CONSULTATION RESPONSE

THE FINANCIAL SERVICES AGENCY GUIDELINES FOR INVESTOR AND COMPANY ENGAGEMENT

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PRI Association

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ABOUT THE PRI

The Principles for Responsible Investment (PRI) is the world's leading initiative on responsible investment. The PRI is now a not-for-profit company with over 3,800 signatories (pension funds, insurers, investment managers and service providers) to the PRI's six principles with approximately US $100 trillion in assets under management.

The PRI supports its international network of signatories in implementing the Principles. As long-term investors acting in the best interests of their beneficiaries and clients, our signatories work to understand the contribution that environmental, social and governance (ESG) factors make to investment performance, the role that investment plays in broader financial markets and the impact that those investments have on the environment and society as a whole.

The PRI works to achieve this sustainable global financial system by encouraging adoption of the Principles and collaboration on their implementation; by fostering good governance, integrity and accountability; and by addressing obstacles to a sustainable financial system that lie within market practices, structures and regulation.

ABOUT THE CONSULTATION

The Financial Services Agency (FSA) has published the revised draft of the "Guidelines for Investor and Company Engagement" based on the proposal by the Council of Experts concerning the follow-up on Japan's Stewardship Code and Japan's Corporate Governance Code. The Guidelines, originally published in 2018, are intended to be supplementary to the Stewardship Code and the Corporate Governance Code, and provide agenda items for engagement between institutional investors and companies. The revised guidelines include agenda items on management's response to ESG issues, responsibilities of the board and on general shareholder meetings.

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PRI'S RESPONSE

The PRI welcomes the revised version by the Council of Experts of the Guidelines for Investor and Company Engagement, which explicitly recognises the importance of sustainability (including ESG issues), board responsibility and diversity in creating long-term corporate value.

We recommend that the Council of Experts provide greater clarity on how these guidelines should be used by investors and companies to implement the Stewardship Code and the Corporate Governance Code. For example, the guidelines could cross reference principles in each of the Codes that these agenda items are designed to support, provide contextual information to users on why specific questions or items have been included and what is current and good practice in the market. We also suggest that a review is conducted to examine how the guidelines are being used by investors and companies and how it can be improved.

While the Guidelines are designed to promote constructive engagement, it is important to ensure they do not lead to investors interpreting their stewardship responsibilities as being limited to asking questions to investee companies. The purpose of the engagement dialogue should be clearly defined, including that investors should clearly communicate their objectives and expectations to companies.

The guidelines should not be interpreted as a checklist of agenda items for engagement but used as a tool to drive a two-way meaningful dialogue between investors and companies. To be effective in promoting the sustainable growth of companies and enhancing medium- to long-term value, constructive and purposeful engagement should enable investors to share their views and expectations of corporate management in general and in relation to managing ESG risks and opportunities, while also allowing companies to provide further detail and clarity on their strategy and the relationship between ESG factors, their business model and financial performance.

Our further comments below draw on specific expertise and evidence from the PRI's work.

Item 1.3 Management response to ESG issues and the SDGs, and establishment of a sustainability committee

We welcome the explicit reference in the guidelines to governance structures that support corporate management of sustainability issues. We recommend inclusion of a corresponding requirement in the corporate governance code asking companies to establish board oversight of sustainability issues, given their relevance to business operations and the overall success of the company. To meet this requirement, companies could establish a board committee with a focus on sustainability or incorporate sustainability into the mandate of an existing board committee. With robust oversight and leadership on sustainability, companies will be better equipped to manage sustainability-related matters in their own operations as well as value chains and maximise environmental, social and economic performance.

Item 3.5 Remuneration

We welcome the agenda item focused on the alignment of remuneration with sustainable growth and increase in corporate value over the mid-to-long term and a clear explanation on executive pay rationale. We recommend that the Corporate Governance Code and the questions in this guidance emphasise that companies should consider ESG factors when determining compensation. We believe that this is one means by which executive pay can be better be aligned with performance, protect, and create long-term value.

Item 3.6 and 3.7 Responsibilities of the board

We welcome the inclusion of diversity as criteria for board composition. However, as mentioned in our response to the consultation on the revision to the corporate governance code, the disclosure requirement should be strengthened by explaining how diversity will be measured and by clarifying minimum expectations around what it means for a board to be diverse. In addition, the definition of diversity should be extended beyond gender representation and include other characteristics which reflect the Japanese society (e.g., age, disability, sexual orientation). Diversity policies should also include strategies to improve equity and inclusion at all levels and not just at the board level, to enable access to opportunity and to decision making to individuals with different identities.

We welcome questions relating to board effectiveness including on board evaluation. In line with our response to the revisions of the corporate governance code, we recommend that there is explicit reference to the use of independent third-party reviewers for board evaluations.

Item 3.8 Appointment of Independent Directors and Their Responsibilities

We recommend incorporating guidance on the use of a skills matrix (as identified in the corporate governance revisions) to evaluate and undertake gap analysis on diversity, skills and expertise on the board. We also recommend including supplementary guidance to strengthen disclosure on succession planning, the role of the nominations committee and information on new board appointments in line with our response to the corporate governance code revisions.

Item 3.12 Whistleblowing

We welcome the focus on whistleblowing within the Guidelines. We recommend that further questions are added to promote investors' understanding of the implementation and effectiveness of whistleblowing systems, specifically around the scope of the whistleblowing policy, channels including options to report anonymously, training and disclosure on type and frequency of whistle-blower reports. The quality of the information provided in these areas can help investors seek improvements on whistleblowing mechanisms and advocate for a speak-up culture.

Item 4.1 General Shareholder meetings

We welcome the agenda items that have been included in the revision designed to enhance communication between investors and companies in relation to shareholder meetings.

Well-informed voting is an essential part of stewardship, enabling investors to communicate with companies in an efficient manner. We therefore welcome the questions that focus on the disclosure of information related to a company's general meetings. Timely disclosure of this information is vital to allow institutional investors sufficient time to make well-informed voting decisions.

We also support the inclusion of agenda items that encourage investors and companies to communicate with each other regarding voting outcomes and investors' rationale for voting, particularly for opposing votes. For voting to be as effective as possible it needs to be coupled by transparency and communication by investors toward companies. This enables companies to understand the rationale for their voting behaviour and to take appropriate actions.