The Council of Experts on the Stewardship Code
Corporate Accounting and Disclosure Division
Financial Services Agency
Tokyo, Japan

31 January 2020

Dear Council Members,

ICGN Statement to the Council of Experts on the Stewardship Code (the "Council")

The International Corporate Governance Network (ICGN) welcomes the opportunity to provide comments to the Council's consultation relating to the revision of the Japanese Stewardship Code, which was released on 20 December 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.

Much of our commentary draws from the ICGN Global Stewardship Principles ("ICGN Principles"), which originally derive from ICGN's Statement on Institutional Investor Responsibilities published in 2003. The ICGN Principles are currently being reviewed and will be put forward for member approval in 9 June 2020 at the ICGN Annual General Meeting taking place in Toronto.

In recent years ICGN has provided considerable input to the Council, as well as the Financial Services Authority and Tokyo Stock Exchange individually, with regard to the development of the Japanese Stewardship Code and Corporate Governance Code. We are encouraged by the positive changes that have taken place in Japan. Our most recent comment letter of 8 November 2019 provided detailed feedback on a wide range of stewardship issues.[1] Our letter today will build from our November letter and focus on the specific questions in your 20 December 2019 consultation document.

In an overarching context we would first like to commend the Council for the positive changes that are being proposed in the revised Stewardship Principles, particularly with regard to the emphasis on sustainability and ESG factors and the greater focus on service providers to investors.

Question 1-1

We think it is positive that the revised Code references other asset classes beyond equities. But we believe the language could be stronger in encouraging stewardship across other

[1] ICGN comment letter 8 November 2019:
https://www.icgn.org/sites/default/files/17_ICGN%20Statement%20to%20the%20Council_8th%20November%202019.pdf

asset classes. In particular, we believe the Code should make specific mention of corporate debt as a key component of corporate capital structures. Creditors, like shareholders, bear the residual risk of the company as financial stakeholders. Moreover, many institutional investors may hold positions in both the debt and equity of the same company, so should have a stewardship interest in promoting sustainable corporate performance that meets the needs of both shareholders and creditors.

Question 1-2

With regard to stewardship and fixed income ICGN has recently published a Viewpoint report on the role of the creditor in corporate governance and stewardship, which outlines an engagement agenda for creditors that is largely compatible with shareholder interest[2]. For convenience we present this engagement agenda in the appendix of this letter.

Question 2

We support the language relating to sustainability and ESG factors. One of ICGN's seven Global Stewardship Principles relates specifically to the integration of ESG factors in the investment process, as a way to support a company's sustainable value creation over a long-term horizon. We believe the specific language of the Preamble could be stronger than simply calling for "consideration" of these factors. We believe the Code should be more explicit in calling for ESG integration through all aspects of the investment process, including valuation, risk assessment, investment decision-making (buying and selling) and engagement.

Question 3

The challenge of encouraging corporate pension plans to participate in stewardship activities is not limited to Japan. We share the view that corporate pension plans should support their beneficiaries' interests through involvement in stewardship, and that the added voice of these funds can further strengthen the impact of stewardship in the market as a whole. We encourage the Council to continue to promote stewardship in corporate pension funds.

Question 4

We think it is best practice for investors to explain their voting rationale when they vote against a management resolution. It is not practical, or necessary, to call for explanations when investors vote in favour of a management resolution.

Question 5-1

We support the new principle relating to service providers to institutional investors. Service providers have an important role to play in the stewardship "ecosystem", and it is important that their activities are aligned with institutional investors to promote sustainable value creation and effective stewardship.

Question 5-2

It is appropriate to highlight proxy advisors and investment consultants, but service providers need not be limited to these particular services and could be expanded. For example, this

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[2] ICGN Viewpoint on the role of the creditor in governance and stewardship (September 2019): https://www.icgn.org/what-role-creditor-corporate-governance-and-investor-stewardship

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could potentially include providers of ESG data and metrics as well as overlay engagement services.

To conclude, we 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. If you have any questions about our response please contact me or George Dallas, ICGN's Policy Director, who would be pleased to elaborate on our position: george.dallas@icgn.org.

Yours faithfully,

Kerrie Waring
Chief Executive Officer
International Corporate Governance Network

Appendix

Creditor expectations of companies

The conflicts between shareholders and creditors will never be completely eliminated, even for companies in a healthy financial position. But there are fundamental governance expectations that creditors can express that need not conflict with the interests of equity investors. These include:

1. **Statement on financial policy and capital allocation.** This should cover a company's own statement on the use of debt and financial leverage and address its overall approach to capital allocation. A risky financial strategy is not intrinsically flawed as long as it is appropriately communicated to creditors.

2. **Risk management, including ESG risks**. Shareholders and creditors both want companies to have robust risk management practices. This includes traditional financial and operational risks, but increasingly focuses on integrating ESG risks in an enterprise-wide context.

3. **Board effectiveness.** Shareholders and creditors want strong boards to provide independent support and constructive challenge to the company and its executive management. As part of the governance of sustainability, creditors expect boards to demonstrate appropriate understanding and oversight of ESG risks.

4. **Audit, accounting and reporting.** Creditors have a clear interest in a robust audit process and prudent accounting policies to ensure accurate reporting and guard against financial risks. Creditors should encourage integrated reporting to ensure consideration of so-called "non-financial" (or pre-financial) issues.

5. **Remuneration.** Incentive structures should discourage executive management to take disproportionate risks to receive bonus awards. This is relevant to all corporate issuers, but of particular relevance to financial institutions given their high gearing and systemic significance.

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