

## **Guidelines for Exercising Shareholders' Voting Rights (Domestic Equities)**

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### **I General provisions**

#### **1. Objective**

The guidelines for exercising voting rights for domestic equities (the "Guidelines") are set forth in accordance with the Investment Guidelines on Adjustment Funds, which are presented to institutions to which the Pension Fund Association for Local Government Officials (the "Association") entrusts the management and administration of its assets ("Entrusted Institutions") so that the Association's opinions as a shareholder will be fully reflected in line with the intent of the corporate governance principles separately established by the Association.

#### **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 are 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. Entrusted Institutions shall exercise voting rights with respect to investee companies suited to the circumstances of the companies after understanding the purpose of the Guidelines and considering the details

of engagement, instead of exercising voting rights in a one-size-fits-all manner.

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 will be secured to a certain extent.

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 dialogues 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.

The Association expects investee companies to be managed in a way that contributes to long-term shareholder value and Entrusted Institutions should call for management needed for enhancing shareholder value. In doing so, instead of unilaterally exercising voting rights, Entrusted Institutions 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 before or after the exercise of voting rights and conduct the exercise of voting rights and engagement in an integrated manner (engagement with companies before general meetings of shareholders and companies' feedback concerning the results of the exercise of voting rights).

As the exercise of voting rights is an important means to sufficiently reflect the opinions of the Association as a shareholder in investee companies' management, Entrusted Institutions shall continue efforts to enhance the effectiveness of this activity. To this end, Entrusted Institutions should enhance the effectiveness of this activity in relation to the exercise of voting rights by developing and using a PDCA cycle in consideration of the viewpoints of other divisions and third-party entities.

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.

## **II Voting standards**

### **1. Structure of the board of directors**

#### **(1) Adoption of the structure of a company with nomination committees**

In principle, we vote for such proposals.

#### **(2) Structure of the board of directors**

- We make positive decisions for a proper number of board members compared to other companies based on the industry and size of the company so that the board of directors can have active and sufficient discussions and make speedy decisions for effective operations. On the other hand, in principle, we vote against the proposal if the number of board members is extremely large.
- We make positive decisions for a reduction in the number of directors, excluding outside directors. On the other hand, we vote against an increase in the number of directors in principle, unless clear and rational explanations are provided for the increase.
- We make negative decisions about electing directors of a board of directors that does not have two or more independent directors, unless

a sufficient explanation is provided to the effect that it is not appropriate to have two or more independent directors. With respect to the increase of directors which is brought by the increase of outside directors, we make a positive decision regardless of the description in the previous item.

- We make positive decisions for the division of duties between the chairperson of the board of directors and the CEO.
- We make positive decisions for measures to clarify oversight and execution, such as the adoption of the executive officer system.

## **2. Election of directors**

### **(1) Election of directors**

As a general rule, we vote for the election of directors, excluding where the candidate is considered not suitable upon considering whether he/she

- was or is involved in irregularities or torts;
- has made any improper management decision that has caused significant damage to shareholder's value;
- has taken any negative action against appropriate profit distributions to shareholders;
- has taken any negative action against appropriate provision of information to shareholders;
- has taken any negative action against appropriate operation of the general meetings of shareholder; or
- has taken any other actions that violate shareholder's value.

However, we request sufficient explanations on the involvement of the board of directors in response to irregularities and examine the election of directors individually.

If the company has posted losses for three consecutive years and improvement is not likely going forward, we vote against the reelection of directors who have been in office consecutively in the period as a general rule.

In order to decide that the candidates are appropriate and proper, we request sufficient disclosure of information, including that stipulated under

laws and regulations, for the evaluation.

## **(2) Election of outside directors**

In principle, we vote for the election of outside directors from the perspective of bringing in objective viewpoints on the board. However, we vote against if the candidate is considered not suitable upon considering whether he/she

- was or is involved in irregularities;
- has made any improper management decision that has caused significant damage to shareholder's value;
- has taken any negative action against appropriate profit distributions to shareholders;
- has taken any negative action against appropriate provision of information to shareholders;
- has taken any negative action against appropriate operation of the general meetings of shareholder for shareholders;
- has taken any other actions that violate shareholder's value; or
- is capable of making decisions from a position independent from the company.

The candidate's attendance rate at the board of directors' meetings, among other factors, shall be also considered from the perspective of ensuring the effectiveness of outside directors. In addition, it is desirable to consider the status of holding posts in other companies.

In order to decide that the outside director candidate is appropriate and proper, we request sufficient disclosure of information, including that stipulated under laws and regulations, for the evaluation. Especially, we request sufficient information on the independence aspect, and in principle, we vote against the proposal if such information has not been disclosed.

It should be noted that the board of directors is responsible for providing such information.

## **3. Election of auditors**

### **(1) Election of auditors**

In principle, we vote for the election of an auditor unless the candidate is not suitable for the position or the election would clearly lower shareholder's value.

In addition, we vote for an increase in the number of auditors as a general rule; however, we make negative decisions for a decrease in the number unless a clear and rational explanation is provided for the reduction.

In order to decide that the candidate proposed is appropriate and proper, we request sufficient disclosure of information, including that stipulated under laws and regulations, for the evaluation.

## **(2) Election of outside auditors**

In principle, we vote for the election of an outside auditor except for cases in which the candidate is not suitable for the position or it is clearly in conflict with shareholder's value.

The candidate's attendance rates at the board of directors' meetings and the board of auditors' meetings, among other factors, shall be also considered from the perspective of ensuring the effectiveness of outside auditors.

We vote for an increase in the number of outside auditors as a general rule; however, we make negative decisions for a decrease in the number unless a clear and rational explanation is provided for the reduction.

In order to decide that the candidate proposed is appropriate and proper, we request sufficient disclosure of information, including that stipulated under laws and regulations, for the evaluation. Especially, we request sufficient information on the independence aspect, and in principle, we vote against the proposal if such information has not been disclosed.

## **4. Directors' compensation**

With respect to directors' compensation, we make positive decisions for a compensation scheme linked to medium- to long-term corporate performance in view of whether it effectively incentivizes the directors to maximize corporate

profits and increase shareholder value over the long term. Compensation levels are judged based on, among other factors, whether they are adequately balanced with corporate profits and reasonable when compared with competitors. In principle, we vote against

- a raise in compensation or a bonus / retirement allowance payment to directors with management responsibility when earnings have declined or profitability is significantly poor compared to industry peers; and
- a bonus / retirement allowance payment to a director involved in irregularities.

However, with respect to the bonus/retirement allowance payment to a director related to irregularities, decisions shall be made on a case-by-case basis, considering the impact on corporate earnings and the level of responsibility of the director.

In principle, we vote against payment of a retirement allowance to outside directors and auditors given that they are expected to serve an oversight function over the management team.

We vote for bonus programs linked to stock prices, such as stock options as a general rule, as long as they do not encourage the right holders to take excessive risks. In the case of significantly diluting the equity of existing shareholders or setting the exercise price below market values or lowering the exercise price for unexercised options, such proposals should be voted against as a general rule.

We make negative decisions for the issuance of share subscription rights if detailed explanations are not provided because their values are determined by complex elements, such as stock price, stock price volatility, exercise price, exercise period, and market interest rate.

In addition, persons covered by bonus programs linked to stock prices, such as stock options, should be limited to those who are suitable for them. Specifically, we make negative decisions against granting such rights to outside directors, auditors and outsiders who are expected to serve an oversight function over the management team.

## **5. Appropriation of surplus**

The appropriation of surpluses shall be judged on a case-by-case basis from the perspective of whether it is appropriate based on the financial position and business strategies of the company. In cases in which the board of directors is authorized to decide on surplus appropriations, the intention shall be presented through director election proposals.

In principle, we vote against property dividends except for cases in which they are significantly advantageous to shareholders compared to monetary dividends.

If a company retains earnings to pursue shareholder's value over the long term based on the going concern assumption, decisions should be made on a case-by-case basis based on whether the surplus is obviously retained for shareholder's value consideration, e.g., whether a sufficient explanation is given to that effect, whether it is balanced versus dividends, and whether it is excessive from the capital efficiency perspective.

## **6. Reorganization**

Decisions on a merger, assignment of business, company split, and other reorganization proposals should be made on a case-by-case basis from the perspective of whether the reorganization may damage shareholder's value over the long time.

If objective evaluations are not provided to show that the purpose, transaction details, valuations, and the like are adequate with respect to proposals for a merger, assignment of business, company split, and the like, we vote against such proposals as a general rule.

## **7. Capital policy**

We examine capital policy-related proposals carefully on the basis of increasing and preventing damage to shareholder's value over the long term and make decisions on a case-by-case basis.

Decisions on capital increase/decrease proposals should be made on a case-by-case basis on the condition that sufficient and rational explanations are



given. Specifically, we vote for a capital decrease as a general rule if it is considered necessary for corporate restructuring considerations and in line with shareholders' interests.

Decisions on third party allotment proposals should be made on a case-by-case basis, considering, among other conditions, whether the exercise price is significantly advantageous compared to the market value, whether share dilution is concerned, and whether persons covered by the allotment are proper.

In principle, we vote for share repurchases if the company has sufficient cash flow for repurchasing its own shares and it is not likely that such repurchases will adversely affect the liquidity of the stock, except for cases in which the repurchase benefits specific shareholders and may infringe the interests of general shareholders.

#### **8. Changes to the articles of incorporation**

Decisions on changes to the articles of incorporation shall be made on a case-by-case basis from the perspective of whether the change restricts shareholders' rights more than necessary and on the basis of increasing or preventing damage to shareholder's value over the long term.

#### **9. Shareholder proposals**

Decisions on shareholder proposals shall be made on a case-by-case basis upon carefully examining them in the same way as company proposals from the perspective of improving shareholder's value over the long term. However, in principle, we vote against proposals that may pursue the interests of certain shareholders only.

#### **10. Antisocial behavior**

In principle, we vote against proposals, such as electing a director and paying a retirement allowance, if social credibility is damaged due to an act that violates laws and regulations or is offensive to public order and morals.

#### **11. Defensive measures against hostile takeovers**

Unless there is sufficient explanation, negative decisions on defensive

measures against hostile takeovers shall be made from the perspective of increasing shareholder's value over the long term based on the following basic principles.

- The management decision respects the enhancement of shareholder's value over the long term to the maximum extent.
- The measure contributes to stable corporate earnings over the long term.

With respect to defensive measures against hostile takeovers that are not proposed to the general meeting of shareholders, the intent shall be expressed through, among other methods, director election proposals.

## **12. Other**

The Association may separately set forth specific criteria for making decisions.

### **[DISCLAIMER]**

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