

# Annual Stewardship Activity Report FY2017

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地方公務員共済組合連合会

Pension Fund Association for Local Government Officials

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## [DISCLAIMER]

When there are any discrepancies between the original Japanese version and the English translation version, the original Japanese version shall prevail.

# Introduction

## ○ Overview of the Association's stewardship activity

The Pension Fund Association for Local Government Officials (“Association”) is required to fulfill its “the fiduciary duty of increasing the value of its assets for the insured over the long term” and “social responsibility as a public pension fund.” In this connection, as the means to seek medium- to long-term enhancement of enterprise values and sustainable growth of investee companies, the Association has been proactively committed to effective stewardship activities, including exercise of voting rights, engagement and ESG investment.

In addition, the Association entrusts investment management institutions (“investment managers”) to make investments in equity of individual companies. The Association believes that conducting the stewardship activities through these investment managers is effective for fulfilling the stewardship responsibility as they have more opportunities to access investee companies and have in-depth insight on corporate management.

Based on this idea, the Association established the “Corporate Governance Principles of Pension Fund Association for Local Government Officials” and the “Guidelines for Exercising Shareholders’ Voting Rights (Domestic Equities)” in 2004 and the “Guidelines for Exercising Shareholders’ Voting Rights (Foreign Equities)” in 2016. These guidelines and principles specify that the Association should conduct stewardship activity based on them when it has concluded contracts with investment managers. In addition, the principles concerning funds specify how the Association should fulfill its stewardship responsibilities. Moreover, in May 2014, the Association signed up to Japan’s Stewardship Code, and in November 2017, the Association made its approach to stewardship activity clearer than before following the revision of the Stewardship Code.

The Association has started investing in ESG fund in 2010, and has entrusted ESG investment through four domestic stock products.

The Association has been monitoring the stewardship activities of the investment manager so as to ensure the compliance with the Association's abovementioned policies, while focusing on the "quality" of stewardship efforts.

## ○ Monitoring of investment managers in FY2017

The Association receives reports concerning stewardship activity from and holds interviews with investment managers of domestic equities every year in order to monitor the appropriateness of their stewardship activity and gather information.

In addition, following the start of the exercise of voting rights concerning foreign equities in FY2016, the Association received reports on stewardship activity concerning foreign equities in FY2017.

In May 2017, the Association held briefing meetings on the direction of stewardship activity of investment managers entrusted with domestic and foreign stock investment in FY2017. In August 2017, the Association sent the form of the annual stewardship activity report to 23 investment managers entrusted with domestic stock investment and the form of the annual stewardship activity report concerning foreign equities to 16 investment managers entrusted with foreign stock investment, and after closely examining the investment managers’ response, the Association held interviews with 18 investment managers entrusted with domestic stock investment with respect to stewardship activity on November 10-24, 2017.

The major viewpoints of the monitoring of investment managers in FY2017 are as follows:

# Introduction

## **Exercise of shareholders' voting rights**

- ✓ Make sure that the exercise of voting rights is in line with the Guidelines for Exercising Shareholders' Voting Rights.
- ✓ Check whether or not the Association's guidelines are mechanically applied to the exercise of voting rights without close examination of individual proposals.
- ✓ Check the status of improvement in governance at investee companies through the exercise of voting rights.

## **Engagement**

- ✓ Make sure that an effective engagement is implemented in order to increase investee companies' corporate value and promote their sustainable growth value in the medium to long term.
- ✓ Make sure that sustained efforts are made to review the effects of engagement and improve the quality of engagement.

## **○ Publication of activities through reports of investment results**

Since FY2015, the Association has been obligated to publish an annual report of investment results describing activities concerning the exercise of voting rights relating to stocks by organizations implementing the activities based on the Local Public Officers, etc. Mutual Aid Association Act. The Association describes its stewardship activity for the relevant year in the annual report and publishes it.

The Association's stewardship activity in FY2016 as observed through monitoring in FY2017 will be described in the Review of Operations for FY2017 (scheduled to be published in FY2018).

## **○ Collaboration with other public pension funds, etc.**

As part of its efforts to enhance the effectiveness of stewardship activity, the Association holds meetings on stewardship activity with the Local Public Service Mutual Aid Associations (the Mutual Aid Association of Prefectural Government Personnel, the Japan Mutual Aid Association of Public School Teachers, the Japan Police Personnel Mutual Aid Association, the Mutual Benefit Association for Tokyo Metropolitan Government Employees, and the National Federation of Mutual Aid Associations for Municipal Personnel) and use common forms of reports concerning stewardship activity to be submitted by investment managers.

The Association has also been participating in the Business and Asset Owners' Forum since the second forum meeting (April 12, 2017). This forum is held in order to let participating companies exchange opinions with investment managers about constructive dialogue and GPIF and to allow other asset owners to use the results as a reference for stewardship activity.

In the following pages, the Association's stewardship activity in FY2016 is described.

## Exercise of Voting Rights and Summary of Initiatives (Domestic Equities)

### **○ Results of the exercise of voting rights**

Between July 2016 and June 2017, regarding the Employees' Pension Insurance Benefit Adjustment Fund, the Association exercised voting rights, through the 23 investment managers entrusted with domestic stock investment, with respect to a total of 15,636 companies which settled accounts between April 2016 and March 2017. The number of proposals concerning which voting rights were exercised was 56,079.

The Association voted against 13,403 (including 2,478 shareholder proposals) of the 56,079 proposals, which translates into a vote-against rate of 23.9% (up 2.1 points from the previous year). The vote-against rate concerning company proposals was 20.4% (up 0.8 point).

The vote-against rate came to 40.9% (up 1.1 points from the previous year) concerning proposals related to the board of directors/directors, 13.3% (down 5.1 points) concerning proposals related to the board of auditors/auditors, 15.3% (up 4.5 points) concerning proposals related to director remuneration, etc. and 4.7% (up 0.3 points) concerning proposals related to appropriation of surplus.

# Exercise of Voting Rights and Summary of Initiatives (Domestic Equities)

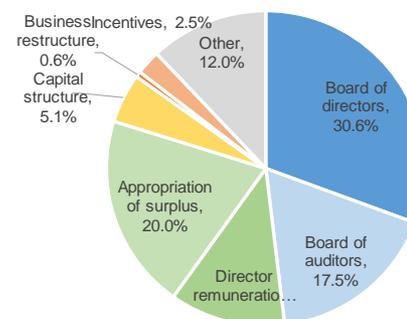
## Voting activity (Employees' Pension Insurance Benefit Adjustment Fund)

### Companies with accounting settlement between April 2016 and March 2017

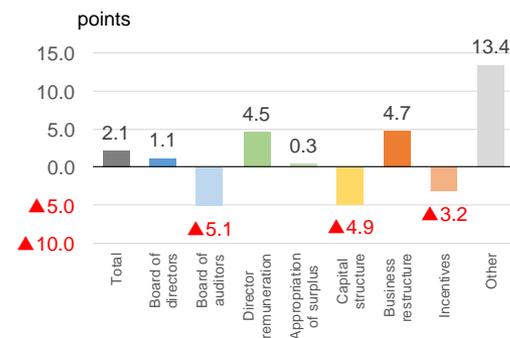
Proposal Subject	Total	Composition	Vote for		Vote against		Vote-against rate in the previous year
				Rate		Rate	
<b>Total</b>	<b>56,079</b>	<b>100%</b>	<b>42,676</b>	<b>76.1%</b>	<b>13,403</b>	<b>23.9%</b>	<b>21.8%</b>
c.f. Company Proposal	53,449	95.3%	42,524	79.6%	10,925	20.4%	19.6%
c.f. Shareholder Proposal	2,630	4.7%	152	5.8%	2,478	94.2%	96.7%
<b>By Subject</b>	<b>56,079</b>	<b>100%</b>	<b>42,676</b>	<b>76.1%</b>	<b>13,403</b>	<b>23.9%</b>	<b>21.8%</b>
Board of Directors/Directors	17,172	30.6%	10,155	59.1%	7,017	40.9%	39.7%
Board of Auditors/Auditors	9,803	17.5%	8,496	86.7%	1,307	13.3%	18.4%
Director Remuneration, etc.	6,594	11.8%	5,583	84.7%	1,011	15.3%	10.8%
Appropriation of Surplus	11,203	20.0%	10,679	95.3%	524	4.7%	4.3%
Capital Structure	2,843	5.1%	2,032	71.5%	811	28.5%	33.4%
Takeover Defense Measures	898	1.6%	103	11.5%	795	88.5%	63.2%
Capital Increase or Reduction	46	0.1%	46	100%	0	0.0%	3.7%
Third Party Allotment of Shares	26	0.0%	21	80.8%	5	19.2%	19.2%
Acquisition of Own Shares	5	0.0%	0	0.0%	5	100%	37.3%
Business Restructure	320	0.6%	299	93.4%	21	6.6%	1.9%
Incentives Improvement for Executives	1,406	2.5%	1,084	77.1%	322	22.9%	26.1%
Other proposals	6,738	12.0%	4,348	64.5%	2,390	35.5%	22.1%

\*The results of the exercise of voting rights were the same with respect to the Transitional Long-term Benefits (TLTB) Adjustment Fund, which adopts the same products.

### Share by proposal subject



### Changes in the vote-against rate (compared with the previous year)



# Exercise of Voting Rights and Summary of Initiatives (Domestic Equities)

## ○ Examples of the exercise by proposal subject (1)

### Proposals related to the board of directors/directors

The vote-against rate remained high at 40.9% for reasons such as a lack of sufficient explanations concerning an increase in the number of internal directors. Investment managers voted against various sorts of proposals as a way to express their disapproval of companies with structural problems such as the absence of multiple outside directors.

[Major reasons for voting against]

- ✓ A board of directors not comprising multiple outside directors
- ✓ Increase of internal directors without sufficient explanations
- ✓ A board of directors with a conspicuously large number of directors
- ✓ A board of directors responsible for sluggish business performance

### Proposals related to the board of auditors/auditors

The vote-against rate declined as some investment managers shifted to the policy of opposing the election of the representative director in the case of a decrease in the number of auditors. Investment managers voted against various sorts of proposals as a way to express their opposition to a decrease in the number of auditors.

[Major reasons for voting against]

- ✓ An outside auditor considered to present an independence issue
- ✓ Decrease of auditors without sufficient explanations

### Proposals related to director remuneration, etc.

The vote-against rate rose as some investment managers changed the criteria for exercising voting rights and opposed the payment of executive bonuses to outside directors and auditors.

[Major reasons for voting against]

- ✓ Payment of retirement allowances to directors who are members of the audit committee and other committees
- ✓ Payment of executive bonuses to auditors

### Proposals related to appropriation of surplus

The vote-against rate remained low as it did in the previous year.

[Major reasons for voting against]

- ✓ Appropriation of surplus by a company whose shareholder return is low

Proposal Subject	Company	Reason for Voting Against
Proposals related to the board of directors/directors	1st sec. of the Tokyo Stock Exch. Chemicals	<u>Board of directors not comprising multiple outside directors</u> Voted against because of the absence of multiple independent outside directors.
	1st sec. of the Tokyo Stock Exch. Electric Appliances	<u>Increase of internal directors without sufficient explanations</u> Voted against the proposal because there was not a clear and rational reason for increasing the number of internal directors.
	1st sec. of the Tokyo Stock Exch. Textile products	<u>A board of directors with a conspicuously large number of directors</u> Voted against because the presence of too many directors could impede quick decision-making by the board.
	1st sec. of the Tokyo Stock Exch. Banks	<u>A board of directors responsible for sluggish business performance</u> Voted against because the board was judged to be responsible for the continued low level of ROE.
Proposals related to the board of auditors/auditors	1st sec. of the Tokyo Stock Exch. Transportation Equipment	<u>An outside auditor considered to present an independence issue</u> Voted against the proposal because the candidate for an outside auditor was a person coming from a major shareholder, which raised an independence issue.
	1st sec. of the Tokyo Stock Exch. Steel	<u>An outside auditor considered to present an independence issue</u> Voted against because of a problem with the independence of a candidate for the outside auditor position who used to work for the company's main bank.
	1st sec. of the Tokyo Stock Exch. Construction	<u>Decrease of auditors without sufficient explanations</u> Voted against the proposal because there was not a clear and rational reason for decreasing the number of outside auditors.
Proposals related to director remuneration, etc.	1st sec. of the Tokyo Stock Exch. Transportation Equipment	<u>Payment of retirement allowances to directors who are audit and other committee members</u> Voted against because the payment of retirement allowances to directors who are members of the audit committee and other committees could impede the supervisory function.
	1st sec. of the Tokyo Stock Exch. Construction	<u>Payment of executive bonuses to auditors</u> Voted against because it would be inappropriate to pay executive bonuses, which are single-year incentive remuneration, to auditors who are responsible for exercising the supervisory function.
Proposals related to appropriation of surplus	1st sec. of the Tokyo Stock Exch. Electric Appliances	<u>Appropriation of surplus by a company whose shareholder return, such as the payout ratio, is low</u> Voted against the proposal because the payout ratio has stayed low for many years.
	1st sec. of the Tokyo Stock Exch. Steel	<u>Appropriation of surplus by a company whose shareholder return, such as the payout ratio, is low</u> Voted against because the payout ratio and ROE were low.

# Exercise of Voting Rights and Summary of Initiatives (Domestic Equities)

## ○ Examples of the exercise by proposal subject (2)

### Proposals related to capital structure

The vote-against rate declined for reasons such as an increase in the proportion of proposals for reverse stock split. On the other hand, the vote-against rate concerning proposals related to takeover defense measures rose steeply to 88.5% because of investment managers' revision of their criteria for exercising voting rights.

[Major reasons for voting against]

- ✓ A takeover defense measure not considered to contribute to an increase in shareholder value

### Proposals related to business restructure

The vote-against rate was low despite rising from the previous year.

[Major reasons for voting against]

- ✓ A share exchange that may undermine shareholder value
- ✓ A merger not considered to contribute to an increase in shareholder value

### Proposals related to incentives improvement for executives

The vote-against rate declined. Concerning proposals related to performance-linked stock-based remuneration, voting behavior was divided between investment managers that judged such remuneration to be equivalent to the grant of stock options whose exercise price is lower than the market price and opposed it and investment managers that judged it to be effective as an incentive enhancement measure and thus supported it.

[Major reasons for voting against]

- ✓ Stock options whose exercise price is lower than the market price
- ✓ A stock option program that raises an appropriateness issue concerning persons to whom stock options are granted

### Other proposals

The vote-against rate rose mainly because of an increase in shareholder proposals.

[Major reasons for voting against]

- ✓ A revision of articles of incorporation that increases the maximum number of directors in an inappropriate manner
- ✓ Grant of the authority to determine dividends to the board of directors

Proposal Subject	Company	Reason for Voting Against
Proposals related to capital structure	1st sec. of the Tokyo Stock Exch. Foods	<u>A takeover defense measure not considered to contribute to an increase in shareholder value</u> Voted against because of the small proportion of independent outside directors in the board of directors, which suggested the possibility that minority shareholders' standpoint was not taken into consideration in decision-making
	1st sec. of the Tokyo Stock Exch. Other products	<u>A takeover defense measure not considered to contribute to an increase in shareholder value</u> Voted against because of doubt about the independence of the independent committee, which suggested the possibility that minority shareholders' standpoint was not taken into consideration in decision-making
	1st sec. of the Tokyo Stock Exch. Chemicals	<u>Third-party allotment of shares to an incorporated foundation</u> Voted against due to concerns that the foundation to which shares would be allotted could become a new stable shareholder.
Proposals related to business restructure	1st sec. of the Tokyo Stock Exch. Electric Appliances	<u>A share exchange that may undermine shareholder value</u> Voted against because the share exchange ratio was too low considering the market value and other factors.
	1st sec. of the Tokyo Stock Exch. Information & Communication	<u>A merger not considered to contribute to an increase in shareholder value</u> Voted against because it was not clear how the merger would contribute to shareholder value due to a lack of clarity over the synergy effects expected from the merger.
Proposals related to incentives improvement for executives	1st sec. of the Tokyo Stock Exch. Pharmaceutical	<u>Stock options whose exercise price is lower than the market price</u> Voted against because the exercise price of stock options was lower than the market price
	1st sec. of the Tokyo Stock Exch. Information & Communication	<u>A stock option program that raises an appropriateness issue concerning persons to whom stock options are granted</u> Voted against because of the inclusion of an outside director among the persons to whom the stock option program was applicable, an arrangement which could impede the supervisory function.
Other proposals	1st sec. of the Tokyo Stock Exch. Pharmaceutical	<u>A revision of articles of incorporation that increases the maximum number of directors in an inappropriate manner</u> Voted against the proposal because there was considered to be no rational reason for the revision of articles of incorporation to increase the maximum number of directors.
	1st sec. of the Tokyo Stock Exch. Transportation Equipment	<u>Grant of the authority to determine dividends to the board of directors</u> Voted against because the revision of articles of incorporation to grant the authority to determine dividends to the board of directors could undermine shareholders' interest given the small proportion of outside directors.
	1st sec. of the Tokyo Stock Exch. Transportation Equipment	<u>A contract for limitation of liability covering inappropriate persons.</u> Voted against the proposal because there was no reference to the exclusion of persons with responsibility for past business performance concerning the conclusion of the contract for limitation of liability

# Exercise of Voting Rights and Summary of Initiatives (Domestic Equities)

## **○ Matters learned through reports and interviews (1)**

Amid the deepening understanding of the Association's policy for the exercise of voting rights among investment managers, it was learned that voting rights were appropriately exercised in line with the Guidelines for Exercising Shareholders' Voting Rights (Domestic Equities).

Concerning the status of corporate governance, while some improvements are observed, including the spread of moves to elect multiple outside directors and growth in companies' awareness about the independence of outside directors and auditors, the vote-against rate remains high. Therefore, the Association believes that there is still ample room for improvement.

- ✓ It was learned that at all investment managers entrusted with domestic stock investment by the Association, the Association's Guidelines for Exercising Shareholders' Voting Rights are applied to their criteria as a priority.
- ✓ It was learned that concerning investment managers whose understanding of the Association's guidelines had been insufficient in the exercise of voting rights in the previous year, their understanding deepened and voting rights were exercised thoroughly in line with the guidelines. Concerning proposals related to takeover defense measures, the rate of "for" votes based on the escape clause declined steeply.
- ✓ Meanwhile, it was learned that some investment managers have not sufficiently incorporated the Association's guidelines into their criteria. (Example: The Association's Guidelines for Exercising Shareholders' Voting Rights prescribe that when investee companies have reported losses for three consecutive business years or longer, the re-election of directors who have stayed in office during that period should be voted against, but the criteria for judgment concerning the election of directors at companies whose shares are held in accounts entrusted by the Association do not include a criterion related to the reporting of losses for three consecutive business years or a longer period.)
- ✓ Concerning proposals related to the election of directors and takeover defense measures, it was learned that many investment managers have reviewed and revised their criteria for exercising voting rights and are calling for companies to establish a higher level of corporate governance.

## **Association's views**

- ✓ With respect to the lack of change in the vote-against rate concerning company proposals in the current fiscal year compared with the previous year, the Association believes that this is a result of the progress made in companies' corporate governance toward the desired state of companies as shown in the Association's Corporate Governance Principles in response to investment managers' call for them to establish a higher level of corporate governance. However, as 20.4% of company proposals were voted against, further efforts should be made.
- ✓ Regarding proposals related to the board of directors and directors in particular, the vote-against rate remained high (40.9%) for reasons such as that the number of internal directors was increased without clear and rational explanations, so the Association believes that there is large room for improvement.
- ✓ It was learned that some investment managers have not sufficiently incorporated the Association's guidelines into their detailed criteria for exercising voting rights, so the Association believes that it is necessary to continue to seek their full understanding concerning its guidelines.

# Exercise of Voting Rights and Summary of Initiatives (Domestic Equities)

## ○ Matters learned through reports and interviews (2)

- ✓ It was learned that the following methods are available as a way to express opposition to the composition of the board of directors and the board of auditors.
  - Increase of internal directors
    - Vote against: the re-election of the representative director or the top manager, the election of a new director to be added to the board of directors, the re-election of internal directors, and the election of all directors (including outside directors)
  - Absence of multiple outside directors
    - Vote against: the re-election of the representative director or the top manager, the re-election of internal directors, the election of all directors (including outside directors)
  - Decrease of auditors
    - Vote against: the re-election of the representative director or the top manager, the re-election of internal auditors, and the election of all auditors
- ✓ The Association has established the “Guidelines for Exercising Shareholders’ Voting Rights (Domestic Equities),” thereby indicating its policy for exercising voting rights, and it has entrusted the exercise of voting rights concerning individual proposals to investment managers. Therefore, in some cases, the judgment on the exercise of voting rights concerning the same proposal varied across investment managers because of differences in their respective judgment criteria.
- ✓ Concerning proposals for which the Association entrusted decision-making to investment managers, such as performance criteria related to the election of directors and independence related to the election of outside directors, it was learned that individual investment managers have established the judgement criteria and made judgments in accordance with them.
- ✓ The Association observed cases in which investment managers showed different responses to the lack of sufficient explanations regarding a stock option-related proposal in the convocation notices (it was not clear whether or not the grant of stock options to outsiders, which is required by the Association’s Guidelines for Exercising Shareholders’ Voting Rights (Domestic Equities) to be subject to negative judgment, was included in the proposal): some investment managers made judgment based on the contents of the convocation notice alone, while others made inquiries to the company.

## **Association's views**

Based on the Corporate Governance Code, companies should accurately provide, as necessary, information that contributes to appropriate decision making by shareholders at general shareholders’ meetings. The Association believes that it is desirable to indicate such information in convocation notices including reference materials related to general shareholders’ meetings. In addition, when there are unclear points in convocation notices including reference materials related to general shareholders’ meetings, investment managers should grasp the details of proposals through means such as making inquiries to companies.

# Exercise of Voting Rights and Summary of Initiatives (Domestic Equities)

## ○ Investment managers' excellent initiatives and issues (1)

During the process of fulfilling the stewardship responsibilities, the Association learned of several problematic issues while observing excellent initiatives related to the exercise of voting rights by investment managers entrusted with domestic stock investment.

Below, we show excellent initiatives conducted by investment managers. We hope that investment managers will use resourceful ideas and make improvements in order to enhance the effectiveness of their stewardship activity by sharing the Association's recognition of problems and other issues.

### ✓ Engagement related to the exercise of voting rights

The Association observed cases in which investment managers conducted the exercise of voting rights and engagement in an integrated manner; for example, some investment managers proactively implemented engagement with companies before general shareholders' meetings, while others gave companies feedback concerning the results of the exercise of voting rights. In particular, there were some cases in which investment managers explicitly indicated the policy of strengthening engagement with companies whose proposals they continuously voted against.

Investment manager	Specific initiative
A	Investment Manager A provides companies with feedback concerning the results of the exercise of voting rights, with precedence given to companies with which intensive dialogue should be conducted. When it has voted against a proposal, the investment manager makes an effort to seek understanding, for example, by explaining the reason for its opposition and proposing an improvement measure.
B	Investment Manager B places priority on ex-ante dialogue although it also considers ex-post dialogue: including the provision of feedback, to be important. The investment manager proactively implements engagement not only with companies which met the criteria for voting against proposals but also with companies which may meet the criteria.
C	Investment Manager C has adopted the history of voting against proposals over a multiple-year period as one of the criteria for selecting companies with which there is a strong need to implement engagement due to problems related to such matters as capital efficiency, shareholder return and the governance system. The investment manager gradually implements engagement with such companies in consideration of the degree of importance of the problem.

On the other hand, in some cases, investment managers do not proactively provide feedback concerning the results of the exercise of voting rights for reasons such as that they publicly disclosed the results concerning individual proposals or because they have announced the criteria for exercising voting rights. The Association also learned of some problems related to engagement with companies reluctant regarding dialogue, mainly those classified as small and mid-cap stocks.

## Association's views

The Association expects investee companies to be managed in a way that contributes to long-term shareholder value and believes that if shareholder value is not likely to increase, it is necessary to call for management needed for enhancing shareholder value. In doing so, the Association believes that instead of unilaterally exercising voting rights, investment managers should share the recognition of problems and other issues with the companies through various means, including explaining the views underlying their judgement on the exercise of voting rights.

The Association expects investment managers to use continuous engagement to encourage improvement by companies for which the exercise of voting rights has not been sufficiently effective in increasing shareholder value as their proposals have continuously been voted against in the exercise of voting rights conducted on behalf of the Association, including those companies which are reluctant concerning dialogue.

# Exercise of Voting Rights and Summary of Initiatives (Domestic Equities)

## ○ Investment managers' excellent initiatives and issues (2)

### ✓ Exercise of voting rights suited to the circumstances of companies

The Association observed cases in which investment managers conducting excellent initiatives exercised voting rights in consideration of the contents of dialogue with companies based on sufficient understanding of the purpose of the Association's guidelines. There were also cases in which investment managers had developed systems to avoid mechanical exercise of voting rights.

Investment manager	Specific initiative
A	A company's proposal for the election of auditors included reduction of the number of outside auditors. However, the investment manager voted for the proposal based on the judgment that this replacement was intended to strengthen supervision as it learned through dialogue that an outside auditor would be replaced by an internal auditor with an engineering background as part of efforts to strengthen a system of supervision by personnel with engineering expertise. *The Association's Guidelines for Exercising Shareholders' Voting Rights (Domestic Equities) stipulate that proposals related to reduction of the number of outside auditors should be subject to negative judgment unless clear and rational explanation is provided.
B	A company's proposal for the election of directors included an increase in the number of inside directors. However, Investment Manager B voted for it based on the judgment that the proposal would contribute to the effectiveness of the board of directors because the candidate for an additional internal director is a person responsible for overseeing a business planned to be expanded. *The Association's Guidelines for Exercising Shareholders' Voting Rights (Domestic Equities) stipulate that an increase in the number of directors other than outside directors should be voted against in principle unless clear and rational explanation is provided
C	Concerning proposals that should be voted against under the Association's guidelines, Investment Manager C seeks explanations from companies, and when it is deemed that there are sufficient reasons for making the proposals, it votes for them after consulting with a responsible investment council whose members include third-party persons. In cases where a decision to vote for a proposal that should be voted against under the guidelines is made, there is the risk of conflicts of interest arising. Therefore, the investment manager has established a third-party committee and is conducting deliberation on the judgement concerning the exercise of voting rights under an enhanced system to manage conflicts of interest.

While the Association's guidelines stipulate that an increase in the number of directors other than outside directors should be voted against in principle unless clear and rational explanation is provided, some investment managers uniformly voted against proposals that would lead to an increase without conducting close examination on a case-by-case basis.

## Association's views

The Association has indicated the "Guidelines for Exercising Shareholders' Voting Rights (Domestic Equities)," and in order to ensure appropriate judgment suited to the circumstances of companies, it entrusts investment managers to make specific judgment on exercising voting rights.

It is desirable that investment managers exercise voting rights based on appropriate judgement suited to the circumstances of companies after sufficiently understanding the purpose of the guidelines, instead of mechanically applying the guidelines to the exercise of voting rights.

# Exercise of Voting Rights and Summary of Initiatives (Domestic Equities)

## ○ Investment managers' excellent initiatives and issues (3)

### ✓ PDCA cycle of the exercise of voting rights

It was learned that most investment managers institutionally conduct at least either ex-ante examination of judgment on exercising voting rights or ex-post examination of the results of the exercise through a division or council independent from the decision-making division concerning the exercise of voting rights.

It was also learned that most investment managers examine the validity of the specific criteria for exercising voting rights applicable to accounts entrusted by the Association.

Investment manager	Specific initiative
A	<p>Investment Manager A conducts two-stage examination of proposals concerning the exercise of voting rights by an internal committee including members independent from investment and sales operations and by persons appointed by the committee from among persons independent from those operations.</p> <p>The committee also examines the results of the exercise of voting rights.</p> <p>Concerning the specific criteria for exercising voting rights applicable to accounts entrusted by the Association, the committee conducts ex-post checks of the exercise of voting rights, and in addition, the board of directors, upon consultation from the committee, conducts self-evaluation of stewardship activity, including the exercise of voting rights. The feedback gained from this process is used to revise the criteria for the next year.</p>
B	<p>Proposals concerning the exercise of voting rights are determined by an executive responsible for the investment division after deliberation at an internal meeting. The meeting is attended by members of a third-party committee as appropriate to check the status of decision-making.</p> <p>Examination of the results of the exercise of voting rights is conducted as follows:</p> <ul style="list-style-type: none"> <li>(i) Monitoring of decision-making and other processes (implemented within the investment division)</li> <li>(ii) Monitoring of conflicts of interest (implemented by a head office section not belonging to any particular division)</li> <li>(iii) Examination by the third-party committee (examination of the results of the internal compliance division's monitoring activity by the third-party committee)</li> </ul> <p>The specific criteria for exercising voting rights applicable to accounts entrusted by the Association are deliberated at internal meetings and are determined by an executive responsible for the investment division, as in the case of the criteria for its own use.</p>

## Association's views

As the Association regards the exercise of voting rights as an important means to sufficiently reflect the opinions of the Association as a shareholder in investee companies' management, it believes that it is necessary to continue efforts to enhance the effectiveness of this activity.

The Association expects investment managers to enhance the effectiveness of this activity by developing and using a PDCA cycle in consideration of the viewpoints of other divisions and third-party entities.

# Engagement and Summary of Initiatives (Domestic Equities)

## ○ Number of cases of engagement

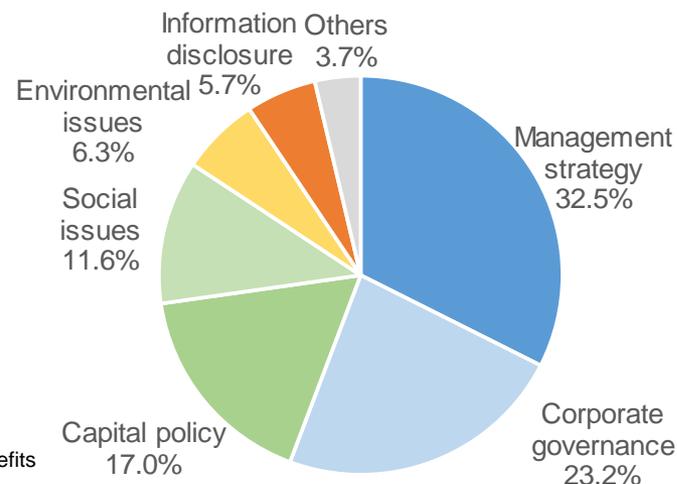
In FY2016, regarding the Employees' Pension Insurance Benefits Adjustment Fund, the Association implemented engagement with a total of 5,134 companies through the 23 investment managers entrusted with domestic stock investment. The number of cases of engagement was 10,732 in total (down 3,275 from the previous year). The number of cases of direct dialogue with top managers of companies was 2,822, or 26.3% of the total.

Regarding major subjects of engagement, the number of cases of dialogue concerning management strategy issues came to 3,485 (down 4,402 from the previous year), or 32.5% of the total, followed by dialogue concerning corporate governance issues with 2,493 (up 454 from the previous year), or 23.2% of the total, and 1,827 cases related to capital policy issues (down 67 from the previous year), or 17% of the total.

### Number of cases of engagement in FY 2016 (including overlaps)

Dialogue subject	Number of cases	Dialogue with top managers			Number of cases in the previous year
		Composition		Rate	
<b>Total</b>	<b>10,732</b>	<b>100.0%</b>	<b>2,822</b>	<b>26.3%</b>	<b>14,007</b>
Dialogue concerning management strategy	3,485	32.5%	1,263	36.2%	7,887
Dialogue concerning corporate governance	2,493	23.2%	578	23.2%	2,039
Dialogue concerning capital policy	1,827	17.0%	445	24.4%	1,894
Dialogue concerning social issues	1,249	11.6%	202	16.2%	669
Dialogue concerning environmental issues	678	6.3%	82	12.1%	419
Dialogue concerning information disclosure	607	5.7%	161	26.5%	790
Other	393	3.7%	91	23.2%	309

### Share by dialogue item



\*The number of cases of activity was the same with respect to the Transitional Long-term Benefits Adjustment Fund, which adopts the same products.

\*The standard for counting the number of cases of engagement varies from fund to fund: some funds count one interview covering several items multiple times, including it in the counting of cases concerning each item, while others count it only once.

\*The number of cases of engagement declined from the previous year mainly because dialogue concerning management strategy conducted by a certain investment manager decreased significantly as the manager shifted emphasis to engagement focusing on substance and quality in FY2016 after conducting broad dialogue concerning management strategy in FY2015 as the first step of engagement.

# Engagement and Summary of Initiatives (Domestic Equities)

## ○ Example cases of engagement that led to some results

Dialogue subject	Company	Specifics	
Dialogue concerning management strategy	1st sec. of the Tokyo Stock Exch. Electric equipment	Dialogue	Conducted dialogue on possible options concerning measures to raise the management efficiency of the overall group, including the revision of capital relationship with a listed subsidiary.
		Result	Announced a business integration with the listed subsidiary.
	1st sec. of the Tokyo Stock Exch. Foods	Dialogue	Requested the review of cross shareholding and non-core businesses as a measure to improve the financial conditions.
		Result	Announced the sale of shares held under the cross-shareholding arrangement.
Dialogue concerning corporate governance	1st sec. of the Tokyo Stock Exch. Chemicals	Dialogue	Proposed a study on a remuneration system intended to ensure awareness of the return on capital among rank-and-file employees.
		Result	Decided to introduce an employee stock ownership trust. Also studying an incentive-based remuneration system (stock price-linked type) for next-generation senior managers.
	1st sec. of the Tokyo Stock Exch. Banks	Dialogue	Pointed out issues related to the composition of the personnel committee and the remuneration committee and proposed the establishment of a system under which outsiders sufficiently exercise the checks-and-balances function.
		Result	Announced the reorganization of these two committees, with a majority of each committee, including the chairman, to be appointed from among outsiders.
Dialogue concerning capital policy	1st sec. of the Tokyo Stock Exch. Construction	Dialogue	Proposed the adoption of the ratio of dividends to shareholders' equity as an indicator of the shareholder return and the retirement of surplus own shares acquired through share repurchases in order to ease concerns in the stock market over possible release of those shares.
		Result	Announced the adoption of the ratio of dividends to shareholders' equity as an indicator of the shareholder return and replied that the retirement of repurchased own shares will continue to be studied internally.

Dialogue subject	Company	Specifics	
Dialogue concerning capital policy	1st sec. of the Tokyo Stock Exch. Other products	Dialogue	Proposed the formulation of a medium-term business plan and an ROE target, the clarification of a capital policy and holding of briefings on financial results.
		Result	Announced plans to formulate a medium-term business plan, set an ROE target, enhance the shareholder return, holding briefings on financial results and strengthen the IR system.
Dialogue concerning social issues	1st sec. of the Tokyo Stock Exch. Information & Communication	Dialogue	Conducted dialogue on the progress in the action plan concerning the empowerment of women and information disclosure concerning diversity.
		Result	Made improvements concerning the empowerment of women, including increasing the proportion of women in new recruits, in accordance with the action plan. Made significant improvements concerning information disclosure, including disclosure of the status of disclosure efforts and numerical data.
Dialogue concerning environmental issues	1st sec. of the Tokyo Stock Exch. Machinery	Dialogue	Proposed expanding ESG activities (reduction of overall CO2 emissions, CSR procurement, diversity, etc.), which had been mainly conducted on a non-consolidated basis, to include activities on a consolidated basis and prescribing unified written guidelines on CSR, adapting to and utilizing SDGs and promoting advanced ESG activities.
		Result	Indicated a target for the mitigation of the environmental impact in 2020 on a consolidated basis under a medium-term business plan. Explicitly prescribed the materiality of CSR issues related to 12 SDGs, in addition to establishing the basic policy for CSR.
Dialogue concerning information disclosure	1st sec. of the Tokyo Stock Exch. Construction	Dialogue	Proposed the announcement of a medium-term business plan, including numerical targets, in reference to exemplary cases observed among other companies in the same industry.
		Result	Publicly announced a medium-term business plan. Also announced numerical targets for the operating profit margin and the payout ratio.
Dialogue concerning information disclosure	1st sec. of the Tokyo Stock Exch. Non-ferrous Metals	Dialogue	Proposed active implementation of information disclosure (particularly with respect to trends in foreign markets where the business conditions are difficult to grasp) because there were problems with the company's approach to IR.
		Result	Enhanced information disclosure related to overseas businesses by disclosing for the first time the company's assumptions for the forecast of financial results in reference documents distributed at briefings on annual financial results.

# Engagement and Summary of Initiatives (Domestic Equities)

## ○ Matters learned through reports and interviews (1)

The Association learned that many investment managers were implementing engagement in order to increase the corporate value of investee companies in the medium to long term and promote the companies' sustainable growth and that they were conducting initiatives to implement effective engagement. The Association also observed cases in which different funds operated by the same investment manager implemented engagement in different ways.

- ✓ Concerning engagement implemented by many funds, the following matters were learned:
  - Engagement is generally defined as “constructive dialogue conducted with investee companies in order to increase the corporate value of investee companies in the medium to long term and promote the companies' sustainable growth,” for example.  
On the other hand, it was learned that some investment managers define engagement as “part of research activity” and that the number of dialogue partner companies per staff member is large at such managers.  
It was also learned that the standard for counting the number of cases of engagement varies from investment manager to investment manager because of differences in the definition of engagement.
  - It was learned that investment managers generally implement engagement in order to promote the companies' “sustainable growth” and “increase the corporate value of investee companies.”  
On the other hand, it was learned that some investment managers implement engagement in order to “share perspectives,” while others do so in order to help to “make investment decisions instead of aiming primarily to change corporate behavior.”
  - It was learned that in order to increase corporate value, some investment managers select dialogue partner companies on the basis of whether the companies are facing problems and whether it is possible to contribute to their sustainable growth.
  - It was learned that some investment managers select dialogue items and methods from the viewpoints of an increase in corporate value and risks (problems and other issues).

## Association's views

- ✓ In the Signup to Japan's Stewardship Code, the Association stipulates as follows: “The Association will continue requiring the investment management institutions to share the awareness of problems with the investees and make efforts for the solution through effective engagement aimed at the medium- to long-term enhancement of enterprise values and sustainable growth of investee companies.” The Association believes that it learned through interviews that initiatives conducted by investment managers are generally in line with its views.
- ✓ The Association believes that it is necessary to continue to seek further understanding on its views concerning the definition of engagement, and engagement initiatives.

# Engagement and Summary of Initiatives (Domestic Equities)

## ○ Matters learned through reports and interviews (2)

- ✓ It was learned that there are differences between investment managers in the allocation of internal resources for active and passive investment. Specifically, the following cases were observed:

Investment manager	Specific initiative
A	When analysts implement engagement with companies, they may do so from the viewpoint of active investment intended to gain an excess return in some cases and from the viewpoint of passive investment considering the impact on the entire market in other cases.
B	In active investment, analysts implement engagement with companies from which an excess return is expected to be gained, while in passive investment, the division dedicated to stewardship implements engagement with companies selected from the viewpoint of the impact on the entire market.
C	In active investment, individual analysts and fund managers implement engagement based on themes on which they are focusing, while in passive investment, the division dedicated to stewardship implements engagement with respect to a comprehensive set of agenda.

## **Association's views**

- ✓ Although the organization structure varies across investment managers, the Association believes that even in the case of passive funds, investment managers have developed systems that enable engagement based on appropriate understanding of the circumstances of dialogue partner companies by assigning analysts and a staff dedicated to stewardship activity.

# Engagement and Summary of Initiatives (Domestic Equities)

## ○ Investment managers' excellent initiatives and issues (1)

In the process of fulfilling of the stewardship responsibilities by the Association, it was learned that while investment managers entrusted with domestic stock investment are conducting excellent engagement initiatives, there are some problems and other issues.

Below, we show excellent initiatives conducted by investment managers. We hope that investment managers will use resourceful ideas and make improvements in order to enhance the effectiveness of their stewardship activity by sharing the Association's recognition of issues.

### ✓ Examination of the effects of engagement

It was learned that investment managers conducting excellent initiatives set qualitative or quantitative targets related to engagement, with the effects of engagement examined by a council or a relevant division.

Concerning the method of examining the effects of engagement, many investment managers reported that they measured the effects in terms of the progress in dialogue.

Investment manager	Specific initiative
A	Investment Manager A sets milestones in accordance with the status of initiatives conducted by individual companies. Concerning companies selected for intensive engagement, the investment manager examines the effects of engagement by monitoring the achievement of milestones by individual companies. The division dedicated to stewardship checks the results of and plans for engagement at weekly meetings and monitors the setting of challenges and the progress in engagement. While managing activities on a weekly basis, the division reports on a quarterly basis to a committee overseeing stewardship activity on the number of cases of activity, the ratio of the number of cases of each type of activity to overall activities, the progress in the achievement of challenges, and individual cases of dialogue.
B	Regarding the success or failure of engagement, Investment Manager B recognizes steady progress in investee companies' activities to address challenges that it has set as a step toward the next stage. The investment manager enhances the effectiveness of engagement by sharing the recognition of the progress with the companies by making "stage judgment" based on the common criteria in each of the stages leading to a final resolution. After conducting dialogue, analysts and fund managers make stage judgement in consideration of the companies' activities to resolve challenges and the results of the activities. The results are summarized on a quarterly basis, are examined and evaluated at internal meetings and reflected in the subsequent engagement policy.

On the other hand, some investment managers do not have a system to examine the effects of engagement, while others do not judge the success or failure of engagement.

## Association's views

As engagement is an objective-oriented dialogue, the Association believes that it is necessary to examine whether or not the objective has been achieved through engagement. The Association also believes that the effectiveness of engagement should be checked in order to ensure sustainable engagement.

The Association expects investment managers to institutionally examine the effects of engagement.

# Engagement and Summary of Initiatives (Domestic Equities)

## ○ Investment managers' excellent initiatives and issues (2)

### ✓ Definition of the quality of engagement and initiatives to enhance the quality

In relation to the quality of engagement, it was learned that many investment managers share with investee companies the recognition of problems and other issues that must be resolved in order to achieve sustainable growth and recognize progress toward the development of specific measures to resolve the problems.

The Association observed the following cases as excellent initiatives to enhance the quality of engagement:

- Resourceful measures to manage progress in engagement
- Enhancement of organizational systems, including the establishment of a division responsible for overseeing engagement activity
- Initiatives to promote a change of the mindset on the part of companies and to increase influence through dialogue.
- Systematic implementation of engagement
- Acquisition and accumulation of knowhow through partnership with external organizations

Investment manager	Specific initiative
A	Investment Manager A subdivided the dialogue processes and is managing progress in dialogue with individual companies based on the processes.
B	Starting in the current year, Investment Manager B will shift to a system under which working groups are responsible for progress management and the supervisory function. Analysts implementing engagement conduct self-evaluation of the progress in dialogue, companies' response, and setting and revisions of the future agenda, among other matters, and periodically report to the working groups.
C	When implementing engagement, Investment Manager C provides dialogue partner companies with the kind of analysis information that individual companies do not necessarily possess, including information on how to look at the stock market, approaches to shareholder value and capital cost, and best practices adopted by other companies.
D	Investment Manager D has established a committee responsible for sharing information and making decisions concerning engagement.
E	Investment Manager E is cooperating with foreign investment teams. It has also concluded a contract with a foreign engagement service company in order to identify global engagement themes and it is studying engagement companies' approaches.

## Association's views

In order to implement sustainable and effective engagement, the Association believes that what is most important is the quality of engagement that enables the sharing of the perception of issues and leads to progress in resolving the issues, rather than formal aspects of engagement, such as the frequency of or the length of time spent on dialogue.

As the scope of engagement partner companies, the necessary dialogue items, and the progress in dialogue vary case by case, the Association expects investment managers to further strengthen initiatives to enhance the quality of engagement.

# Engagement and Summary of Initiatives (Domestic Equities)

## ○ Investment managers' excellent initiatives and issues (3)

### ✓ Checking the function and effectiveness of outside directors

Against the backdrop of the establishment of the Corporate Governance Code, the proportion of companies with two or more outside directors is growing. However, there were cases in which investment managers checked the function and effectiveness of outside directors through engagement based on the recognition that in some cases, there is doubt about the function and effectiveness of outside directors for reasons such as that they concurrently serve on multiple companies' boards.

Investment manager	Specific initiative
A	Investment Manager A requests interviews with outside directors, and when the requests are not met, it checks what kind of opinions the companies are seeking from outside directors. Investment Manager A hopes that persons knowledgeable about the whole industry and capable of correcting companies' internal logic will serve as outside directors.

## Association's views

The Association considers the board of directors to be responsible for playing the central role in supervising business execution, so it calls for companies to appoint multiple outside directors so that the board can sufficiently supervise business execution as necessary.

The Association expects investment managers to check not only the number of outside directors but also their function and effectiveness.

# Investment Managers' Recognition of Challenges (Domestic Equities)

## ○Challenges recognized by investment managers in relation to the fulfillment of the stewardship responsibilities

As a result of monitoring, the Association learned that investment managers were recognizing the following challenges in the process of the fulfillment of the stewardship responsibilities:

### **Challenges for investment managers**

- ✓ Enhancing institutional systems, increasing personnel, and improving skills at the organization and individual levels.
- ✓ Encouraging companies to strengthen governance and raise capital efficiency by enhancing collaboration between engagement and exercise of voting rights.
- ✓ Establishing a method of self-evaluation that investment managers are required to conduct under Japan's Stewardship Code.
- ✓ Developing capabilities related to long-term investment, and setting of dialogue agenda, among other matters.
- ✓ Improving the efficiency of stewardship activity through cooperation between asset owners, investment managers and investee companies.

### **Challenges for companies**

- ✓ Companies are lacking in sufficient knowledge concerning matters of business management such as capital cost and in a sense of responsibility
- ✓ There are a significant number of companies reluctant about providing corporate information in order to enhance the effects of engagement.
- ✓ Some companies refuse to share the recognition of challenges or make no improvement.

### **Association's views**

- ✓ The Association expects investment managers to conduct effective stewardship activity by continuing to address the above challenges. The Association also expects companies to move closer to the desired state of companies as shown in the Association's Corporate Governance Principles and actively conduct dialogue with investment managers.
- ✓ In order to improve the efficiency of stewardship activity, the Association and Local Public Service Mutual Aid Associations will use common forms of report on stewardship activity to be submitted by investment managers and will also consider measures to further improve the efficiency.

# ESG Investment

## OESG investment initiative

As the Association invests pension funds over the long term, it is rational to aim to maximize the long-term return by paying attention not only to short-term business performance when making investment but also to factors related to sustainability, including ESG.

The Association believes that it can simultaneously fulfill “the fiduciary duty of increasing the value of stocks for the insured persons over the long term” and “the social responsibility as a public pension fund” by seeking to increase the investment return through the sustainable growth of investee companies and the enhancement of shareholder value and by encouraging efforts to resolve social challenges, such as environmental, human rights and employment issues.

The Association started investing in ESG funds in 2010. Subsequently, the Association gradually increased the number of adopted products and the amount of investments. As of the end of December 2017, the Association was entrusting ESG investment through four domestic stock products with a combined market capitalization of 115.8 billion yen (approximately 2% of the outstanding balance of domestic stocks in the Association’s portfolio). As around 90% of existing active funds claim to give consideration to ESG elements in the investment process, the Association uses ESG mainly as a supplemental judgement factor for stock selection.

## OApproach to ESG investment

Of the ESG-related four products adopted by the Association, three fall into the ESG integration category and one falls into the engagement category. ESG integration refers to an investment approach that gives consideration to the ESG elements in the process of selecting stocks from the investment universe for possible inclusion in the portfolio. Engagement refers to objective-oriented constructive dialogue based on in-depth understanding of investee companies and their operating environment.

Specifically, with respect to the products adopted by the Association, investment is made through the following methods:

Category	Investment manager	Approach
Integration	A	Investment Manager A uses an external organization to select stocks relatively highly evaluated in terms of ESG within each industry as components of the investment universe. Fund managers select stocks from the universe based on evaluation conducted from two view points—the stock price level and whether the companies’ ESG initiatives are likely to lead to earnings growth. The portfolio is comprised mainly of stocks highly evaluated by fund managers in terms of ESG.
	B	Analysts evaluate stocks under research in terms of their fundamentals and ESG performance. The ESG evaluation is a combination of basic evaluation based on third-party information obtained from external ESG evaluation organizations and analysts’ evaluation based on qualitative information obtained through dialogue. A score table is prepared with scores given with respect to detailed items concerning the ESG elements. Fund managers integrate the fundamentals evaluation and the ESG evaluation and select stocks in such a way that the deviation value of each of the items concerning the ESG elements in the whole portfolio is higher than 50.
	C	Investment Manager C has adopted a smart beta strategy under which its funds track an index internally developed based on the combination of the ESG evaluation and the stock price evaluation. The investment manager uses an external organization to recognize companies whose ESG performance exceed a certain level as components of the index. Asset weight allocation is determined by adding to the basic weight (a uniform weight for all stocks: 60% of the overall weight) a weight calculated on the basis of an ESG-adjusted stock price (40%), which is a stock price multiplied by a co-efficient reflecting the ESG evaluation.
Engagement	D	After picking stocks with high quality in terms of ROIC (return on invested capital), Investment Manager D makes stock selection from among them in light of factors such as the room for improvement of competitiveness and the viability of the dialogue effect, aiming to increase corporate value through cooperative engagement from the view point of ESG.

The approach to ESG varies from product to product. However, through interviews with investment managers, the Association learned that they make efforts to identify the ESG elements concerning individual products and use ESG as a reference for stock selection. In this way, they are reducing the risk of corporate value being undermined and are promoting investment in companies whose corporate value is expected to increase in the medium to long term.

# ESG Investment

## ○Performance of ESG investment

Investment managers are making ESG investment through various approaches based not only on the ESG evaluation but also on the stock price evaluation with respect to individual products. However, many products adopted by the Association are delivering an excess return over the policy benchmark (TOPIX index including dividends).

There is not yet an established consensus whether the ESG approach leads to an excess return, and the method of analyzing the relationship of the ESG evaluation and engagement with investment performance varies across investment managers. Specifically, the following methods are used.

### <Integration>

Investment manager	Analysis method
A	Investment Manager A indicates each stock's total contributions concerning the ESG elements based on a six-quadrant classification (high ESG and medium ESG) x (discount, neutral and premium), including the evaluation of stock price premium and discount. In terms of the total return over the past five years, the investment manager gained an excess return from stocks highly evaluated in terms of ESG, so its ESG evaluation is considered to be functioning to a certain degree from the long-term perspective. (Image: Figure 1)
B	Investment Manager B indicates each stock's total contributions based on whether the stock is highly or poorly rated in the ESG and fundamentals evaluations. Regarding the group of stocks highly rated in the ESG evaluation, tracking error (TE) is limited in the medium to long term, so the ESG approach is effective in improving the information ratio (IR), rather than in increasing the excess return. (Image: Figure 2)
C	As overweighting in medium-cap stocks and underweighting in large- and small-cap stocks tend to continue, Investment Manager C calculates the ESG stock selection and allocation effect that excludes size impact. Although this effect includes an element of stock price evaluation, it tends to make positive contribution. (Image: Figure 3)

### <Engagement>

Investment manager	Analysis method
D	Investment Manager D measures the engagement effect by multiplying the difference between the expected return including the dialogue/engagement effect and the expected return excluding the effect by the engagement success probability for the sake of convenience. Engagement makes positive contribution, accounting for a certain portion of the excess return. (Image: Figure 4)

The return from each product change from year to year, and the measurement period is less than three years for many products. Therefore, the Association plans to continue ESG initiatives, including evaluating the effectiveness and usefulness of ESG investment according to the investment horizon by cooperating with investment managers in how the ESG elements are contributing to the investment performance.

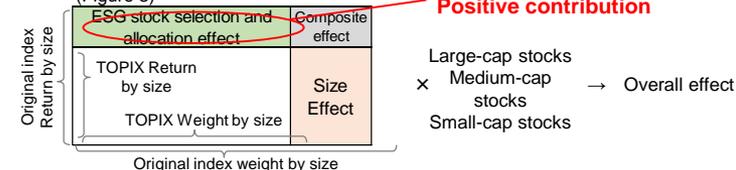
(Figure 1)

	...	FY2017	Past 5 years
Excess return	...	0%	0%
Contribution of evaluated stocks			
High ESG	...	0%	0%
Discount	...	0%	0%
Neutral	...	0%	0%
Premium	...	0%	0%
Medium ESG	...	0%	0%
Discount	...	0%	0%

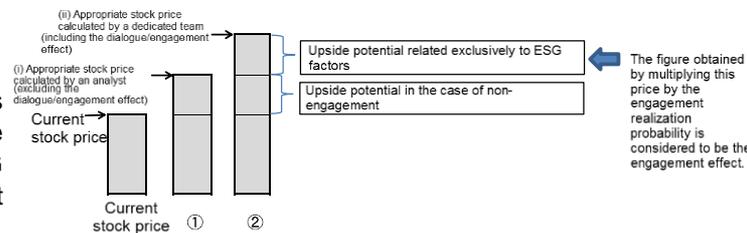
(Figure 2)

Past _ years	High ESG		Poor ESG		Total
	Fundamentals Highly rated	Fundamentals Poorly rated	Fundamentals Highly rated	Fundamentals Poorly rated	
Excess return	0%	0%	0%	0%	0%
TE (Annual rate)	0%	0%	0%	0%	0%
IR (Annual rate)	0	0	0	0	0

(Figure 3)



(Figure 4)



# Exercise of Voting Rights and Summary of Initiatives (Foreign Equities)

## ○ Results of the exercise of voting rights

Through all of the 16 investment managers entrusted with foreign stock investment, the Employees' Pension Insurance Benefit Adjustment Fund exercised voting rights with respect to a total of 7,771 companies which settled accounts between April 2016 and March 2017 and which held general shareholders' meetings on or later than July 1, 2016. The number of proposals for which voting rights were exercised was 55,546.

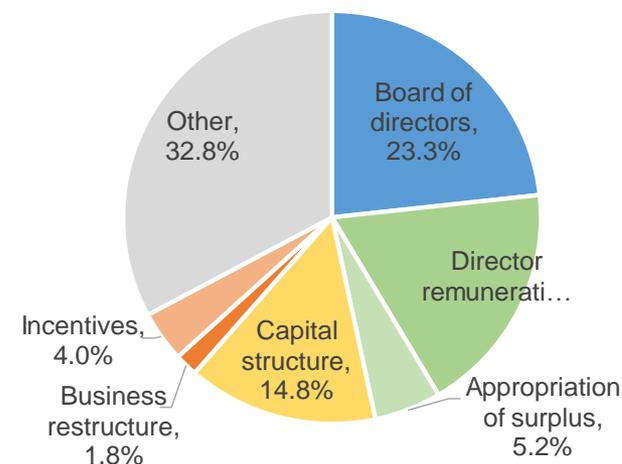
Of the 55,546 proposals, 5,868 (including 1,590 shareholder proposals) were voted against, translating into a vote-against rate of 10.6%. The vote-against rate concerning company proposals was 8.2%.

The vote-against rate came to 11.2% concerning proposals related to the board of directors/directors, 7.7% concerning proposals related to director remuneration, etc. and 2.5% concerning proposals related to appropriation of surplus.

### Voting activity (Employees' Pension Insurance Benefit Adjustment Fund) Companies with accounting settlement between April 2016 and March 2017

Proposal Subject	Total	Composition	Vote for		Vote against	
				Rate		Rate
<b>Total</b>	<b>55,546</b>	<b>100%</b>	<b>49,678</b>	<b>89.4%</b>	<b>5,868</b>	<b>10.6%</b>
c.f. Company Proposal	52,345	94.2%	48,067	91.8%	4,278	8.2%
c.f. Shareholder Proposal	3,201	5.8%	1,611	50.3%	1,590	49.7%
<b>By Subject</b>	<b>55,546</b>	<b>100%</b>	<b>49,678</b>	<b>89.4%</b>	<b>5,868</b>	<b>10.6%</b>
Board of Directors/Directors	12,924	23.3%	11,475	88.8%	1,449	11.2%
Director Remuneration, etc.	10,112	18.2%	9,330	92.3%	782	7.7%
Appropriation of Surplus	2,884	5.2%	2,813	97.5%	71	2.5%
Capital Structure	8,198	14.8%	7,207	87.9%	991	12.1%
Takeover Defense Measures	444	0.8%	404	91.0%	40	9.0%
Capital Increase or Reduction	2,426	4.4%	2,034	83.8%	392	16.2%
Third Party Allotment of Shares	488	0.9%	482	98.8%	6	1.2%
Acquisition of Own Shares	1,759	3.2%	1,697	96.5%	62	3.5%
Business Restructure	988	1.8%	932	94.3%	56	5.7%
Incentives Improvement for Executives	2,206	4.0%	1,686	76.4%	520	23.6%
Other proposals	18,234	32.8%	16,235	89.0%	1,999	11.0%

### Share by proposal subject



\*The results of the exercise of voting rights were the same with respect to the Transitional Long-term Benefits (TLTB) Adjustment Fund, which adopts the same products.

\*From the viewpoints of constraints related to the exercise of voting rights and additional cost burden, the exercise of voting rights is limited to 16 countries (the United States, Canada, the United Kingdom, Ireland, Australia, New Zealand, Singapore, Hong Kong, Chile, the Czech Republic, Indonesia, Mexico, the Philippines, South Africa, Taiwan and Thailand).

# Exercise of Voting Rights and Summary of Initiatives (Foreign Equities)

## **○ Matters learned through reports**

In FY2016, the Association established the “Guidelines for Exercising Shareholders’ Voting Rights (Foreign Equities)” and started exercising voting rights with respect to foreign equities.

The Association ascertained that voting rights concerning foreign equities were exercised in accordance with the Guidelines for Exercising Shareholders’ Voting Rights (Foreign Equities) and observed that the procedures for the exercise of voting rights were different from the procedures concerning domestic equities.

- ✓ The Association ascertained that foreign equity funds entrusted with investment by it gave precedence in application to its guidelines for exercising voting rights over their guidelines and that the voting rights were generally exercised with respect to the countries to which the exercise is applicable.
- ✓ The Association has established the “Guidelines for Exercising Shareholders’ Voting Rights (Foreign Equities)” as in the case of domestic equities, thereby indicating its policy for exercising voting rights. Concerning response to individual proposals, the Association’s policy is to leave judgement on the exercise of voting rights to investment managers. Therefore, in some cases, judgement on the exercise of voting rights concerning the same proposal across investment managers differs due to differences in the managers’ judgment criteria.
- ✓ It was learned that unlike domestic stock funds entrusted with investment by the Association, all foreign equity funds entrusted with investment by the Association were using companies providing advisory services related to the exercise of voting rights. One factor behind this is the need to receive expert advice concerning the approaches to proposals presented by relevant companies in various countries due to the wide differences in the corporate governance code across regions around the world.
- ✓ Possible reasons for the low vote-against rate for the exercise of voting rights concerning foreign equities compared with the rate for domestic equities are as follows:
  1. In other countries, the vote-against rate concerning proposals related to the board of directors and directors is low for reasons such that in many cases, independent directors account for a majority of the board of directors.
  2. In other countries, the vote-against rate concerning proposals related to takeover defense measures is low because in many cases, independent directors account for a majority of the board of directors, which means that takeover defense measures are presumed to have been introduced after sufficient measures to protect shareholder value have been implemented.

# Engagement and Summary of Initiatives (Foreign Equities)

## ○ Number of cases of engagement

Employees' Pension Insurance Benefit Adjustment Fund implemented engagement with a total of 1,137 companies in FY2016 through 13 of the 16 investment managers entrusted with foreign stock investment. Two of the companies with which engagement was implemented were not included in the data tabulation. The number of cases of engagement was 3,051 in total. The number of cases of direct dialogue with top managers of companies was 967, or 31.7% of the total.

As for the main themes of engagement, the number of cases of dialogue concerning corporate governance came to 952, accounting for 31.2% of the total, followed by dialogue concerning management strategy with 691 cases (22.6%) and dialogue concerning environmental issues with 404 cases (13.2%).

One reason for the large share of dialogue concerning corporate governance or environmental issues compared with the case of domestic equities is that some investment managers frequently conducted dialogue about corporate governance based on their emphasis on governance, while others appointed a dedicated ESG staff or implemented engagement in cooperation with external organizations with ESG expertise.

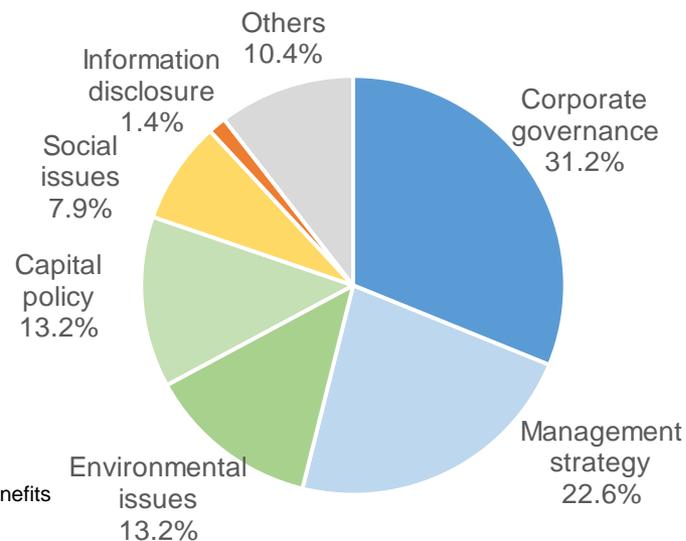
### Number of cases of engagement in FY 2016 (including overlaps)

Dialogue subject	Number of cases		Dialogue with top managers	
	Composition	Rate	Rate	Rate
Total	3,051	100.0%	967	31.7%
Dialogue concerning corporate governance	952	31.2%	157	16.5%
Dialogue concerning management strategy	691	22.6%	278	40.2%
Dialogue concerning environmental issues	404	13.2%	29	7.2%
Dialogue concerning capital policy	403	13.2%	236	58.6%
Dialogue concerning social issues	241	7.9%	44	18.3%
Dialogue concerning information disclosure	42	1.4%	9	21.4%
Other	318	10.4%	214	67.3%

\*The number of cases of activity was the same with respect to the Transitional Long-term Benefits Adjustment Fund, which adopts the same products.

\*The standard for the tabulation of engagement data varies from fund to fund.

### Share by dialogue item



# Engagement and Summary of Initiatives (Foreign Equities)

## ○ Example cases of engagement that led to some results

Dialogue subject	Specifics	
Dialogue concerning corporate governance	Dialogue	Proposed an increase in the proportion of stock grants in CEO remuneration because the proportion of cash was too large.
	Result	Adopted a more formulaic short-term incentive system based on free cash flow or per-share earnings. Introduced once-in-three-year performance-linked, stock-based remuneration in place of biennial cash remuneration.
Dialogue concerning management strategy	Dialogue	Proposed a spinoff or sale of a noncore business because its presence was considered to be a factor behind the stock price discount.
	Result	Announced a spinoff of the business.
Dialogue concerning environmental issues	Dialogue	Conducted fact-checking concerning the company's suspected involvement in water pollution at a plantation owned by a subsidiary and engaged in dialogue about efforts to improve the situation.
	Result	Conducted environmental assessment as a step toward correcting the problem and agreed with local residents about future policy

Dialogue subject	Specifics	
Dialogue concerning capital policy	Dialogue	Engaged in dialogue about the levels of capital and investment because an excessive leverage was a cause for concern.
	Result	Continuously lowered the leverage.
Dialogue concerning social issues	Dialogue	Engaged in dialogue about awareness of diversity-related issues and the status of improvement efforts because there was no female director.
	Result	Received the company's reply that it recognized diversity as an important issue and that it would make efforts to prepare for the election of a female director at the subsequent general shareholders' meeting.
Dialogue concerning information disclosure	Dialogue	Requested improvement of the disclosure level because disclosure data concerning the performance of human capital was lacking.
	Result	Started disclosing significant data concerning human capital, including the employee turnover rate, the level of employee satisfaction, and wage inequality by gender.

# Engagement and Summary of Initiatives (Foreign Equities)

## ○ Matters learned through reports

The Association learned that many investment managers are implementing engagement in order to increase the corporate value of investee companies in the medium to long term and promote their sustainable growth and that they are making efforts to implement effective engagement.

- ✓ The Association learned of the following matters with respect to many funds implementing engagement.
  - Many funds are implementing engagement defined as “constructive dialogue with investee companies conducted in order to promote their sustainable growth and increase their corporate value in the medium to long term” or “sustainable dialogue concerning ESG issues with investee companies,” for example. Meanwhile, it was also learned that some funds define engagement as “communication with companies.”
  - Many funds are implementing engagement in order to promote “companies’ sustainable growth” and “an increase in corporate value.” In some cases, the objective of engagement is “sharing the recognition of issues” or “clarifying business prospects.”
  - Many funds select dialogue partner companies on the basis of whether the companies are “facing problems” and “the status of ESG initiatives”
  - Many funds select dialogue items and methods from the viewpoints of “companies’ profitability improvement” and “risks (problems and other issues).”
- ✓ The Association learned that some funds are not implementing engagement.
- ✓ The association recognized the following cases as excellent initiatives to improve the quality of engagement.

Investment manager	Specific initiative
A	Investment manager A cooperates with external organizations in engagement in order to conduct in-depth engagement and improve the efficiency of activity.
B	Investment Manger B has stored records of engagement since 2000 in its internal database. The investment manager uses those records when conducting progress management intended to promote effective engagement activity and sharing information with relevant parties.

## Association's views

- ✓ The Association’s policy is to continue requiring investment managers to share the recognition of problems and other issues with investees and make improvement efforts through effective engagement aimed at a medium- to long-term increase in corporate value and sustainable growth of investee companies. Based on reports, the Association believes that initiatives conducted by many investment managers are generally in line with its views.
- ✓ The Association believes that it is necessary to continue to seek further understanding on its views concerning the definition of engagement, and engagement initiatives.

# Compliance with Japan's Stewardship Code

## ○ Compliance with the revised version of Japan's Stewardship Code

Japan's Stewardship Code was established in February 2014, and the Association signed up to the code on May 30, 2014. Since then, there has been no change in the Association's approach to stewardship activity. However, to make the approach clearer, the Association conducted a review following the announcement of the revised code on May 29, 2017 and signed up to the revised code.

The Association complies with the principles of Japan's Stewardship Code.

The Association's stance toward individual principles is as follows:

### **Principle 1**

- ✓ Significance of the Association's implementation of stewardship activity (fiduciary duty and social responsibility)
- ✓ It is necessary to promote sustainable and stable growth of the entire market so as to ensure a necessary return in the long term.
- ✓ Investment managers actually implement stewardship activity, and the Association can effectively fulfill the stewardship responsibilities by monitoring the implementation.
- ✓ The Association has established the guidelines, etc. under which investment managers are expressly bound to implement stewardship activity.
- ✓ The Association conducts monitoring focusing on the "quality" of stewardship efforts..

### **Principle 2**

- ✓ The Association exercises voting rights through investment managers instead of doing so directly.
- ✓ The Association monitors investment managers to ensure that proper governance structures are in place and conflicts of interest are avoided.

### **Principle 3**

- ✓ The Association requires investment managers to grasp the business conditions of investees as a prerequisite for engagement.

### **Principle 4**

- ✓ The Association monitors investment managers' engagement with investee companies to check whether the engagement is effective.
- ✓ The Association requires investment managers to share the awareness of problems with investee companies and make improvement efforts.

# Compliance with Japan's Stewardship Code

## Principle 5

- ✓ The Association requires investment managers to disclose the results of the exercise of voting rights for each investee and proposal and also requires investment managers that do not make disclosures to explain the reasons for the non-disclosures.

## Principle 6

- ✓ The Association makes reports on its stewardship activities in the Review of Operations report and public relations magazines and publishes annual reports on stewardship activities.

## Principle 7

- ✓ The Association periodically reviews the implementation of the principles set out in the Stewardship Code.
- ✓ The Association develops the structures and human resources for stewardship activities and requires investment managers to develop their abilities for appropriate decision-making in relation to stewardship activities.

## **ODisclosure of the results of the exercise of voting rights for each investee company and proposal**

As stipulated in Principle 5 of the Signup to Japan's Stewardship Code, the Association asked all investment managers entrusted with domestic stock investment to disclose the results of the exercise of voting rights for each investee and proposal, and all replied that they will disclose the results.

The Association checked the disclosure status and made inquiries to investment managers that had not made disclosures in order to make sure once again that they will make disclosures.

The websites where the results disclosed by investment managers and the disclosure schedule of investment managers that have not yet made disclosures are available as indicated in the following section of the Association's website.

<http://www.chikyoren.or.jp/sikin/kobetukaiji.html>

# Future Initiatives

## ○ **The Association's future initiatives**

The Association intends to actively conduct stewardship activity, mainly the exercise of voting rights, engagement and ESG investment, in order to simultaneously fulfill its fiduciary and social responsibilities.

The Association believes that it can more effectively fulfill the stewardship responsibilities as a whole through the following activities: indicating the Association's approach and policy for the exercise of voting rights by continuing to appropriately develop the Guidelines for Exercising Shareholders' Voting Rights, etc.; conducting stewardship activity through investment managers with in-depth knowledge concerning corporate management; and appropriately monitoring stewardship activity conducted by investment managers from the viewpoint of the enhancing effectiveness of the activity.

Specifically, the Association is considering the following initiatives.

### ✓ Implementation of effective monitoring of investment managers

The Association will continue to make sure that investment managers' stewardship activity is consistent with the Association's policy and will conduct monitoring with emphasis placed on the "quality" of initiatives in terms of whether investment managers are implementing engagement with investee companies and are exercising voting rights in an effective manner and whether they are encouraging the companies to ensure substantive corporate governance.

### ✓ Review of the approach to engagement

The Association will review its basic approach to engagement from the viewpoint of enhancing the effectiveness and sustainability of engagement activity by investment managers.

### ✓ Revision of the Corporate Governance Principles, etc.

The Association will revise the "Corporate Governance Principles of Pension Fund Association for Local Government Officials" the "Guidelines for Exercising Shareholders' Voting Rights (Domestic Equities)" and the "Guidelines for Exercising Shareholders' Voting Rights (Foreign Equities)" as necessary while taking into consideration revisions of laws, regulations and codes and changes in the social situation.

### ✓ Collaboration with other public pension funds, etc.

The Association will make appropriate judgment on matters related to dialogue with investee companies and stewardship activity. As part of its efforts to enhance the effectiveness and efficiency of stewardship activity, the Association will also exchange opinions with its member associations and other public pension funds, among other activities.

# Reference Materials

- **Policy concerning stewardship activity(1)**

**Basic Policy on Funds (established on October 1, 2015)**

**3. Activities to fulfill the stewardship responsibilities**

Shareholders' voting rights are exercised so as to ensure that companies conduct business management in a way that maximizes shareholders' interests in the long term.

When the Association issues instructions for the exercise of voting rights individually, it orders investment managers to exercise the rights in accordance with the instructions. When the Association does not issue instructions for the exercise of voting rights individually, it requires investment managers to exercise the rights in accordance with the purposes of the Association's Corporate Governance Principles and Guidelines for Exercising Shareholders' Voting Rights. In addition, the Association requires investment managers to report on the status of the exercise of voting rights.

When doing so, the Association reviews the Corporate Governance Principles and the Guidelines for Exercising Shareholders' Voting Rights as necessary in consideration of the Principles for Responsible Institutional Investors 《Japan's Stewardship Code》 (prepared by the Council of Experts Concerning the Japanese Version of the Stewardship Code on February 26, 2014) and the Corporate Governance Code (Tokyo Stock Exchange, June 1, 2015). The Association also conducts activities in line with the basic policy for fulfilling the stewardship responsibilities (which refer to institutional investors' responsibilities for increasing investment returns for customers and beneficiaries in the medium to long term by encouraging companies to increase their corporate value and achieve sustainable growth through constructive engagement based on deep understanding concerning investee companies in Japan and their business environment.

When reviewing the Corporate Governance Principles and the Guidelines for Exercising Shareholders' Voting Rights, the Association submits the review to deliberation by the committee and reports the status of stewardship activity to the committee in a timely manner.

As part of efforts to help make appropriate decisions related to dialogue with investee companies and the stewardship activity, the Association also considers exchanging opinions with other implementing organizations and administration and management entities, such as Government Pension Investment Fund, the Federation of National Public Service Personnel Mutual Aid Associations and the Promotion and Mutual Aid Corporation for Private Schools of Japan, and creating opportunities to do so as necessary.

\*The full text is posted on the Association's website.

# Reference Materials

## Corporate Governance Principles (established on April 1, 2004)

### **(1) Basic perspectives of the Association**

The Association has a role of managing the Employees' Pension Insurance Benefit Adjustment Fund, Annuity Retirement Benefits Adjustment Fund and Transitional Long-Term Benefits Adjustment Fund under the pension fund scheme for local government officials and, like any other public pension fund, is considered to have the fiduciary responsibility that consists of the duty of loyalty and the duty of care.

The Association holds equity for no other purpose than to increase the value of its assets over the long term to contribute to the interests of the Association members. Therefore, the Association, like many other shareholders, invests in shares of companies which values are expected to increase over the long term, expecting those companies to be managed in a way that contributes to long-term shareholder's value. If shareholder's value is not likely to increase, the Association will call for management needed for enhancing shareholder's value, in order to fulfill its fiduciary responsibility.

To this end, if shareholder's value of an investee company is not expected to increase sufficiently over the long term, the Association will take actions so that its opinions as a shareholder will be fully reflected in management of the company.

Furthermore, it is considered necessary for the Association to fulfill its social responsibility as a public pension fund, and it needs to actively work on the enhancement of corporate governance also in this context.

\*The full text is posted on the Association's website.

# Reference Materials

## Guidelines for Exercising Shareholders' Voting Rights(Domestic Equities) (established on April 1, 2004)

### 2. Operation

Given that stocks currently held by the Association are all managed by Entrusted Institutions, which are considered to have more opportunities to contact individual companies and thus more capable of making suitable decisions than the Association based on the standing of the companies, each Entrusted Institution shall, in principle, make specific decisions on exercising voting rights in accordance with the intent of these Guidelines for the foreseeable future. However, if an Entrusted Institution has a concern about possible conflicts of interest in exercising voting rights, the Entrusted Institution shall establish a policy to avoid such conflicts of interest. In addition, in cases in which the Association entrusts stock lending transactions to an Entrusted Institution, the Entrusted Institution shall manage the number of shares that can be lent so that the voting rights to a certain extent will be secured.

If the Association determines that voting in a unified manner is required, it will provide Entrusted Institutions with specific instructions on exercising voting rights to individual companies.

The Association shall request Entrusted Institutions to report on their corporate governance related actions, such as the status of exercising voting rights, which the Association will leverage when providing instructions for Entrusted Institutions and consider when evaluating the Entrusted Institutions.

The Association believes that it is necessary to enhance the transparency of business execution by companies. Therefore, the Association requests that each company actively disclose information and engage in dialogs with shareholders and investors and expects Entrusted Institutions to take advantage of such opportunities to make decisions appropriate for each company. In addition, when exercising voting rights on proposals for electing directors that serve important roles in the oversight and execution of business management, the structure of the board of directors and their attitude toward corporate earnings, capital efficiency, social responsibility, operation of the general meeting of shareholders, information disclosure, and the like shall be considered in a comprehensive manner.

In principle, abstentions or carte blanche shall not be used when exercising voting rights, since it is desirable to clarify decisions in terms of fiduciary responsibility and they make no effective change in the legal effect.

The non-exercise of voting rights shall not be taken as a general rule.

\*The full text is posted on the Association's website.

# Reference Materials

## ○ Policy concerning stewardship activity (2)

### Signup to Japan's Stewardship Code (Revised on November 30 2017)

The Pension Fund Association for Local Government Officials (the "Association") hereby announces its sign-up to principles stipulated in Japan's Stewardship Code (revised on May 29, 2017).

**Principle 1. Institutional investors should have a clear policy on how they fulfill their stewardship responsibilities and publicly disclose it.**

- The Association is required to fulfill its "fiduciary duty to the insured" and "social responsibility as a public pension fund." In this connection, as the means to seek medium- to long-term enhancement of enterprise values and sustainable growth of investee companies, the Association is required to proactively commit to effective stewardship activities, including exercise of voting rights, engagement and ESG investment.
- To this end, considering the large scale of the Association's investment assets widely covering the entire market, it is necessary to promote sustainable and stable growth of the entire market so as to ensure return which would be needed in the long term.
- In addition, the Association entrusts investment management institutions to make investments in equity of individual companies. The Association believes that conducting the stewardship activities through these investment management institutions is effective for fulfilling the stewardship responsibility as they have more opportunities to access investee companies and have in-depth insight on corporate management.
- Thus, the Association formulated the "Corporate Governance Principles of Pension Fund Association for Local Government Officials" and "Guidelines for Exercising Shareholders' Voting Rights (Domestic Equity)" in 2004. The investment management institutions are expressly bound under the agreements with the Association to engage in stewardship activities in compliance with these policies.
- The Association will continue monitoring the stewardship activities of the investment management institutions so as to ensure the compliance with the Association's abovementioned policies, while focusing on the "quality" of stewardship efforts.

**Principle 2. Institutional investors should have a clear policy on how they manage conflicts of interest in fulfilling their stewardship responsibilities and publicly disclose it.**

- The Association makes equity investment in individual companies through the investment management institutions. The Association exercises voting rights through these institutions, and does not directly exercise them.
- The Association formulates and publicizes the "Guidelines for Exercising Shareholders' Voting Rights (Domestic Equity)," containing a policy on managing conflicts of interest in the exercise of voting rights by the investment management institutions.
- The Association monitors the investment management institutions, by requiring reports and hearings, to ensure that proper governance structures are in place and conflicts of interest are avoided in an appropriate way.

**Principle 3. Institutional investors should monitor investee companies so that they can appropriately fulfill their stewardship responsibilities with an orientation towards the sustainable growth of the companies.**

- The Association makes equity investment in individual companies through the investment management institutions. In order to appropriately meet its stewardship responsibilities, the Association requires the investment management institutions to grasp the business conditions of investees in an accurate way and performs monitoring on the status on a periodical basis.

## Reference Materials

**Principle 4. Institutional investors should seek to arrive at an understanding in common with investee companies and work to solve problems through constructive engagement with investee companies.**

- The Association grasps the status of engagements with investee companies by the investment management institutions by monitoring their effectiveness.
- The Association will continue requiring the investment management institutions to share the awareness of problems with the investees and make efforts for the solution through effective engagement aimed at the medium- to long-term enhancement of enterprise values and sustainable growth of investee companies.

**Principle 5. Institutional investors should have a clear policy on voting and disclosure of voting activity. The policy on voting should not consist only of a mechanical checklist; it should be designed to contribute to the sustainable growth of investee companies.**

- In order to enhance enterprise values and sustainable growth of investee companies in a medium- to long-term, the Association has formulated the "Guidelines for Exercising Shareholders' Voting Rights (Domestic Equity)," which sets the policy on the exercise of voting rights. Under these guidelines, the Association has the investment management institutions exercise the voting rights in relation to individual proposals.
- The Association requires the investment management institutions to disclose the results of exercise of the voting rights for each investee and proposal, and also requires institutions that do not disclose such information to explain the reasons for the non-disclosure.
- The Association grasps the status of exercise of voting rights by the investment management institutions by monitoring their compliance with the "Guidelines for Exercising Shareholders' Voting Rights (Domestic Equity)." In addition, the Association summarizes and aggregates the results of exercise of voting rights by major categories of proposals and publicizes them.

**Principle 6. Institutional investors, in principle, should report periodically on how they fulfill their stewardship responsibilities, including their voting responsibilities, to their clients and beneficiaries.**

- The Association makes reports on its stewardship activities on annual reports on investment results (Review of Operations) and public relations magazines for the related associations. In addition, the Association also publicizes annual reports on stewardship activities which are available on its website.
- The "Corporate Governance Principles of Pension Fund Association for Local Government Officials" and "Guidelines for Exercising Shareholders' Voting Rights (Domestic Equity)" are also available on the website.

**Principle 7. To contribute positively to the sustainable growth of investee companies, institutional investors should have in-depth knowledge of the investee companies and their business environments and skills and the resources needed to appropriately engage with the companies and make proper judgments in fulfilling their stewardship activities.**

- The Association will periodically review the implementation of the principles set out in the code, and will make further efforts to ensure appropriate stewardship activities in the future.
- To this end, the Association will develop the structures and human resources for stewardship activities. The Association will also instruct its investment management institutions to develop their abilities for appropriate decision-making in relation to the stewardship activities and to make efforts and improvement for more effective stewardship activities.

# Reference Materials

## ○ Chronology of the Association’s stewardship activity

2002	May	Instructed trust banks to exercise voting rights based on specified comprehensive trust contracts.
2003	June	Made revisions so as to require investment managers to exercise voting rights based on discretionary investment contracts.
2004	April	Established the “Corporate Governance Principles of Pension Fund Association for Local Government Officials.” Established the “Guidelines for Exercising Shareholders’ Voting Rights.” Instructed investment managers to exercise voting rights in line with the Guidelines.
2005	June	Announced the “Pension Fund Association for Local Government Officials’ Approach to Proposals on Takeover Defense Measures.”
2006	March	Revised the “Guidelines for Exercising Shareholders’ Voting Rights.” <ul style="list-style-type: none"> <li>• Requested the establishment of the outside director post</li> <li>• Specified the definition of antisocial acts</li> <li>• Established the takeover defensive measure item</li> </ul>
2007	March	Revised the “Guidelines for Exercising Shareholders’ Voting Rights.” <ul style="list-style-type: none"> <li>• Tolerated non-exercise of voting rights related to companies’ own shares and shares of parent companies with the risk of conflict of interest.</li> </ul>
2008	March	Revised the “Guidelines for Exercising Shareholders’ Voting Rights.” <ul style="list-style-type: none"> <li>• Added appropriation of surplus to the scope of factors that should be considered in relation to proposals for the election of directors.</li> </ul>
2009	March	Revised the “Guidelines for Exercising Shareholders’ Voting Rights.” <ul style="list-style-type: none"> <li>• Incorporated the viewpoint of undervalued dividends into appropriation of surplus.</li> <li>• Requested that shareholders’ proposals be as closely examined as companies’ proposals are.</li> <li>• Clarified the criteria for antisocial acts.</li> </ul> Revised the “Pension Fund Association for Local Government Officials’ Approach to Proposals on Takeover Defense Measures.” <ul style="list-style-type: none"> <li>• Added non-support for indefinite extension of the period of consideration by takeover targets.</li> </ul>
2010	February	Started entrusted investment in SRI funds concerning domestic stocks.
	March	Revised the “Pension Fund Association for Local Government Officials’ Approach to Proposals on Takeover Defense Measures.” <ul style="list-style-type: none"> <li>• Made an explicit reference to the independence of third-party committees.</li> </ul>

# Reference Materials

2011	March	<p>Revised the “Corporate Governance Principles of Pension Fund Association for Local Government Officials.”</p> <ul style="list-style-type: none"> <li>• Unified wordings and clarified the contents.</li> </ul> <p>Revised the “Guidelines for Exercising Shareholders’ Voting Rights.”</p> <ul style="list-style-type: none"> <li>• Shifted to case-by-case judgment concerning proposals for the election of special directors.</li> <li>• Adopted case-by-case judgment concerning stock options whose exercise price is lower than the market price.</li> </ul> <p>Revised the “Pension Fund Association for Local Government Officials’ Approach to Proposals on Takeover Defense Measures.”</p> <ul style="list-style-type: none"> <li>• Decided that when the requirements for the initiation of takeover defense measures are clear and leave no room for discretion, the measures may be voted for even if importance is not attached to the judgment of independent outside persons.</li> </ul>
2013	March	<p>Revised the “Guidelines for Exercising Shareholders’ Voting Rights.”</p> <ul style="list-style-type: none"> <li>• Requested that consideration be given to the attendance rate, etc. in the re-election of outside directors and outside auditors.</li> </ul>
2014	May	<p>Signed up to Japan’s Stewardship Code.</p> <p>Revised the “Guidelines for Exercising Shareholders’ Voting Rights.”</p> <ul style="list-style-type: none"> <li>• Added descriptions corresponding to the footnotes to Principle 2 (prevention of conflicts of interest) and Principle 5 (voting rights related to stock lending) of Japan’s Stewardship Code.</li> </ul> <p>Newly adopted ESG funds concerning domestic stocks.</p>
2015	March	<p>Revised the “Corporate Governance Principles of Pension Fund Association for Local Government Officials.”</p> <ul style="list-style-type: none"> <li>• Added descriptions concerning the use of independent outside directors and directors who are not executive directors.</li> <li>• Added descriptions concerning requests for corporate management teams to disclose information, including non-financial information.</li> <li>• Added descriptions concerning requests for corporate management teams to conduct active dialogue with investors.</li> </ul> <p>Revised the “Guidelines for Exercising Shareholders’ Voting Rights.”</p> <ul style="list-style-type: none"> <li>• Requested that consideration be given to the situation of concurrent assumption of executive posts at other companies at the time of re-election of outside directors and outside auditors.</li> <li>• Decided that negative judgment be made concerning takeover defense measures in principle</li> </ul>
	October	<p>Established the “Administration and Investment Policy” and the “Basic Policy” in association with the unification of pension systems.</p> <ul style="list-style-type: none"> <li>• Specified measures to fulfill the stewardship responsibilities.</li> </ul>
	December	<p>Newly adopted two ESG funds concerning domestic stocks</p>
2016	March	<p>Revised the “Guidelines for Exercising Shareholders’ Voting Rights.”</p> <ul style="list-style-type: none"> <li>• Changed the name to the Guidelines for Exercising Shareholders’ Voting Rights (Domestic Equities) and unified wordings in association with the establishment of Guidelines for Exercising Shareholders’ Voting Rights (Foreign Equities).</li> </ul>
	April	<p>Established the Guidelines for Exercising Shareholders’ Voting Rights (Foreign Equities).</p> <p>Instructed investment managers to exercise voting rights in line with the Guidelines.</p>
2017	November	<p>Signed up to Japan’s Stewardship Code (Revised Version)</p>

# Reference Materials

## ○ Reporting items concerning stewardship activity in FY2017 (domestic equities)

No.	Description of report
<b>Q1</b>	<b>Stewardship activities in general</b>
Q1-1	If any of the principles of Japan's Stewardship Codes is not being implemented, explain the reason for non-implementation. Also explain the status of compliance with Japan's Stewardship Code, which was revised on May 29, 2017.
Q1-2	If any change has been made to the policy and systems for the fulfillment of the stewardship responsibilities compared with the previous time, explain the contents of and the reason for the change. Describe any changes that you are considering. *In the case of investment managers which did not reply to the previous questionnaire, "the previous time" should be deemed to be replaced with "last year."
Q1-3	If there are challenges recognized by you in relation to the fulfillment of the stewardship responsibilities, cite them.
Q1-4	Submit proposals, if any, in relation to the Association's stewardship activity.
<b>Q2</b>	<b>Exercise of voting rights in general</b>
Q2-1	Fill in your company name, information concerning your fund, the number of investee companies and the results of the exercise of voting rights. *For information on classification, refer to the supplementary note.
Q2-2	Attach here a digital file of your most recent guidelines for exercising voting rights. If there is any internal regulation other than the guidelines, attach its digital file as well. (no reply area)
Q2-3	Describe the specific criteria for exercising the voting rights (internal criteria) under your guidelines for exercising voting rights. If there is any change from the previous time, describe the change and explain the background to it. *In the case of investment managers which did not reply to the previous questionnaire, "the previous time" should be deemed to be replaced with "last year."
Q2-4	Describe your current system of the exercise of voting rights (including the number of personnel). If there is any change from the previous time, describe the change and explain the background to it. Also describe any problems or changes you are considering with respect to the current system. *In the case of investment managers which did not reply to the previous questionnaire, "the previous time" should be deemed to be replaced with "last year."
Q2-5	Describe your current process of exercising voting rights. If you use a paid external service for the exercise of voting rights, specify the name of the service provider, and contents of the service, and explain the position of the service in the process of the exercise of voting rights. *If you give feedback on the results of the exercise of voting rights to companies, describe the method of doing so.
Q2-6	Describe your policy and system for managing conflicts of interest related to the exercise of voting rights. Also indicate the presence or absence of a third-party committee responsible for examination related to the exercise of voting rights concerning proposals subject to the management of conflicts of interest and describe the function and position of the third-party committee, the management status of the committee (meeting frequency, timing, etc.), the share of independent outside members in the committee and the definition of independence.
Q2-7	If you engage in stock lending transactions, describe the policy for managing the number of shares that may be lent out in order to secure voting rights.
Q2-8	Cite an example case, if any, in which the judgment on the exercise of voting rights in relation to an account entrusted by the Association was different from the judgment made on behalf of other clients due to differences between the specific criteria for exercising voting rights related to the Association account (account criteria) and the criteria under your own guidelines (internal guidelines).
Q2-9	Explain in specific terms your policy regarding companies whose proposals you have continued to vote against over a multiple-year period.
<b>Q3</b>	<b>Election of directors and auditors</b>
Q3-1	Concerning proposals related to the election of directors and auditors, describe the specific criteria for exercising voting rights related to the account entrusted by the Association (account criteria).
Q3-2	Concerning proposals related to the election of directors and auditors, cite any cases in which you voted against a proposal that should be in principle voted for or judged positively under the Association's guidelines for exercising voting rights. *Enumerate all such cases.
Q3-3	Concerning proposals related to the election of directors and auditors, cite cases, if any, in which you voted for a proposal that should be in principle voted against or judged negatively under the Association's guidelines for exercising voting rights. *Enumerate all such cases.
Q3-4	Describe the elements that you consider must be in place for outside directors to function effectively (e.g. composition (number of outside directors), concurrent assumption of posts, and qualities).
<b>Q4</b>	<b>Director remuneration, etc.</b>
Q4-1	Concerning proposals related to director remuneration, describe the specific criteria for exercising voting rights related to the account entrusted by the Association (account criteria).
Q4-2	Concerning proposals related to director remuneration, cite cases, if any, in which you voted against a proposal that should be in principle voted for or judged positively under the Association's guidelines for exercising voting rights. *Enumerate all such cases.
Q4-3	Concerning proposals related to director remuneration, cite cases, if any, in which you voted for a proposal that should be in principle voted against or judged negatively under the Association's guidelines for exercising voting rights. *Enumerate all such cases.
<b>Q5</b>	<b>Appropriation of surplus</b>
Q5-1	Concerning proposals related to appropriation of surplus, describe the specific criteria for exercising voting rights related to the account entrusted by the Association (account criteria).
Q5-2	Concerning proposals related to appropriation of surplus, cite cases, if any, in which you voted for a proposal related to dividends in kind, which should be in principle voted against under the Association's guidelines for exercising voting rights. *Enumerate all such cases.
<b>Q6</b>	<b>Reorganization, etc.</b>
Q6-1	Concerning proposals related to reorganization, describe the specific criteria for exercising voting rights related to the account entrusted by the Association (account criteria).
Q6-2	Under the Association's guidelines for exercising voting rights, proposals related to mergers, transfer of business operations, company splits, etc. should be in principle voted against unless they are accompanied by objective analysis that shows them to be appropriate in terms of the objective, transaction specifics and valuation, among other factors. Cite cases, if any, in which you voted for such proposals. *Enumerate all such cases.

# Reference Materials

## ○ Reporting items concerning stewardship activity in FY2017 (domestic equities)

No.	Description of report
<b>Q7</b>	<b>Capital policy measures, including capital increase and reduction.</b>
Q7-1	Concerning proposals related to capital policy measures, including capital increase and reduction, describe the specific criteria for exercising voting rights related to the account entrusted by the Association (account criteria).
Q7-2	Concerning proposals related to capital policy measures, including capital increase and reduction, cite cases, if any, in which you voted against a proposal that should be in principle voted for or judged positively under the Association's guidelines for exercising voting rights. *Enumerate all such cases.
Q7-3	If there are cases in which you voted for proposals related to third-party allotment of shares, specify the allottees and explain the reasons for voting for the proposals. *Enumerate all such cases.
<b>Q8</b>	<b>Revision of articles of incorporation</b>
Q8-1	Concerning proposals related to revision of articles of incorporation, describe the specific criteria for exercising voting rights related to the account entrusted by the Association (account criteria).
Q8-2	Cite cases, if any, in which you voted against proposals related to the establishment of a nomination committee, etc., which should be in principle voted for under the Association's guidelines for exercising voting rights. *Enumerate all such cases.
Q8-3	Cite cases, if any, in which you voted for a revision of articles of incorporation to prescribe for an advisor or counsellor system or voted against a revision of articles of incorporation to abolish the system and explain the reason for your vote. *Enumerate all such cases.
<b>Q9</b>	<b>Shareholder proposals</b>
Q9-1	Concerning shareholder proposals, describe the specific criteria for exercising voting rights related to the account entrusted by the Association (account criteria).
Q9-2	Cite cases, if any, in which you voted for shareholder proposals and explain the reasons for voting for them. *Enumerate all such cases.
<b>Q10</b>	<b>Antisocial activity</b>
Q10-1	Describe specifically how you identify companies which conducted antisocial activity. If there is any change from the previous time, describe it. *In the case of investment managers which did not reply to the previous questionnaire, "the previous time" should be deemed to be replaced with "last year."
Q10-2	Describe how you deal with investee companies engaging in antisocial activity. *Enumerate all such cases.
<b>Q11</b>	<b>Takeover defense measure</b>
Q11-1	Concerning proposals related to takeover defense measures, describe the specific criteria for exercising voting rights related to the account entrusted by the Association (account criteria).
Q11-2	Cite cases, if any, in which you voted for proposals related to the introduction or continuation of takeover defense measures, which should be judged negatively under the Association's guidelines for exercising voting rights. *Enumerate all such cases.
<b>Q12</b>	<b>Engagement activities in general</b>
Q12-1	Explain your definition and objective of engagement, your approach to engagement, the relationship between engagement and the exercise of voting rights, and the importance of engagement for investment decisions with respect to relevant funds.
Q12-2	Describe the specifics of your current processes of implementing engagement (selection of dialogue partner companies and dialogue subjects, setting of plans (qualitative and numerical targets) and the target achievement period, progress management, the method of monitoring and verifying the effects of the monitoring, the judgment criteria concerning the success or failure of engagement, etc.) with respect to relevant funds. When you are using an external engagement service, specify the name of the service provider, and explain the reason for the adoption of the provider, the contents of the service and the importance of the service for the engagement implementation processes.
Q12-3	Describe your initiatives to enhance the "quality" of engagement activity.
Q12-4	Describe your policy, systems and processes of management of conflicts of interest related to engagement activity.
Q12-5	Describe the relationship between your investment method and engagement activity with respect to relevant funds.
Q12-6	Describe the relationship between your current engagement system (including the number of personnel) and system for exercising voting rights with respect to relevant funds.
Q12-7	Describe the involvement of your fund managers and analysts in engagement activity with respect to relevant funds.
Q12-8	Describe the criteria for evaluating engagement activity by the engagement staff under the personnel evaluation and remuneration systems and specify the weighting of evaluation items.
Q12-9	Specify the number of companies with which you conducted engagement this year and the number of cases of engagement with respect to relevant funds.
Q12-10	Describe the contents of engagement conducted with dialogue partner companies this year with respect to relevant funds. The description should cover dialogue items, partners, and (the summary of) the matters proposed by you. *As for the number of dialogue items and partners, refer to Supplementary Note (ii).
Q12-11	If there are cases in which engagement activities - not limited to those implemented this year - led to an increase in an investee company's corporate value or sustainable growth, cite up to five such cases and specify the names of the companies, the objective of dialogue, and the contents and results of the activities.
Q12-12	Describe your mechanism for ensuring the sustainability of engagement activity (intra-company sharing of information, skills improvement, training and organizational systems, etc.).

# Reference Materials

## ○ Reporting items concerning stewardship activity in FY2017 (foreign equities)

No.	Description of report
<b>Q1</b>	<b>Stewardship activities in general</b>
Q1-1	Explain your policy and systems for fulfilling the stewardship responsibilities. Describe any changes you are considering now.
Q1-2	If there are challenges recognized by you in relation to the fulfillment of the stewardship responsibilities, cite them.
Q1-3	Submit proposals, if any, in relation to the Association's stewardship activity.
<b>Q2</b>	<b>Exercise of voting rights in general</b>
Q2-1	Fill in your company name, information concerning your fund, the number of investee companies and the results of the exercise of voting rights. *For information on classification, refer to the supplementary note.
Q2-2	Attach here a digital file of your most recent guidelines for exercising voting rights. If there is any internal regulation other than the guidelines, attach its digital file as well. (no reply area)
Q2-3	Describe the specific criteria for exercising the voting rights (internal criteria) under your guidelines for exercising voting rights.
Q2-4	Describe your current system of the exercise of voting rights (including the number of personnel). Also describe any problems or changes you are considering with respect to the current system. *If you entrust investment to an external organization, describe the situation of the organization with respect to the relevant items as well as your monitoring system and process.
Q2-5	Describe your current process of exercising voting rights. If you use a paid external service for the exercise of voting rights, specify the name of the service provider, and contents of the service, and explain the position of the service in the process of the exercise of voting rights. *If you give feedback on the results of the exercise of voting rights to companies, describe the method of doing so. *2 If you entrust investment to an external organization, describe the situation of the organization with respect to the relevant items as well as your monitoring system and process.
Q2-6	Describe your policy and system for managing conflicts of interest related to the exercise of voting rights. Also indicate the presence or absence of a third-party committee responsible for examination related to the exercise of voting rights concerning proposals subject to the management of conflicts of interest, and describe the function and position of the third-party committee, the management status of the committee (meeting frequency, timing, etc.), the share of independent outside members in the committee and the definition of independence. *If you entrust investment to an external organization, describe the situation of the organization with respect to the relevant items as well as your monitoring system and process.
Q2-7	If you engage in stock lending transactions, describe the policy for managing the number of shares that may be lent out in order to secure voting rights. *If you entrust investment to an external organization, describe the situation of the organization with respect to the relevant items as well as your monitoring system and process.
Q2-8	Cite an example case, if any, in which the judgment on the exercise of voting rights in relation to an account entrusted by the Association was different from the judgment made on behalf of other clients due to differences between the specific criteria for exercising voting rights related to the Association account (account criteria) and the criteria under your own guidelines (internal guidelines).
Q2-9	Explain in specific terms your policy regarding companies whose proposals you have continued to vote against over a multiple-year period. *If you entrust investment to an external organization, describe the situation of the organization with respect to the relevant items as well as your monitoring system and process.
Q2-10	If there are cases in which you did not exercise voting rights with respect to companies to which the exercise of voting rights is applicable, describe the outline of the proposals and the reason for not exercising the rights. *1: Enumerate all such cases.*Enumerate all such cases. *2 If you entrust investment to an external organization, describe the situation of the organization with respect to the relevant items as well as your monitoring system and process.
<b>Q3</b>	<b>Election of directors and auditors</b>
Q3-1	Concerning proposals related to the election of directors and auditors, describe the specific criteria for exercising voting rights related to the account entrusted by the Association (account criteria).
Q3-2	Concerning proposals related to the election of directors, cite cases, if any, in which you voted against the separation of the posts of chairman of the board of directors and CEO, which should be judged positively under the Association's guidelines for exercising voting rights. *Enumerate all such cases.
Q3-3	Concerning proposals related to the election of directors, cite cases, if any, in which you voted for a proposal that should be in principle voted against or judged negatively under the Association's guidelines for exercising voting rights. *Enumerate all such cases.

# Reference Materials

## ○ Reporting items concerning stewardship activity in FY2017 (foreign equities)

№	Description of report
<b>Q4</b>	<b>Director remuneration, etc.</b>
Q4-1	Concerning proposals related to director remuneration, describe the specific criteria for exercising voting rights related to the account entrusted by the Association (account criteria).
Q4-2	Concerning proposals related to director remuneration, cite cases, if any, in which you voted against a proposal related to a remuneration system linked to the company's medium- to long-term business performance, which should be in principle judged positively under the Association's guidelines for exercising voting rights. *Enumerate all such cases.
<b>Q5</b>	<b>Capital policy</b>
Q5-1	Cite cases, if any, in which you voted for a proposal related to the introduction of or increase in two classes of shares with voting rights or the introduction of a new class of common shares with superior voting rights. *Enumerate all such cases.
<b>Q6</b>	<b>Antisocial activity</b>
Q6-1	Describe specifically how you identify companies which conducted antisocial activity.
Q6-2	Describe how you deal with investee companies engaging in antisocial activity. *Enumerate all such cases.
<b>Q7</b>	<b>Takeover defense measure</b>
Q7-1	Concerning proposals related to takeover defense measures, describe the specific criteria for exercising voting rights related to the account entrusted by the Association (account criteria).
Q7-2	Cite cases, if any, in which you voted for proposals related to the introduction or continuation of takeover defense measures, which should be judged negatively under the Association's guidelines for exercising voting rights. *Enumerate all such cases.
<b>Q8</b>	<b>Engagement activities in general</b>
Q8-1	Explain your definition and objective of engagement, your approach to engagement, the relationship between engagement and the exercise of voting rights, and the importance of engagement for investment decisions with respect to relevant funds.
Q8-2	Describe the specifics of your current processes of implementing engagement (selection of dialogue partner companies and dialogue subjects, setting of plans (qualitative and numerical targets) and the target achievement period, progress management, the method of monitoring and verifying the effects of the monitoring, the judgment criteria concerning the success or failure of engagement, etc.) with respect to relevant funds. When you are using an external engagement service, specify the name of the service provider, and explain the reason for the adoption of the provider, the contents of the service and the importance of the service for the engagement implementation processes.
Q8-3	Describe your initiatives to enhance the "quality" of engagement activity. *If you entrust investment to an external organization, describe the situation of the organization with respect to the relevant items as well as your monitoring system and process.
Q8-4	Describe your policy, systems and processes of management of conflicts of interest related to engagement activity. *If you entrust investment to an external organization, describe the situation of the organization with respect to the relevant items as well as your monitoring system and process.
Q8-5	Describe the relationship between your investment method and engagement activity with respect to relevant funds.
Q8-6	Describe the relationship between your current engagement system (including the number of personnel) and system for exercising voting rights with respect to relevant funds.
Q8-7	Describe the involvement of your fund managers and analysts in engagement activity with respect to relevant funds.
Q8-8	Describe the criteria for evaluating engagement activity by the engagement staff under the personnel evaluation and remuneration systems and specify the weighting of evaluation items.
Q8-9	Specify the number of companies with which you conducted engagement this year and the number of cases of engagement with respect to relevant funds.
Q8-10	Describe the contents of engagement conducted with dialogue partner companies this year with respect to relevant funds. The description should cover dialogue items, partners, and (the summary of) the matters proposed by you. *As for the number of dialogue items and partners, refer to Supplementary Note (ii).
Q8-11	If there are cases in which engagement activities - not limited to those implemented this year - led to an increase in an investee company's corporate value or sustainable growth, cite up to five such cases and specify the names of the companies, the objective of dialogue, and the contents and results of the activities.
Q8-12	Describe your mechanism for ensuring the sustainability of engagement activity (intra-company sharing of information, skills improvement, training and organizational systems, etc.). *If you entrust investment to an external organization, describe the situation of the organization with respect to the relevant items as well as your monitoring system and process.