



ICGN

International Corporate Governance Network

July 2016

To: Financial Services Authority (FSA), Japan

RE: ICGN response to the request for comments concerning constructive dialogues between companies and investors

Dear Madam or Sir,

The International Corporate Governance Network (ICGN) is an investor-led organisation of governance professionals with members including institutional investors responsible for assets under management in excess of US\$ 26 trillion.¹ Our mission is to promote effective standards of corporate governance and investor stewardship to advance efficient markets and sustainable economies worldwide.

ICGN is very supportive of the recent initiatives to develop corporate governance and stewardship codes in Japan, and has responded to a number of consultations relating to the development of these codes. We are also happy to provide this response to the FSA's recent request for comments concerning constructive dialogues between companies and investors. Our comments draw from ICGN's Global Governance Principles² and from our more recently developed Global Stewardship Principles.

Making investor stewardship a reality is one of ICGN's fundamental policy priorities, and we are therefore encouraged to see attention given to promoting better engagement between investors and companies in Japan. As noted above ICGN has developed its own Global Stewardship Principles, recently approved at ICGN's AGM in San Francisco this past month, which underscores ICGN's commitment to supporting the development of stewardship codes in markets around the world. We hope and believe that the ICGN Global Stewardship Principles can play a positive role in influencing and supporting the ongoing development of the Japanese Stewardship Code—and we would encourage you to make use of these Stewardship Principles as you consider the results of your consultation.

With regard to our comments to the FSA consultation we will focus, as requested, on questions 2-7. But we also think Question 1 is important, and we respond to that as well.

- **Question 1: Quality of engagement.** We agree that quality of dialogue between investors and companies is important, and we believe its purpose is to build trust

¹ For more information about ICGN, please visit <https://www.icgn.org>

² See ICGN Global Governance Principles: http://icgn.flpbks.com/icgn_global_governance_principles/#p=1

and understanding in common support of the company's own sustainability and long-term value creation. Time frame is important here. As stated in Part Two, Section 1.1 of ICGN's Global Governance Principles, the primary stewardship responsibility of investors is to promote and safeguard value which is aligned in the interest of beneficiaries and clients on a long-term basis. It is important that company/investor dialogue seek to find common ground in terms of promoting long-term value, rather than focus on short term outcomes. While we agree that investors should be well-prepared for engagement meetings, we would also encourage directors of Japanese companies (both executive and non-executive) to meet with key investors, either individually or collectively.

- **Question 2: Conflicts of interest.** We would highlight that ICGN's own Governance Stewardship Principles begin with internal investor governance as the first step towards building an effective stewardship capability. The ICGN Principles certainly identify conflicts of interest as one of the key investor governance considerations; but in Part Two, Section 1 the ICGN Stewardship Principles extend into other aspects of investor governance which include time horizons, independent oversight, ethics, capacity and remuneration. The FSA may wish to bring these more detailed considerations into subsequent drafts of its stewardship code. ICGN is not prescriptive on particular governance mechanism to address conflicts and other governance questions. That is likely to be investor-specific. But in our view a robust governance structure, including independent oversight, where conflicts may exist, is the foundation for effective stewardship.
- **Question 3: Transparency of proxy voting.** As discussed in a recent email exchange with Amane Fujimoto of the FSA, the voting guidelines in ICGN's Global Stewardship Principles are broad in scope and their practical application can differ depending on the specifics of individual investors or investment institutions. But as a general rule an investor's voting records should mainly show how the investor voted on an individual company basis-- with regard to resolutions presented at the company's shareholder's meeting. Ideally, the voting records should also summarise the reasons for not voting in favour of a management-propose issue. In that email I forwarded hotlink to the voting web page of a large global asset management firm to illustrate a good example of voting disclosure.
- **Question 4: Passive funds and engagement.** We agree that passive funds have an important role to play in stewardship. This can be challenging when indexed portfolios can include hundreds, if not thousands of companies; in many cases limited resources may not allow for detailed engagement with every company. Large portfolio holdings do not remove the accountability of passive investors to be good fiduciary stewards. But where resources are limited passive

funds should develop ways to prioritise individual companies for engagement and other forms of stewardship. Section 3.2 of ICGN's Global Stewardship Principles state in this context that "investors should develop methods or risk based tools to identify and prioritise portfolio companies for further analysis and engagement which can include environmental, social and governance issues. This is particularly important for asset owners and managers with passively run portfolios, where the number of companies held in portfolios may be large."

- **Question 5: Asset owners, part 1.** One of the main applications of the ICGN Global Stewardship Principles is to serve as a guide for asset owners and their trustees in terms of monitoring an asset manager's adherence to stewardship practices. Many asset owners have limited in-house capacity to implement all aspects of stewardship; where this may be the case asset owners should instead satisfy themselves that stewardship principles are being implemented satisfactorily by their asset managers and service providers.

Both asset owners and assets managers should establish clear policies outlining their approach to stewardship and engagement. This calls for an integrated approach in which investors engage both with executive management and also board directors. It also calls for investors to present a unified face to company issuers when investors have both portfolio managers and corporate governance teams.

A mechanism that Japanese asset owners can employ to strengthen engagement of asset managers is the inclusion of stewardship related language in the terms of investment management agreements between asset owners and asset managers. ICGN's Global Stewardship Principles include an annex containing "model mandate" contract terms to embed stewardship into the overall investment services provided and reported upon by asset managers to asset owners. These may require revision to fit into a Japanese legal context but we believe that hardwiring stewardship and engagement into the investment management agreement should stimulate stronger stewardship in practice.

- **Question 6: Asset owners, part 2.** We recognise that asset owners have a different role in stewardship than asset managers. In particular, pension funds and other asset owners often do not have in-house resources to engage in day to day stewardship activities. Rather, they must monitor asset managers and satisfy themselves that the asset manager is living up to its stewardship responsibilities. In this context we believe that Japanese pension funds provide active oversight over the stewardship process, and report to both trustees and beneficiaries on the stewardship activities undertaken by their asset managers. In due course the

FSA may also wish to elaborate on guidance for the distinct roles of asset owners and asset managers in the stewardship “ecosystem”, as ICGN has done in Part Three of its Global Stewardship Principles.

- **Question 7: Proxy advisors.** Proxy advisors play a useful role in helping investors gather information, research and executive voting decisions. They help to make the voting process much more manageable and efficient, particularly for large investors with international holdings. Having said that, blind use and acceptance of proxy advisor voting recommendations is not a good stewardship process. Proxy advisors should serve as a tool for investors, not as a crutch.

ICGN’s Global Stewardship Principles address the role of proxy advisors and other service providers, and in Section Three it is noted that they can “assist asset owners and asset managers with developing and implementing their responsibilities as part of their advisory services. Such consultants and advisors provide research and voting services which can assume stewardship responsibilities and they are therefore subject to many of the principles outlined in the ICGN Global Stewardship Principles. In doing so consultants, advisors and other service providers – which include proxy voting agencies, analytical services and custodians -- should endeavour to understand their role in the investment chain and to provide services in the interests of their immediate clients and ultimate beneficiaries.”

Thank you for the opportunity to provide comments on your consultation relating to promoting constructive dialogue between companies and institutional investors. Should you wish to discuss our comments further, please contact George Dallas, ICGN’s Policy Director, by email at george.dallas@icgn.org.

Yours faithfully,

Erik Breen

Chairman, ICGN Board

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