Material 2

Supplementary Materials

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I.(1) Proposed revision to the UK Stewardship Code and EU Shareholder Rights Directive

- The UK Stewardship Code was established in 2010 following the global financial crisis. After a revision in 2012, another proposed revision was released in January 2019 (scheduled to be finalized this summer).
- This proposed revision focuses on developing stewardship that delivers sustainable value, conducting revision on the structure of the Stewardship Code to follow the Corporate Governance Code, and requires the application of the Code into the Principles on an **"apply and explain"** basis.

  *Asset managers are required to disclose their commitment to the UK Stewardship Code (or their investment strategy if commitment has not been made) based on the regulations of the Financial Conduct Authority (FCA.)

- The EU Shareholder Rights Directive (SRD II) was revised in 2017, **and regulations have been introduced to improve the transparency of institutional investors and proxy advisory** (partially on a "comply or explain" basis).

[Relationship between proposed revision to the UK Stewardship Code and EU Shareholder Rights Directive]

	Europe	UK	
Governing laws, etc.	EU Shareholder Rights Directive (SRD II)	Proposed revision of FCA Handbook	Draft revision of UK Stewardship Code
Timing	Enacted in June 2017 (Member states to develop domestic legislation by June 10, 2019)	Released in January 2019 (Scheduled to be enacted on June 10, 2019)	Released in January 2019 (Scheduled to be finalized this summer)
Method	"Comply or explain" basis will apply for some regulations	"Comply or explain" basis will apply for some regulations, in the same manner as the EU SRDII *However, opinions on the pros and cons of application are being invited	Principles: Apply and explain Provisions: Comply or explain
Position	—	Domestic legislation in response to SRD II (note)	Requires a higher level than SRD II

Notes: The FCA Handbook describes the regulations for various providers and areas including financial institutions. The proposed revision is to be positioned as the minimum baseline for stewardship activities.

I(2) Overview of US Stewardship Principles

- **In the US, the Investor Stewardship Group (ISG),** a self-regulating body, developed the Stewardship Principles in January 2017 (applied from January 2018).

Reference: ISG is a self-regulating body by the institutional investors that was formed to establish stewardship and corporate governance frameworks.

- **The Stewardship Principles are principles-based self-regulating framework** that clarify the basic responsibilities institutional investors should fulfill in stewardship activities. Signatory institutions are released on ISG's website.

2-level structure of principles and guidance

Principle A	**Accountability** to beneficiaries
Principle B	Demonstration of **evaluation method with regards to the governance factors** of investee
Principle C	Disclosure of **management policies of conflicts of interest**
Principle D	Understanding the activities of **proxy advisors**
Principle E	**Constructive engagement** with companies
Principle F	**Collaboration** by institutional investors

Main contents

- Institutional investors should establish and disclose guidelines with regards to proxy voting and engagement, and disclose the relevant results. Asset owners should evaluate how asset managers are fulfilling their stewardship responsibilities.
- Institutional investors should ensure that there are mechanisms to avoid conflicts of interest (including potential conflicts of interest).
- If a proxy advisor is used, institutional investors should ensure that the proxy advisor manages conflicts of interest.
- Institutional investors should disclose to companies what further actions they may take in the event they are dissatisfied with the outcome of their engagement efforts with companies.
- Institutional investors should consider addressing common concerns related to corporate governance practices.

II. Proxy advisors (1): Disclosure regulations in Japan, EU, and UK

Country	Japan	EU	UK	
Related law, regulation, or code	Stewardship Code	Shareholder Rights Directive (SRD II)	Stewardship Code	Proposed revision of Stewardship Code
Introduction timing	Revised in May 2017	Revised in June 2017 [Member states to establish domestic legislation by June 2019]	Revised in 2012	Released in January 2019 [To be finalized in summer of 2019]
Application to proxy advisors	[Objectives of the code] 8. The Code also applies to proxy advisors and other service providers commissioned by the institutional investors.	Preamble (26): Member States should ensure that proxy advisors that are subject to code of conduct provide effective report on the application of the code to themselves. Article 1 (1) (a) 2: For proxy advisors, the Member State in which the proxy advisor has its registered office, or, where the proxy advisor does not have its registered office in a Member State, the Member State in which the proxy advisor has its head office, or, where the proxy advisor has neither its registered office nor its head office in a Member State, the Member State in which the proxy advisor has an establishment.	[Application of the Code] 2. (Excerpt) Accordingly, the Code also applies, by extension, to service providers, such as proxy advisors and investment consultants. 5. In particular the disclosures should address, with respect to proxy voting agencies, how the signatory uses their advice (excerpt).	2. Who the Code is for The Code is written for asset owners, asset managers and entities providing services to the institutional investment community, including: investment consultants, proxy advisers and other service providers that want to demonstrate their commitment to stewardship.
Response from institutional investors	Guidance 5-4. (Excerpt) When disclosing the result of their voting activities, institutional investors using the service of proxy advisors should publicly disclose the fact and how they utilize the service in making voting judgments.	Article 3g: Institutional investors and asset managers shall, on an annual basis, publicly disclose how their engagement policy has been implemented, including a general description of voting behaviour, an explanation of the most significant votes and the use of the services of proxy advisors.	Principle 6 [Guidance] (Excerpt) Institutional investors should disclose the use made, if any, of proxy voting or other voting advisory services. They should describe the scope of such services, identify the providers and disclose the extent to which they follow, rely upon or use recommendations made by such services.	Chapter 5 Exercise rights and responsibilities [Provision 24] Signatories should indicate which, if any, proxy voting adviser(s) they use, the scope of services procured and how advice/information received is used as part of the signatories' stewardship activities.
Response from advisory firms	Guidance 5-5. Proxy advisors should dedicate sufficient management resources to ensure sound judgement in the evaluation of companies and furnish their services appropriately, keeping in mind that the principles of the Code, including guidance, apply to themselves. Proxy advisors should disclose their efforts on matters such as operational structure, management of conflicts of interest, and procedures of developing voting recommendations.	Article 3j: Transparency of proxy advisors Member States shall ensure that proxy advisors publicly disclose on an annual basis at least all of the following information. ・The essential features of the methodologies and models they apply ・The main information sources they use ・Procedures put in place to ensure quality of the research, advice and voting recommendations and qualifications of the staff involved ・Whether and, if so, how they take national market, legal, regulatory and company-specific conditions into account ・The 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 ・The policy regarding the prevention and management of potential conflicts of interests (The information above shall be made publicly available on the websites of proxy advisors and shall remain available free of charge for at least three years from the date of publication.)	―	Service Providers Principle B Signatories must ensure they execute their role in the investment community in a manner that promotes and enables effective stewardship. Principle D Signatories must establish policies to manage conflicts of interest, which put the interests of clients first. [Provisions 1 to 6] ・Signatories must inform clients about the accuracy of their services and demonstrate service quality. ・Signatories should ensure their workforce has appropriate experience, qualifications and/or oversight to deliver their services. ・Signatories should disclose their conflicts of interest policy and how it has been applied. ・Signatories should establish a code of conduct.

Source: Summary made by the Financial Services Agency

II. Proxy advisors (2): Examples of disclosures based on the Japanese code (sufficient management resources)

Guidance 5-5: Proxy advisors should dedicate sufficient management resources to ensure sound judgement in the evaluation of companies and furnish their services appropriately, keeping in mind that the principles of the Code, including guidance, apply to them. (Below omitted)

ISS Compliance Statement to UK Stewardship Code (November 2017)

(Relevant section)

Concerning human resources, as of June 30, 2017, ISS' global research and data teams consisted of approximately 450 analysts, including approximately 270 research analysts and 180 data analysts, located in ISS offices in Europe, North America, Asia, and Australia. The minimum education standard for research analysts is a bachelors degree from an accredited college or university, but many ISS analysts also have advanced degrees in areas such as finance, business, and law and/or professional certifications (such as CFA, CPA, CEP).

Glass Lewis Stewardship Code Statement (revised in November 2017)

(Relevant section)

The Japanese team has approximately 30 team members working out of two offices (i.e.San Francisco and Sydney) to produce research on a nearly 24hour cycle during its proxy season. We continually evaluate the resourcing demands of each market, including Japan, based on the evolving trends and expectations in the market. We expect the staffing levels for the Japanese team to increase as our research universe and engagement demands evolve over time.

Source: Excerpts from company websites.

II. Proxy advisors (2): Examples of disclosures based on the Japanese code (engagement with companies)

Guidance 5-5: (Excerpt) Proxy advisors should disclose their approach to providing the services including the operational structure, management of conflicts of interest and developing procedures of voting recommendations.

ISS Compliance Statement to UK Stewardship Code (November 2017)

(Relevant section)

As noted above, ISS will make available to each company a copy of ISS' proxy research report on that company on request for transparency and accountability, through ICS. This is provided to companies free of charge via the Governance Analytics platform, irrespective of any client relationship with ICS. If ISS becomes aware of new and material information after a report has been published and before client voting cutoff deadlines, or where any material factual inaccuracy or error that warrants correction is drawn to ISS' attention, ISS promptly issues an Alert (i.e., an updated report) to clients. In addition, ISS provides an open mechanism for comment and input through its Feedback Review Board, which is accessible on the ISS website (www.issgovernance.com), and serves as an additional channel for any market participant to communicate with ISS regarding accuracy of research, accuracy of data, policy application and general fairness of ISS' policies, research, and vote recommendations.

Glass Lewis Stewardship Code Statement (revised in November 2017)

(Relevant section)

In 2016, the research team over 1,000 formal engagement meetings, approximately 100 of which were with Japanese issuers. The Japanese research team expects to engage with over 125 Japanese issuers in 2017. Further, the team has conducted a survey targeting Japanese issuers in 2017 to gain greater understanding of the market. As of November 20, 2017, more than 200 issuers have completed the survey. On top of these one-on-meetings with issuers, the Japanese research team also conducts numerous seminars with groups of issuers throughout the year, (omitted)

In addition, Glass Lewis has developed a data only version of its Proxy Paper research reports for subject companies (Issuer Data Report). This free service, initially offered to a pilot group of companies in 2015, allows selected companies to verify the underlying data that drives recommendations to our clients.

Source: Excerpts from company websites

III. Overview of interviews with companies (cross-shareholdings, corporate pension funds)

- Following the revision of the Corporate Governance Code in June of last year, the FSA held **interviews** with dozens of companies from November of last year to January of this year on their efforts related to **the reduction of cross-shareholdings and corporate pension fund stewardship activities.**

Reducing cross-shareholdings

[Important findings]

- Some companies are strongly pursuing reduction, led by the finance division.
- While pressing forward the disposal of cross-shareholdings, some companies experienced implicit suggestions from their counterparties of a negative impact on the business relationship as a result of the disposal.
- Business and marketing departments are apt to be reluctant toward selling off cross-shareholdings in order to maintain business relationships, and adjustments can take some time.
- Some financial institutions are reluctant to reducing cross-shareholdings due to historical business practices.

Stewardship activities of corporate pension funds

[Key answers]

- While there are no major burdens with accepting the Code, establishing an evaluation process for asset managers is an issue.
- We are preparing to accept the Code and keeping a close watch on the situations of other companies.
- We had the misunderstanding that if we accepted the Code, it would be necessary for pension funds to directly engage with investee companies. There are many corporate pension funds that have concerns about the scope and degree of stewardship activities that are expected of corporate pension funds.
- The understanding of both managers and employees that run corporate pension funds is necessary.