



May 7, 2017

Corporate Accounting and Disclosure Division  
Planning and Coordination Bureau  
Financial Services Agency  
3-2-1 Kasumigaseki  
Chiyoda-ku, Tokyo  
100-8967 Japan

By post and email: [stewardship2017-2@fsa.go.jp](mailto:stewardship2017-2@fsa.go.jp)

**ACGA Submission on Revised Japan Stewardship Code:  
“Principles for Responsible Institutional Investors”**

Dear Sir,

The Asian Corporate Governance Association (ACGA) is an independent, not-for-profit association chartered under the laws of Hong Kong. The Association is dedicated to assisting companies and markets across Asia in their efforts to improve corporate governance practices. In our educational outreach, we are guided by a practical, long-term approach. ACGA’s operations are supported by a membership base of institutional investors, such as public pension funds and fund managers, as well as listed Asian companies, international accounting firms, business associations and universities. ACGA now has more than 110 organisations as members, two-thirds of which are institutional investors with more than US\$26 trillion in assets under management globally. They are also significant investors in the Japan market.

We welcome the opportunity to respond to the consultation on the revised Stewardship Code, which we believe marks an important step forward in several areas on the original 2014 Code. We also commend the Financial Services Agency (FSA) for reviewing the Code within a reasonable period of time and in response to lessons learned from its first phase of implementation.

**General comments**

Our overall view of the revised Code is positive and we appreciate, in particular, the following additions and clarifications:

- Greater clarity on the role of asset owners in stewardship and their approach to managing asset managers.
- Additional explanation as to how asset managers should manage conflicts of interest.
- An explicit reference to the involvement of passive investors in stewardship.
- Inclusion of the concept of collective engagement in the code and recognition that it can be beneficial.
- A strong recommendation that investors should disclose their voting records for each investee company and on an individual resolution basis.

- The importance of sufficient experience and capacity in the management teams of institutional investors to undertake stewardship properly, and to operate independently of “affiliated financial groups”.
- The value of self-evaluation with regard to how an asset manager is implementing the Code.

If these principles are followed in spirit, and not merely to the letter, then the current momentum behind investor stewardship in Japan should be enhanced.

#### **Specific comments**

Notwithstanding our positive observations above, we have certain areas of concern about the new Code:

#### **Principle 2: Managing Conflicts of Interest**

While the added focus on managing conflicts of interest is welcome, including the guidance that asset managers “set out and disclose specific policies on measures for avoiding such conflicts and effectively eliminating the influences”, we have some concerns about the specificity of the recommendation regarding the appropriate governance structures for achieving these objectives. Guidance 2-3 states that such structures could include an independent board of directors or third-party committees. Yet some asset managers might conclude that such structures are required or the only options acceptable. At this stage, it may be sensible to allow greater latitude for asset managers to develop their own systems for managing conflicts and then disclose the rationale in their policies. There is also some scepticism that asset managers facing significant conflicts of interest would be incentivised to nominate genuinely independent people to a board of directors. The end result may be window-dressing.

We would therefore like to propose the following language as a possible alternative to Guidance 2-3:

“Asset managers should establish governance and oversight structures sufficient to ensure all material conflicts are managed and that all voting decisions have been made on the basis of the interests of clients and beneficiaries. Where potential conflicts, such as decisions relating to an asset manager’s business group, may reasonably be assumed to be difficult to divorce from decision making, the asset manager should be able to demonstrate sufficient independence of oversight of voting decisions.”

#### **Principle 4: Collective Engagement**

While the new Code rightly recognises the value that can be achieved through institutional investors working together on stewardship issues, as a best-practice document it is not able to address the underlying complexity of Japan’s regulation of concert-party (“joint holder”) action and the limitations imposed on shareholders who wish to recommend governance improvements to companies (the “act of making important suggestions”). The Code refers to the FSA’s February 2014 clarification on this matter, however this document does not address all the current concerns that investors have. We believe that some form of regulatory reform is needed to remove the undue restrictions placed on investors in this regard. Without such changes, collective engagement will continue to be limited.

There are also concerns that the language of the Japanese and English versions of the Code differ in a material way, namely that the former is less encouraging than the latter. The Japanese version in effect says (underlining added):

“In addition to institutional investors engaging with investee companies independently, there could be cases where it is beneficial for them to engage with investee companies in collaboration with other institutional investors (collective engagement) as necessary.”

Whereas the English is arguably more positive:

“In addition to institutional investors engaging with investee companies independently, it would be beneficial for them to engage with investee companies in collaboration with other institutional investors (collective engagement) as necessary.”

The English version clearly endorses the concept of collective engagement, whereas the Japanese version appears somewhat ambivalent.

#### **Additional comments and suggestions**

- Ongoing review: We believe that a review of the Code every three years is sensible.
- Clearer communication between asset owners and managers: Page 5 of the Code states: “The asset managers should aim to know the intention of the asset owners so that they can provide services as expected...” The language here could be more precise: there should be a clear mandate from asset owner to manager on what is expected.
- Differentiating asset owners and asset managers: While the language of the Code starts off drawing clear distinctions between these two groups of investors, it is inconsistently applied in the draft and the more generic “institutional investor” is often used.
- Use of advisors: The Code imposes certain responsibilities on proxy advisors commissioned by institutional investors. It should broadly cover other governance-related advisors working for investors as well.
- “Sustainable growth”: In Principle 7, the Code states that one of the objectives of stewardship is to “contribute positively to the sustainable growth of investee companies”. It is not clear to a general reader if “sustainable growth” means growth in line with the principles and objectives of “sustainable development”, as originally defined by the Brundtland Commission in 1987, or if it simply means maintaining revenue and profitability growth at the individual company level indefinitely. These two perspectives may or may not be aligned depending on a company’s business and ESG strategies. It would help if the Code were more precise in this regard.

#### **What the Code does not address**

Finally, we believe it is important to distinguish between different types of investment funds and their approach to stewardship. A distinction is made between active and passive funds, yet much of the Code appears to assume all investors can play an equally useful stewardship role and can engage actively with all their holdings based on an in-depth knowledge of companies. Yet for certain investment styles, especially strategies that are quantitatively derived (“quants”) as opposed to being based on fundamental analysis, this will never be possible.



This does not mean, however, that such funds have no role to play in improving corporate governance. They can take a market approach and support broad initiatives that will generally improve corporate governance, such as through support for non-profit initiatives. They can select a number of companies that they find meaningful to engage with, such as those posing high-risk to their overall investments. And they can join collective engagement efforts, not only to increase potential impact, but to broaden their coverage. In other words, stewardship has many dimensions. It is not simply an equation involving a single investor engaging a single company on a set of issues.

We would be pleased to discuss any of the points above in further detail.

Yours truly,

A handwritten signature in black ink, appearing to read 'JA', located below the 'Yours truly,' text.

Jamie Allen  
Secretary General

*(Members of the ACGA Japan Working Group contributed to this letter.)*