



ICGN

International Corporate Governance Network

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

5th March 2019

Dear Fellow Council Members,

ICGN Statement to the Council of Experts for the Follow-up of Japan's Stewardship Code and Japan's Corporate Governance Code (the "Council")

I have pleasure in providing comments on the items noted in the Agenda for the next Council Meeting which will take place on 5th March 2019.

Led by investors responsible for assets under management in excess of USD\$34 trillion, ICGN is a leading authority on global standards of corporate governance and investor stewardship. Our membership is based in more than 45 countries and includes companies, advisors and other stakeholders. ICGN's mission is to promote high standards of professionalism in governance for investors and companies alike in their mutual pursuit of long-term value creation contributing to sustainable economies world-wide.

I understand that the subject of discussion will be around the effectiveness of investor stewardship. As such my comments will draw from ICGN initiatives, namely:

- ICGN Global Stewardship Principles, first published in 2003 and most recently updated in 2017 and which provide a global investor perspective on stewardship obligations and practices;
- ICGN Global Stewardship Awards, held in December 2018, to celebrate excellence and innovation in stewardship disclosures – ultimately to help improve overall quality and share best practices;
- ICGN Model Disclosure Templates, published December 2018, which summarise key elements in a good quality policy as well as sharing case-study examples; and
- ICGN Annual Investor Stewardship Survey Results, published in February 2019, reflecting opinion from investors responsible for assets under management of USD \$11 trillion based in 12 markets.

This statement will address:

1. Engagement rationale;
2. Scale, resources and prioritisation;
3. Facilitating investor collaboration;
4. Quality of stewardship disclosures; and
5. Stewardship Code innovations.

Engagement rationale

Investors are responsible for preserving and enhancing the assets they manage on behalf of beneficiaries or clients. This requires engagement with companies to help mitigate risk on the one hand, while identifying opportunities to help improve long-term performance on the other.

The ICGN Global Stewardship Principles (Engagement, Principle 4) states:

“Investors should engage with investee companies with the aim of preserving or enhancing value on behalf of beneficiaries or clients and should be prepared to collaborate with other investors to communicate areas of concern”.

Scale, resources and prioritisation

Respondents to the ICGN Annual Investor Survey said that they engage with up to 500 companies a year, with some reporting significantly more than this. Most activity (62%) happens in the home market or home region. Engagement takes up 33% of an investor’s overall workload, and stewardship is taken seriously at the highest level with 90% of teams reporting either to the CIO or CEO.

Given the scale of investment portfolios, in terms of number of investee companies and also geographic scope, investors must optimize their use of human resources to prioritise their engagement efforts effectively. Many investors use screening tools, linked to ESG scoring methodologies which culminates in risk assessments and priority engagement themes. Other considerations include:

- Alignment with their investment strategy, client objectives and overall investment beliefs, for example violations of the UN Global Compact Principles, labour standards controversies or environmental harm. According to the ICGN Investor Survey, over 80% of institutions now have some form of exclusions policy, with controversial weapons excluded by most; followed by tobacco and thermal coal.
- Scale of investment in terms of size of holding and level of value at risk. The size of the holding as a fraction of the value of the fund will determine how much resource to employ into the engagement effort and the degree of influence and impact that can be achieved. With a larger share of equity, direct influence can often be exerted towards the board - where the shareholding is smaller, collaborative initiatives help to leverage the power of influence.
- Investor rights and protections in any given market to facilitate constructive engagement with companies. In particular, clarity around the ability to act collectively is an important factor, particularly for overseas minority investors.
- Materiality of risks and opportunities relative to asset exposure and financial performance – ultimately impacting share value. This is often assessed in relation to the industry sector (high impact sectors such as oil, gas, mining or infrastructure), geography (politically sensitive regions) or by theme.
- Long-term sustainability - poor ESG performance is closely monitored, particularly recurring issues, and whether it could materialize into a significant business detriment; or impact the share price in the short, medium or long term.

- Responding to unforeseen events, for example Chairman / CEO resignation, an acquisition not aligned to strategic direction, changes to remuneration policy and accounting concerns. Collaboration is particularly helpful in reacting to controversial events, particularly via a collective Investor Forum, which can facilitate dialogue with companies or through strategic partnerships with stakeholders and NGOs.

Facilitating investor collaboration

ICGN encourages collaboration, particularly among domestic and overseas investors, to leverage the voice of minority investors and exert influence, where required, with companies. According to the ICGN Annual Investor Survey, 28% of respondents said that they collaborate with others, albeit mostly informally.

ICGN welcomes reference to collaboration in the Japan Stewardship Code guidance under Principle 4 on engagement. This is an important step however, there is still nervousness amongst global investors around the potential to be perceived as colluding in a negative way (for example staging a hostile takeover) when in fact they wish to collaborate to improve the governance and sustainability of investee companies.

ICGN Members would welcome further clarity around their ability to act collaboratively with other investors. As such it would be helpful for the FSA to confirm that as long as they do not collude to vote in the same way on items related to the control and direction of the company, they will not breach rules regarding collective holding thresholds above which would trigger onerous reporting requirements.

As I suggested at a previous Council meeting, the publication of guidance such as the list from the European Securities Markets Authority might help to give investors more confidence in being able to engage constructively with Japanese companies. It is a public statement made under the European Takeover Bids Directive (Directive 2004/25/EC) which indicates a list of activities indicating that co-operation by investors will not lead to a conclusion that the shareholders are acting in concert. This includes voting on proposals relating to directors' remuneration, capital and financial policies, the environment or any other matter relating to social responsibility. (see annex 1)

Quality of stewardship disclosures

Last year, the inaugural ICGN Global Stewardship Awards was held to celebrate excellence and innovation in stewardship disclosures – ultimately to help improve overall quality and share best practices. We published what we learnt from the analysis and summarized what we consider to be the key elements in a good quality policy as well as sharing case-study examples in a series of 'Model Disclosure Documents' dealing with monitoring, engagement, voting and managing conflicts of interest.

As part of the analysis for the Awards, while we found that while there are some good examples of stewardship disclosures, most if not all would benefit from improvements. Many policies were too short, generic or out of date and failed to provide evidence of what investors are doing in terms of stewardship.

A good engagement policy should be succinct with clear language so the reader can fully understand how stewardship is taking place. It would include a description of:

- the rationale for engagement and how this contributes towards enhancing and preserving the assets being managed on behalf of beneficiaries or clients;

- how the investor operates strategically in alignment with their investment beliefs and client objectives;
- approach to prioritising engagement, including how and when engagement might be escalated in the event company dialogue is failing;
- the resources and processes in place to conduct engagement efficiently and how this is coordinated and integrated within the investment organisation; and
- approach to collaborating with others to leverage a higher degree of influence to positively effect an engagement outcome.

Stewardship Code innovations

In 2016, the ICGN established the Global Stewardship Codes Network which today has members based on over 20 jurisdictions, including the Japan FSA. The network serves to support the sharing of information around stewardship code developments, the following of which may be useful for consideration in the context of Japan:

- **ESG Integration:** ICGN's Global Stewardship Principles (GSP) highlight the importance of integrating environmental, social and governance (ESG) factors in stewardship activities to promote a company's long-term success and sustainable value creation. Investors should consider ways to analyse, monitor, assess and integrate ESG related risks and opportunities as part of their stewardship obligations. This is increasingly becoming a trend in national stewardship codes. Malaysia has a specific reference to ESG, the recently revised Dutch code states that stewardship policies should "promote long-term value creation" in investee companies, and the draft updated UK code contains similar sentiments.
- **Systemic risk:** ICGN's Principles also highlights that investors should build awareness of long-term systemic threats, including factors relating to overall economic development, financial market quality and stability. Investors should prioritise the mitigation of system-level risk and have respect for basic norms over short-term value. ICGN Guidance on Investor Fiduciary Duties (2018) articulates systemic risk as macro-economic (e.g. political, legal, regulatory, fiscal), environmental (e.g. climate change, water scarcity, pollution), social (e.g. human rights, income inequality, populism), governance (e.g. shareholder rights, corporate culture, board quality) and technological (e.g. artificial intelligence, cyber security).
- **Stewardship Activities Reporting:** UK Financial Reporting Council is consulting on changes to the UK Stewardship Code. One of the recommendations is to introduce new reporting requirements. Signatory reporting will be in two parts: a Policy and Practice Statement upon signing the Code; and an annual Activities and Outcomes Report. Signatories must submit a Report which details: (a) compliance with their Statement and any departures from this; (b) activities they have undertaken to implement the Provisions in the preceding 12 months; and (c) an evaluation of how well stewardship objectives have been met, and/or have enabled clients to meet theirs, and the outcomes achieved.

- Stewardship across asset classes: ICGN's Principles assert that stewardship policies should address the scope of assets held in an investment portfolio including but not limited to, listed equities and debt obligations. More recently, the UK Financial Reporting Council is proposing to introduce stewardship responsibilities for all asset classes, noting that capital is allocated to a range of asset types over which investors have different terms, rights and levels of influence. Signatories should use the resources, rights and influence available to them to exercise stewardship, no matter how capital is invested.

To conclude, I would like to congratulate the leadership of the Council once again on the progress that is being made in Japan in terms of corporate governance and investor stewardship reform. I look forward to welcoming many Council colleagues at the ICGN Annual Conference hosted by the Tokyo Stock Exchange at the New Otani Hotel which will take place between 16th – 18th July 2019.

Yours faithfully,



Kerrie Waring
Chief Executive Officer, ICGN

ESMA List on shareholder cooperation

ESMA White List on shareholder cooperation

“4.1 When shareholders cooperate to engage in any of the activities listed below, that cooperation will not, in and of itself, lead to a conclusion that the shareholders are acting in concert:

(d) other than in relation to a resolution for the appointment of board members and insofar as such a resolution is provided for under national company law, agreeing to vote the same way on a resolution put to a general meeting, in order, for example:

(A) to approve or reject:

- (i) a proposal relating to directors' remuneration;
 - (ii) an acquisition or disposal of assets;
 - (iii) a reduction of capital and/or share buy-back;
 - (iv) a capital increase;
 - (v) a dividend distribution;
 - (vi) the appointment, removal or remuneration of auditors;
 - (vii) the appointment of a special investigator;
 - (viii) the company's accounts; or
 - (ix) the company's policy in relation to the environment or any other matter relating to social responsibility or compliance with recognised standards or codes of conduct;
- or

(B) to reject a related party transaction.

Financial Conduct Authority letter on shareholder engagement

In the UK, the Financial Conduct Authority issued a letter in 2009 stating that there were no fundamental inconsistencies regarding the extent to which active shareholder engagement relates to market abuse, disclosure of substantial shareholdings and changes in control rules. This clarified that ad-hoc discussions with the management of investee companies regarding legitimate concerns on corporate issues, events or matters of governance would not trigger restrictions or disclosures imposed by UK FCA rules.

“We are satisfied that there is no fundamental inconsistency. In the three areas mentioned above [market abuse, disclosure of substantial shareholdings and changes in control rules] we do not believe that our regulatory requirements prevent collective engagement by institutional shareholders designed to raise legitimate concerns on corporate issues, events or matters of governance with the management of investee companies. Ad-hoc discussions or understandings of this nature would not, in our view, trigger the restrictions or disclosure rules imposed by our rules.”