May 7, 2021

Institutional Investors Collective Engagement Forum

Comments on the "Guidelines for Investor and Company Engagement" (Revision Draft)

We submitted the following comments to the Corporate Accounting and Disclosure Division, Policy and Markets Bureau of the Financial Services Agency in response to its request for public comments on the revision draft of the Guidelines for Investor and Company Engagement.

[Regarding Relationship between the CG Code and the Engagement Guidelines]

The proposed revision includes not only revisions to the Japan's Corporate Governance Code (hereinafter "CG Code"), but also important revisions to the Guidelines for Investor and Company Engagement (hereinafter the "Engagement Guidelines"). We agree with and support these revisions.

The Engagement Guidelines "are intended to be a supplemental document to the Stewardship Code and the Corporate Governance Code," and companies "are expected to consider the contents of the Guidelines" when they comply with a principle of the CG Code. However, there is a risk that many companies and investors will not pay much attention to the revision of the Engagement Guidelines. Therefore, we request that the authorities provide such disclosure, explanation, and public relations that help them to understand the relationship between the CG Code and the Engagement Guidelines and that the items stipulated in the Engagement Guidelines are also what listed companies are expected to achieve.

[Regarding Footnote 2]

We request that Footnote 2: "…even when a company complies with a principle, it is beneficial for the company to proactively explain its specific implementation activities" to the "Guidelines for Investor and Company Engagement" section, which is the preamble of the Engagement Guidelines, be included in the text of the Engagement Guidelines rather than in footnotes.

<Reason> Sufficient information disclosure is a prerequisite for dialogue between a company and its shareholders and investors. Investors want companies to disclose and explain how they are implementing specifically the governance principles with which they claim to comply. On the other hand, as the 11 items that should be disclosed in Corporate Governance Report are exhaustively prescribed, most companies currently understand that it suffices to disclose these 11 items only. Therefore, it is extremely beneficial to include the explanation mentioned above in the text of the Guidelines.

[Regarding "2. Investment Strategy and Financial Management Policy"]

We propose that the term "financial management" be changed to "capital policy" and that the text of 2.2 be revised and expanded to "Is capital policy (including capital structure decisions and use of cash on hand in recognition of the company's cost of capital, dividend and shareholder return policies, and key performance indicators (KPIs) of capital efficiency) established and managed appropriately…?"

<Reason> As the CG Code does not use the term "financial management" and stipulates that "companies should explain their basic strategy with respect to their capital policy," the Engagement Guidelines would be easier to understand if the terminology is unified. Given that "management in recognition of the company's cost of capital" is currently not a widely accepted practice, it would be beneficial if the Guidelines indicate specific examples of its contents expected by investors.

[Regarding cross-shareholdings]

Regarding 4.2.1, we request that the phrase "benefits and" be deleted from "…whether the purpose is appropriate and whether the ~~benefits and~~ risks from each holding…" and "it is inappropriate to require shareholdings as a condition for a commercial relationship" be added to this principle.

Regarding 4.2.2, we request that "When the board has approved a plan to reduce cross-shareholdings, the company should promptly disclose it." be added.

Regarding 4.2.3, we propose that a company specifically states in the CG Report or elsewhere that "when cross-shareholders…indicate their intention to sell their shares, the company will not hinder the sale of the cross-held shares by, for instance, implying possible reduction of business transactions" and to add "whether the company thoroughly enforces compliance with this principle by all employees."

<Reason> As companies' understanding and efforts on cross-shareholdings have been quite insufficient, we believe that it is necessary to take measures to further clarify the position of the CG Code on this matter.

First, regarding the holding purpose, Supplementary Principle 1.4.1 of the CG Code states that "…should not imply a possible reduction of business transactions when cross-shareholders indicate their intention to sell their shares." Therefore, such a wording as "maintaining and strengthening the commercial relationship" presented by many companies as a reason for cross-holdings, i.e., the reason that shareholdings would strengthen the commercial relationship is clearly inconsistent with the spirit of Supplementary Principle 1.4.1. This should be expressly stated by the Engagement Guidelines. Furthermore, as the notion that cross-shareholdings ~~will~~ bring some "benefits" beyond ordinary shareholder rights contradicts the principle of "securing equal treatment of shareholders" set forth in General Principle 1, the use of the word "benefits" itself is inappropriate.

Next, given the current situation in which there are only a very few companies that disclose specific plans to reduce cross-shareholdings, investors would be able to ascertain the attitude of each company if it discloses a specific plans to reduce cross-shareholdings when the plan is approved by the board. Investors would also be able to assume that a company without such disclosure has not formulated a specific plan and measures to reduce cross-shareholdings. This is expected to promote dialogue with investors.

Moreover, it is assumed that there are cases in which the management of the company that demands cross-shareholdings of other companies is not aware of the actual interaction in the course of sales activities (such as rejecting the other company's proposal to sell its shares). Therefore, regarding Supplementary Principle 1.4.1, it would be effective for the company to specifically states in the CG Report or elsewhere that it complies with the principle and to verify whether the company thoroughly enforces compliance with the principle by all employees.

[Regarding the analysis of votes against proposals]

Regarding 4.1.1, we request that "when a considerable number of votes excluding the shares held by a controlling shareholder have been cast against, does a company that has the controlling shareholder… " be added.

As it is not clear what constitutes "a considerable number of votes cast against," companies currently interpret it at their discretion. Therefore, it would be useful to indicate such guidelines as "Although it is not necessarily appropriate to set forth a uniform threshold due to differences in shareholder composition among companies, the UK Corporate Governance Code, for example, requires an explanation when 20% or more of votes are against a particular proposal." in the form of a footnote, for example.

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