The Tenth Council of Experts Concerning the Follow-up of Japan's Stewardship Code and Japan's Corporate Governance Code

November 8, 2016

[Ikeo, Chairman] Although it is a couple of minutes earlier than the scheduled opening time, all prospective participants are already here. I'd like to open the tenth Council of Experts Concerning the Follow-up of Japan's Stewardship Code and Japan's Corporate Governance Code.

Thank you very much for taking the time from your busy schedule.

We have extensively discussed constructive dialogue between companies and institutional investors over the past several meetings. Today, to summarize our views, I'd like you to discuss the draft Opinion Statement of the Follow-up Council, which was prepared by the secretariat based on our discussions in the past.

Now I'd like to hand it over to a representative of the Financial Services Agency, who will explain the draft Opinion Statement.

[Tahara, Director of the Corporate Accounting and Disclosure Division, FSA] I'll explain the draft Opinion Statement in accordance with the material at your hand. The title is "Effective Stewardship Activities of Institutional Investors".

The Opinion Statement consists of 4 chapters: "Introduction", a chapter concerning asset managers, a chapter concerning asset owners, and finally "Closing Remarks".

First, let's look at "Introduction". As discussed in previous meetings, sustainable growth of companies serves as the source of wealth of the entire nation. In order for a company to achieve sustainable growth, it is important that businesses are managed from a mid- to long-term perspective under the leadership of the management team and board. To promote such business management, it is necessary to further advance corporate governance reform efforts. In response to the implementation of the Codes [i.e. Stewardship Code and Corporate Governance Code], as well as the public release of our Opinion Statement, the necessary framework for reform has been developed. The key challenge now is to deepen the reform in order for it to be substantive. This is what the members have discussed, I believe.

To this end, as discussed over the last five meetings, institutional investors need to be aware of their roles in the investment chain, and have in-depth constructive dialogue with investee companies with respect to the companies' business strategies and challenges in creating sustainable growth, taking into account company-specific circumstances and the surrounding operating environment. And this Opinion Statement offers recommendations concerning what is required from both asset managers and asset owners. These are written in "I. Introduction".

Now I'm moving on to the second chapter titled "II. Effective Stewardship Activities of Asset Managers". Institutional investors, especially asset managers who directly carry out dialogue with investee companies, should be expected to conduct effective stewardship activities based on in-depth corporate valuations and taking a mid- to long-term perspective. Furthermore, in doing so, it is important for institutional investors to make careful judgments by taking note of the particular circumstances of individual companies, instead of mechanically applying formal criteria or depending on proxy advisors.

The chapter concerning asset managers is divided into 4 sections. The first section is about "governance and management of conflicts of interest", which were extensively discussed by this Council. When asset managers undertake effective stewardship activities, it is essential for the asset managers to place priority on the interests of ultimate beneficiaries, thus ensuring that their activities are client-centered. Meanwhile, when asset managers belong to financial groups, it was pointed out that their measures to eliminate conflicts of interest are not necessarily working well, and it was suggested that they should make such efforts as improving their governance and managing potential conflicts of interest more appropriately.

Specifically, the first point made by the Council is about the enhancement of asset managers' governance. In order to secure the interests of ultimate beneficiaries and prevent conflicts of interest, asset managers should have in place such governance structures as independent boards and/or third-party committees for making proxy voting decisions and carrying out oversight. Enhancing such governance would increase the effectiveness of dialogue when asset managers discuss corporate governance with investee companies.

The second point: asset managers should identify specific circumstances that may give rise to conflicts of interest which may significantly influence the exercise of voting rights and/or

dialogue with companies, and set out and disclose specific policies on measures for avoiding such conflicts and/or nullifying the effects of such conflicts. We summarized your discussion in this way.

Please move to the third point. This point is about adequate capabilities and experience of senior management team. In the discussion of the Council, the members pointed out a concern about appointment of senior management in asset managers, which belong to financial groups: senior management personnel seem to be appointed according to the logic of such financial groups. Their senior management teams should have adequate capabilities and experience to effectively fulfill stewardship responsibilities. The team of an asset manager should also recognize that they have the responsibility to carry out the important tasks of strengthening corporate governance and managing conflicts of interest, and should engage in promoting measures to address these issues.

Section 2 is titled as “Enhanced Disclosure of Voting Results”. With the intent to enhance the visibility as to whether institutional investors properly exercise their voting rights, the Stewardship Code requires institutional investors to disclose their voting records, by aggregating them by major categories of proposals. It has, however, been pointed out that in some business segments, only a small percentage of institutional investors disclose aggregate voting results. To secure the transparency of the exercise of voting rights, it is important that asset managers carry out this disclosure.

On that basis, the members pointed as follows: to fulfill their accountability to ultimate beneficiaries and to enhance their transparency, it is important that asset managers and the like disclose their voting results at the company/proposal level. Some examples in other countries were shared. In the United States, the U.S. Securities and Exchange Commission (SEC) rules on investment funds require disclosures of voting results at the company level; and in the UK, for the purposes of enhancing accountability and managing conflicts of interest, institutional investors’ company-level disclosures of their voting results are not uncommon.

Please turn to the next page. As shown in these overseas examples, company-level voting disclosure can be considered an effective way of ensuring that asset managers and the like exercise their voting rights truly in the interest of ultimate beneficiaries. Moreover, such a practice where asset managers and the like clearly explain in public their reasons for voting

“for”, “against” or “abstain” can contribute to increasing transparency.

On the other hand, some argued that it is sufficient that company-level voting disclosures be made to pension funds and other asset owners who have given mandates to asset managers. However, the ultimate beneficiaries of asset owners consist of a wide range of individuals, including pensioners. In many cases, it could be said that ultimate beneficiaries, including potential beneficiaries, are the Japanese citizenry itself. Besides, in order to dispel concerns about conflicts of interest, it was argued that asset managers should move toward company-level disclosures of voting results.

Therefore, in order to secure the interests of ultimate beneficiaries, and to enhance the transparency, both asset managers and asset owner should make it a general rule that they disclose company-level voting records to the public, not merely to asset owners, at a minimum based on a ‘Comply or Explain’ approach. We summarized your discussion in this way.

Section 3 is about “Engagement in Passive Management”. While passive management has recently constituted an increasing proportion of investing, passive managers have limited choices in terms of selling shares of investee companies and greater need to facilitate increases in corporate value over the mid- to long-term. Accordingly, asset managers and the like should conduct engagement activities (dialogue) more proactively and exercise voting rights from a mid- to long-term viewpoint.

From the perspective of enhancing effectiveness of passive management, it was also pointed out that relevant parties are expected to consider removing stocks which are deemed obviously inappropriate for investment from their passive index.

Section 4 is about “Self-Evaluation of Asset Managers”. Asset managers should regularly conduct self-evaluations of their implementation of the Stewardship Code and disclose the results to the public. Examples in the UK were introduced to the Council. Such self-evaluations are expected to help asset owners select and/or evaluate asset managers.

Now I’m moving on to Chapter III on page 5, which summarized what was discussed with regard to asset owners. In the investment chain, asset owners are positioned closer to ultimate beneficiaries and have a direct responsibility to secure the interests of the ultimate beneficiaries. Taking this position into account, asset owners need to move forward with the following efforts. We classified such efforts into three sections.

Section 1 is titled as “Asset Owners’ Initiatives to Ensure Effective Stewardship Activities”. Asset owners should conduct their own stewardship activities to the greatest extent possible in order to secure the interests of ultimate beneficiaries. Furthermore, in cases where they do not conduct stewardship activities involving their direct exercise of voting rights, they should require asset managers to carry out effective stewardship activities. The next paragraph summarized the Council’s point of view in this regard for confirmation. We also added the members’ input in the last paragraph: asset owners should realize that asset managers have stewardship responsibilities not only to the asset owners, but also to other clients and other ultimate beneficiaries.

Section 2 is titled as “Clarifying What Asset Owners Expect from Asset Managers”. To ensure that stewardship responsibilities are fulfilled, when selecting and/or issuing mandates to asset managers, asset owners should clearly specify issues and principles with regards to their expectations for asset managers vis-à-vis stewardship activities, including the exercise of voting rights. Large asset owners especially should articulate the stewardship issues and principles, including the exercise of voting rights, and proactively include their own considerations.

Section 3 is about monitoring of asset managers in terms of progress of the above-mentioned requirements. Asset owners should effectively monitor asset managers to ensure that their stewardship activities are aligned with their own policies, making use of the asset managers’ self-evaluations. We also added the following input from the members: in conducting such monitoring, it is important to look at the quality, instead of merely checking the formality.

Lastly, I’ll explain Chapter IV “Closing Remarks”. In the first half, we once again referred to significant roles of asset managers and asset owners, which were also written in the “Introduction”. We articulated our expectation that ‘constructive dialogue’ and efforts to deepen such dialogue will contribute to realizing a virtuous cycle for the entire Japanese economy.

We prepared this draft, believing that recommendations herein are important for institutional investors in order for them to effectively perform their stewardship responsibilities. It has been three years since the Stewardship Code was established – meaning that it is time for

reviewing the Code as originally planned. Therefore, we concluded that the Follow-up Council expects that the Stewardship Code will be reviewed/revised, taking into account this Opinion Statement together with international discussions on stewardship responsibilities as well as practices of the Code.

That's all for my brief explanation of the draft Opinion Statement. Thank you very much.

[Ikeo, Chairman] Thank you very much. I'd like you to make comments on the draft Opinion Statement, which the secretariat just explained. Mr. Toyama and Mr. Nishiyama submitted their opinion statements, which are distributed to you today. As the secretariat already sent the copies to the members in advance, I will not read them out here, but please take their opinions into account during the discussion, as necessary.

Furthermore, although Mr. Kawamura, Mr. Kanda, and Mr. Tanaka are absent today, we received their comments that they agree with the draft Opinion Statement.

Now I'd like to hear your comments. You can express your views on any part of the draft, but I'd like to suggest that we will start from matters concerning asset managers in the first half.

I mean – although you can make comments on any parts of the draft, but in terms of the sequence of chapters, the draft describes opinions about asset managers first, and then about asset owners. So what about discussing asset managers first?

Professor Kawakita, would you like to start?

[Kawakita, member] It is not specifically about asset managers, but I think it would be appropriate to talk a little about the entire structure of the Statement. Although the quality of dialogue is discussed throughout the draft Statement in the first paragraph of Chapter II, it refers to "in-depth corporate valuations and taking a mid- to long-term perspective." Then, in the body of this Chapter, Section 1 discusses conflicts of interest or asset managers' governance, and Section 2 goes straight to the issue of proxy voting. I got an impression that the explanation lacks step by step details. First, we should discuss the quality of dialogue. To exercise voting rights, they need to have dialogue with investee companies – not just dialogue, but high-quality discussion, including in-depth evaluation of companies, which is referred to in the draft. We should make this point first. So I suggest a change of the flow: dialogue is included in the process of proxy voting, and leads to desirable proxy voting; then what should

be discussed and how in such dialogue? The Opinion Statement should articulate our discussion on the quality of dialogue in this way.

As a flow of dialogue, for instance, in order to secure the level of ROE, which satisfies investors, over the long-term – although I don't mean to take sides with the Ministry of Economy, Trade and Industry, and also to increase corporate value, it is necessary to increase sales. Therefore, specifically, although circumstances vary from investor to investor, for instance, they need to consider how to increase amount of sales or profit rate per product/service, and how to maintain/enhance highly profitable business segments. For such purposes, they may need to expand overseas, and develop strategies for capital investments, research & development (R&D) investments, and M&A. The Opinion Statements should describe or discuss these points first. Although the draft refers to capital investments and R&D investments, which I just mentioned, in Chapter III, Section 1 on page 5, these points should be taken into account.

Conversely speaking, what should they do with unprofitable business segments? Do they sell such segments? And what do they consider their target capital structure to be? In this connection, what about their target payout ratio? And how do they regard it in the context of segment strategies or capital structure? According to a certain prominent investor, when companies increase in capital, investors, for instance, need to ask the reasons for the capital increase or take other actions in response. Although Chapter III, Section 1 on page 5 somewhat refers to these points, it would be desirable, if such things were added between Section 1 and Section 2 of Chapter II. As a result, the quality of dialogue will be secured, and subsequent proxy voting will be more meaningful. Unlike just casting "for" or "against" votes, I think companies can reflect what they learned from dialogue to their corporate management. Then, there will be no such situation where companies are surprised at "against" votes upon disclosures.

For your reference, on June 1, Professor Kanda made a comment on conflicts of interest in connection with proxy voting, placing an emphasis on the process of dialogue. Furthermore, several top managers of companies mentioned, "proxy voting without quality dialogue seems nothing but a noise." So I wanted to make comments on the structure of this Opinion Statement.

That's all.

[Ikeo, Chairman] All right?

Please go ahead.

[Era, member] I would like to make comments on the overall structure of the Opinion Statement and the discussion process, as well as the enhancement of asset managers' governance.

The draft Opinion Statement is highly influential therefore I feel that we should take more time to discuss the effectiveness and impact of the practices mentioned in the statement, based on evidence, and clearly sort out the merits and demerits before publishing the Statement.

Moreover, as highlighted in the Statement, I believe that moving the focus to 'Substance' from 'Form' is an important point in order to deepen the governance reform. In that sense, I believe it is extremely important to inform the broad audience of our discussion process upon reaching to a certain conclusion, including the merits and demerits which I mentioned earlier, as well as the objectives and background of these discussions, in order to ensure 'Substance'. Therefore, I'd appreciate it, if you added such supplementary descriptions.

Next, I'd like to talk about the section on the asset managers' governance. It is obvious, that asset management companies must fulfill their responsibilities, putting clients' interests first, and strengthen their governance structures. Furthermore, it is essential to manage conflicts of interest properly. Meanwhile, with regard to specific measures to achieve such purposes, it is essential to consider the necessity and the effectiveness of such measures, taking into account diverse situations, such as capital ties and business structures. I believe that such considerations would further enhance the effectiveness of such efforts. Accordingly, as for specific measures, such as the establishment of an independent board or third-party committee for decision-making or supervision of proxy voting, which were explained by the secretariat as examples, I feel it is more appropriate to merely introduce such specific measures as examples in the Statement. That's all.

[Ikeo, Chairman] Mr. Iwama, please.

[Iwama, member] I'd like to talk about asset management companies' governance, and proxy voting. Before that, I'd like to respond to Professor Kawakita.

I understand his point, but basically, in engagement activities, agenda-setting should be

done by players who actually make investments. Selection of agenda should be free and broad. Matters raised by Professor Kawakita would be naturally included in such agenda. Rather, it is expected that investors observe and evaluate whether individual asset management companies can do that, so I don't think it is appropriate to stipulate too many details in the Opinion Statement.

Another point is about asset management companies' governance. I consider that in the background, there is a public image that governance of asset management companies is rather poor, and structures which generate conflicts of interest are left uncontrolled. I do think that asset managers should take it seriously. In this regard, as Mr. Era mentioned, the essential point would be how each asset management company can explain it under its own circumstances. Concerning such measures as ensuring whether the board properly performs supervisory function, establishing a body to check whether the structure of conflicts of interest is turned into reality, or monitoring the independence of proxy voting decisions, I think we should respect asset management companies' autonomy in management in terms of how they explain such measures under their own circumstances. Then what form is desirable? That should be seriously considered by individual companies. As pointed out earlier, it would be appropriate that the said measures are introduced as examples.

Concerning the issue of proxy voting, based on insights gained from our long history, I consider that situations are very different between cases under discretionary investment management contracts and cases of publicly offered investment trusts. In the case of publicly offered investment trusts, as stipulated in the SEC's rules, I understand it is a global trend that company-level voting disclosures are considered to be appropriate. Many asset management companies are doing businesses both in investment trusts and discretionary investment management. In that sense, if company-level voting disclosures are deemed appropriate for publicly offered investment trusts, you might think that almost all asset managers will disclose proxy voting results at the company level, but in reality, in cases under discretionary investment management contracts, they take actions based on views of individual asset owner clients. Accordingly, some asset owners may prohibit company-level voting disclosures, stating that such disclosures constitute breaches of confidentiality. That's the current situation. We are aware that how to cope with it is a big challenge.

Therefore, our Association instructed our members to establish and announce guidelines concerning voting disclosures. We also conduct an annual survey of proxy voting, aggregate and disclose the results. We make aggregated disclosures for the above-mentioned reasons. Of course, if we are told by individual asset owners to disclose voting results at the company level, we will do so. Therefore, we do not rule out company-level voting disclosures, but if company-level voting disclosures are uniformly required, we need the coordination with asset owner clients to some extent. So under the current circumstances, we believe what we are doing now is the greatest possible effort, although the future direction is another story. As I mentioned in the previous meeting, I do understand that the global trend is moving toward company-level voting disclosures.

[Ikeo, Chairman] Thank you very much.

Dr. Ueda, please.

[Ueda, member] Thank you. First, I'd like to express my view of the overall structure of the Statement. Some members have referred to the quality of dialogue. I'll leave aside the question of individual agenda. Although Principle 7 of the Stewardship Code stipulates obligations to make efforts to improve the quality of dialogue, I consider that it would be better to add more specific descriptions: for instance, devoting resources – human resources or budgets, in order to strengthen this aspect. In addition, the current Code describes collective engagement in a very vague way. Accordingly, when investors are moving in that direction, some investors interpret the Code in a conservative way, stating "We should not do things which are not written in the Code." Therefore, I feel that the Code could describe the collaboration of investors more clearly, suggesting that collective engagement is one of the engagement methods. In other words, the Code could provide another tool for improving the quality of dialogue.

Now, I'd like to make some comments on the specifics of the draft Statement.

First, I'd like to refer to "Asset Managers' Governance and Management of their Conflicts of Interest" on page 2. I assume that this Section is based on the premise that, in Japan, many asset managers belong to financial groups, and thus conflicts of interest are inherent. Although this Section is intended to ensure that asset managers within financial groups operate independently and properly, it looks like placing an additional burden – or pressures if you'll

excuse the expression – on such asset managers for the sake of the management of conflicts of interest. What is important here is the fact that roots of conflicts of interest lie in client companies outside financial institutions. There may be some inappropriate pressures from them. Because conflicts of interest will not be generated without such pressures, there may be some pressures or there may be people who consider there should be pressures. Then, at the same time we recommend that asset managers under pressures from client companies or financial groups should make efforts toward managing conflicts of interest, we should also suggest parties which put pressure on them – specifically a parent company of a financial group, or client companies outside the group – to have an awareness of asset managers' fiduciary duties and stewardship responsibilities. It may be difficult to stipulate it in that way in the Code itself, but our Opinion Statement could require such pressure parties to raise awareness, I think.

In this connection, please look at page 5 of the draft prepared by the secretariat. In the paragraph starting from "Moreover", it is stated that an asset owner should realize that assets under management also include monies of other asset owners. For example, in case assets under management of a corporate pension fund are held in a aggregated account, if the funds place a pressure for a specific instruction or proxy voting decision in its favor, other clients in that account will be also affected. I suppose that the said paragraph includes such an example case. This would also be from a perspective of relations between a financial group and external clients.

Next, I'd like to talk about disclosure of voting results on page 3. I think this part would be the most controversial. In the last sentence of the first paragraph, it is written that "it is important carry out this disclosure". I understand that it refers to "some business segments". For such business segments which have not even disclosed aggregated voting results, I recommend that we change the wording from "it is important…" to "should disclose".

This is related to the next sentence which ends with "taking a step forward from aggregate voting disclosures." It reads, "it is important that institutional investors… disclose their voting records at the company/proposal level." Both expressions are "it is important…" It would be better to clarify the sequence. First, asset managers, which have not yet made aggregate disclosure of voting results, should make disclosures. In addition, if it is deemed strategically

necessary for some asset managers to make company-level voting disclosures, it is important for them to do so. I believe that the logic should be articulated this way.

Next, I'd like to refer to investment trust funds in the next sentence. My understanding was that since there are individual investors behind the funds, company-level voting disclosures are necessary for dissolving the issue of information asymmetry. However, when I talked with asset managers, they asked me, "If individual disclosures are required, when an asset manager manages 100 funds, will it be required to make disclosures of each fund?" Instead of such fund-level disclosures, we expect them to make judgments based on their policies – stewardship policies – of asset management companies. I think it is necessary to sort out practical matters.

In this regard, I'd like to refer to discretionary investment management with asset owners. There are cases where asset management companies make voting decisions in accordance with their own policies, and cases where they exercise voting rights in accordance with clients' instructions or proxy voting guidelines. In the latter cases involving clients' decisions, without giving consideration to the wishes of and relationships with their clients or asset owners, I don't think that asset managers can discretionally disclose voting results which involved their clients' decisions. Concerning asset owners, on page 4, it is written that asset managers should make disclosures to secure the interests of ultimate beneficiaries. I understand it, but in this context, it can be interpreted that asset owners do not have to make disclosures primarily. In this logic flow for securing interests of the ultimate beneficiaries, when it is stated in the latter part that asset owners play a key role in coordinating their interests, readers may consequently wonder what asset owners are supposed to do. Whether it is to be written in the Code, and what should be the nominative of the sentence - institutional investors or asset managers, are technical issues, but I'd like to know the view of the secretariat on what asset owners should do in this context.

Also on page 4, in the second paragraph of the section of Engagement in Passive Management, there is a sentence in the second paragraph, which concludes that passive managers "should conduct engagement activities (dialogue) more proactively and exercise voting rights…" I feel that this expression should be changed to a milder one – for instance, "it is important to note that some argue…" or "it is important to note that some pointed out…"

This is because one of advantages of adopting the passive strategy is often said to be its low costs. If they must conduct engagement activities, the premise of passive strategy will break down: they can no longer enjoy low costs. Then who bears such costs? Asset managers bear the costs? Asset owners do? In case of investment funds, individual investors bear the costs? If we conclude that they "should conduct engagement activities (dialogue)" without sorting out this issue, there will inevitably remain the cost issue facing asset management companies. That needs further discussions.

In this regard, as the secretariat's draft also refers to it, ICGN has the Model Mandate Initiative, which is like principles compiling model contract terms between asset owners and their asset managers. In the Model Mandate Initiative, it states that if asset managers alone must bear the costs, asset management business itself will no longer be viable. Excellent players will run out of business, and that will not be an advantage for asset owners. So ICGN recommends that parties involved should thoroughly consider the cost sharing. Especially, in the case of passive management, there is a potential conflict over the costs. In this context, I suggest that we should refer to the costs in the Statement – something like "should consider the costs" or "asset owners or individual investors should also have awareness" of the cost issue.

I'm sorry for taking a long time. Finally, I'd like to refer to Self-Evaluation. Similarly to board evaluations of the Corporate Governance Code, I think self-evaluations of asset managers are important, but probably difficult to conduct. So I introduced the self-evaluation sheet developed by the UK's National Association of Pension Funds. Some prepared and used the Japanese version of the sheet. In addition, I'd like to share another practice in the UK. Asset management companies in the UK publish Stewardship Reports, which have a characteristic of annual reports on stewardship activities. In the Reports, they provide specific details of their proxy voting activities and dialogue. Currently, I think that Japanese asset management companies also make disclosures of such information, but files of such information are scattered across their websites. If they compile and report such information in a structured manner, such a process will be a kind of self-review. And by the external use of such reports, investment funds can directly report to individual investors, and provide them to asset owners for the purposes of explanation and report. So I consider that such reports would be useful, and wanted to share such efforts with you.I'm sorry that I took a long time. That's all.

Thank you.

[Ikeo, Chairman] Mr. Oguchi, please go ahead.

[Oguchi, member] Thank you. Today's topic is "constructive dialogue" between companies and institutional investors, and I believe that everyone takes a positive stance on "dialogue", which is the keyword. I consulted the *Kojien* dictionary to check the definition of "dialogue". The term is defined as a face-to-face conversation between two (or more) people or groups. The term "dialogue" has an implication that both parties are on equal footing, with no dominance of one side. I realized anew that the term would be, therefore, easily accepted by both investee companies and institutional investors. In such a situation, the Follow-up Council had several meetings. The first half of the meetings focused on securing transparency and accountability – which may be required more for listed companies, and published the in-depth Opinion Statement concerning corporate boards, especially their independent supervisory responsibilities, as stated in "Introduction" of today's draft. Given that the Follow-up Council made such recommendations to companies, it is quite natural and appropriate to require institutional investors to ensure the transparency and accountability, since they are counterparties of dialogue and on equal footing. I would say that it would not be fair, if the Council did not present recommendations to institutional investors as well.

Looking at the draft Opinion Statement in this context, leaving aside the exact wording, it refers to the enhancement of asset managers' accountability and governance. As stated in Chapter II, Section 1 (1), obviously such efforts are necessary for building trust in asset managers, increasing the effectiveness of dialogue, and earning trust from companies. As for company-level disclosures of voting results, there may be diverse opinions, but such disclosures are already put into practice in other countries, as an effective way to dispel concerns about conflicts of interest. Someone mentioned earlier that we need to have a discussion based on evidence. Certainly, since such disclosures are not made in Japan, you might think there is no evidence. Meanwhile, as shown in examples in the UK and the US, which are a step ahead, and as expressed in the view of ICGN, an organization of international institutional investors, other countries already have experience with such disclosures. Although there may be various problems, in general, such disclosures are deemed effective for dispelling concern about conflicts of interest, and enhancing the transparency.

Concerning company-level disclosures of voting results, we are talking about making it a principle: since it is a principle based on 'Comply or Explain' approach, the compliance is not mandatory. When we talk about securing transparency, the same level of transparency as required of companies, is required of institutional investors. If it is not appropriate under specific circumstances of investors, or if non-compliance with the principle of company-level disclosures rather secures the interest of clients or beneficiaries as Mr. Iwama mentioned earlier, they are expected to explain such reasons for non-compliance, thus fulfilling their accountability. I believe that applying 'Comply or Explain' approach to such disclosures would be convincing.

I also think about potential cases of choosing 'Explain'. For example, one of such cases is disclosures by concentrate funds: while they make investments by selecting stocks, company-level disclosures of voting results will constitute disclosures of their holdings, and may adversely affect their investment management. Actually, I could not think of other cases. In this example, however, they do not disclose the number of holdings. They disclose names of holdings in the past, when disclosing voting results. They do not disclose current holdings, so there may not be a big problem. Another potential reason for non-compliance would be lack of resources among smaller companies. Resourceful asset managers, including passive managers, hold wide-ranged securities. Therefore, frankly, I can't think of disadvantages of disclosing individual names of their holdings.

Foreign pension funds, which are our clients, disclose their proxy voting results at the company level, including those for Japanese equities, on their websites. I checked their websites this morning, and confirmed such disclosures. While we have extensive dialogue with companies, in which our clients invest, we are often told that, frankly, they have not experienced any situation where such disclosures posed an obstacle; and that during actual dialogue between institutional investors and companies, the companies would appreciate it, if the investors clearly communicated their voting results. Of course, the companies prefer to be clearly informed of the facts. Although this is an example from my limited experience, frankly speaking, I don't understand what disadvantages they may have as a result of company-level disclosures. Therefore, I believe that we should establish a principle of such disclosures, leaving an option to choose to explain non-compliance for special reasons.

Someone earlier referred to collective engagement. I'm actually involved in collective engagement, so I'm in a position to support it. However, I'd like to share my insight of risks associated with collective engagement. Inevitably, agenda tends to be merely formal. When multiple investors participate in collective engagement, not all of them have enough understanding of investee companies. Accordingly, they have dialogue by setting formal agenda, especially outstanding agenda. Then, as Professor Kawakita and Mr. Iwama mentioned earlier, while we discuss how to improve the quality of dialogue, or consider that engagement varies from company to company, from asset manager to asset manager, such discussions will not be applicable to collective engagement. While the Stewardship Code stipulates "constructive engagement, or purposeful dialogue, based on in-depth knowledge of the companies and their business environment", collective engagement is conducted by multiple institutional investors, and thus tends to become merely formal. Unless consideration is given to this point, even though investors without in-depth knowledge of companies get together for certain agenda and express their views, the companies may feel that they are just noises, as Professor Kawakita mentioned earlier. There is such a risk. We need to logically organize the said point. Then collective engagement may be an option. However, if we recommend collective engagement without addressing the said issue, despite the fact that we have been discussing the shift from 'Form' to 'Substance', there will be a risk of pushing the focus back to 'Form' instead of 'Substance'.

That's all.

[Ikeo, Chairman] Mr. Uchida, please.

[Uchida, member] Thank you. I'd like to make three points. The first point is about enhancing asset managers' governance. Securing interests of ultimate beneficiaries and preventing conflicts of interest are obvious things to do, and I agree that the Opinion Statement refers to them. As for specific measures to this end, each asset management company is expected to use its creativity. Therefore, other measures should be of course allowed than introduction of independent board members or third-party committees as written in the draft. In this regard, my view is the same as Mr. Era's and Mr. Iwama's: specific governance structures written in the draft should be treated as examples, and we should insert the term "for example" here, similarly to the presentation by the secretariat.

My second point is about enhanced disclosure of voting results. In the third paragraph on page 4, there is an assertion that they should make it a general rule to disclose company-level voting results to the public. Certainly, from the perspective of accountability to ultimate beneficiaries, I think it is very important to enhance transparency of proxy voting by institutional investors. On the other hand, as mentioned in the last meeting, it is natural that institutional investors make voting decisions, which do not conform to their proxy voting standards, as a result of constructive dialogue with investee companies, instead of formally applying such standards. In such cases, if they make company-level voting disclosures to the public – people who are not involved, it is highly likely that only the voting results got attention, and institutional investors are criticized or required to provide explanations, which incur costs.

Accordingly, to avoid such criticism or demand for explanations, issuing companies are concerned that when exercising voting rights, institutional investors may become stuck to proxy voting standards for form's sake, not based on constructive dialogue. Issuing companies are worried about that. It runs counter to the corporate governance reform that moves from 'Form' to 'Substance', and may hamper constructive dialogue between investors and companies, which these two Codes call for, so we should be careful about this point.

Another point. If it is disclosed to the public that a highly influential institutional investor voted against a proposal of a certain company, it may provoke speculation that the institutional investor will sell its shares of the company before very long. I'm afraid that individual investors are likely to be influenced by such speculation. Although I cannot tell if such influence is good or bad for them, there is such a concern. We should assume such a case.

Next, as described in the last paragraph on page 3, it is investment companies that are required to disclose proxy voting results at the company level even in the US. The target is limited to investment companies, etc. which are registered with the SEC. Therefore, as for the scope of institutional investors which are required to make company-level disclosures, I think it is necessary to consider the scope, taking into account their fiduciary duties and differences in business types. Due to such concerns, I believe that we should devote more time to thorough discussions concerning disclosures of proxy voting results to the public.

Thirdly, as I believe that this Opinion Statement will have a significant impact, I'd like to

refer to details on Section 2 on page 3. In the first paragraph, it is written that "the Stewardship Code requires institutional investors to disclose their voting records, by aggregating them by major categories of proposals" and refers to an excerpt from Guidance 5-3 of the Stewardship Code in the footnote. Actually, if you look at the Stewardship Code, this Guidance is followed by a long conditional statement, concluding that if there is an appropriate disclosure approach other than aggregated disclosure, investors may choose such an approach while explaining the reason. I was not involved in the process of establishing the Stewardship Code, so this is just my assumption: I assume that this long statement is added as a result of extensive discussions. Therefore, in my opinion, it is problematic to quote only a part of the Guidance in our Opinion Statement without the conditional statement.

That's all.

[Ikeo, Chairman] Ms. Takayama, please.

[Takayama, member] I'd like to make some comments on company-level voting disclosures. I'd like to provide a supplementary explanation of overseas situations, in addition to what is referred to in the Opinion Statement, and express my understanding of the current state in Japan.

First, in the UK, as written in the footnote No. 3 on page 3 of the draft, many institutional investors have already made company-level voting disclosures. According to our research, it was confirmed that major pension funds and major asset managers make company-level voting disclosures, so I think company-level voting disclosures is the best practice among major investors in the UK. In the US, major pension funds, including CalSTRS, which participated in the telephone conference with us the other day, CalPERS, and TIAA, have made company-level voting disclosures. On the other hand, it seems that asset management companies have not yet significantly moved in that direction compared to such pension funds. Nonetheless, as discussed earlier, under the SEC's rules, investment funds [i.e. mutual funds] have already made company-level voting disclosures. You might think that because only investment funds are in the scope, the number of company-level voting disclosures is rather small. However, sources of equity investments in the US are roughly divided into two groups, namely investment funds and pension funds. In terms of the investment amount, investment funds account for roughly 60%, while pension funds account for 40%. Investment funds

disclose their voting results at the company level. That's the situation. Moreover, many asset managers are engaged in asset management of both pension funds and investment funds. The investment funds include many index funds. In case of index funds, company-level voting disclosures means disclosing voting results for major companies or virtually almost all companies in the index. I think this is the situation facing US investors.

As I just mentioned, company-level voting disclosures have been increasingly becoming common in Europe and the US, and I understand that major investors there have already established governance structures for securing interests of ultimate beneficiaries.

Looking at the situation in Japan, I think that company-level voting disclosures have both advantages and disadvantages. In order to minimize disadvantages and enjoy advantages to the maximum extent, an enabling structure is required. That is exactly the focus of this Council – specifically, enhancement of asset managers' governance, and management of conflicts of interest. If a shift to company-level voting disclosures is made only after asset managers establish such structures, advantages from company-level voting disclosures will be enjoyed to the maximum extent, in my opinion.

That's all.

[Ikeo, Chairman] Thank you very much.

Mr. Iwama, would you like to make an additional comment? Please.

[Iwama, member] I'd like to clarify my position toward or view of company-level voting disclosures once again, and also talk about some technical issues of investment trusts, which were pointed out by Dr. Ueda.

We are not in a position to oppose company-level voting disclosures. What I'm saying is that when asset owners provided us with discretionary investment contracts, we cannot make such disclosures without permission of the asset owners. Our Guidelines do not exclude company-level voting disclosures. However, since long time ago, we have been considering that it is necessary to inform broad public of proxy-voting activities of our members, and thus encouraging them to disclose voting results annually. As shown on our website, we have relevant Guidelines, which include a table showing reporting standards as the attachment. This is our minimum requirement. Of course, if our clients require us to make company-level voting disclosures, we are supposed to do so.

Therefore, what I'm saying is that these points should be sorted out and described in the Statement. At least, in case of discretionary investment contracts, I believe that it is necessary to clearly sort out the position of asset owners and the position of asset managers as their agents.

Now I'd like to talk about the issues of investment trusts. Certainly, disclosure of voting results for each fund requires significant time and effort, which is not surprising. Cost will significantly offset revenue, and investments trusts will not be able to stand it. There are many investment trusts in Japan, and even large-sized funds do not really generate revenue which commensurates with the size. So I'm afraid that it is likely to cause a serious problem. Considering the global trend, however, I believe that we should move toward company-level voting disclosures. Nonetheless, I'm not in a position to represent investment trusts, so I'm not sure whether it is appropriate to make such a comment. I think we should explore feasible ways, using creativity.

[Ikeo, Chairman] Mr. Tsukuda, please.

[Tsukuda, member] Thank you. I cannot agree more with what Mr. Iwama just mentioned. I'd like to make two comments.

My first comment is about "Section 1. Asset Managers' Governance and Management of their Conflicts of Interest". As Ms. Takayama mentioned earlier, I believe that both enhancing governance and managing conflicts of interest are very important elements, and I have no objection to what is written in the draft. As the third element, it refers to "adequate capabilities and experience". As an expert in this area, I have plenty to say, but I think it is all right to describe it in this way. The important point here, however, is that both "(1) Enhancement of Asset Managers' Governance" and (2) Management of Conflicts of Interest will not be promoted without "(3) Securing Adequate Capabilities and Experience". I'd like to point out such a relationship among these three elements.

Accordingly, what are these adequate capabilities and adequate experience? Probably, we do not have to show examples. Rather, it would be extremely important that each asset management company or each financial group has internal discussions in this regard. Personally, I'd like them to have at least three capabilities. The first one is conceptual ability. In this rapidly changing world, I believe that conceptual ability is extremely important for

considering how to make Japan's asset management industry globally competitive. As stated in the "Report of the Working Group on Asset Management" which Mr. Tanaka also referred to during the last meeting, considering the current position of Japan's asset management industry, I believe that conceptual ability is indispensable. The second one is ability to make changes, challenging conventional ways of doing things. This is also essential. Lastly, the third one is courage. As another member mentioned earlier, it is no surprise that senior management is criticized from the outside, especially in the Japanese culture, and it may hold them back. To achieve big objectives, senior management needs to carry out things decisively. So the courage would be important. When we discuss what capabilities and experience would be appropriate in the future, I'd like you to consider these elements.

My second point is related to the first one. In the third paragraph on page 4, the sentence starting with "Therefore" stipulates that asset managers should make it a general rule that they disclose company-level voting results to the public, not merely to asset owners, based on 'Comply or Explain' approach. I personally support this context. Whether to comply or explain reasons why they cannot comply should be judged by asset managers' senior management team, or the top management. Without discussing such a basic policy, we cannot expect the growth of the asset management industry. In that sense, it would be very meaningful to provide such a direction, under the principle stipulating that such disclosures are to be promoted by considering how to make it feasible as Mr. Iwama mentioned earlier, how to reduce burdens on asset management companies, while making it a principle that basically such disclosures are up to asset managers' decisions.

That's all from me.

[Ikeo, Chairman] Thank you very much. As some members already expressed their views more than once, now we can talk about the latter half of the draft, concerning asset owners, as well.

Mr. Kawakita, please.

[Kawakita, member] I raised my hand, because discussion on Chapter II is almost over. I do not have anything special to share with you as far as the governance issue, conflicts of interest, and voting disclosures are concerned, and I'll leave these issues to other members. I just want to express my view concerning passive management.

My conclusion is the same as what Dr. Ueda mentioned earlier. The nature of passive management is that passive managers trust efficient price formation function of the market, and do not actively manage funds, thus enjoying the benefit of low costs. This is the essence, but it does not negate dialogue or proxy voting in order to increase the efficiency. However, to carry out such dialogue or proxy voting, passive managers need to consider how they deal with companies, which they found inappropriate through such activities. In this regard, the Statement refers to, as an example, possible exclusion of stocks, which are deemed inappropriate for investment, from the universe. So I think the discussion in the draft would be OK.

However, as for wording of the text, I agree with what Dr. Ueda mentioned. On the one hand, the Statement asserts that they should engage in dialogue and proxy voting. On the other hand, the wording is milder for the removal of inappropriate stocks, just requiring consideration. I feel there is an imbalance. This is related to the next opinion concerning asset owners. Currently, many passive managers use TOPIX as their index. TOPIX includes roughly 2,000 companies. It would be impossible to have real dialogue with that many companies, nor exercise voting rights in a real sense, since it will be too costly. According to investee companies, after the establishment of the Stewardship Code, they sometimes wasted time on ineffective meetings with incompetent institutional investors, and thus feel dialogue is not very meaningful. Therefore, although passive managers could have dialogue or exercise voting rights, then what is passive management in such situations? Although mutual funds disclose voting results in the US, I don't think that a passive management portfolio includes several thousands of companies. I understand that the number is several hundreds. We should consider this point more seriously. This is my first point. Mr. Nishiyama also made a similar point, referring to JPX400. We still need to discuss this point.

As Mr. Chairman said it is OK to talk about asset owners, I'd like to make some comments about the chapter concerning asset owners. On page 5, it is described that asset owners should conduct their own stewardship activities to the greatest extent possible. If they really conduct such activities as dialogue and proxy voting, it will incur significant costs. Even if the scope is limited to JPX400, they will need to have dialogue with 400 companies. How will they address the cost issue? The cost issue is a big issue. Nonetheless, at the moment, asset management

companies must solve the issue by themselves. I heard from representatives of asset management companies that they have a serious doubt about how they can conduct such activities with the current level of fees. However, they cannot discuss the issue with their clients. Therefore, I suggest that the Statement should refer to the issue of costs, or fees in the last paragraph of Chapter III, Section 1 – specifically, in the sentence which reads "asset owners should … pay attention not to interfere with appropriate activities of the asset managers."

That's all.

[Ikeo, Chairman] Thank you very much.

Mr. Era, please.

[Era, member] Thank you. Regarding the company-level vote result disclosure, various merits and demerits were pointed out in this meeting and also at previous meetings. I believe several members including myself expressed concerns about demerits, such as potential compromise of the substance of dialogue, by pointing out, for example, the risk of promoting proxy voting for form's sake. My point is that company-level disclosure have been controversial, therefore I suggest that the Statement should clearly describe this fact.

I feel that such an expression of "make it a general rule" is too strong given the fact that there were mixed views regarding this point. I also think a more detailed discussion on this point is required.

Now allow me to go into the details. The Statement refers to the survey results by the UK's Investment Association. I reviewed the original report, and found that the Association sent the survey to 288 companies, which signed up for the UK's Stewardship Code, and the response ratio was 45% - meaning only 130 companies responded to the survey. Out of those respondents, 59 companies disclosed their proxy voting results, and three-fourth of them made company-level voting disclosures. I assumed this was the reason why the Statement draft used such an expression as "not uncommon". However, whether company-level vote result disclosure practices are mainstream or common, still seems debatable even in the UK. That's all about company-level voting disclosures from me.

Now I would like to comment on the second half of the Statement, on the point regarding "clarification of what client asset owners expect from asset managers". I believe it is important

for asset owners to properly evaluate and encourage asset managers' stewardship activities. Some members pointed out that the evaluation needs to take into account the cost associated with engagement activities in passive management. I also believe it is important to properly evaluate stewardship activities, taking into account the costs and characteristics of their investment strategies and approaches, including passive.

Furthermore, I would like to note that asset managers have already made efforts. Many asset managers have voluntarily and actively conducted stewardship activities, making the best use of capabilities and strengths of their management approaches. Furthermore, since the establishment of the Stewardship Code, more asset managers have each pursued their own initiatives, thus the entire industry has been moving in that direction.

I believe that such voluntary nature of these efforts are extremely important in securing 'Substance' of the stewardship activities. Therefore, I hope that the existing activities, practices and efforts will be sufficiently considered, and that, if possible, we clearly note about such efforts and consideration in the Statement. And as a result of such consideration of these voluntary efforts by the asset managers, it is also possible that asset owners reach to a conclusion which the asset managers' policies are the best, and it would be best to simply accept the current policies and practices. I suggest that we use a wording which allows such conclusion. To be more specific, page 6, there is a clause stating "instead of mechanically accepting asset managers' policies". Readers of this clause may interpret it in the following way: acceptance of the existing policies is not desirable. So if we add a supplemental explanation, the intent will be properly understood.

That's all.

[Ikeo, Chairman] Thank you very much.

In response to your discussions, I'd like share my views as well, although I usually do not express my views here. I agree with the view that it is important to aim at improving the quality of dialogue, and consider that Professor Kawakita made a valid point at the beginning of this discussion session. However, I agree with Mr. Iwama's opinion. For example, describing in the Statement such suggestions that institutional investors should discuss how to increase revenue, discuss capital policy, or discuss payout policy, seems as if we were treating institutional investors as children. Dr. Ueda's suggestion about devoting resources also seems

as if we were talking to children. I believe that we should not write the Opinion Statement with a bossy attitude. As Mr. Tsukuda mentioned, it would be sufficient for this Opinion Statement to recommend such things with the sentence of Section 1 (3) on page 3 describing that senior management team should recognize their mission or responsibility, and seriously consider such things. Actually, I requested the secretariat to add this sentence starting with "Senior management team should also recognize…" in the Opinion Statement. The sentence is in the paragraph under the title of "Securing Adequate Capabilities and Experience". I'm thinking about changing the title to something like mission or responsibilities of the management, or stating that senior management really needs to improve the quality of dialogue, so that you will accept the structure or logical flow of the Statement.

Furthermore, as written in the Conclusion, I understand that discussion for reviewing or revising the Stewardship Code will start in response to the Opinion Statement. Concerning collective engagement, if we take more time for in-depth discussion for the purpose of including our view in the Opinion Statement, it will delay the start of discussion for reviewing the Stewardship Code. Therefore, I recommend that we do not include our view of collective engagement in this Opinion Statement, and leave the discussion of collective engagement to the separate body which reviews the Stewardship Code. I think it is preferable.

As for proxy voting disclosures, I believe that there is room for additional descriptions of concerns, and will consider edition in a way to include opinions and concerns raised by Mr. Uchida and other members. However, although Mr. Toyama stated in his opinion statement that we should move toward making it mandatory to disclose voting results, I believe that institutional investors are allowed to make their own decisions based on the 'Comply or Explain' approach. In doing so, it is important to define what a principle is. I believe that we should make it a principle to disclose voting results, and require their necessary response to the principle. So depending on what the principle is, what to comply with and what to explain, differ. Some members pointed out that the expression "should make it a general rule [i.e. principle]" is too strong, but when the Code adopted the 'Comply or Explain' approach, I believe that there is no alternative but to make company-level voting disclosures a principle. I hope you will understand the logic.

Lastly, members pointed out some rhetorical issues. For instance, on page 2, it was pointed

out that we should add the wording “for example”. I agree with that. As for Section 2 on page 3, specifically, the wording “it is important…” in the last sentence of the first paragraph, Dr. Ueda stated that it is insufficient, and suggested that we use “should”. However, as Mr. Uchida mentioned, there have been various discussions, including those written in the footnote. Taking a balance between these two opinions, I think that it would be better not to change the wording to “it is important…” I hope you understand such an edition. These are what I’m thinking at the moment.

Mr. Takei, and then Mr. Callon, please.

[Takei, member] I put my hand up last. May I speak before other members who raised their hands earlier than me?

[Ikeo, Chairman] Let’s stick to the order, on a first-come-first-served basis. Mr. Oguchi already had an opportunity to share his view. So, Mr. Callon, please go ahead.

[Callon, member] Thank you very much.

I have three points if I may. First of all, I think that the Opinion Statement summarizes our views quite well and in a balanced way, while appropriately addressing matters of concern within a ‘Comply or Explain’ framework. As such, after adding some explanation to address today’s discussion of discretionary investment management (DIM) contracts, I think this draft is good to go.

My second point is about “Engagement in Passive Management” on page 4, where I agree with Ms. Ueda and Mr. Kawakita. Intense price competition among Japanese passive asset managers has driven down the level of fees to the point where the asset managers do not have sufficient returns to finance engagement. Engagement activities will thus be loss-making for them. In effect, it’s a prisoner’s dilemma for the asset managers. While they need to carry out engagement to support long-term returns, they cannot do so due to cost constraints.

I therefore believe that the Opinion Statement should maintain the existing wording of asset managers “should conduct” engagement, with a supplementary explanation of the cost issues they face. In a context of the increasing share of passive management in Japan, in order to improve the current situation where almost no passive asset managers can effectively conduct long-term engagement activities, the Opinion Statement should stipulate that asset owners need to bear a certain level of engagement costs for the benefit of the Japanese public.

Finally, while I know it is difficult and we have had a vigorous debate today, I believe that the most important reform recommendation in this Opinion Statement is company-level voting disclosure based on a 'Comply or Explain' approach. I understand there may be some implementation challenges, and we have to minimize these challenges. However, company-level voting disclosure is already being conducted in Europe and the US, and there have been no adverse effects. If possible, we should aim even higher: rather than just catching up with Europe and the US, we should seek to establish best practices which move Japan ahead. While recognizing there are pros and cons to company-level voting disclosure, with respect to the draft statement on page 4 that "In light of this trend in other countries, company-level voting disclosure can be considered an effective way of ensuring that asset managers and the like exercise their voting rights truly in the interest of ultimate beneficiaries," is there truly any member present today who can be against this statement? If the members remain polarized, I think we need to include this statement on the basis of a majority vote of the members. This statement is vitally important.

Finally, I believe that what can be done in Europe and the US can also be done in Japan, and indeed we should seek to surpass them. I'm also aware of the practicalities: I'm not saying that we need to immediately start company-level voting disclosure, but we need to provide a direction which supports Japan's governance reforms. It is my sincere hope that the Opinion Statement shows that Japan can innovate just like Europe and the US have innovated.

[Ikeo, Chairman] Thank you very much.

Mr. Takei, please go ahead.

[Takei, member] Thank you. This Opinion Statement takes the perspective of improving the governance from 'Form' to 'Substance'. From such a perspective, I feel that it would enhance 'Substance', if we simultaneously consider how to prevent formal correspondences or how to challenge formalism. From such a perspective, I'd like to make some comments.

In the chapter concerning asset managers, I think this draft included appropriate descriptions. I understand that there are concerns about conflicts of interest. To address such concerns about conflicts of interest, their responses tend to be for form's sake, for instance, by delegating decision-making to external parties. We should draw attention to prevent such responses. We should also raise an alert that conversely, it is also wrong to leave everything to

external parties in order to dispel concerns about conflicts of interest. On page 3, it is described that institutional investors should not delegate everything to external parties. This is good. In this connection, while discussing conflicts of interest, I suggest that the Opinion Statement emphasizes the importance of 'Substance' in establishing governance structures, and draw attention to the concern that they may respond merely for form's sake.

Now I'd like to move on to company-level voting disclosures. There are advantages and disadvantages. While I was considering why there are disadvantages, I thought that the root cause may be formalism in the society and formal correspondences.

As for disclosures which we discuss, there are three types of disclosures, depending on the scope of audience. The first area is disclosures to clients or asset owners, and the second area is disclosures to investee companies. Company-level disclosures to the public, which we discuss this time, go beyond the first and second area to the third area: disclosures to the public. In addition, each of the above types is further classified into two categories depending on the content of disclosures – whether disclosures are made in the form of summary (aggregate disclosures) or at the company/proposal level. When there are 6 categories of disclosures, the Council is going to recommend company-level disclosures to the public, which is the strictest one or level 6. When they go for level 6 disclosures, and face various disadvantages due to various causes, including conflicts of interest, what can be done? I believe that we are discussing that point.

Various disadvantages have already been pointed out by other members. For instance, company-level voting disclosures may negatively affect efforts for constructive dialogue, as Mr. Era pointed out. We should take this comment seriously, since it was from a person who is actually involved in constructive dialogue.

Another disadvantage is that proxy voting may be performed for form's sake, as pointed out by Mr. Uchida. Especially, when institutional investors are required to disclose proxy voting results to the third scope of audience, beyond the first and second scopes, unless they cast "against" votes, they may be deemed not to have done their jobs. How do we cope with such a stereotyped formalistic view? This is my concern. I think that we should consider how to dispel such formalism.

Furthermore, as Mr. Uchida mentioned, while their proxy voting standards were already

published, there may be cases where they, as a result of dialogue with companies, should decide to vote "for" certain proposals, which they were expected to vote "against" if they formally followed the standards. Yet they may be reluctant to change such voting decisions through dialogue with the companies in question, to avoid taking trouble of making external explanations. This is another possible formalism of institutional investors. Due to such formalistic reactions which contradict our objectives that pursue 'Substance' of governance, we are worried about adverse effects of company-level voting disclosures. In that sense, it would be better to raise awareness to get rid of such formalism or formal reactions.

As for disadvantages for asset owners, for example, they do not want to disclose which stocks they own. As another example: as Mr. Uchida mentioned, if the fact that they voted against a certain company's proposal is disclosed, it may be deemed as a message that they will sell their shares of the company; and if such a message is known to outsiders, they cannot sell the shares at a favorable price. Eventually, their clients and asset owners may make a loss. I can think of such real disadvantages.

So there are circumstances where they choose to explain reasons for non-compliance. In order to encourage compliance, we should form a clear view of what meaningful explanations for non-compliance are.

Therefore, I suggest that the Council should raise alerts for three types of formalism and formal correspondences. The first one is such a formalistic view that "unless institutional investors cast "against" votes, we deem that they have not done their jobs." It is wrong to make such a formal reaction in a way to evaluate institutional investors' performance by focusing on the percentage of "against" votes they cast. Second, we should raise an alert to formal reactions which focus on how they look: as I mentioned earlier, they should not cast "against" vote for form's sake, formally following their proxy voting standards in order to avoid taking trouble of making external explanations. The third type of formal correspondences is cases where they mechanically choose to comply, when it is reasonable to explain reasons for non-compliance. Even if it makes sense to choose to provide explanations, they will be pressured to comply. Only after carefully eliminating these three adverse effects due to formalism, the objectives will be achieved. Therefore, I think we should raise alerts, although other members may have different opinions regarding whether or not we write such adverse effects of formalism in our

paper.

With regard to these three points, especially when the Statement discusses asset owners in the second half, we should warn about the possibility that asset owners impose formalism on asset managers. In other words, asset owners may require asset managers to comply with principles, without allowing them to choose to explain reasons for non-compliance. As a result, asset managers choose compliance for form's sake. Including such cases, including asset owners, we could issue alerts in the Statement to avoid such formal correspondences. That is a possible viewpoint for considering adverse effects, I think.

That's all.

[Ikeo, Chairman] I totally agree with what Mr. Takei just pointed out. That is a very important point, and I'd like to endorse his statement, but I don't think it is appropriate to include it in the Opinion Statement. All meeting minutes of this Council are disclosed to the public, so your point is recorded in the meeting minutes, through which your view can be reflected in various processes in the future. I hesitate to include it in the Opinion Statement.

[Takei, member] I'm sorry that I raised such an issue after our discussion was almost summarized.

[Ikeo, Chairman] Professor Kansaku, please go ahead.

[Kansaku, member] Thank you. I was absent from the past several meetings, and it may be too late to express my opinions in this meeting for finalizing the Opinion Statement. Anyway, I'd like to share my feedback on this draft.

The main objective of stewardship would be to increase corporate value over the mid- to long-term through proxy voting and engagement, and the Stewardship Code compiled best practices as the code of conduct for institutional investors for that purpose. However, due to conflicts of interest, based on a judgment of the form, there is a doubt as to whether they are properly conducting stewardship activities. This is an undesirable situation. They need to formally demonstrate, to some extent, that they control such conflicts of interest, and conduct stewardship activities in the best interest of their clients. Unless they actively demonstrate it in a formal way, people will not be easily convinced.

For that purpose, as stated at the beginning of the Opinion Statement, it is very logical to discuss governance issues first, focusing on asset managers' governance and management of

conflicts of interest which are very important, followed by the discussion of disclosures of proxy voting results. After establishing the structure to manage conflicts of interest, and actually control conflicts, it makes sense to show the consequence. In that sense, the sequence of Sections in the draft, which discusses conflicts of interest first, and then refers to disclosures of proxy voting results, makes sense from the perspective focusing on conflicts of interest. Furthermore, conflicts of interest usually arise between individual companies and asset managers. Then, by disclosing asset managers' voting decisions on companies' proposals, concerns about conflicts of interest will likely be dispelled, at least formally. So making company-level voting disclosure as a principle is a very logical flow from the perspective of managing conflicts of interest, as just mentioned.

On the other hand, company-level voting disclosures have various problems. Today's discussion alone shed light on many points at issue. We still have many points at issue. From the legal viewpoint, I'm a little concerned about a possible breach of legal obligations between financial institutions and their direct clients, as a result of complying with the Stewardship Code, which is a legally non-binding norm. This is unwanted. I assume that Mr. Iwama pointed out this issue. I believe that we should form a clear view of this issue.

In this connection, I'd like to ask a question to Ms. Takayama or Mr. Callon. Under a discretionary investment contract, if a direct client explicitly or implicitly requires an asset manager not to disclose proxy voting results related to the client's shareholding, does the asset manager still make company-level voting disclosure? Or in this case, even in the US and the EU, are company-level voting disclosures not made? As Mr. Iwama mentioned, I understand that in case there is an overlap between investment funds, investment companies, SEC-registered asset managers in the US, and UCITS in Europe – such clients or beneficiaries or equity owners – and ultimate beneficiaries, voting disclosures are required. In the US, such disclosures are legal obligations, in my understanding. I feel that we need to examine possible conflicts between legal obligations to direct clients and stewardship codes. I'd appreciate it, if you could tell me about the situations in the US and the EU concerning this point.

The last comment was a question. That's all from me.

[Ikeo, Chairman] Would you like to respond to that?

[Takayama, member] Unfortunately, I don't have an answer at the moment. Allow me to

repeat what I mentioned earlier. I reviewed disclosures of major institutional investors. In the US, I got an impression that many asset managers other than SEC-registered investment funds have not yet moved toward company-level disclosures. In the UK, judging from disclosures of asset managers, which are large shareholders of Japanese companies, a considerable number of asset managers have made company-level voting disclosures. However, I cannot figure out from such disclosed information what they discussed with their clients, or what contracts they concluded. It may provide important reference data for reviewing the Stewardship Code, so I expect the secretariat to clarify the matter.

[Callon, member] May I?

[Ikeo, Chairman] Sure.

[Callon, member] If I could please make a supplementary comment: asset owners and asset managers do not have in any way structural conflicts of interest. And in Europe and the US, asset managers carry out company-level voting disclosures without revealing asset owners' names.

[Ikeo, Chairman] Mr. Oguchi, please.

[Oguchi, member] Thank you. Various opinions were expressed concerning proxy voting or company-level voting disclosures. Since everyone has no experience in Japan, it is natural that there are various concerns or fears. I'd like to revisit what the Follow-up Council stands for. The Council consists of this many members, and publishes its meeting minutes to enhance the transparency. The Council publishes full meeting minutes, which recorded everything including the fact that members expressed different opinions, instead of summary versions. The English versions are also available. Such debates prove the healthiness of the Council, and disclosures of all discussions secure the transparency of the Council. However, the Council also has accountability. I believe that it will be meaningless to merely show that various opinions were expressed. The Council has a role to provide a direction and deliver such messages. This Opinion Statement is a tool to articulate our views to the outside world: while the members expressed various opinions, the Follow-up Council has reached this conclusion, and would like to promote this and that.

In such a context, I really do not think of any advantage from issuing the Opinion Statement where we take a negative stance toward company-level voting disclosure, which has

already become a global standard or global practice. I won't say we should aim at getting ahead of other countries, as Mr. Callon mentioned, but at least, we should aim at moving toward global standards. Frankly speaking, after we have worked hard to deepen the governance reform, moving its focus from 'Form' to 'Substance', and especially after we have overcome more difficult challenges associated with the Corporate Governance Code, I do not believe that this Follow-up Council could have such an option as delivering such a negative message.

Now I'd like to talk about effective monitoring by asset owners. At the beginning of the chapter, it is explained that the investment chain extends from ultimate beneficiaries to investee companies. Some members referred to cost issues today. How can they conduct stewardship activities and maintain the investment chain, while bearing costs incurred everywhere? In Part 3 of ICGN Principles, which were introduced at the last meeting, there is a term "ecosystem of stewardship". In the ecosystem of stewardship where various players, including asset owners and asset managers, interact organically, it would be asset owners that perform the monitoring function, like board members of a company. From the closest position to ultimate beneficiaries, asset owners provide instructions to asset managers. Accordingly, even though they delegate actual tasks to such service providers as asset managers, similarly to corporate boards which are required to fulfill supervisory responsibilities, in the ecosystem of stewardship, asset owners fulfill such supervisory responsibilities. I think that such a mechanism revitalizes the entire investment chain.

In ICGN Principles – which were distributed last time, and are not included in today's reference materials, its Guidance 2.3 refers to delegation. As it was impressive, I brought the Principles today. The point of this Guidance is that "asset owners cannot delegate their fiduciary responsibilities." Asset owners cannot evade ultimate responsibilities, similarly to responsibilities of the board. This draft Opinion Statement discusses asset managers and asset owners separately, in an easy-to-understand manner. However, when we discuss these two separately, it will not be clear who takes ultimate responsibilities of the ecosystem. As Mr. Takei mentioned earlier, there may be a risk that everyone leaves their responsibilities to someone else. While each player conducts its own activities, I think that it is necessary to clarify who takes ultimate responsibilities.

Although it is obvious and everyone knows it, in Chapter III “Effective Oversight by Asset Owners”, it is written “In the investment chain, asset owners are positioned closer to ultimate beneficiaries and have a direct responsibility to secure interests of the ultimate beneficiaries.” It would be better to add, for instance, such a phrase as “asset owners cannot delegate their own fiduciary duties” in order to clarify how the ecosystem of stewardship functions properly, although it might be redundant.

The reason for this suggestion is related to discussions on supervision and execution under the Corporate Governance Code. We had extensive discussions on that topic, and eventually presented recommendations on supervisory function of corporate boards. I think we could take a similar approach here. Asset owners also lack resources, and may not be able to do everything. It should, however, be clarified that asset owners have ultimate fiduciary duties. In terms of making up for the lack of resources and enhancing the effectiveness, I suggest that this Opinion Statement should clarify supervision and execution within the ecosystem of stewardship, although I’m not sure about what wording is appropriate. I think that such an approach would be coherent with our previous discussions on roles of corporate boards.

That’s all.

[Ikeo, Chairman] In economics, the investment chain is described as multi-layered principal-agent relationships. While an ultimate … initial principal is an ultimate investor, from the viewpoint of the ultimate investor, an asset owner is their agent: however, between an asset manager and asset owner, the asset owner is the principal, and thus has responsibilities as the principal. When an institutional investor holds shares of a company, the investor is the principal in the relationship with the company. In such a multi-layered structure, asset owners are positioned closer to ultimate beneficiaries. That’s what the sentence in question means. Are you suggesting that we should clearly state that asset owners have responsibilities of principals?

[Oguchi, member] Yes, although it is obvious, it would become clearer, if we added that point.

[Ikeo, Chairman] I see. I think we are looking in the same direction. I have no objection. It’s a matter of how to describe it.

Mr. Iwama, please.

[Iwama, member] First, I'd like to discuss passive management. It has been increasingly considered that engagement in passive management is very important. Their fees are certainly low, so they need to find highly creative solutions in order to conduct effective engagement activities. For example, it is highly unlikely that they engage with all TOPIX companies. A realistic approach would be as follows: they conduct screening, selectively consider where problems occur, and conduct engagement activities in a step-by-step manner. For example, I understand that Norges Bank, GPIF, and various other players including BlackRock or Vanguard have already been moving in that direction. I consider that such a move is favorable.

Next, I'd like to talk about company-level voting disclosures. I believe that situations are totally different, depending on whether clients are pension funds or financial institutions. Pension funds have accountabilities to ultimate beneficiaries. Especially in the US, there is the Employee Retirement Income Security Act (ERISA). Also in the UK, transparency and accountability are clearly required under a very strict law. Basically, asset owners are expected to establish their own policies, and to carry out stewardship activities by themselves instead of leaving everything to players, as a CalSTRS representative mentioned the other day. This is especially applicable to large asset owners.

Meanwhile, when financial institutions award equity investment mandates to asset managers, although cases vary by financial institutions, they might request the asset managers to report proxy voting results to them. I don't think they would request company-level voting disclosures to the outside world. Decisions on whether or not to go for such disclosures would be up to clients. While there are various cases, asset managers will take action [i.e. make disclosures] under the mandates in accordance with 'Comply or Explain' approach. By doing so in a matter-of-fact way, I think things will go in the right direction.

[Ikeo, Chairman] Dr. Ueda, please.

[Ueda, member] Thank you. This is related to the question raised by Professor Kansaku. In other countries many asset owners reserve their own voting rights: asset managers make investment decisions, and asset owners exercise their own voting rights. In contract, most of Japanese asset owners delegate both investments and proxy voting to asset managers. I assume that most of asset managers – Japanese asset management companies – make diverse exercise of voting rights. This is probably because they make voting decisions for some portion of

voting rights according to their own guidelines, and other portion according to their clients' guidelines, etc. If company-level voting disclosures are made, we will find various ways of casting "against" votes: for example, they may vote only against a representative director candidate, or against all candidates.

Then, in case asset owners do not have their own voting policies, do not make voting decisions, and delegate such decision-making to asset managers, it would be OK that the asset managers make judgment on disclosures. However, in case asset owners have their own voting guidelines or standards, and provide specific instructions to asset managers regarding proxy voting, it is necessary to consider whether disclosures should be made by asset owners themselves or through asset managers.

I won't deny the view that company-level voting disclosure is a global standard, especially among institutional investors which exercise stewardship actively. However, we should note that in other countries – in Europe and the US, asset owners generally have made detailed company-level voting disclosures in the first place. Norges Bank as well as all major pension funds has made disclosures, with reservation of their own voting rights. Furthermore, key asset managers, which are players, also have disclosed their voting decisions. Therefore, even though we say "global standard", we leave out asset owners, and require only asset managers to disclose voting results at the company level because it is a global standard. I'm not comfortable with that. When you say, "This is a global standard, and Japan should also adopt it," I believe that it is not right to apply a global standard only to asset managers, and to give consideration to disclosures by asset owners in a Japanese way. That is an unbalanced approach.

In this context, I'd like to refer to the chapter about asset owners in the Opinion Statement. In Section 1 on page 5, there is a provocative sentence: "Asset owners should conduct their own stewardship activities to the greatest extent possible in order to secure the interests of ultimate beneficiaries." Judging from my impression from the text of the current Stewardship Code, I first thought that the expression "should … to the greatest extent possible" means something like "it is preferable to conduct such activities, if possible," but now I assume that this expression may be stronger.

I just checked the Stewardship Code. On page 3, in the bullet point No. 7, the third

paragraph, it refers to institutional investors as asset owners: the “institutional investors as asset owners” are expected to do this and that through their own actions and/or the actions of the asset managers, to which they outsource their asset management activities. I understood that the main actor is asset managers, and asset owners are expected to make efforts, if possible. Now I’m wondering if it means that more proactive efforts are required. They have various roles. Even though the Opinion Statement recommends that asset owners should conduct stewardship activities to the greatest extent possible, the number of asset owners, which can do that to the greatest extent possible, would probably be no more than five. Accordingly, a significant number of asset owners will have no choice but to explain reasons for non-compliance.

That’s all. Thank you.

[Ikeo, Chairman] With regard to the point you just raised, I don’t think it is necessary to change the wording. On page 4, the term “asset managers and the like” is used in the middle of the page. Please understand that the term includes asset owners, that exercise their own voting rights and conduct engagement activities, etc. You might think that it is difficult to get the sense, but I hesitate to write something like “including asset owners which conduct their own activities”. I’d like you to have that understanding.

[Ueda, member] Thank you.

[Ikeo, Chairman] We had extensive discussions and various opinions were expressed. Taking them into account, we’d like to edit and finalize the draft. I believe that there was no major objection to the direction of how to edit, and we reached a consensus to a certain degree. Specifically, concerning company-level voting disclosures on page 4, we will add possible concerns. Accordingly, the second paragraph on page 4 will be expanded, doubling the volume, while maintaining the next sentence starting from “Therefore” as it is. I assume there is no objection, is there?

With regard to the next Section concerning passive management, as well as page 5 Chapter III, Section 1, the paragraph starting from “Moreover, asset owners”, we have discussed cost sharing – sharing costs of engagement activities. I believe it is necessary to edit these parts by describing that cost sharing needs to be considered.

Concerning other parts, we will change them in the manner I already mentioned, or

maintain them as they are. If you have no objection, the Secretariat and I will revise the text, and send you the revised version for your confirmation. Upon your agreement, we will publish the Opinion Statement. I don't think it is necessary to meet for that purpose, so communications will be made via e-mail to finalize the draft. Do you agree with this procedure? After reaching agreement on the final draft, please allow me to edit the text for minor changes of wording or for ensuring consistency at my discretion. Of course, we will obtain your approval on the final draft, but please allow me to make last corrections to the approved draft prior to the publication. Is that all right?

Thank you very much.

I'm glad that we have reached a consensus. Today's meeting is almost over, and I'd like to close our discussion on constructive dialogue between companies and institutional investors, and hand it over to the team for reviewing the Stewardship Code. Nonetheless, the Follow-up Council will continue to exist. We will meet again, although the Council is likely to have a long break. This is not the end of the Council's activities. Thank you for your cooperation.

Lastly, I'd like to hand it over to the Secretariat for an administrative announcement.

[Tahara] Thank you for your participation today. As for the date of the next meeting, we will fix the date – probably next year - upon consulting with Chairman, and let you know.

Thank you very much.

[Ikeo, Chairman] Now I'd like to declare the meeting adjourned. Thank you for your participation.