

Japan's Stewardship Code (1)

~ Survey of disclosure by institutional investor signatories in the first year of implementation ~

Short Review
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The Japan's Stewardship Code (hereafter, the "Code") was published by the Financial Services Agency (hereafter, "FSA") in February 2014. Domestic and foreign institutional investors have continued to adopt the Code ever since its establishment. According to FSA, 191 institutional investors had signed the Code by the end of June 2015. The number of signatories has been steadily increasing over the past year, especially among pension funds and investment managers (see Table 1 below).

Table 1 - Numbers of institutional investor signatories

Category	Organization	I	II	III	IV	V
		Jun, 2014	Sep, 2014	Dec, 2014	Mar, 2015	Jun, 2015
Asset Owner	Pension Funds	12	17	19	21	23
	Insurance Companies	19	21	21	21	21
Asset Manager	Trust Banks	6	6	6	6	7
	Investment Managers	86	109	122	129	133
Service Provider	Proxy Advisers	4	7	7	7	7
Total		127	160	175	184	191

Source: FSA

FSA expects all signatories to disclose, as well as annually review and update, the following information on their website, in accordance with the principles of the Code:

- (1) Their policy on fulfilling their stewardship responsibilities and justification of areas of non-compliance, if any (related to Principle 1);
- (2) Their policy on managing conflicts of interest in the fulfillment of their stewardship responsibilities (related to Principle 2);
- (3) Their policy on voting, including their policy on lending stock when they have a practice of lending stock across the determination date of the voting right (related to Principle 5); and
- (4) Disclosure of voting activities including whether they avail the services of proxy advisors and how they utilize these services in making voting judgments (related to Principle 5);

Every signatory is allowed to adapt the disclosure of the information of its activities according to its own context. While institutional investors, such as asset owners, and asset managers investing in the Japanese stock market, are the main subjects of the Code, certain institutions without investment activities may also adopt the principles of the Code. We analyzed the disclosure practices of 153 out of 191 signatories who invest in the Japanese stock market, by studying the information they disclose on their websites in response to the list of disclosure requirements above.

Table 2 summarizes the latest disclosure situation. Three levels are set for the sufficiency of disclosure of each item, Level 1, when detailed information is disclosed; Level 2, when only basic information is disclosed; and Level 3, when there is no public disclosure. According to our research, almost all signatories have explained item 1 in detail (Level 1) or with basic information (Level 2), but there is a wide variation in disclosure levels for items 2, 3 and 4 (see Table 2 below).

Table 2 - Disclosure of the published items

Items	Disclosure levels	Asset Owner		Asset Manager	
		Pension Funds	Insurance Companies	Trust Banks	Investment Managers
		(21)	(21)	(7)	(104)
(1)Stewardship responsibility	① disclosure is sufficient to enable understanding of their objectives, strategy and engagement approach	9.5%	23.8%	28.6%	18.3%
	② basic information is documented	90.5%	76.2%	71.4%	80.8%
	③ no disclosure	0.0%	0.0%	0.0%	1.0%
	Total (①+②)	100.0%	100.0%	100.0%	99.0%
(2)Conflicts of interest	① disclosure is sufficient to enable understanding of their approach to manage conflicts of interest including the identification of such situations and prevention measures	4.8%	76.2%	71.4%	22.1%
	② summary of policy is disclosed	61.9%	19.0%	28.6%	64.4%
	③ no disclosure	33.3%	4.8%	0.0%	13.5%
	Total (①+②)	66.7%	95.2%	100.0%	86.5%
(3)Policy on voting	① disclosure is sufficient to enable understanding of the agenda, structure, and decision making process of the organization	47.6%	47.6%	57.1%	61.5%
	② summary of policy is disclosed	19.0%	33.3%	28.6%	28.8%
	③ no disclosure	33.3%	19.0%	14.3%	9.6%
	Total (①+②)	66.7%	81.0%	85.7%	90.4%

(4)voting activities	① disclosure of all voting records and regular reports of voting activities	57.1%	9.5%	71.4%	59.6%
	② disclosure of ratio of objections and approvals only	4.8%	19.0%	0.0%	1.0%
	③ no disclosure	38.1%	71.4%	28.6%	39.4%
	Total (①+②)	61.9%	28.6%	71.4%	60.6%

Source: Nikko Research Center, as at end July 2015.

Within the items, the level of disclosure is also quite different across the various organizations of institutional investors. Voting is an important element of stewardship activities. In the disclosed information, pension funds (mainly public pension funds) published, the details of their voting rights exercise on domestic stocks by type of proposal and by fiscal year. On the other hand, insurance companies rarely share such information on their website. Most signatories only disclose the ratio of objections and approvals.

In addition to the four disclosure items above, it was found that some institutional investors voluntarily disclose the status and contents of purposeful dialogue (engagement) with investee companies, undertaken as part of the stewardship activities. The followings are examples of such disclosure.

- Examples of purposeful dialogue

Signatories conduct constructive dialogue with investee companies to highlight problems and express their views. In some cases, the positive responses or acceptance of such requests from the investee companies are described as the following:

"Company A (listed on the First Section of the Tokyo Stock Exchange) did not present their targets for capital efficiency and return to shareholders in the medium-term management plans, or other similar documents. We held dialogues on measures to improve corporate value and business strategy. As a result of our continuous dialogue with the CEO, target ROE and total return ratio are now included in a published report of the midterm-term management plan. We will continue dialogues concerning businesses that show poor investment efficiency." (Japan's Pension Fund Association for Local Government Officials)

- Overview of engagement activities

Signatories report the number and major themes of dialogues with investee companies over the year, and list the names of investee companies. They initiate high-level meetings with management teams, focused on governance.

“The meetings held at NAM’s office (approximately 1,900 in FY2013), presented considerable opportunities to hold relatively high-level discussions. Around 260 top meetings were held, attended by directors in charge of corporate management, with discussions that covered a wide range of management issues, including management strategies and capital policies. These meetings strengthened engagement. Furthermore, we held 90 governance meetings, over the past year, focused mainly on voting. The major themes were related to key considerations such as the election of directors and dividend policies, and hence we believe that these may also be considered as constructive engagement activities.” (Nomura Asset Management)

- Engagement letters to investee companies for shareholder proposals

Signatories communicate with investee companies by sending letters to top management about shareholder proposals, including the status and the evidence of these proposals.

“We sent a letter, titled “The implementation of Corporate Governance Code” with a cover letter directly to the president & CEO of Company A (listed on the First Section of the Tokyo Stock Exchange).” (Strategic Capital, Inc.)

The first year of the Code’s implementation has seen the beginning of dialogue between companies and institutional investors, with the goal of achieving expansion of long-term investment returns for their clients and beneficiaries. The “comply or explain” approach is subject to the discretion of each signatory. Increased disclosure is observed among asset owners (public pension funds) and asset managers (trust banks and investment managers). However, most cases of disclosure remain superficial and lacking in detail. Signatories are asked to disclose their status of stewardship activities with the Code. Accordingly, clear policies how to disclose their stewardship activities including internal company policies, should also be shared.