

July 19, 2018

Letter Requesting Effective Disclosures and Engagement Meeting Opportunities with
Outside Directors on Scandal Handling (*abridged translation*)

IICEF and the five participants of its collective engagement program (Pension Fund Association, Sumitomo Mitsui Asset Management, Sumitomo Mitsui Trust Bank, Mitsubishi UFJ Trust Bank, and Resona Bank) have jointly started sending letters to listed companies that caused major scandals recently. In the letters we (IICEF and the participating institutional investors mentioned above) are asking for effective disclosure regarding the scandals, as well as collective engagement meeting opportunities with outside directors about the companies' scandal handling.

1. Target companies

In recent years, there have been a series of unfair and/or inappropriate behaviors that could lead to violation of laws and social condemnation (hereinafter referred to as scandals) at Japanese companies. We pick up companies which caused major scandals and their responses are currently in progress. For the moment, we do not disclose the specific target company names. We are not aiming at just blaming the management teams of companies for their misconducts. Rather we would like to share with various companies in Japan and other investors how long-term investors view major scandals at listed companies. In the event of a scandal at any other company in future, our message here can hopefully be a reference for expected efforts by that company toward revitalization of corporate value in the long term. Given the nature of this engagement agenda, our target company list may expand in the future.

2. Key messages

The participating institutional investors have spent time to discuss the scandal handling

agenda, to come up with the common views to be addressed in the letters. The letters are to be sent to the president/representative director, outside directors and outside corporate auditors/outside audit & supervisory board members (where applicable).

(1) Participating investors' perspective on listed company scandals

Significant scandals will depress the social reputation, adversely affect the business performances, and damage corporate value of the relevant companies. Even if major stock price declines of certain stocks are expected due to scandals, however, passive investors will basically try to continue holding the shares to keep their portfolio tracking error optimal. Passive investors are very well-diversified and very long-term investors, and can be regarded as the owners of the “Japan Inc.”

Guidance 4-1 of “Principles for Responsible Institutional Investors <Japan’s Stewardship Code>” states: *In case a risk of possible loss in corporate value is identified through the monitoring of and dialogue with companies, institutional investors should endeavor to arrive at a more in-depth common understanding by requesting further explanation from the companies and to solve the problem.* We believe that passive investors, like other responsible institutional investors, should try to contact companies with scandals to request sufficient explanations of the problems, share investors’ concerns about them, and support revitalization of the companies’ corporate values.

We thus believe that the scandal handling should be an important collective engagement agenda by a group of institutional investors involved in passive investment. For example, we will encourage companies with scandals to:

- establish a reliable third-party committee with independence, neutrality and expertise
- conduct thorough investigation to find out underlying issues/root causes
- come up with effective countermeasures
- promote corporate governance and corporate culture reforms, working with independent board members

If possible, we would like to help the companies to present their revitalization processes to other companies as “case studies.”

(2) What participating investors believe are most essential

Companies that have scandals should promptly conduct thorough investigation of what happened and the root causes of the problems, without any attempt of concealment, cheating, self-protection, etc. They should also promote company-wide reforms and implement effective measures to prevent recurrence of the problems, and work on revitalizing corporate value. We believe that Japan Exchange Regulation's "Principles for Responding to Corporate Scandals" paper is a good reference for those companies, in this context.

It is often important to involve third parties outside the company, when conducting scandal investigation. We would appreciate if a company establishes a third-party committee with high degree of independence, in accordance with "Guidelines for Third-Party Committees in Corporate Misconduct" released by Japan Federation of Bar Associations, strongly supports the committee's activities, and takes its recommendations very seriously.

In addition, we suspect that there may be issues with corporate culture behind most scandals. In our view, scandals at Japanese companies are not always driven by executives and employees to pursue their personal (financial) interests. Rather, in quite a few cases it appears that their misconduct actions are taken "for the sake of the companies," at least in their mind. We believe that there should be deep-rooted problems in corporate culture in such cases, and that both the corporate functions (internal control, compliance, internal audit, etc.) and the supervisory functions of the board of directors and/or the board of corporate auditors (or the audit & supervisory board) do not work sufficiently, because of those problems.

Therefore, in order to recover the damaged corporate value, not only fact finding and thorough investigation of the root causes but reforms from the corporate culture level are necessary, in our view. We thus believe that we need corporate governance improvement based on outsiders' perspective, and we strongly encourage outside directors and outside corporate auditors/audit & supervisory board members (where applicable) to play important roles.

(3) Our suggestions for effective disclosures

We would like the target companies to promptly and properly disclose information on what happened, the root causes, effective measures to prevent recurrence of the problems, and expected impact on the business performances, regarding their misconduct cases (including potential risk of similar problems at the relevant companies). Where applicable, we would ask the target companies to provide full support to the activities of the third-party committees, and to make prompt and appropriate disclosure of the committees' reports.

If it is expected that the target companies are going to hold their annual shareholders meetings in near future, we would like them to have in-depth disclosure of information of the candidates for outside directors and outside corporate auditors/audit & supervisory board members (where applicable). Those candidates' superior expertise, rich experience, high insight and strong motivation are essential for the target companies to enhance corporate governance for corporate value recovery. We would ask the target companies' management teams to explain clearly about the nomination processes, the skill sets of the candidates, the candidates' views on the scandals, etc., before the shareholders meetings.

(4) Our request for collective engagement meeting opportunities with outside directors

We also would like to have opportunities to talk with outside directors and outside corporate auditors/audit & supervisory board members (where applicable). As discussed above, we believe that there would be major issues with corporate culture behind scandals, and that outsiders' viewpoints are essential for necessary reviews and reforms of those issues. We intend to provide full support to outside directors and outside corporate auditors/audit & supervisory board members (where applicable) in their activities in response to the scandals, which will work positively for shareholders' interests – our emphasis here is on trying to work with and support them, rather than challenging them asking many difficult questions. In the collective engagement meetings with them, we would like to cover various discussion points such as:

- our very high expectations for effective functions of the outside board members, especially in finding out corporate governance problems and in promoting company-wide reforms
- our suggestions to refer to the scandals-related principles prepared by Japan Exchange

Regulation, when monitoring the management teams' efforts

- importance of careful monitoring of the management teams' faithful and serious response to the third-party committees' reports and recommendations (where applicable)

We have initiated collective engagement dialogues with multiple companies, with the above-mentioned contents. Suggestions, opinions and inquiries are welcome.

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