ASIAN CORPORATE GOVERNANCE ASSOCIATION

Unlocking shareholder value through collaborative engagement

17 DECEMBER 2024

How can collaborative engagement be pivotal to ongoing corporate governance reform in Japan?

Unlock shareholder value through collaborative engagement

What's needed from investors: Strategic framework driven by timebound, quantitative and qualitative KPIs and two-way dialogue

What’s needed from regulators: Regulatory environment to create legal certainty for collaborative dialogue between corporates and investors in a safe and neutral space

What’s needed from companies: Responsive IR, senior management and independent director involvement, disclosures and transparency, earnest alignment of targets (not box-ticking) with investors through dialogue

Practical case studies from ACGA investor sub-groups from Japan and other regional markets showing characteristics of both success and poor outcomes

Investors: Strategic framework driven by timebound, quantitative and qualitative KPIs and two-way dialogue

- **Collaborative platforms/investor-forums**: Foreign investors can recommend global best practises while domestic investors have perspective on local corporate culture. Both foreign and domestic investors should define clear, shared goals for joint engagement through collaborative platforms. This involves outlining specific outcomes they aim to achieve, which helps align efforts and resources.

- **Effective strategy:** Clearly defined objectives (higher price/book, higher ROE, board diversity, Scope 3 reporting), along with a **strategic plan** to reach goals with **time-line** and interim targets to **track progress** (quantitative KPIs) effectively.

- **Evaluation of engagement opportunities:** If possible, meet both parent company and subsidiaries to get full picture and to assess engagement potential. Meet diverse stakeholders like proxy firms, director training academies, business corporations to express our view from investors' perspective.

- **Two-way dialogue:** Companies likely have unique challenges – engagement should be two-way, allocating time for companies to ask questions of their investors.

- **Partnership approach:** ***Short-term engagement*** for easy fixes on capital efficiency can be combined with ***long-term engagement*** to discuss best practices domestically and globally for mid-term plans. This requires investors' patience, *but incremental changes can accumulate into significant impact.*

Collaborative platforms can drive change through constructive dialogue

UK-Investor Forum

- A non-profit community interest company set up by institutional investors in UK equities, confirm the role that effective communications can have in driving sustainable long term value creation amidst rapidly changing stakeholder interests and market dynamics.

Global-UN Principles for Responsible Investment (PRI)

- The PRI is an international network of investors working together to understand the investment implications of environmental, social, and governance (ESG) factors. It encourages collaborative engagement as part of its framework.

Global-Climate Action 100+

- Brings together over 700 investors to engage with companies on their climate-related strategies. Focuses on collective action to drive significant changes in corporate behavior regarding emissions reduction.

USA Conference Board Governance Center

- Hosts confidential discussions among senior executives from corporations, investors and advisors to address mutual concerns.
- Provides guidelines for effective engagement strategies between companies and their investors.

Regulators role: Japan needs clear rules for legal certainty, a safe place for collaborative dialogue between corporates and investors

Stewardship code revision to clarify "joint holders" and "act of material proposal" The revision of Financial Instruments and Exchange Act (FIEA) clarified the definition of "joint holders": excludes asset managers agreeing on exercising shareholder rights, including proxy voting rights, not for the purpose of jointly proposing "the act of a material proposal". *However, still not clear if collaborative engagement is considered as "act of a material proposal" and if investors are not regarded as "joint holders"* (i.e. if there needs to be a safe harbor provision).

ACGA would recommend to follow European Securities and Markets Authority ("ESMA") which has published a "whitelist" of activities that shareholders may undertake without being deemed to be acting in concert for the purposes of Directive 2004/25/EC on Takeover Bids (the "ESMA Takeover Guidance"). FSA could consider including this in its stewardship code revision expected in March 2025 to increase transparency and legal certainty.

Shareholder cooperation and acting in concert

3.1 ESMA recognises that shareholders may wish to cooperate in a variety of ways and in relation to a variety of issues for the purpose of exercising good corporate governance but without seeking to acquire or exercise control over the companies in which they have invested. Cooperation might consist of discussing together issues that could be raised with the board, making representations to the board on those issues, or tabling or voting together on a particular resolution. The issues on which shareholders might cooperate could include commercial matters (e.g. particular acquisitions or disposals, dividend policy, or financial structuring); matters relating to the management of the company (e.g. board composition or directors' remuneration); or matters relating to corporate social responsibility (e.g. environmental policy or compliance with recognised standards or codes of conduct).

Regulators role: Japan needs clear rules for legal certainty, a safe place for collaborative dialogue between corporates and investors (2)

Transparency of beneficial shareholders: Currently Japanese companies require multiple steps to attend AGMs if shares that are held under custodian names; often shareholders are not allowed to ask questions. Institutional investors are thus not able to use the annual shareholder meeting for dialogue, to enhance long term corporate value. AGMs need to be generally accessible and inclusive (please refer to ACGA's open letter of 17 October 2024).

We believe that FSA could work with Ministry of Justice for amendments to legislation requiring disclosure of substantial shareholder shares to include a provision that disclosed shareholders should be entitled to full AGM rights (including attending and speaking).

Incentivize companies to shift their record dates so that corporates do not cluster their AGMs at 3 months from the end of the financial year, i.e. end June. Holding AGMs later in the year would allow them to publish financial statements ahead of AGM, thus providing relevant disclosures to investors in a timely fashion and enhance the quality of dialogue in engagements.

Regulatory examples of stewardship codes supporting collaborative engagement framework

ESMA 1.5 public statement - If shareholders cooperate to engage in any activity on the Whitelist**,** insofar as that activity is available to them under national company law, that cooperation, in and of itself, will not lead to those shareholders being regarded as persons acting in concert and thus being at risk of having to make a mandatory bid

G20/OECD Principles of Corporate Governance help policy makers evaluate and improve the legal, regulatory and institutional framework for corporate governance of listed companies and state-owned enterprises

The UK Stewardship Code (2020) sets high stewardship standards for those investing funds on behalf of UK savers and pensioners, and those that support them; "Principle 10: Signatories, where necessary, to participate in collaborative engagement to influence issuers"

The **Framework for US Stewardship and Governance** codifies the fundamentals of good corporate governance and establishes baseline expectations for U.S. corporations and their institutional shareholders; "Principle F: Institutional investors should work together, where appropriate, to encourage the adoption and implementation of the Corporate Governance and Stewardship principles"

Dutch Stewardship Code developed by institutional investor platform Eumedion, emphasizes engagement and responsibilities of institutional investors in Dutch listed companies and should further boost engagement with the investees

The New Zealand Stewardship Code:

Aotearoa New Zealand's first Stewardship Code gives investors a clear framework for using their influence to steer the companies they own on critical environmental, social and corporate governance issues

ACGA recom-mendations for successful collaborative engagement

ACGA is a unique collaborative platform that combines diverse members from many different countries, backgrounds (legal, stewardship officials, portfolio mangers) to share common areas of concern. From our experience, below are recommendations for successful collaborative engagements:

Investors

- Have preparatory calls ahead of the meeting for comprehensive planning: allocate sub-group members to individual topics for the meeting
- Focus on key issues for company engagement (pre-determine speakers and focus questions for the meeting rather than laundry-list approach)
- Facilitate collaborative engagement that includes voices outside of Japan and recommendations in line with global best practices
- Two-way conversation for all meetings: allocate time at end of discussion for companies to ask questions
- Have sequential meetings with managers, directors over a period of 2-3 years
- Meet the company in-person at least once a year to build trust with the company
- Respect Acting in Concert rules and make sure to provide agenda of potential discussion topics that make this clear
- No one member to dictate the narrative, discuss investors' common priority areas before the call with the corporate
- Set short term and mid term KPIs for the engagement process and update after each engagement meeting

Corporates

- Encourage having more company officials hear the view of investor members; ensure investor concerns are discussed at the board level for effective implementation
- Align targets with investor dialogues and not just box-ticking; awareness of financial terms including valuations, ROE, cost of capital through director and key management personnel training
- Disclosures and transparency on recognized areas for improvement, including transparency on board evaluations

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Collaborative engagement follows relevant regulations and laws

- **Compliance with Competition Law**: Attendees must adhere to competition laws and avoid agreements or practices that prevent, restrict, or distort competition.
- **Prohibition on sensitive information exchange**: Attendees must not disclose or exchange strategic or competition-sensitive information about their businesses, such as pricing, volumes, costs, customer or supplier details, business strategies, or investment plans.
- **Avoid coordination**: Attendees must not coordinate views or actions that could restrict competition or result in concerted action between members or investment companies.
- **Information exchange caution**: Any inadvertent exchanges of information that could breach competition law must be avoided.
- **Legal compliance**: Participation in meetings requires full compliance with competition law. Attendees subject to legal or regulatory regimes must ensure they comply with their obligations, including public disclosure requirements.
- **No financial, legal or investment advice**: ACGA's and the Japan Working Group (JWG) inputs do not include financial, legal or investment advice.

ACGA Japan Working Group: topics and timelines in engagement process

Each company engagement is led by a sub–group chair; members meet a broad mix of IR, management and directors multiple times a year. The agenda is decided depending on common priority topics.

Company	Governance	Environment & Social	Capital Management	Others
Company A	Board independence Board diversity (skillset, gender) Board effectiveness (role of committees) Sustainability governance	Public policy on climate change Long-term GHG reduction	Cross shareholdings Parent-child listings Capex planning for carbon neutral target	Product Safety & Quality
Company B	Board independence Board diversity (skillset, gender) Board effectiveness (role of committees) Management compensation Sustainability governance Audit effectiveness	Materiality analysis ESG integration into business plan	Capital efficiency Cross-shareholdings	
Company C	Board independence Board diversity (skillset, gender) Board effectiveness (role of committees) Management compensation Sustainability governance	Chemicals safety Long-term GHG reduction	Capital efficiency Parent-child listings Mid to long-term business plan	

Subgroup	4Q21	1Q22	2Q22	3Q22	4Q22	2Q23	3Q23	1Q24	2Q24	3Q24
Company A (Investor X is sub chair lead)	Speaker: IR Team Agenda: Capital Management, Corporate Governance and Environment	Speaker: Chief Sustainability Officer Agenda: Environment, Corporate Governance		Speaker: External Director Agenda: Capital Management, Corporate Governance and Environment		Speaker: Chief Officer, Accounting Agenda: Corporate Governance, Climate Lobbying	Speaker: Head of IR Agenda: Capital Management, Corporate Governance, Climate Lobbying	Speaker: Head of IR Agenda: Climate Lobbying, Corporate Governance, Capital Management, Corporate Governance	Speaker: CEO, Chief Officer, Accounting Agenda: Climate Lobbying, Corporate Governance, Capital Management, Corporate Governance, Product Quality & Safety	Speaker: Chief Officer, Accounting Agenda: Product Quality & Safety, Capital Management, Corporate Governance
Company B (Investor Y is sub chair lead)	Speaker: IR Team Agenda: Capital Management, Corporate Governance and Audit Effectiveness		Speaker: External Director Agenda: Capital Management, Corporate Governance and Audit Effectiveness			Speakers: External Directors Agenda: Capital Management, Compensation, Succession Planning, Human Capital	Speaker: External Director, Director of Accounting Agenda: Corporate Governance, Capital Management, Mgmt Compensation			Speaker: External Director Agenda: Capital Management, Corporate Governance, Materiality Analysis
Company C (Investor Z is sub chair lead)	Speaker: IR Executive Officer Agenda: Capital Management, Corporate Governance		Speaker: IR Executive Officer Agenda: Capital Management, Corporate Governance"		Speaker: IR Executive Officer Agenda: Capital Management, Corporate Governance, Climate Change, Product Safety	Speakers: Head of IR, IR Exec. Officer Agenda: Corporate Governance				

Case study 1: Successful collaborative engagement with Company A

1) Background

Our collaborative engagement with Company A began in 4Q21: we conducted eight meetings with the firm's CEO, Chief Sustainability Officer, External Director, Chief Officer of Accounting and IR. The sub-group lead was initially with Investor X as chair and recently transitioned to Investor Y. Company A is widely recognized for its commitment to innovation, particularly in automotive technology and manufacturing processes.

2) Objective

The subjects covered with Company A span across capital management (cross shareholdings), corporate governance (board independence, diversity, succession planning), group governance and climate change. We recently added product safety and quality as an additional subject in light of quality and safety inspection issues that engulfed the group.

3) Scope and Process

This collaborative engagement has been successful as we have been able to hold constructive two-way dialogue with the company, achieving tangible results. We have been able to hold deep and insightful discussions with key management representatives as well as an external director. In each meeting, we have been able to gain better visibility of the company's efforts to address material issues while providing constructive feedback with respect to the company's capital management, governance and sustainability strategies. This was made possible by: (1) with Investor X sub-group leadership, well prepared meetings that led to better communication with the company; (2) engagement based on mutual respect and trust. Over the years that we have engaged the company, we have built up trust with the company that has allowed us to meet with various decision-makers including the CEO.

4) Outcomes

Positive outcomes include progress from the company to address: (A) unwinding of cross shareholdings across financial institutions, business partners and group companies; (B) improved disclosure of board independence requirements; (C) improved disclosure on climate lobbying activities.

5) Future goals for Company A

(1) Improved disclosure on capital management policy including future plans to unwind cross shareholdings; (2) corporate governance relating to board independence and skillset diversity; (3) strengthening group-wide compliance regarding product safety and quality.

Timeline of collaborative engagement with Company A

Key Objectives

Capital Management: Cross shareholdings, Parent-child listings, Capex planning for carbon neutral target

Corporate Governance: Board independence, Board diversity (skillset, gender), Board effectiveness (role of committees), Sustainability governance

Environment & Social: Public policy on climate change, Long-term GHG reduction

Others: Product safety & Quality

4Q2021
Speaker: IR Team
Agenda: Capital Management, Corporate Governance and Environment

1Q2022
Speaker: IR Team
Agenda: Capital Management, Corporate Governance and Environment

3Q2022
Speaker: External Director
Agenda: Capital Management, Corporate Governance and Environment

2Q2023
Speaker: Chief Officer, Accounting
Agenda: Corporate Governance, Climate Lobbying

3Q2023
Speaker: Head of IR
Agenda: Capital Management, Corporate Governance, Climate Lobbying

1Q2024
Speaker: Head of IR
Agenda: Climate Lobbying, Corporate Governance, Capital Management, Corporate Governance

2Q2024
Speaker: CEO, Chief Officer, Accounting
Agenda: Climate Lobbying, Corporate Governance, Capital Management, Corporate Governance, Product Quality & Safety

3Q2024
Speaker: Chief Officer, Accounting
Agenda: Product Quality & Safety, Capital Management, Corporate Governance

Company A appreciated our collaborative engagement and welcomed the in-depth dialogue with investors

Case study 2: Successful collaborative engagement with Company B

1) Background

Our collaborative engagement with Company B began in 4Q21, we have had 5 meetings to 4Q24 including 2 onsite visits and the same sub chair Investor Y led all engagements. Company B is a leading Japanese manufacturer specializing in pneumatic control equipment and industrial automation solutions, with a significant global presence.

2) Objective

The subjects covered with Company B span across board effectiveness, management compensation, audit effectiveness and capital management (including cross-shareholdings).

3) Scope and Process

ACGA conducted this engagement with multiple speakers from our investor group to tackle each agenda individually. Each topic was led by an investor who prepared discussion points including peer comparisons and KPIs to track progress, e.g. for audit effectiveness the lead investor recommended to improve disclosure on external auditor and review the process undertaken to appoint the external auditor.

4) Outcomes

- The board increased external independent board members, now 4 external directors out of 12 board members. Also, increased female directors from zero to two.
- Introduced performance-based bonus and stock compensation for senior executives.
- Since listing company B used the same external auditor M for 38 years, and has now changed to Auditor N.

5) Future goals for company B

Capital management: This is still a developing agenda item, ACGA JWG continues to request the company to introduce ROE or ROIC as part of management KPI.

Agenda of collaborative engagement with Company B

Topics	Leads	Discussion points, including peer comparisons	Set objectives (KPIs/milestones)
Board effectiveness	Investor S	• The boards understanding of who they can appoint based on ISS independence criteria/our comfort zone for industry directors. • Composition of the board committees, non-independent nomination and compensation committee chairs. • Continue to develop the concept of being a truly global corporation.	• Continue progress by appointing additional international experienced directors – possibly foreign nationality. • Meet an outside director and have a deeper dive into governance of the company.
Management compensation	Investor T	• Aim to increase disclosure of pay structures – fix/variable split; performance measures; shareholding guidelines; deferrals etc. • Understand the core drivers of pay and challenges faced by remco given the global management teams. • 2020 remco established – short/mid term areas of focus?	• Establish a pay structure that we are comfortable with – aligned with shareholders' interests with clear performance measures for incentives. • Disclosure the above effectively to shareholders.
Audit Effectiveness	Investor U	• Encourage the company to better explain the process undertaken to review and oversee Auditor M role as external Auditor. • Encourage a formal tender process to take place. • Better disclose the role other auditors have in auditing global parts of business - PWC/Deloitte mentioned. • Establish an auditor rotation policy.	• Improve disclosure on external auditor. • Carry out tender process for external auditor. • Ideally the result of this process would be a change of auditor – the group has different auditors in different countries, pointing to coverage/scale issues.
Capital management (including cross-shareholdings)	Investor V	• Better disclosure on existing cross-shareholdings (CS) and unwinding policy if any. Disclosure of governance around such holdings. Also details on voting policy. • Buyback policy – biggest for many years just implemented – how does this tie into capital management plan? • Dividend policy – longer term outlook. Payout ratio increase?	• 2023 Reduction target set. • Improve disclosure of CS in English. • Improved stewardship of holdings – disclosure of holdings; disclosure of rationale for holdings and voting of holdings against disclosed policy.

Case study 3: Poor outcome of attempted collaborative engagement with Company C

ACGA

1) Background

Our collaborative engagement with Company C began in 4Q21, we have conducted 4 meetings till 2Q23 and the same sub chair Investor Z led all four engagements. Company C is a leading Japanese chemical manufacturer specializing in organic and inorganic chemicals, semiconductor materials and functional materials, with a significant global market presence.

2) Objective

The subjects covered with Company C span across capital management (capital efficiency, parent-child listings, mid- to long-term business plan) and climate disclosure including safety of chemical production and long-term green house gas (GHG) reduction.

3) Scope and Process

Company C was not keen to make management and/or external directors available for meeting investors, raising concerns about the company's commitment to addressing issues raised. Despite this being a large market capitalization company, IR often cited "lack of resources" to meet. In two instances, the company cited Fair Disclosure Rules as a reason for not accepting, which we find extraordinary as we do not discuss material non-public information, and we provide agenda of potential discussion topics that make this clear.

4) Outcomes

ACGA had to discontinue engagement with company.

5) Future goals for Company C

This is a 'collaborative' engagement which is not just among investors but also with management ranks at the company, hence decision-makers should also reciprocate. It is the responsibility of all directors including external directors to garner all shareholders views including minority investors to be reflected at the board.

Case study 4: Successful collaborative engagement in the region with Company D

ACGA

1) Background

In September 2023, the ACGA China Working Group (CWG) formed a subgroup to engage with Company D, led by Investors X and Y. That November, Investors X and Y, along with an ACGA research manager, visited the company to initiate dialogue. Company D is a leading Chinese multinational company specializing in electric vehicles, batteries and renewable energy solutions.

2) Objective

They discussed a wide range of ESG issues with the company's IR team, including board diversity and effectiveness, sustainability reporting and corporate strategy. Notably, they flagged the company's e-cigarette business as a concern, despite this representing a small percentage of their revenue. The e-cigarette business is financially non-material but important to investors because of product addiction concerns.

3) Scope and Process

While the subgroup attempted to schedule a follow-up meeting in early 2024, they were met with indifference from the company. In July 2024, Investor X shared a research report on the potential impact of the EU guidelines on ESG funds, highlighting that the company's e-cigarette business would prevent investors from maintaining their exposure. Investor Y sent a letter directly to the CEO of Company D, underscoring the seriousness of this issue and urging further discussion; the letter was written in both Chinese and English and sent in late July. This prompted the company to agree to an online meeting in October 2024.

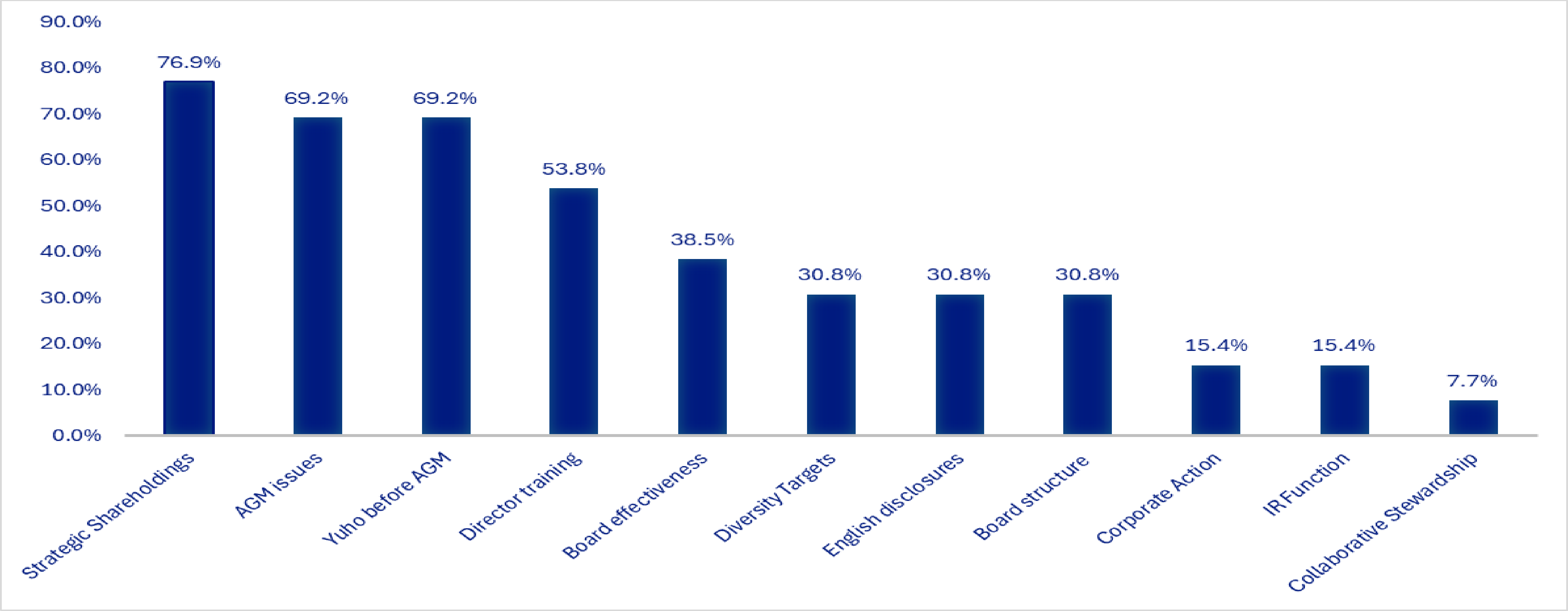
4) Outcomes

During the October meeting, Company D's IR verbally informed that they had divested from the e-cigarette business, an important step for investibility of the company. The subgroup is currently seeking written confirmation of the divestment. The engagement progress was driven by two key factors: leadership of Investors X and Y, and efficient exchange of information among subgroup members.

5) Future goals for company D

Improve sustainability reporting and disclosures.

ACGA members ranked areas of improvement for Japanese corporates



This graph is based on member feedback after ACGA Japan delegation on 24-27 September 2024. The delegation consisted of 31 delegates from 25 asset managers.

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