

[REPORT ON THE SEVENTH INVESTORS FORUM]

Forum of Investors Japan

Theme:	How Communication between Companies and Institutional Investors Should Be on Exercise of Voting Rights
Time:	August 4, 2016, 6:30 p.m. - 8:30 p.m., September 8, 2016, 6:30 p.m. - 6:50 p.m.
Venue:	Meeting Room, QUICK Corporation
Participants:	23 persons
Purposes:	<ol style="list-style-type: none">i. Some companies are said to have complained that investors are not willing to give answers to the companies' inquiries on exercise of voting rights. Do institutional investors provide sufficient explanations to the companies on exercise of their voting rights? If the answer is no, why is it? What is behind the lack of explanation?ii. How should information on exercise of voting rights be shared among the people inside the institutional investors and investee companies?iii. Through this forum, we would like to express how institutional investors should think about the topic as stated above and further to discuss how institutional investors think the exercise of voting rights should be.iv. In addition, we are going to express our opinion about recent discussion on company-level voting disclosure.

Below, we have listed without modification to the extent possible the main opinions of the participants of the Seventh Investors Forum. Please note that, in order to clarify the points of discussion and the details of the opinions, competing opinions (if any) are presented together.

1 Explanations on Exercise of Voting Rights

◇ <The Raised Issue> At the 8th council of FSA meeting “The Council of Experts Concerning the Follow-up of Japan’s Stewardship Code and Japan’s Corporate Governance Code,” (the “8th Follow-up Meeting”) the member Ms. Ueda introduced an opinion that institutional investors are not willing to give answers to the companies’ inquiries on exercise of voting rights¹. It is heard that such complaints are also made by investee companies.

¹ Remark at the eighth council of the Follow-up Meeting by the member Ms. Ueda on June 1, 2016 <http://www.fsa.go.jp/en/refer/councils/follow-up/index.html> (English Translation of the Minutes is not available at the date of this Report, but is forthcoming.)

- ✧ This sounds odd for investors; because most investors said that they would, in general, welcome the inquiries from companies about the reason for vote against the proposal and their requests to meet for discussion after the general shareholders meeting. However, some investors pointed out that before the general shareholders meeting, in answering such inquiries and requests, investors have to consider different factors from those after the meeting. Further, how definitely they should inform the company approval or disapproval may vary among investors.

(1) Before the shareholders meeting

(Investors who always provide clear-cut explanation on whether approval or not)

- We give companies simple yes or no according to our voting standard.
- When we cast a negative vote on the company's proposal, we inform companies of our intention to do so before the vote.

(Investors who does not always provide clear-cut explanation on whether approval or not)

- We give our answers when required, but not always so clearly to the inquiries on individual agenda item especially before the shareholders meeting.
- Our response varies depending on whether the inquiry is made before the agenda items are fixed or after they are fixed. We can expect the change of the concerned agenda items by telling the companies our voting standard before they are fixed. For inquiries after the agenda items are fixed, we tell the companies only a touch of affirmative or negative, adding that it is not a final decision.
- We tell companies our stance on each agenda item as much as possible beforehand, since we do not want any agenda item to be put on a vote.
- The investors' response may vary depending on whether the inquiry is directly from the company or from the advisor of the company. Direct inquiry is preferred because, in case of inquiry from a third party, only yes/no may have wings without explanation of why the investor would so vote.

(2) After the shareholders meeting

- For the companies visiting us after the shareholders meeting, we disclose our vote without even being asked.
- Many companies do not even bring up the subject of the result of the votes already casted unless we do, because they are not so interested.

(3) Why companies complain about non-explanation of investors for voting?

- Among those complaints, there may be a number of cases where the inquiries are made from IR division of the company to fund managers. Fund managers usually do not know about voting.
- Even if the fund manager had no idea, such inquiries should have been transferred to someone in charge of voting. Such lack of internal communication is regrettable.
- Companies' IR and SR divisions should have known the voting of individual investors with some ideas about the reasons of such vote. The problem might be that such information and understanding are not shared from the ground level to the top management inside the company.

- The cause of miscommunication between companies and investors might also be that who to ask and who to be asked are unclear at both sides.

2 Communications inside the Each Organization

(1). Inside the investment company

- It is important to have consistent policy on investment decisions and voting decisions inside investment companies.
- If the investment and voting are both operated by a single team, and the fund manager is involved in standard making, such inconsistency would not happen.
- It is difficult to pay close attention to individual cases for investment companies who vote on more than a thousand companies in the proxy season. Many such investment companies separate voting personnel from investment personnel.
- There are some cases where investment companies with such separated structure actually changed its policy in order to include fund manager's opinion in the discussion on their voting standard in the process of adopting the Japan's Stewardship Code.
- Such involvement of fund managers and analysts in individual voting decision may lead to having double standards for passive and active management.
- The extent may vary among investment managers, but there are certain number of fund managers and analysts who have little interest in voting or governance of investee companies. Some IR personnel of companies may feel that such fund managers and analysts should take more interests in such matters.
- In the case of agendas regarding, for example, corporate actions such as restructuring of the organization, the decision of individual investors with the information on prior estimate for the number of votes can collectively be deemed as "material non-public information" under the insider-trading regulations, and therefore some investment companies separate voting personnel from investment personnel.

(2). Inside the investee companies

- IR personnel does not seem to be so interested in individual voting unlike SR division including the personnel in charge of shareholders meeting who has strong interests in individual voting.
- The companies' indifference to the voting after the shareholders meeting might be caused by the disconnected IR- SR relationship in the company. We hold a dialogue with SR person before the shareholders meeting, cast a negative vote to the agenda concerned and then explain the reason of the vote to IR person, but IR person shows little interest. This may happen because the discussion in the dialogue is not shared between SR and IR.
- More and more IR personnel attend the meeting about voting. The companies' attitude is becoming polarized; SR-IR cooperation becoming closer in some companies, but SR and IR do their own business separately in other companies.

3 How Voting Should Be

- ✧ **<The Raised Issue>** One of the agendas companies are most eager to know the reason for negative voting is election vote of their top executives. When investor casts a “negative vote as a message” only to show his/her dissatisfaction at some other concerns which is not included in the agendas in the shareholders meeting, it might be hard for companies to surmise the message behind the vote.

(1) Negative Vote as a Message against Election of Officers

(Negative Views)

- The concern is that the voter cannot bear the responsibility if the CEO and all the other executives are not elected partly because of his/her negative vote, even if the vote itself is only a message from the investor. In such case, the voter should make a counterproposal. However, in Japan, unlike in United States, the investors do not have so much resource to propose alternatives.
- It is a sort of a cynical ploy to send a message by a negative vote even with an assumption that it would not result in dis-election.
- Should there be a case where a one-in-a-million CEO is dis-elected, such a voting policy as “showing dissatisfaction at management in general or objection to issues which is not on the table by voting against the CEO or other executive election” might be a bad policy.
- The vote against the election of the CEO is a very rare case for us. Objection to the top of the company is a critical issue. We would rather sell such companies’ shares than vote against the election of its top executives.
- Another concern is that, for small-sized companies, absence of CEO could be a major obstacle to the company management.
- Investors determine the vote in consideration for increasing the corporate value of the investee company. Analysts and fund managers vote for the election in a case where dis-election of the CEO causes a significant decrease of the corporate value.

(Affirmative Views)

- It is important to send a message from shareholders. Investors who vote against the election as a message may not have intention to dis-elect the executives, but if it consequently turns out to be a consensus, it could result in dis-election of all the executives. And, still, it does not mean an immediate shutdown for management. After the dis-election of the management, companies have another chance to elect the directors. That is why we do not think that investors should refrain from voting against the election if they have no counterproposal.

(2) Voting Standard: Minimum Requirement vs. Best Practice

(Minimum Requirement Approach)

- With portfolio managers with various opinions, our voting standard tends to be one-size-fits-all. We usually end up in casting negative vote only on the seriously problematic agendas.
- Having numerous voting agendas, we share the tasks while keeping a concurrent judgment. That is why we tend to avoid having qualitative voting standard.
- Minimum requirement approach is useful in leading to a common conclusion and being accountable to everyone.

- If the investors take an approach like minimum requirement, it is important to share untold requirements with the investee companies in an individual dialogue to encourage its betterment.
- The term “minimum” varies a good deal among investment companies. The “Minimum Requirement” in this session is just an idea for the comparison with the other approach - “Best Practice.”

(Best Practice Approach)

- It is good to have rooms for discretion or qualitative judgment in voting standard. Suppose that an investment company’s voting standard requires the investee company to raise its dividend propensity when a certain requirement is satisfied. In such case, considering the unique variables such as the timing and needs of capital investment of the company or profit piled by an extraordinary income into account may enable more appropriate voting.
- If fund managers try to give weight to the analysis in the investee company’s fundamentals in voting judgment, the fund managers need to have a certain level of discretion. Pursuing simply transparency and accountability is not always a priority issue.
- The application of voting standard varies depending on investee companies. “Vote no, if the performance does not meet the best practice” such static judgment based on clear-cut standard may be a choice when investing only in the bluest of blue-chip companies. The same standard would not work for the companies just after the IPO. It may result in negative votes against most of the election of their officers.
- It is also important to urge the investee companies to increase their corporate value by setting the higher standard for voting for them to hurdle.

(3) Unified of Diverse Exercise of Votes

(Opinions for Unified Exercise of Votes)

- It is easier to show the investors’ opinion to the investee companies by unified votes. Also, the message will be clearer.
- Being either active or passive manager, votes should be unified to serve the shared objective of the increase of investees’ corporate value.
- Even when fund managers have different judgments, discussion may help to reach the unified voting.

(Justification for Diverse Exercise of Votes)

- Consistent judgment on investment and voting of each fund is made possible by reflecting various approaches of individual fund managers with different investment approaches and time axes into the votes in a single investee company. Diverse voting may happen as a by-product of such investment through multiple funds.
- If the investment companies place much value on individual dialogues with companies as its policy, there is relatively large room for qualitative judgment such as evaluation on progress of dialogue. Unified exercise of votes as a result is not always necessary.

4 Company-level Voting Disclosure

- ◇ **<The Raised Issue>** Company-level voting disclosure has been proposed in the 8th Follow-up Meeting like investment companies overseas.
 - There would be no problem in disclosing voting results to the individual investee companies, but publishing such information would lead to the media toning up such results improperly and our investor-investee relationship based upon constructive dialogue would be distorted and brought down to another level; like investor- media and company-media relations. Such distortion would negatively affect investor-investee relationship based on hard-earned trust. Careful consideration is required.
 - It is hard to believe that company-level voting disclosure would enhance our engagement activities. Basic principle of any dialogue is confidentiality; dialogue in the room should stay in the room unless otherwise required by exceptional circumstances. Company-level voting disclosure would be a disclosure of disagreement in the dialogue, which is against the principle of the dialogue.
 - In the UK, investors and companies place high value on the discussion before the agendas are fixed. Deliberate dialogues are held on controversial issues before the shareholders meeting and, as a result, most agenda items are approved. This may be a model for Japanese corporate governance.
 - Company-level voting disclosure may emphasize the results of the voting, and disagreement would be on focus, and therefore the accumulated momentum toward investor-investee dialogue would be dispersed. Further, focus on conflict poses reputation risk for both investment companies and investee companies.
 - Company-level voting disclosure cannot be valued positively in advancing investors' engagement and corporate governance. In addition, costs to be borne by investment companies to make the disclosure happen would not be small. A blanket application of the disclosure seems to bring more harm than good. The problem of conflict of interest can be addressed by vesting voting rights to a third party and so forth.

▪ <Forum of Investors Japan: Mission Statement>

With the aging and decreasing population in Japan, how to maintain and generate national wealth has become a crucial issue for the Japanese. In order to deal with this issue, a more effective use of capital to create value, that is, a more effective combination of human capital, intellectual capital and financial capital will be required. Companies are the stage for this. Reinforcement of the competitiveness and earning power of every company is believed to be the condition necessary for building the strength to create value in Japan as a whole.

On the other hand, the role of investors is to provide capital to companies that take on such task (retained earnings is a form that investors provide capital, in addition to IPOs and POs). Return from invested capital will be reinvested, which will promote the creation of more value to companies. As the main body of the investment chain that creates such virtuous cycle, investors are expected to assume the crucial role of "stewardship responsibilities".

From these perspectives, we want to understand in more depth measures taken by the companies to create values in the long-term, and to hold straight-forward talks with listed companies about the issues that the companies encounter.

With regard to our interests as mentioned above, the implementation of the Corporate Governance Code is expected to create a better environment for "dialogue with shareholders", but at the same time, as the Japan's Stewardship Code and Ito Review point out (Notes 1 and 2), institutional investors are required to enhance their "capability" to share knowledge and experience in order to have better dialogue with companies and make better judgments.

We operate the "Forum of Investors Japan" for the purpose of supporting institutional investors acquire skills to appropriately fulfill their stewardship responsibilities toward their investee companies, and thereby realize constructive dialogue between the institutional investors and investee companies, and contribute to the sustainable growth of such companies.

(Note 1) Japan's Stewardship Code, Principle 7-3

Exchanging views with other investors and having a forum for the purpose may help institutional investors conduct better engagement with investee companies and make better judgments.

(Note 2) Ito Review (pp.116-117)

"In order to enhance their capability for having dialogue with companies, it is important for a platform to be established in which institutional investors can share knowledge and experience, and have frank discussions on this matter. It is expected that this platform will help to provide a shared intellectual basis for dialogue and engagement, including issues such as the depth, appropriate counterparty at the company, and focus of dialogue.

* Please see the website below for more information on the activities of the Forum of Investors Japan
<http://investorforum.jp>