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Council of Experts Concerning the Japanese Version of the Stewardship Code
c/o The Japan Financial Services Agency
Corporate Accounting and Disclosure Division
Email: jstewardship@fsc.go.jp

To the Members of the Council:

We are writing on behalf of Sodali, the international corporate governance consultancy and service provider to companies in major markets around the world (www.sodali.com). In Japan, Sodali works in partnership with J-Eurus Investor Relations Company, Inc. (www.j-eurusir.com). Together we offer Japanese client companies both a global and local perspective on matters relating to their relations with shareholders, corporate governance, board structure and responsibilities, conduct of shareholder meetings and vote solicitation, activism and contests for control, communication and engagement with investors about financial performance, environmental, societal and governance issues (ESG).

We welcome the opportunity to comment on Japan's Stewardship Code (the "Code"), which deals with issues of great importance to both our corporate clients and to the global community of institutional investors whose interests are central our business.

In our view, the Code represents a comprehensive approach that is consistent with the UK Stewardship code and similar codes being developed in other markets. We congratulate the Council for taking this approach. As Japan is the third largest global economy, adoption of the Code will have global impact and will contribute to the acceptance of uniform stewardship standards that are needed in today's borderless investment environment.

We support the Code and we believe that its seven principles provide an effective framework for strengthening the stewardship role of investors in Japanese companies.

- Principle 1 makes the Code self-enforcing, requiring investors to fulfill their responsibilities and to publicly disclose that they do so.

- Principle 2 mandates accountability on conflicts of interest. It will take time to determine the effectiveness of this provision, which will depend on how conflicts are defined and how accountability is enforced by regulators and the courts. Conflicts of interest in the financial markets are complex and difficult to manage, as the financial crisis of 2008 so clearly demonstrated. The evolution of effective conflict policies will require a collective effort involving all the major financial markets, not just Japan.

- Principle 3 mandates monitoring of portfolio companies. Here again, the meaning of this responsibility and implementation strategies will develop over time.

- We applaud Principle 4, which encourages constructive engagement rather than confrontation between investors and companies. Sodali's motto, "aligning interests", is based on this very principle. However, it is important to recognize that companies, even more than investors, should accept primary responsibility for seeking common ground with investors and initiating constructive engagement. Although activism has consistently been initiated by shareholders, there is a growing awareness that companies and their boards of directors must make a greater effort to understand shareholder expectations, must engage and communicate more effectively and more substantively with investors and must provide greater transparency about boardroom decisions and business strategy.

- We strongly endorse Principle 5 and we hope that the Council will work with Japanese companies, investors, regulators, custodians, record keepers and other global intermediaries to facilitate the cross-border voting process. Despite its technical complexity, share voting is the sine qua non of good governance and accountability of both investors and companies.

- Principle 6 seems to differ from Principle 1 primarily in its requirement for periodic reporting. It is our hope that the reporting requirement will be broadened to include the public rather than being limited to clients and beneficiaries.

- Principle 7 is essential to the implementation of principles-based, comply-or-explain stewardship. Institutional investors must include in their investment criteria the concept of "sustainable growth" (i.e., adopting a long-term value perspective and acknowledging the importance of ESG and non-financial metrics over and above quarterly earnings and short-term financial goals). Investors must also maintain "in-depth knowledge" of individual companies and their business conditions. We recognize that it will be difficult to enforce this principle. There will inevitably be disagreements on the part of companies as to how well investors understand a business and its challenges. Nevertheless, this principle is fundamental to effective stewardship. Proxy advisory firms also should be required to adhere to this principle in evaluating Japanese companies and making vote recommendations.

Our final comment relates to the inextricable relationship between investor stewardship and corporate governance. Stewardship standards for investors work in tandem with corporate governance standards for companies. Indeed, the goal of many commentators who endorse stewardship codes is to harmonize the oversight of institutional investors with that of listed companies. Although public companies and institutional investors both have well defined fiduciary roles, there is longstanding concern that companies are overregulated while investors are underregulated, particularly on matters relating to governance and conflicts of interest. Accordingly, in the wake of the global financial crisis and decades of governance reforms aimed at companies, attention is now turning to the governance and fiduciary responsibilities of institutional investors and financial service companies.

Our concern is that in Japan the regulatory conditions are uniquely different: corporate governance standards for Japanese companies are underdeveloped and lag far behind global best practice guidelines. This deficiency will create serious problems for the Code. First, Japan does not have a framework of corporate governance rules and best practices against which investors can evaluate Japanese investee companies. Second, the comply-or-explain mechanism embraced by the Code cannot work effectively in the absence of corporate governance principles against which a Japanese company's non-compliance can be evaluated. Lacking a corporate governance code for Japanese companies, institutional investors will be compelled to make stewardship decisions on the basis of global standards and proxy advisors' policies. It is already clear that Japanese companies do not fare well when measured by these external criteria. In our view this "bottom-up" approach – focusing on investor stewardship ahead of corporate governance – "puts the cart before the horse." We are concerned that it will have unfortunate consequences for Japanese companies, increasing pressure for strict compliance, perpetuating the one-size-fits-all, box-ticking approach and fueling governance disputes and shareholder activism.

Sodali believes that Japan needs its own Corporate Governance Code. Japanese companies, market leaders and regulators should work together to develop corporate governance principles that validate Japanese business traditions and culture. Such important characteristics as consensus decision-making, commitment to customer satisfaction, focus on market share and other business and labor practices that are fundamental to the success of Japanese companies globally should be integral to Japanese principles of corporate governance. A Japanese Corporate Governance Code would in turn serve as the basis for developing a comply-or-explain governance system and for implementing the stewardship code.

Although we support uniform global stewardship standards for institutional investors, we do not endorse uniformity, strict compliance or a one-size-fits-all approach to corporate governance. We would urge Japanese companies (as we do with Sodali clients in other countries around the world) to adopt a distinct Japanese model of corporate governance based on policies and practices that are best suited to their particular business goals, traditions and circumstances. We would further urge Japanese companies to increase their transparency and to explain in strategic business terms how their governance choices are intended to strengthen the enterprise and create value for shareholders over the long term. At the same time, we believe that executives and directors of Japanese companies should understand global sodali ALIGNING INTERESTS

expectations, should be well-informed about global corporate governance practices and should be capable of benchmarking their companies against them.

Until Japanese companies commit to developing their own corporate governance principles, they will face growing pressure from investors to conform to governance standards that may or may not be appropriate. Adoption of the Stewardship Code will certainly increase this pressure.

We hope the members of the Council to recognize that the Code will achieve its goals only if firmly linked to an effective set of corporate governance principles for Japanese companies.

Respectfully submitted,

John C. Wilcox	Alvise Recchi	Andrea Di Segni
Chairman	CEO	Head of Corporate Advisory