Material 2

# Opinion Summary for Discussion Points

2019.11.08

Financial Services Agency

# 1: Measures to realize Constructive Dialogue

## Opinion Statement No.4 from Follow-up Council

■ In order to fulfill their accountability to asset owners as well as deepen mutual understanding with companies via constructive dialogue, it is important to encourage asset managers to improve the disclosure of **(1) the reasons for their voting decisions, (2)their stewardship activities with companies and their results, and (3) self-evaluation of their stewardship activities.**

## Major opinions on this issue

＜Opinions in the Follow-up Council＞

- Asset managers should not only disclose their voting results, but also **improve their disclosure on stewardship activities with companies** previous to asset managers' voting decisions.
- Since **the disclosure required by the Code is insufficient, it is hard to address constructive dialogue.**

＜Opinions from others＞

- There are concerns that **investee companies may become reluctant to have a dialogue after the disclosure of the reasons for voting decisions.**
- If asset managers **cast a vote for their investee companies which have conflicts of interests**, they should **disclose the reasons why they do so.**

## Opinions in the First Council

■ Individual disclosures of voting records made both investors and companies change their behavior in ways that bring them closer together, and have a positive effect on dialogue between investors and companies.

■ Disclosure of individual voting records is still lagging, with 70% of companies not disclosing the reasons for their votes. This would indicate that there is significant room for improvement with respect to Principle 5 of the Code. It would seem prudent to disclose voting reasons for agenda items where suspect to have conflicts of interest or agenda items that have garnered public attention.

■ Disclosing the reasons for voting for or against agenda items is essential for ensuring transparency in stewardship activities, but there are serious concerns that demanding across-the-board disclosure of specific details that would reveal specific details about dialogues could undermine mutual trust with companies and adversely impact future dialogue efforts, so this should be considered very carefully.

■ It is vital that companies exercise creativity and ingenuity in continually striving to enhance disclosure but, at the same time, the approaches taken should be flexible and should give due consideration to the actual capabilities and strengths of individual companies.

# 2. Sustainability

## Opinion Statement No.4 from Follow-up Council

■ **When asset managers engage with companies on sustainability issues, including ESG factors**, asset managers are expected to **promote dialogue that is consistent with their investment strategies and that leads to the sustainable growth of companies and their mid- to long-term increases in corporate value**.

## Major opinions on this issue

＜Opinions in Follow-up Council＞

- **In corporate valuation, ESG factors such as environment, society, governance are becoming more and more important.**
- It is important to **integrate ESG factors into stewardship activities**.
- **Discussion and approach to ESG can easily lose its seriousness.**
- It is important to have a constructive dialogue with investee companies and to **seek out their original strategies about ESG**.
- Both investors and investees should be careful **not to focus only on E&S, neglecting G**.

＜Opinions from others＞

・ Even during dialogue, asset managers have much **more interests in short-term performance data**.

・ Japanese investee companies are **not focusing enough on ESG**.

## Opinions in the First Council

■ Companies and investors have been able to engage in deeper and more frequent dialogue about ESG.

■ About 80% of investment companies say they have never received a mandate to take ESG factors into consideration. More than 60% of investment companies engaged in active investment have decided to take ESG factors into account. From the perspective of promoting investment that incorporates ESG factors as advocated in Principle 3, there is still significant room for improvement.

■ There is significant risk involved in long-term investments that fail to given consideration not only to G but also to the environment and society so, when deciding on rational investment strategies, engagement through dialogue with companies should become a more widespread practice.

■ More emphasis should be given to the S part of ESG in terms of labor and human rights.

■ As the stances of individual companies on ESG matter vary widely, careful consideration should be given at this stage to incorporating, or integrating, ESG factors obtained through constructive dialogue into the investment process, and including them immediately and uniformly into the Code.

# 3. Asset Owners

## Opinion Statement No.4 from Follow-up Council

■ It is important to **promote measures to support the stewardship activities of corporate pension funds** in collaboration with the business sector and other stakeholders.

### Major opinions on this issue

＜Opinions in Follow-up Council＞

- In order to support the functioning of the investment chain in which asset owners are located closest to final beneficiaries, **the role of asset owners is critically important** to encourage and monitor the asset managers who are the direct dialogue counterparts to companies.
- **The number of corporate pension funds that have signed the Stewardship Code remains limited**.
- **The benefits and responsibilities of stewardship activities expected of corporate pension funds are not well understood**.

＜Opinions from others＞

（Asset owners）

- Since it is pointed out that the commission fees are low, we provided **a new commission fee structure which incorporates engagement with investee companies**.
- **We misunderstood** that if we sign the Stewardship Code, **we have to have a direct dialogue with investee companies and have to vote**.

（Asset managers, etc.）

- **We doubt that asset owners really want to receive stewardship reports** because **they have little interest in stewardship.**
- For both asset owners and asset managers, it **is inconvenient not to have a standardized format of stewardship activity reports**.

## Opinions in the First Council

■ For a relatively small-scale corporate pension, it is important that sponsoring company of the corporate pension supports.

■ It is important to clarify to asset managers the views of the corporate pensions on stewardship responsibilities and decision-making criteria.

■ Where an asset manager engages in constructive dialogue, asset owners who have signed up for the Stewardship Code could leave the asset manager a certain degree of discretion.

# 4. Proxy Advisors

## Opinion Statement No.4 from Follow-up Council

- It is important that proxy advisors provide **recommendations based on correct information with respect to individual companies** to asset managers in order to support voting which serves the sustainable growth of companies.
- Proxy advisors are expected to **secure sufficient and appropriate human resources and organizational structures**, **disclose their processes (including the resources and organization) for developing voting recommendations**, and directly and proactively engage with companies as necessary.
- When developing voting recommendations, proxy advisors are expected to **directly and proactively engage with companies** as necessary, **not only to check the public information** of those companies.
- It is important that asset managers also **provide explanations and information on their usage of proxy advisors**, such as **the names of proxy advisors**, **their processes to confirm the advice of proxy advisors, and how specifically they use the proxy advisors' advice**.

## Major opinions on this issue

＜Opinions in Follow-up Council＞

- **The procedures for developing voting recommendations are not yet sufficiently transparent**, and proxy advisors may **not have sufficient human and operational resources necessary for making substantive evaluations of companies' specific circumstances**, including AGM director election proposals.
- It is pointed out that proxy advisors are making recommendations by kind of a one-size-fits-all approach, and **they don't incorporate individual circumstances of investee companies**.
- Foreign institutional investors who invest passively have the tendency to rely on proxy advisors' voting recommendations. Since most of them don't accept Japan's Stewardship Code yet, **proxy advisors take an important role in achieving voting behaviors with "substance"**.

＜Opinions from others＞

- Sometimes, proxy advisors **made judgements for recommendation, based on incorrect information**.
- It is better if investee companies can get **opportunities to check the content of recommendation reports in advance** and **to post their opinions on the recommendations.**

## Opinions in the First Council

- Proxy advisors manage conflicts of interest with constructing a firewall, enhancing information disclosure, etc. With information technology having advanced as far as it has, the research can be conducted via networks anywhere in the world, and support is received throughout the year from offices outside of Japan.
- It is an essential precondition that accurate information be disseminated, and extremely important to enhance personnel and organizational systems.
- It is not appropriate for a proxy advisor to try to satisfy their accountability by pursuing a superficial course.
- The roles of advisors include key gatekeepers under Japan's Stewardship Code framework. They sign on to the Code to take part in constructive dialogue.

# 5. Investment Consultants

## Opinion Statement No.4 from Follow-up Council

- It is important to encourage investment consultants to **manage conflicts of interest and disclose their activities** due to their roles as important actors in support of the stewardship activities of corporate pension funds and to enhance the overall functioning of the investment chain.

## Major opinions on this issue

＜Opinions in the Follow-up Council＞

- Investment consultants in the process of providing consulting services **sometime solicit sales of their own investment products**.
- There **is concern that they do not appropriately evaluate the stewardship activities of asset managers**.

## Opinions in the First Council

■ Consulting companies advise customers on selecting the asset manager best suited to their investment needs. In some cases, consulting companies can not only offer selection advice but also be commissioned to make and execute the selection themselves. This is the extent to which consulting companies engage in "investment". Here, "investment" do not mean making investments themselves by actually buying or selling shares or bonds. As a gatekeeper, consulting companies are simply entrusted with selecting an asset manager to which such investments will be consigned. Potential conflicts of interest are properly managed as a consultant and as a gatekeeper as well.

■ Fewer than 40% of investment companies had been asked by investment consultants about their activities pertaining to Japan's Stewardship Code or been sent written inquiries, and this may need to be raised as an issue in order to raise this number a little.

■ Inquiries from investment consultants to asset mangers are increasing. However, the quality of the inquiries could be improved. The ultimate goal is the sustained improvement of corporate value, but there are concerns about actually being able to achieve the goal in this way.

# 6-1. Other topics (conflicts of interest management in asset managers)

## Opinions in the First Council

■ It is heard that major financial groups lobby the parent organizations of corporate pension funds, with the end result being that changes in outsourcing companies or even in the makeup of portfolios may not be possible without consulting financial or sales personnel from the group. Corporate pensions in Japan have extremely limited resources, and people lacking the needed expertise are often struggling to run them. It might be that pension funds, if their hands are tied by master trustees, or in some cases the parent organization's main bank, borrowers, or business partners, often find it difficult or impossible to fulfill their fiduciary responsibilities nor to accept the Stewardship Code.

■ Master trustees for pensions are responsible for the administrative tasks connected with operating and managing a corporate pension program, and these duties do not include making investments for the corporate pension. They tend to have more frequent interaction with customers, which results in more opportunities for them to hear customer needs and to propose programs and investments. However, even at those pensions for which master trustees serve, customers are now giving more careful scrutiny to products before signing up, and it is an everyday occurrence that customers cancel their investment products and acquire those of other companies. Major financial groups follow strict procedures designed to prevent abuse of dominant positions in pension and all other operations.

■ Asset management companies may offer asset management advice, but this is directed at promoting their own investment products and clearly differs from investment consulting that entails comparative recommendations of other companies' investment products.

■ The large number of asset managers in Japan belong to financial conglomerates. With regard to managing conflicts of interest, if no solution can be found for an issue that has been previously discussed, it might be reasonable to consider revamping some of the rules.

# 6-2. Other topics

## Opinions in the First Council

■ The Code was created to ensure sustainable corporate growth and improve medium- to long-term investment returns. Signatories have to think hard from their respective positions and come up with the best ways to carry out these stewardship activities, so that they need to incorporate their outcome awareness and undertake public disclosures.

■ Investors should conduct more dialogues with non-executive officers. Investors would be interested in asking if executives are giving briefings or submitting documents to external directors, if reports are being made in an appropriate and timely manner, and if non-executive officers are allowed to attend Management Board meetings if they wish. Asking questions such as these will give investors a better picture of the views on governance held by the company's executives. With such dialogues it can be checked how knowledgeable non-executive officers are with respect to governance and other topics.

■ While discussions on upgrading stewardship activities and engagement activities will be pursued further here, it is asked that these discussions do not go in the direction of making things more restrictive. The stricter requirements promote the more "formalization".

■ It is heard that "Clarification of Legal Issues Related to the Development of the Japan's Stewardship Code" doesn't make clear the scope of the collective engagement. FSA and the large shareholding report regulations still have a chilling effect. Does it need to consider to clarify the scope of "Act of Making Important Suggestions" and the "Joint Holder" under the large shareholding reporting system?

■ In Japan general corporate shareholders make up nearly 25%, and there are few people required to comply with the Stewardship Code. So, the Stewardship Code appears to small and powerless compared to the Corporate Governance Code, which basically applies to listed companies. Any company holding other companies' shares should also be required to sign up for the Stewardship Code.