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Corporate Accounting and Disclosure Division
Financial Services Agency
By Email: stewardship_info_19@fsa.go.jp

31st January 2020

Comments on proposed revision of the Principles for Responsible Institutional Investors

Dear Sir or madam,

We welcome the opportunity to provide our comments on the proposed revision to the Principles for Responsible Institutional Investors «Japan's Stewardship Code» ("the Code" hereafter).

Hermes Investment Management is an asset manager with a difference. Hermes EOS is one of the world's leading engagement resources, advising on US$781.4 billion (JPY84.4 trillion) as of 30th September 2019 on behalf of over 40 international institutional investors. The views expressed in this communication are those of Hermes EOS and do not necessarily represent the views of all clients.

We largely support the proposed changes to the Code, not least the inclusion of other asset classes to the scope of the Code as well as the added emphasis on consideration of medium- to long-term sustainability including ESG factors. We however have some specific comments and suggestions, which we provide below.

Please do not hesitate to contact us should you have any questions.

Yours sincerely,

鈴木 祥

Sachi Suzuki
Associate Director – Engagement
Hermes EOS

Question 1-1
We welcome the addition of other asset classes to the scope of the Code. We believe there are many shared interests between investors in equites and those in other asset classes and that it is important for all investors to fulfil their stewardship responsibilities. We therefore suggest strengthening the wording, from the current 'the Code may also apply to other asset classes' to 'the Code should also apply where relevant…'. Especially in the original Japanese text, it reads more like 'the Code could apply' and we consider it too weak.

We note that the application to proxy advisors and service providers has been moved to a separate section, which is positive. We suggest extending the application of the Code beyond institutional investors and to companies which invest in other companies as strategic or cross-shareholdings. Given the significant portion of Japanese listed equities held by these corporates, they should also be expected to fulfil duties as responsible investors and to disclose the extent to which any conflicts of interests are identified and addressed, and if they cannot be effectively managed, the plan for exits.

Question 1-2
While we think most interests are shared between investors in equities and those in other asset classes, there are some obvious differences. For example, one obvious difference is that fixed income investors do not have voting rights and therefore need to exercise their rights through other means. As outlined in the 2020 UK Stewardship Code, fixed income investors should explain their approach to seeking amendments to terms and conditions in indentures or contracts; seeking access to information provided in trust deeds; impairment rights; and reviewing prospectus and transaction documents.

Question 2
We welcome the addition of consideration of sustainability across the Code, as ESG risks and opportunities should be considered as part of core investment strategies. It is important that the consideration of sustainability is included in Principle 1 regarding institutional investor's policy on how they fulfil their stewardship responsibilities because the consideration of sustainability equates addressing medium- to long-term challenges and opportunities, which should be in the interest of asset owners and beneficiaries.

However, we are concerned that including 'corresponding to their investment management strategies' (Guidance 1-1 and 1-2) may run the risk of being interpreted as investors not needing to consider sustainability if it does not correspond to their investment management strategies. We recommend strengthening the message intended to seek clarity in stewardship approach and methodology unique to each investor. We believe that investment management strategies, particularly those employed by responsible investors, should take into account medium- to long-term issues, and it is the responsibility of the investment managers and service providers to establish a clear engagement plan and rationale for engaging on specific ESG issues. The same point applies to Guidance 4-2, Principle 7 and Guidance 7-1.

Question 3
Most Japanese corporate pension funds do not directly manage investments but delegate the activities to external managers. However, it should be made clear that only activities are delegated; asset owners retain their stewardship responsibilities. Asset owners should be encouraged to work closely with asset managers by contributing to the formation of stewardship strategy by asset managers and participating in engagement meetings with companies. As a minimum, asset owners should have a clear voting policy for their

investment managers and service providers, and over time, consider to be more involved in engagement when resources allow. See further explanation in our reply to Question 5-1.

Question 4
We welcome the additional expectations for investors to explain the reason for voting for or against certain proposals at shareholder meetings. We believe this will enhance the accountability of investors particularly if there are potential conflicts of interest. In addition, providing explanations on their voting decisions would help send the right messages to companies and facilitate the engagement process.

Question 5-1
We support the additional principle on service providers as they are proven to have significant influence over institutional investors regarding their voting decisions. The new requirements would help improve transparency around their procedures and consistency of voting recommendations. We agree with most of the requirements including that proxy advisors should exchange views with companies and ensure the accuracy of information they use, prior to making voting recommendations.

However, we think the requirement that proxy advisors should have a business establishment in Japan overly prescriptive and potentially demanding. It should not be assumed that proxy advisors cannot sufficiently engage with companies and obtain accurate information without having a base in Japan.

Question 5-2
We support the wider definition of 'service providers for institutional investors', which is not limited to proxy advisors and investment consultants for pension funds. However, under the current proposal, only Guidance 8-1 is applicable to service providers who are not proxy advisors (as both 8-2 and 8-3 are specifically for proxy advisors), and it only refers to management of conflicts of interests. We think that those service providers should also be expected to explain how they support their clients' stewardship activities, particularly in enhancing long-term value and ensuring sustainability.

Question 6
We mostly welcome the proposed amendments and additions, but have some specific comments on the below.

Guidance 4-1
We highly welcome the additional notes that institutional investors are encouraged to have dialogue with non-executive directors and kansayaku (audit and supervisory board members) for better understanding. We find such meetings very helpful and think that they should be done more often, as they are already in other markets such as the UK, and increasingly in the US. We strongly ask that this point be included in the main text rather than the footnote.

Guidance 4-5
We support the use of the word 'collaborative' in place of 'collective' engagement, which we think describes the action more accurately. However, we are disappointed that there is no stronger encouragement for collaborative engagement in the amended version, particularly in the original Japanese text. While the English translation is 'it would be beneficial for them to engage with investee companies in collaboration…', the original Japanese text reads 'it could be beneficial in some cases…', which we think is significantly weaker. Given the level of

anxiety among investors about working collaboratively due to the 5% rule, we believe that the Code should encourage collaborative engagement more explicitly.

Principle 6

As mentioned above, we welcome the additional notes about the consideration of sustainability across the Code and particularly to Guidance 1-1 and 1-2, asking that investors should consider sustainability in their stewardship policies. Importantly, investors should be asked to demonstrate how they integrated sustainability and ESG factors in fulfilling their stewardship responsibilities in their reporting. It is important that the reporting does not only mention the process but also focuses on the outcome of the activities.