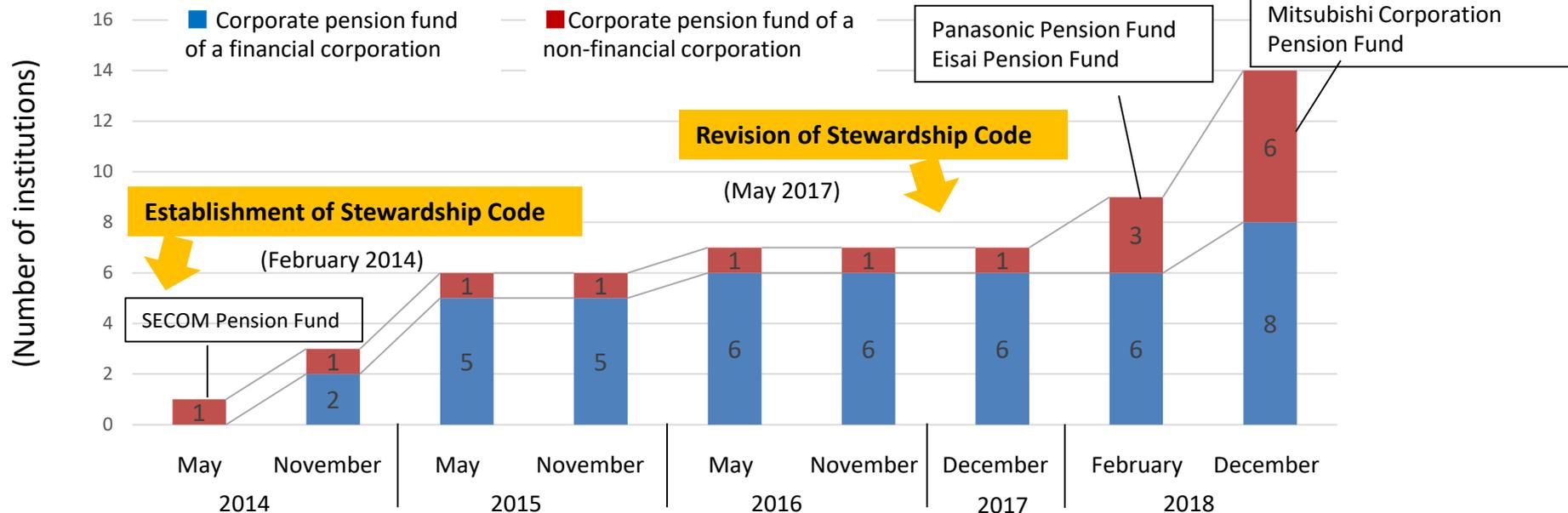
I. Stewardship

(3) Corporate pension funds and other asset owners

I.(3) Corporate pension funds and other asset owners (1): Acceptance status of the Stewardship Code

Among the 239 institutional investors that have accepted the Stewardship Code, there are 14 corporate pension funds (seven funds newly expressed their acceptance in 2018).

[Acceptance by corporate pension funds]



「責任ある機関投資家」の諸原則《日本版スチュワードシップ・コード》の受入れ

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TEL 06-6907-4816 FAX 06-6907-4818
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パナソニック企業年金基金
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- ▶ 海外居住者について
- ▶ 企業年金の税金について
- ▶ 各種のお手続きについて
- ▶ 年金受給権者のご家族様へ

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I.(3) Corporate pension funds and other asset owners (2): Request of Japan Business Federation to member companies (December 25, 2018)

Takashi Inoue, Managing Director
Japan Business Federation

Request on the stewardship activities of corporate pension funds

As you may be aware, the Japan Business Federation is engaged in activities to attain the SDGs through the realization of Society 5.0. In order to spark innovation toward the realization of Society 5.0, it is extremely important to further improve the appeal of Japanese companies as investments and bring in funds from around the world to the Japanese capital market, and to do so, it is necessary to promote measures aimed at achieving effective corporate governance. We believe that member companies are steadily implementing measures aimed at establishing desirable corporate governance in light of the circumstances at their company.

The efforts of institutional investors in addition to efforts by issuer companies are essential to make corporate governance truly effective. It is necessary for institutional investors to encourage improvements in corporate value in companies invested in through constructive engagement based on a deep understanding of such companies and factors such as the business environment. Against this backdrop, the government revised the Japan Stewardship Code on May 29 of last year from the perspective emphasizing the role of asset owners, who stand in the nearest position to the ultimate beneficiaries as well as encourage and monitor asset managers that are the direct counterparties in engagement with companies. The role of asset owners is now further clarified. In addition, a revision to the Corporate Governance Code on June 1 of this year has required personnel and management efforts by sponsoring companies so that corporate pension funds perform their roles as asset owners.

We believe that strengthening the stewardship activities of corporate pension funds will not only contribute to improved corporate governance for companies in Japan overall, but will also have a positive effect on stable asset formation by employees and the financial position of companies. In this sense, the Japan Business Federation hopes that more corporate pension funds accept the Stewardship Code and implement effective stewardship activities.

While member companies are already implementing various measures regarding their own corporate pension funds, may we request that companies continue to put forth their best effort to strengthen the stewardship activities of corporate pension funds, including the acceptance of the Stewardship Code.

te: Underline was added by the
Financial Services Agency.

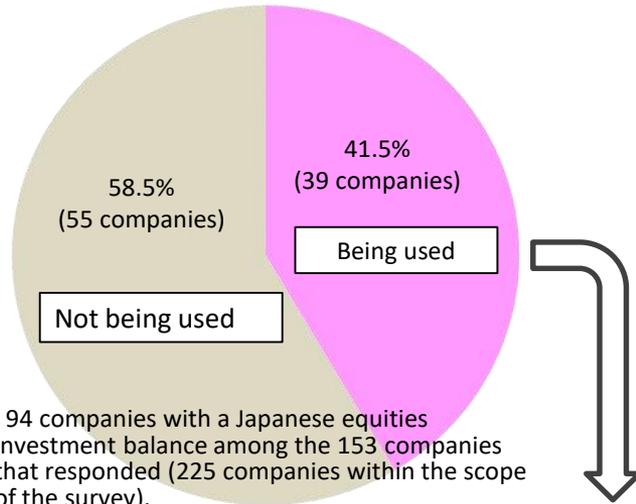
I. Stewardship

(4) Proxy advisors

I.(4) Proxy advisors (1): Usage of proxy advisors by institutional investors

- Approximately 40% of institutional investors use a proxy advisor.
- Some institutional investors make specific disclosures on the use of a proxy advisor.

[Usage of proxy advisors]



*Scope is 94 companies with a Japanese equities investment balance among the 153 companies that responded (225 companies within the scope of the survey).

[Example of disclosure on use of a proxy advisor]

[Example of disclosure on specific use method]

For company proposals that are subject to separate consideration under the Company's approval judgment standards, conflicts of interest are eliminated and the neutrality of decision regarding the exercise of voting rights is ensured by exercising voting rights in accordance with the advice of an external specialist organization. However, if it is deemed that it would not be appropriate to follow such advice due to factors such as issues with the reliability of the contents of the advice, the CIO will decide on the pros and cons independently after deliberations by the Stewardship Committee. In such a case, efforts will be made to eliminate conflicts of interest and ensure neutrality through a report to the Audit Committee before exercise the voting rights on the background behind the advice being deemed not appropriate, the details of the separate deliberations by the Stewardship Committee, and the decision on the pros and cons by the CIO.

Overall	Number of responses 39 companies
Always exercise voting rights in accordance with the contents of advice	2.6% (1 company)
Exercise voting rights in accordance with the contents of advice in principle, although there are some rare exceptions	30.8% (12 companies)
Exercises voting rights in accordance with the contents of advice on matters relating to the parent company etc.	20.5% (8 companies)
Use as reference when making decisions on the exercise of voting rights	43.6% (17 companies)
Other (main item: contract with the creation of proposals for exercising voting rights in accordance with the Company's guidelines)	33.3% (13 companies)

[Example of clearly indicating the name of the proxy advisor]

In terms of the use of a proxy advisor, the Company acquires a report based on the guidelines of Institutional Shareholder Services Inc. (ISS). This report is used as a reference point by the Company when exercising voting rights in order to gain an understanding on the consensus toward the exercising of voting rights, and final judgments are made by the Company's investment department.

1.(4) Proxy advisors (2): Regulations overseas (US)

US

The US Securities and Exchange Commission (SEC) held a round table on the process of exercising voting rights including the involvement of proxy advisors in November 2018. Note that an act on proxy advisors was discarded at the conclusion of a meeting of Congress.

[Holding of round table by the SEC on proxy advisors]

○ The roles of proxy advisors and their involvement in the process of exercising voting rights were discussed at a round table held in November 2018 by the SEC.

*In addition, frameworks and technologies of the proxy exercise of voting rights and effective engagement with shareholders were also discussed.

○ In light of these discussions, the SEC is considering how to address mainly the following points in relation to proxy advisors.

(1) **Ensuring access for investors to comments by companies in response to proxy advisor reports**

(2) **Analysis of recommendations on exercising voting rights and clarification of the decision-making process**

(3) **Framework in response to conflicts of interest**

[Status of act on proxy advisors]

○ Although the following act was submitted in October 2017 and it passed House of Representatives, it was discarded at the conclusion of a meeting of Congress.

Name of the act	Corporate Governance Reform and Transparency Act of 2017
Details	(1) System for registration to the SEC (filing on organizational structure, management of conflicts of interest, etc.) (2) Obligation to assign a compliance officer (3) Obligation to provide the company covered with the opportunity to review and comment on advice proposals (4) Obligation to submit an annual report that includes the number of proposals subject to advice, the number of staff members, etc.

○ Although the Corporate Governance Fairness Act that proposed the adoption of registration system for large-scale proxy advisors and regular inspections by the SEC was submitted to the Senate and discussed, it was discarded at the conclusion of a meeting of Congress.

1.(4) Proxy advisors (3): Regulations overseas (Europe)

EU

In the EU, the Shareholder Rights Directive was revised in June 2017 in relation to disclosures by proxy advisors on matters such as procedures to ensure the quality of staff members, considerations of individual circumstances affecting companies, the status of engagement with companies, and responding to conflicts of interest (each EU member state to develop domestic legislation by June 10, 2019).

Name of law	EU Shareholder Rights Directive
Overview	<p>[Disclosure regulations]</p> <p>Member States shall ensure that proxy advisors publicly disclose on an annual basis at least all of the following information in relation to the preparation of their advice, etc.:</p> <ul style="list-style-type: none">• The essential features of the methodologies and models they apply• Main information sources they use• Procedures put in place to ensure quality of service and qualifications of the staff involved• Whether and, if so, how they take national market, legal and regulatory and company-specific conditions into account• Essential features of the voting policies they apply for each market• Whether they have dialogues with the companies which are the object of their research, advice or voting recommendations and with the stakeholders of the company, and, if so, the extent and nature thereof• Policy regarding the prevention and management of potential conflicts of interests <p>*In addition, member states are required to introduce regulations on institutional investors, etc. that require them to either disclose annually, or if disclosure is not possible explain (comply or explain), how they implement policies including the use of proxy advisors.</p> <p>[Disclosures on conflicts of interest]</p> <p>Member States shall ensure that proxy advisors disclose to their clients any actual or potential conflicts of interest or business relationships that may influence their services and the actions they have undertaken to eliminate, mitigate or manage the actual or potential conflict of interest.</p>

Best Practice Principle Group that was formed by proxy advisors in response to requests by the European Securities and Markets Authority (ESMA) established the Best Practice Principles (BPP) for the Providers of Shareholder Voting Research & Analysis in 2014. Revisions of these Principles are being considered in response to the revision of the Directive described above.

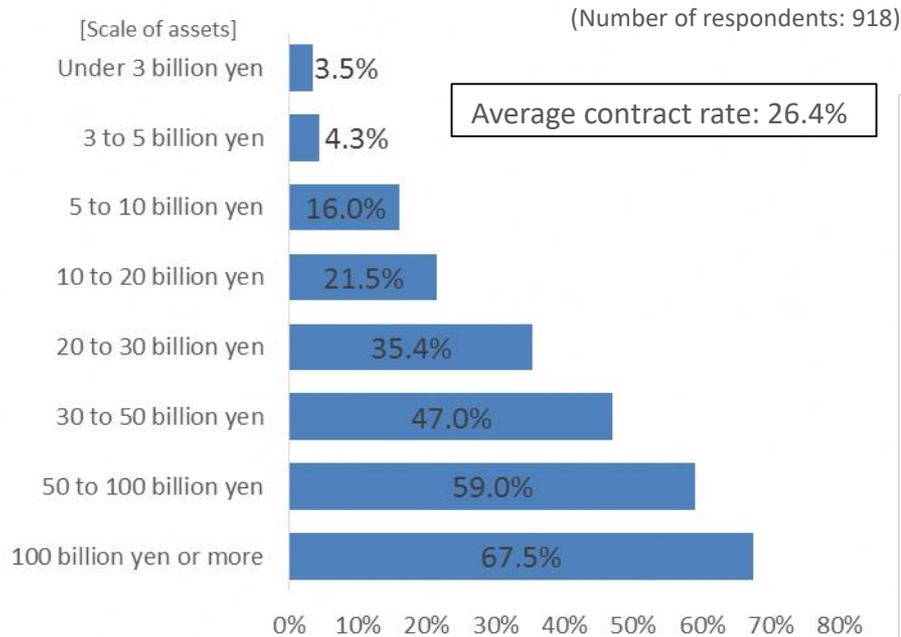
I. Stewardship

(5) Investment consultants

I.(5) Investment consultants (1): Usage of investment consultants by corporate pension funds

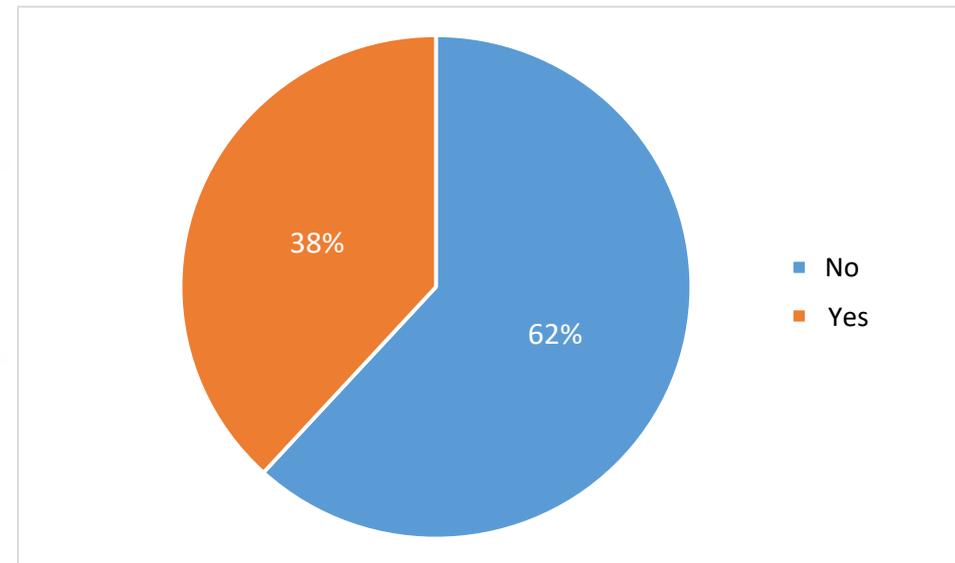
- ❑ Many of corporate pension funds with large amounts of assets **use investment consultants**.
- ❑ **It has been pointed out that investment consultants may not be fully aware of the stewardship activities** of asset managers.

**[Contracts with investment consultants at corporate pension funds]
(By scale of assets)**



[Results of questionnaire survey with investment advisory companies]

- ❑ **Have you received questions or a question form concerning activities related to Japan's Stewardship Code from an investment consultant over the past year?**



Source: Pension Fund Association, "Field Survey Summary 2017"

Source: Japan Investment Advisers Association, "Questionnaire Survey Results" (as of October 2018)

I.(5) Investment consultants (2): Overview of CMA report and order draft (UK)

- ❑ In December 2018, The UK Competition & Markets Authority (CMA) released a final report on an **investment consultants market investigation**. In February 2019, a draft order was released to investment consultants. The order is scheduled to be enacted around June 2019 after a public consultation period until March 13, 2019.

[Overview of the report]

- Investment consultants have influence over GBP 1.6 trillion of pension scheme assets, and they are important for pension trustees.
 - Competition issues related to investment consultants:
 - (1) Due to low levels of engagement with pension fund trustees, it is difficult to access and assess information
 - (2) Firms that offer both investment consultancy and fiduciary management services have an advantage over companies that only offer one of either services
 - **Potential conflicts of interest** involving investment consultants
 - (1) **Purchasing or recommending their own asset management products**
 - (2) Relationships with asset managers
 - (3) The receipt of gifts and hospitality
 - (4) Sales of master trusts by investment consultants that also provide employee benefit consultancy services
- 
- In light of the results of the investigation above, the CMA **released a draft order to investment consultants**.

Contents of order (draft) to investment consultants

- It is prohibited for firms that offer both investment consultancy and fiduciary management services **to offer advice on fiduciary management services and make a solicitation for the purchase of their own firm's investment consultancy services within the same document.**
- As a general rule, pension fund trustees are prohibited from entering or continuing a consultant contract unless they **set strategic objectives for their investment consultant.**
- Conditions have been set when an investment consultant reports the performance of an asset management products for solicitation to a potential customer.
 - ⇒ **It is required to submit a statement for each set period of time that these provisions are being complied with.**

II. Individual issues related to corporate governance reform

(1) Corporate governance reform and revisions to disclosure systems

II. (1) Corporate governance reform and revisions to disclosure systems (1): Overall perspective

Revisions to narrative information (annual securities report)

- **Enhancement of descriptions of narrative information (*)**
(Management strategy, management discussion and analysis (MD&A), risk information, etc.)
- **Enhancement of audit related information**
(Activities of the *kansayaku* board, auditor tenure, etc.)
- **Enhancement of governance information**
(executive remuneration, cross-shareholdings, etc.)

Release of Principles for the Disclosure of Narrative Information and Best Practices

From FYE March 2019

From FYE March 2020

From FYE March 2021

Enhancement of disclosure of corporate information

KAM
Start of early application

KAM
Start of full application

Revisions to audit reports (introduction of KAM)

Statement of key audit matters (KAM) in audit reports

(*)Summary of approach to disclosure of narrative information, such as disclosures from the perspective of management

II.(1) Corporate governance reform and revisions to disclosure systems (2):

Overview of revision of Corporate Disclosure Ordinance based on the report by the Working Group on Corporate Disclosure of the Financial System Council

(Promulgated and enacted on January 31, 2019)

Contents of the main revisions

I Improvement of financial and narrative information

- It is required to provide a description on the awareness of management toward business policies and business strategies including market conditions, competitive advantage, main products and services, and customer base.
- It is required to provide a description on business risks in terms of the degree of possibility and timing of such risks emerging, the impact of such risks on the business, and measures in response to these risks.
- It is required to provide a description on the awareness of management toward accounting estimates and assumptions used in estimates including the details of uncertainties and the impact fluctuations could have on management results.

II Disclosing corporate governance information to promote constructive dialogue

- It is required to provide a description on executive remuneration including a description of the remuneration program (information on performance-linked remuneration and the policies on the remuneration amount by each position) and the actual remuneration based on the program.
- For cross-shareholdings, it is required to disclose matters including the examination method for the reasonableness of holdings, and the number of stocks subject to separate disclosure has been expanded from 30 stocks to 60 stocks.

III Measures to assure the reliability and timeliness of information

- It is required to provide disclosures on activities of the *Kansayaku* Board (including frequency of the *Kansayaku* Board meetings held and major considerations, attendance of individual *Kansayaku*) and the auditor tenure, etc.

Application timing

(1) Application from FYE March 2019 (items stated in “II Disclosing corporate governance information to promote constructive dialogue” above)

(2) Application from FYE March 2020 (besides (1))

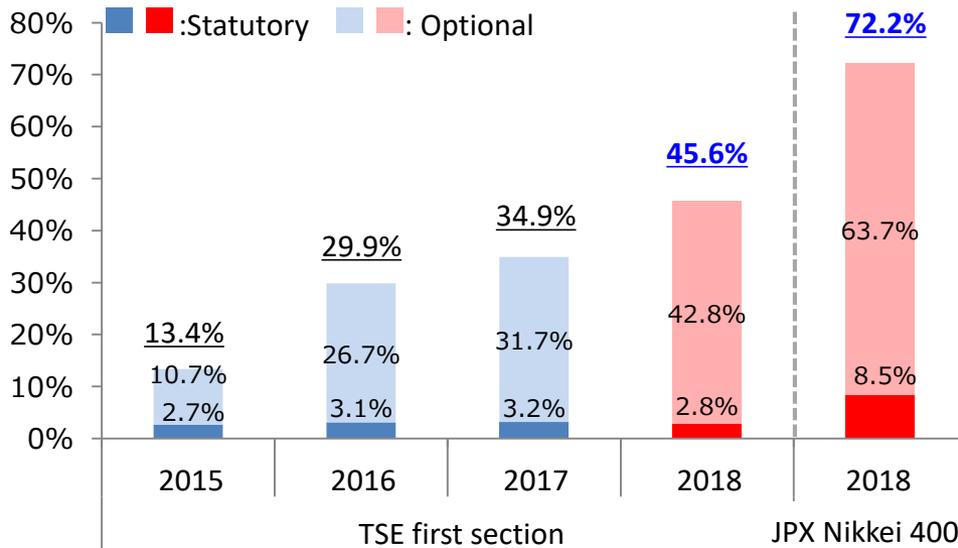
II. Individual issues related to corporate governance reform

(2) Governance regarding executive remuneration

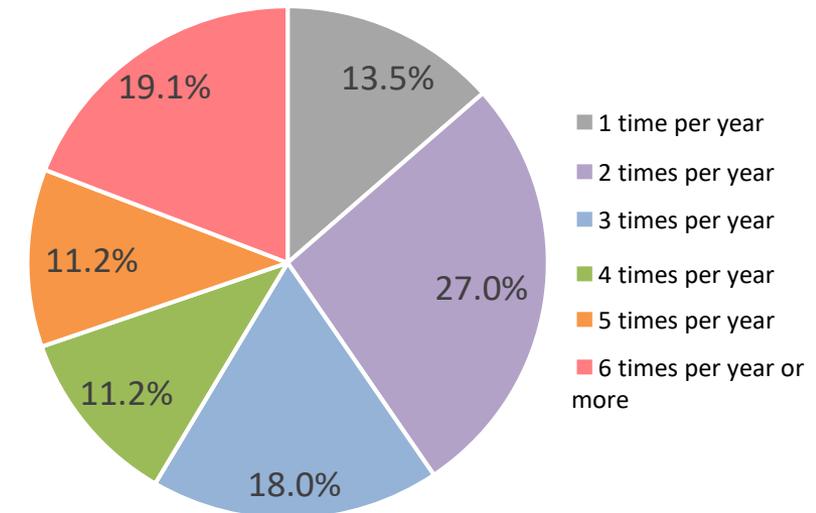
II.(2) Governance regarding executive remuneration

- While there has been progress in the establishment of remuneration committees, there are issues in terms of **effective independence and the frequency of holding such committees**.
- There are still few companies where the contents of disclosures regarding remuneration is a matter discussed by the remuneration committees.

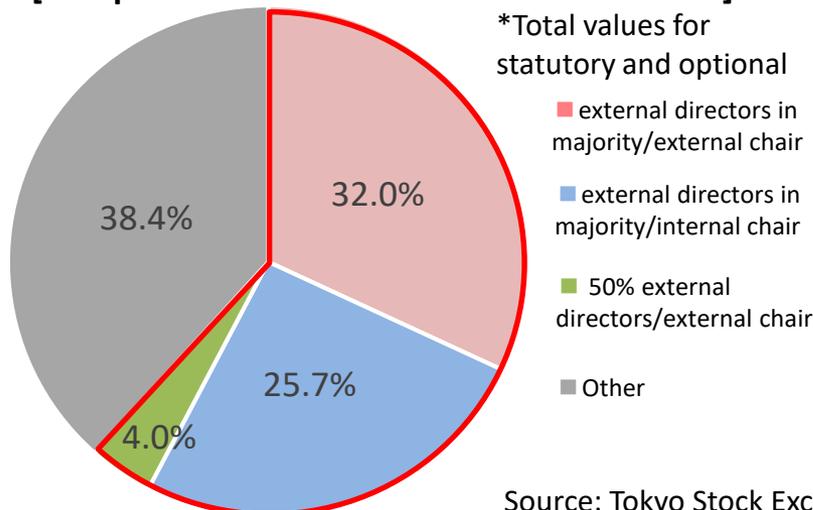
[Status of remuneration committee establishment]



[Number of times remuneration committee held]

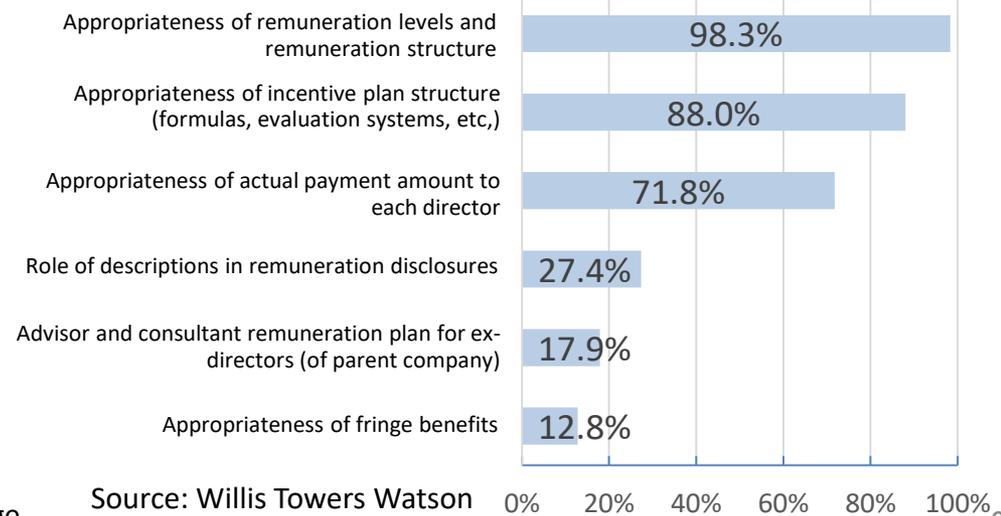


[Independence of remuneration committees]



Source: Tokyo Stock Exchange

[Main discussion matters of remuneration committees]



Source: Willis Towers Watson