Basic Policy on the Exercise of Shareholder Rights (Japanese Equity)

English translation provided for reference only

Our basic policy on exercising shareholder rights, from the perspective of our fiduciary responsibility as an asset manager, is to request that the companies in which we invest address corporate governance in good faith, and in the interest of clients and beneficiaries. Good corporate governance is an essential part of increasing investment returns. As shareholders, it is not enough simply to exercise our voting rights; we seek also to communicate our views to company management, and promote a shared understanding of any challenges. One key component of fulfilling our fiduciary responsibility is to ensure that our voting intentions in particular are clear.

(1) Purpose of shareholder voting

Our clients – including pension funds and investment trust beneficiaries – are the real asset owners, and all voting decisions shall be made solely for the purpose of contributing to our clients' interests.

In managing assets for our clients, the primary source of investment returns is the shareholder value created by the companies in which we invest.

The impact of good corporate governance is threefold: (i) good-faith management, (ii) effective use of resources and (iii) appropriate selection of investments. Our voting decisions are based on these three aspects, with the purpose of seeking to maximise shareholder value. Companies should be managed not solely in pursuit of short-term shareholder interests, but in balance with the interests of employees, business partners, regional communities, and other stakeholders; building a cooperative relationship with stakeholders is what best creates long-term shareholder value.

(2) Duty of loyalty

We have a duty of loyalty to our clients; where any potential conflict of interest arises due to direct or indirect capital ties, personal or business relationships, or other such fiduciary-specific reasons, all voting decisions shall be made purely in our clients' interests.

Our duty of loyalty further extends to careful consideration of any proposed distribution of profits, regardless of whether shares are to be sold after the voting date. Institutional investors have a general responsibility to capital markets, which we shall also discharge when exercising voting rights.

(3) Management stance

Shareholders and capital markets alike demand that companies maintain a clear focus on corporate governance; as fiduciary, we call on the companies in which we invest to actively address corporate governance themes.

(4) Social impact

We expect companies to abide by the rule of law and standards of public order and decency; and to refrain from any act with a negative impact on a company's social credibility – pollution, for example – potentially causing economic loss to shareholders, customers or employees. Any failure to live up to such standards shall be treated as unlawful or unethical behaviour, and reflected in our voting decisions.

(5) Disclosure

Greater transparency in company management is an important component in increasing corporate value. We shall call for active disclosure, to the extent that it allows companies to maintain and enhance their competitive edge and does not compromise fair disclosure.

(6) Research access

The nature of the asset management business necessitates access to the companies in which we invest. We shall use regular company visits and other research activities, in addition to exercising our voting rights, to call for an active commitment to good corporate governance.

(7) Efficient exercise of voting rights

The costs associated with voting are ultimately borne by clients, and the impact of these costs on investment performance cannot be ignored. As fiduciary, we must fully consider cost effectiveness and efficiency, and endeavour to exercise voting rights in an appropriate and professional manner.

(8) Changes to this policy

Any changes to this policy shall require the resolution of the Responsible Investment Committee and be reported to the Responsible Investment Monitoring Committee. Minor edits to wording and suchlike shall be made by the Chair of the Responsible Investment Committee.

Shareholder Voting Guidelines (Japanese Equity)

English translation provided for reference only

Voting decisions are made and intentions indicated on a case-by-case basis, pursuant to the basic policy and guidelines set forth within this document. Where the exercise of voting rights may have an impact on our management due to capital ties, business relationships or other such reasons, we will take advice from a proxy advisory firm and vote in accordance with the Responsible Investment Committee's decisions in order to avoid any conflict of interest.

We take company performance into account as part of our voting criteria. As a general rule, management decisions of companies performing well are treated favourably, while stricter governance standards are applied to companies performing poorly.

In this context, poorly performing means primarily a company that clearly remains depressed as shown by operating loss, net loss, no dividend payout, low ROE level, poor price performance relative to sector average over the past three consecutive years, or other such indicators.

(1) Distribution of profits

As a general rule, vote in favour of distribution of profits. Vote case-by-case if the payout ratio is less than 25% or more than 100%, after detailed scrutiny of the proposal, financial conditions, and the company's growth potential. Generally vote against if the company does not have an effective investment plan, maintains excessive internal reserves, and proposes a low level of dividends for non-transitory reasons.

Generally vote against the proposal if the company has posted a non-extraordinary loss, but seeks to increase dividends or maintain a level of dividends that could impair financial health in the future. Use consolidated figures when taking into consideration capital ratio, payout ratio and other financial indicators.

- Generally vote against if the capital ratio is more than 50% and the payout ratio below 25%, except for nonrecurring reasons.
- Generally vote against any dividend payout exceeding 10% of retained earnings where the company is posting a current loss or the payout ratio is above 100%.
- Generally vote against if net cash relative to total assets is excessive.

As a general rule, vote against director appointments where payment of dividends is decided at the board's discretion, and payouts approved fall under any of the cases described above.

(2) Appointment of directors

As a general rule, vote in favour of proposed appointments.

Vote against any nominee responsible for unlawful or unethical behaviour, or otherwise judged unable to manage in the best interests of shareholders. Vote against any nominee whose decision-making has significantly impaired shareholder value.

- Where companies operate through an executive officer structure, vote against the appointment of directors where they all serve concurrently as executive officers.

- As a general rule, vote against the reappointment of nominees where performance clearly remains depressed as shown by operating losses or no dividend payout over the past three consecutive years.
- As a general rule, vote against the reappointment of nominees at companies with low price performance relative to the sector average or with low ROE over the past three years.
- As a general rule, vote against any increase in the number of internal directors where there is no rational explanation of how the increase will contribute to shareholder value in terms of the board's effectiveness.
- As a general rule, vote against the appointment of directors where a post-shareholder meeting board of over 20 directors may be inefficient.
- Vote case-by-case in the best interest of shareholders, bearing in mind management track record on significant share dilution through third-party capital increase or simple cross-shareholding as takeover defence measures; and inefficient capital/dividend policy.
- Generally vote against the appointment of outside directors not meeting the independence criteria described elsewhere within these guidelines.
- Companies with an audit committee with supervisory functions and companies with a US-type three committee structure (namely audit, nomination, and compensation committees) should appoint a majority of independent outside directors to each committee. Generally vote against the appointment of directors where independent outside directors do not form a majority.
- Under any governance structure, multiple independent outside directors should be appointed. Generally vote against the appointment of directors where companies do not appoint multiple independent outside directors.
- Companies with a controlling shareholder should appoint multiple independent outside directors, making up at least one third of the Board. Generally vote against the appointment of directors where the company does not appoint multiple independent outside directors comprising at least one third of the Board.
- Consider whether the audit and check-and-balance framework of independent outside directors is effective by scrutinising support mechanisms, attendance, and the number of positions held by outside directors.
- Generally vote against nominees concurrently holding more than five positions; exceptions may be made in reappointing those with a 100% attendance rate in the previous year.
- Generally vote against the reappointment of outside directors with board attendance below 75% in the previous year.

(3) Appointment of audit and supervisory board members[1] (including substitutes)

As a general rule, vote in favour of the nominated audit and supervisory board members. Vote against any nominee responsible for unlawful or unethical behaviour, or otherwise judged unable to provide oversight in the best interests of shareholders.

- Where companies have an audit committee with supervisory functions, directors serving on the audit

[1] For a detailed explanation of Japan's audit & supervisory board mechanism, please see: http://www.kansa.or.jp/en/whats-new/explanatory-memorandum-on-the-audit-supervisory-board-members.html

committee should be selected in accordance with the same guidelines as used for selecting audit & supervisory board members.

- Generally vote against the appointment of outside audit & supervisory board members not meeting the independence criteria for outside directors described elsewhere within these guidelines.
- Companies with an audit and supervisory board should appoint a majority of independent outside audit and supervisory board members.
- Consider whether the audit and check-and-balance framework of independent outside audit and supervisory board members is effective by scrutinising support mechanisms and attendance.
- Generally vote against nominees concurrently holding more than five positions; exceptions may be made in reappointing those with a 100% attendance rate in the previous year.
- Generally vote against the reappointment of outside audit & supervisory board members with attendance at meetings of the board of directors or of the audit & supervisory board below 75% in the previous year.
- Generally vote against the appointment of directors in case of any reduction in the number of audit and supervisory board members; exceptions may be made where a company with an audit and supervisory board is changing to a different organisational structure.

Independence criteria for outside directors

Candidates falling under any of the conditions listed below are deemed insufficiently independent until ten years after such person ceases to be in such a position.

- Employees of the company or its affiliates
- Family of employees of the company (related to within two degrees of separation)
- Employees of major shareholders (owning a stake of 10% or more)
- Employees of companies accounting for 2% or more of the company's revenue
- Employees of financial institutions listed as major lenders in business reports
- Employees of companies dispatching directors to each other
- Employees of audit firms acting as the company's external auditors
- Legal counsel or similar who, or whose companies, receive financial compensation from the company
- Employees of any institution that receives donations from the company of more than JPY 10 million per year
- Outside directors serving for over 10 years

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(4) Appointment of external auditors

As a general rule, vote in favour of the proposed appointment of external auditors, unless an audit firm is to be changed due to a divergence of views on accounting policies, or there are reasonable grounds to conclude that the interest of shareholders may not be fully reflected.

(5) Share buybacks

As a general rule, vote in favour of share buyback proposals. Vote against proposals where the repurchase of shares from specified shareholders at higher than the market price is liable to undermine the company’s stability or impair liquidity by materially reducing the free-float ratio, thereby disadvantaging other shareholders.

- Generally vote against proposals that would bring the capital ratio below 10%, notwithstanding sector-specific factors and other such extenuating circumstances.
- Vote against proposals that would bring the free-float rate below 5%, or give specified large shareholders over two thirds of shares.

(6) Retirement benefits

As a general rule, vote in favour of retirement benefit proposals. Vote against payment to any director responsible for unlawful or unethical behaviour, or otherwise judged to have significantly impaired shareholder value.

Vote against payment where performance clearly remains depressed as shown by operating losses or no dividend payout over the past three consecutive years; and vote against payment to outside directors and audit and supervisory board members. Vote against payment where the total sum of retirement benefits is not disclosed.

(7) Director compensation

As a general rule, vote in favour of compensation proposals for directors, including bonuses. Generally vote against payment to any director responsible for unlawful or unethical behaviour, or otherwise judged to have significantly impaired shareholder value. Generally vote against payment where performance clearly remains depressed as shown by operating losses or no dividend payout over the past three consecutive years.

As a general rule, vote in favour of any reduction in the total amount provided in compensation for directors. Vote in favour of increases in total compensation justified by inflation, an increase in the number of directors as the business expands, or other such reasonable grounds. Vote against increases where performance clearly remains depressed as shown by three consecutive years of ROE below 5%, operating losses, or no dividend payout; or where compensation is deemed excessive.

- Consider in particular whether compensation for outside directors and outside audit and supervisory board members is excessive.
- Vote against any payment of bonuses to outside directors and audit and supervisory board members.

(8) Mergers, acquisitions and business transfers

Vote in favour of mergers, acquisitions and business transfers where deals are intended to enhance the company's competitiveness or longer-term profitability, and the process of deciding the terms of the deal is deemed fair to all shareholders.

Vote against proposals where there is insufficient disclosure of asset valuations or other important information, or where a conflict of interest is deemed likely to arise between intermediaries and shareholders. Vote against deals intended to bail out a poorly performing company, contrary to the best interests of the shareholders of the company in question.

- Consider in particular whether appraisers and appraisals of mergers, acquisitions and business transfers are impartial and appropriate.

(9) Stock options

As a general rule, vote in favour of the use of stock options and other equity compensation plans to create a shared interest between management and shareholders, where these constitute appropriate incentives to promote continued improvements in shareholder value and do not encourage option holders to take excessive business risks. Vote against stock option plans if the equity interest of existing shareholders is significantly diluted, the strike price is set below the market price (except for equity compensation plans) or the strike price is lowered for any portion not yet exercised.

- Vote against granting stock options where no specific explanation is given, particularly when those eligible are from outside the company. As a general rule, persons outside the company such as employees of business partners, accountants and lawyers shall not be eligible to share the interests of shareholders.
- Vote against granting stock options to outside directors and audit and supervisory board members.
- Generally vote against granting stock options unless they vest either after three years or after retirement.
- Vote against stock option plans if the potential dilution rate exceeds 5% of the total number of issued shares. The potential dilution rate shall include any options not yet converted.

(10) Article amendments

Vote case-by-case on amendments to articles of association from the perspective of materiality, with particular attention paid to the following areas:

1. Payment of dividends or repurchase of shares at the board's discretion

- As a general rule, vote against any amendment allowing dividend payments or share buybacks at the board’s discretion, as this interferes with the ability to perform advance checks into credit and liquidity risks.

2. Changes in number of directors

- Vote in favour of any increase in the number of directors and addition of outside directors as the business expands. Vote against any such increase, however, if it is deemed likely to interfere with the company’s ability to make decisions in a timely manner.
- As a general rule, vote in favour of any decrease in the number of directors. Bear in mind, however, that a marked decrease in the number of vacancies could, depending on the purpose and extent of the decrease, be a type of takeover defence.

3. Increase in authorised capital

- Vote case-by-case on increasing authorised capital. Vote against any such increase that could lead to dilution in the equity interest of existing shareholders where the purpose and impact is unclear or detrimental to the interests of existing shareholders.

4. Change in business strategy or nature of business

- As a general rule, vote in favour of any change in business strategy or nature of business based on appropriate management plans, unless such change is likely to lower shareholder value.

5. Issuance of new class shares

- Vote case-by-case on any proposal to issue new class shares, with due regard to voting rights granted, terms of conversion to ordinary shares, and other such factors. Vote against the issuance of shares with multiple voting rights from a fairness standpoint.

6. Limitation of liability for directors

- Vote case-by-case on proposals limiting liability for directors in shareholder litigation. It is appropriate to limit liability for directors and audit & supervisory board members, provided that they execute business in good faith and do not breach civil or criminal codes in the course of business. Bear in mind, however, that shareholders' interests could be harmed if responsibility can be evaded for any behaviour resulting in a loss of shareholder value.

7. Limitation of liability for external auditors

- As a general rule, vote against any proposal limiting liability for external auditors in shareholder litigation. External auditors are to be held responsible for conducting strict, rigorous audits from a professional and fully independent standpoint.

8. Lower quorum requirement for special resolutions

- Vote case-by-case on lowering quorum requirements for special resolutions where shareholders are not provided with sufficient explanation, with due regard to the level of ownership by specific shareholders, diversification among major shareholders, and overseas ownership.

(11) Capital reduction

Vote case-by-case on any proposed capital reduction. As a general rule, vote in favour of proposals where rejection is likely to lead to bankruptcy.

(12) Shareholder proposals

Vote case-by-case on shareholder proposals. As a general rule, vote in favour of any proposal that is consistent with these guidelines and is expected to help improve longer-term shareholder value. Vote against proposals deemed likely to damage the interests of general shareholders; shareholder proposals where insufficient explanation has been provided; and proposals with largely social or political aims.

(13) Takeover defence measures

The best takeover defence is the continued enhancement of shareholder value, to which end companies should constantly be working; as a general rule, therefore, vote against any proposal that introduces or extends defence measures against hostile takeover.

Any introduction or extension of hostile takeover defence measures shall require resolution at the shareholders meeting. If such measures are adopted by resolution of the board alone without being submitted to the shareholders, as a general rule, vote against the appointment of directors at the shareholders meeting.

(14) Unlawful or unethical behaviour

Vote case-by-case where any unlawful or unethical behaviour is detected, with due regard to the extent to which shareholder value is likely to be impaired. Request that the company explain the course of events, including any measures taken after the fact; indicate voting intentions on individual proposals in line with the interests of shareholders, upon scrutinising proposals from the standpoint of clearer management, post hoc measures taken by the company, and other such extenuating circumstances.

(15) Revision and abolition of voting guidelines

Any changes to these guidelines shall require the resolution of the Responsible Investment Committee and be reported to the Responsible Investment Monitoring Committee. Minor edits to wording and suchlike shall be made by the Chief Investment Officer, and reported to the Chair of the Responsible Investment Committee.

Supplementary: Shareholder Voting Review Framework (Japanese Equity)

English translation provided for reference only

- As a general rule, all shares held in active products shall be subject to scrutiny before voting.
- Under the provisions of section (7) Efficient Shareholder Voting in our Basic Policy on the Exercise of Shareholder Rights, companies exhibiting ROE of less than 5% for three consecutive years, or held in the products specified in the attached Appendix 1, shall be subject to scrutiny; Equity Investment Research analysts, investment department portfolio managers, and Responsible Investment analysts shall scrutinise proposals.
- If companies held in active products are already subject to scrutiny, the results of such scrutiny shall be used as the basis for shareholder voting. As a general rule, we shall vote in favour of proposals made by companies not subject to scrutiny.
- We shall also exercise voting rights on companies selected by the Responsible Investment team as subject to increased scrutiny for reasons including (but not limited to) poor performance, unlawful or unethical behaviour, and corporate governance issues.
- We shall exercise voting rights on J-REITs in accordance with these voting guidelines.
- As a general rule, authority concerning shareholder voting on Japanese equity shall be delegated by the head of each investment department to the Head of Equity Investment Research. In practice, sector analysts, investment department portfolio managers and Responsible Investment analysts shall vote case-by-case on each resolution for companies subject to scrutiny in accordance with voting guidelines, and obtain the approval of the Head of Equity Investment Research. With regard to the products specified in Appendix 2, authority concerning shareholder voting shall not be delegated to the Head of Equity Investment Research, and decisions shall instead be made by the head of the relevant investment department. The Head of Equity Investment Research shall immediately report the results of decisions, made in accordance with voting guidelines, to the Head of Responsible Investment and the Chief Investment Officer.
- The status of shareholder voting shall be reported each month to the Performance Review Committee (PRC), and each quarter to the Responsible Investment Monitoring Committee.
- Records shall be maintained on any contentious proposals for five years after the end of the accounting period during which instructions have been given. These records shall include notice of the shareholder meeting pertaining to the proposal in question, reasons why it presents a problem and reasons for the decision.
- As a general rule, shareholder voting instructions shall be consistent, unless the client gives specific voting instructions, for example. If we consider these instructions to be irrational, however, we will endeavour to voice our opinion to the customer at that time. Inconsistent instructions may be given regarding the products specified in Appendix 2 in view of specific investment objectives.
- Shareholder voting results shall be compiled in accordance with whatever methods are needed to meet the disclosure requirements of the Investment Trusts Association, Japan and the Japan Investment Advisers Association. These shall also be disclosed for each invested company and proposal.

Appendix 1

Holdings subject to review of proposals	Review all (All holdings)	Select companies subject to review (Screened names)	Select companies subject to increased scrutiny (Other than active holdings and screened names)		
		ROE below 5% for three consecutive years	Poor performance	Unlawful or unethical behaviour	Corporate governance issues
Active Products (Excluding below)	○	–	Companies designated by the Responsible Investment team		
TOPIX Index	×	○			
Japanese Equity Market Neutral	×	○			
Tokai Three Prefectures	×	○			
Mitsubishi Group Shares	×	○			
Japanese Equity High Dividend/Low Volatility	×	○			
Nikkei 225 Index Fund	×	○			
JPX Nikkei 400 Index	×	○			
JPX Nikkei 400 High Dividend/Low Volatility	×	○			
Japanese Equity High Dividend/Low Volatility (Beta Hedge Class)	×	○			
Japanese Equity Smart Epsilon	×	○			
Japanese Equity Low Carbon	×	○			
Japanese Equity High Dividend/Low Volatility (Higher liquidity)	×	○			

If companies held in active products are already subject to scrutiny, the results of such scrutiny shall be used as the basis for shareholder voting.

Appendix 2

Products subject to voting decisions by the investment department head	
Product code	Product name
JE350	Japan Equity Engagement Investment