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**B**uilding an information environment essential  
for success of Japan's stewardship code

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## Executive Summary



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**NOTE**

- 1) A stewardship code is a set of principles intended to guide institutional investors in fulfilling their responsibilities to both their clients/beneficiaries and investee companies (excerpted from FSA's website).
- 2) Its official name is the Council of Experts Concerning the Japanese Version of the Stewardship Code.

*The FSA has decided to introduce a Japanese stewardship code(stewardship responsibilities: <http://www.fsa.go.jp/en/news/pub/01.pdf>). The stewardship code mainly seeks to ensure that institutional investors monitor the status of their investee companies, engage constructively with investees, exercise their voting rights, and report to their clients and beneficiaries. The asset management industry is now weighing the stewardship code's costs and benefits.*

On February 26, 2014, a Japanese stewardship code<sup>1)</sup> was approved by a council of experts<sup>2)</sup> assembled by the Financial Services Agency (FSA). When the council was first established, the asset management industry was concerned that it was unable to do more than it was already doing and that compliance with the code would not be cost-beneficial. While no one disputes the importance of institutional investors monitoring the status of their investee companies and exercising their voting rights in the aim of improving investment returns, the benefits of time and money spent gathering the requisite information are hard to predict because investee companies are influenced by other shareholders' actions also. The stewardship code's seventh principal requires that institutional investors possess the capability to make proper judgments in fulfilling their stewardship responsibilities. If many shareholders do not adequately possess such capabilities, there is a risk that they may vote in a manner not conducive to companies' sustained growth. The stewardship code will not be highly effective unless it is embraced by many institutional investors and shareholders in aggregate engage companies in high-quality dialogue and exercise their voting rights. What is needed for this to happen?

### Challenges to realization of Japan's stewardship code

Gathering information to monitor companies' status and exercise voting rights currently poses a heavy burden for institutional investors. Even if some investors

**Summary of principles of Japan's stewardship code for institutional investors**

1	Formulate and publicly disclose policy on fulfillment of stewardship responsibilities
2	Formulate and publicly disclose policy to manage conflicts of interest
3	Reliably obtain information on investee companies to fulfill stewardship responsibilities
4	Endeavor to constructively engage with investee companies
5	Set clear policy on voting and disclosure of actual votes
6	Periodically report to clients and beneficiaries
7	Possess the capability to make proper judgments in conjunction with stewardship activities

Source: NRI, based on FSA expert council's report

engage investee companies in dialogue based on diligent research, such efforts will not serve to enhance the companies' value without the understanding of other shareholders. However, many investors face information bottlenecks that impede swift and equal dissemination of high-quality understanding.

Currently, 70% of listed Japanese companies have a March fiscal year-end. Most annual general meetings of shareholders are concentrated at the end of June. Consequently, thoroughly researching the state of individual companies' operations and voicing opinions at shareholder general meetings is a Herculean task for institutional investors. The densely packed schedule of shareholder general meetings is not the only problem. Many asset management companies currently manage information by manually inputting it into their spreadsheets. Although some information is provided by electronic data services, non-financial information, unlike numerical data simply used for decision-making, usually must be interpreted and assessed when it is inputted. Some information processing tasks are still done manually by individual asset management companies.

When a shareholder general meeting agenda arrives, asset management companies analyze the latest information as described above, but relevant information is sometimes dispersed among various sources and difficult to reliably obtain. Some asset management companies complain that they are unable to set broad voting policies to enable them to make decisions based on consistently available information.

Because institutional investors perform such tasks under tight time constraints, they could reach differing conclusions due to information insufficiency. In such an event, shareholders' influence on companies would be dispersed, the quality of overall shareholder engagement would worsen, and asset management companies would end up only incurring costs without benefiting from enhancement of investee companies' value.

### **Situation in the UK, birthplace of stewardship code**

Before exercising their voting rights, institutional investors should devote adequate time to studying the resolutions to be voted on at shareholder general meetings. If they do not have the latitude to do so because they are too busy gathering information, they have lost sight of the forest for the trees. The same issue exists in the UK. If gathering information to engage investee companies and exercise voting rights is too burdensome, shareholders in aggregate would not obtain sufficient information,

shareholder votes would have divided outcomes, time spent engaging companies in dialogue would decrease, and shareholder engagement would be unlikely to have much effect on companies' growth. The UK's experience dealing with such practical challenges offers valuable lessons.

In the UK, pension funds have since 1995 been required by the Pensions Act to formulate investment principles that take into consideration investee companies' business environment, ethics, and governance and, if they outsource portfolio management to external asset managers, to monitor whether the asset managers are investing in accord with equivalent investment principles. As the UK's stewardship code became widely adopted, small pension funds that initially exercised voting rights themselves increasingly delegated voting to asset managers with a high degree of information-gathering and engagement capabilities and assumed an oversight role<sup>3)</sup>. Many institutional investors that exercise their voting rights themselves have outsourced the task of gathering the information upon which they base their voting decisions. When institutional investors are unable to directly speak to companies (e.g., in the case of foreign stocks), they often utilize research services. Some such services provide detailed reports based on company interviews conducted on behalf of institutional investors. Such services not only reduce information-gathering cost per company and improve overall efficiency, they also enable institutional investors to allocate more time to in-depth analysis and engagement with companies. Additionally, some institutional investors that manage assets themselves and devote substantial resources to engaging companies and exercising their voting rights offer new "overlay" services whereby they help other investors exercise of voting rights and engage companies in dialogue. In 2012, overlay service users increased 50% relative to 2011<sup>4)</sup>.

### Building information infrastructure required to realize stewardship code's benefits

Over the course of the six months during which the FSA's expert council discussed adopting a stewardship code, some within Japan's asset management industry have started to express the view that asset management companies should see the stewardship code's adoption as an opportunity to upgrade in-house information infrastructure to facilitate compliance with the stewardship code. However, the industry as a whole needs to create an environment in which basic information is readily available and institutional investors have sufficient time to engage companies.

From 2014, the FSA is expanding the scope of XBRL<sup>5)</sup> disclosure to encompass the

3) According to UK pension-related institutions' corporate governance staff.

4) According to "Adherence to the FRC's stewardship code at 30 September 2013" (published by the Investment Management Association), which reported that the percentage of survey respondents that use overlay services increased from 6% in 2011 to 9% 2012.

5) The FSA has required listed companies to submit security reports' primary financial statements in XBRL (eXtensible Business Reporting Language) format since 2008. In conjunction with a September 2013 system upgrade, the FSA expanded the scope of XBRL disclosure to 64 forms, including large shareholder reports and extraordinary reports. Listed companies are now required to submit these documents, including nonfinancial information, entirely in XBRL format. As a result, disclosure documents can now be automatically checked for complete compliance with statutory disclosure requirements.

entirety of securities reports, extraordinary reports, and other documents submitted to the FSA's EDINET electronic disclosure system. Since discussions of the stewardship code began, institutional investors have become interested in whether all extraordinary report content on the outcome of votes at shareholder general meetings will be available in data format. For example, one possibility is adoption of notation compatible with XBRL in the reports, such as quantitative descriptions or identifiers for non-quantitative information<sup>6)</sup>. XBRL's functions include English tags, which enable foreign investors to obtain information and ascertain its content at the same time as Japanese investors. Facilitating dissemination of information to all shareholders as soon as it is disclosed should help institutional investors allocate sufficient time to reviewing the information in preparation for voting and to qualitatively improve such reviews. Another idea is to enable shareholder general meeting agendas, like securities reports, to be submitted to EDINET and made available in not only PDF but also XBRL format as soon as they are prepared<sup>7)</sup>. This may be help to expand research and other services in addition to enhancing institutional investors' convenience.

6) Even if prepared in XBRL format, the portion of nonfinancial information that can be processed as data is currently limited. Conceivable means of making data more user-friendly include assigning uniform codes and transliterating corporate officers' names into the Western alphabet in securities reports. Inclusion of such information in securities reports would enable users to efficiently ascertain corporate officers' dual-role status and other such matters.

7) Currently, shareholder general meeting resolutions are submitted to EDINET as PDF attachments at the time of or after securities reports' submission.

Even for support service providers, gathering information currently poses a high hurdle in terms of both costs and time constraints. If information infrastructure is provided by the FSA or other parties, this infrastructure should be a tailwind for such services. Initiatives to improve the disclosure information environment so that institutional investors can devote more time to engagement and high quality voting in the aim of enhancing investee companies' value should be a top priority.

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