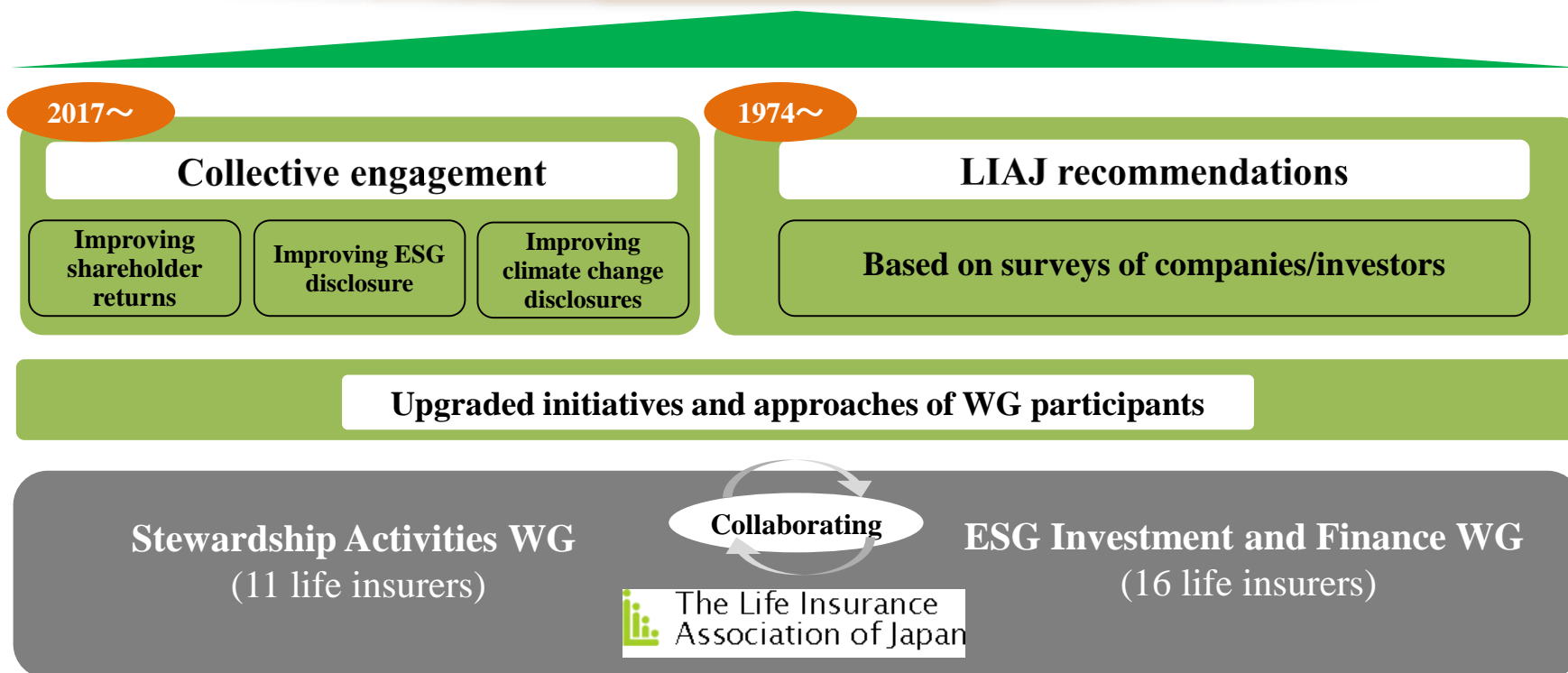


# LIAJ initiatives in FY2019

- Working groups on stewardship activities and ESG investment and finance were set up to contribute to equity market reinvigoration and achieving a sustainable society. Continued to publish the LIAJ recommendations (this report) and implement collective engagement in FY2019.
- Implemented measures to refine and raise the sophistication of activities at each LIAJ member firm in FY2019. Key measures included holding joint working group (WG) seminars based on the common theme of “Addressing climate change” as an institutional investor.
- LIAJ believes that when companies and shareholders engage in a constructive dialogue and share a mutual awareness of issues, companies will be encouraged to take steps to increase shareholder value over the medium and long terms. Based on this belief, LIAJ hopes that this report will help to increase shareholder value over the medium and long terms, leading to the reinvigoration of the stock market as a whole.

## Equity market reinvigoration/Achieving a sustainable society



# FY2019 policy recommendations

- The following recommendations were made for management goals/financial strategy, improving corporate governance, enhancing dialogue, shareholder voting, and promoting ESG initiatives.
- Recommendations for enhancing dialogue were added in FY2019.

Recommendations		Target	Recommendations		Target
Management goals /financial strategies	① Raise shareholder returns over the medium and long terms (dividend payout ratios of at least 30%)	Companies	Shareholder voting	⑧ Revised Provide clearer explanations of proposals with a high dissent ratio	Companies
	⑨ Greater transparency for shareholder voting processes			Investors	
Improving corporate governance	③ Improve disclosure about expectations of external directors and their performance		Promoting ESG initiatives	⑩ Disclose ESG initiatives using integrated reports and other means	Companies
Enhancing dialogue	④ Improve disclosure/dialogue relating to medium- and long-term investment strategy			⑪ Incorporate ESG initiatives in medium-term management plans	Companies
	⑤ Revised Encourage involvement of top management in dialogue			⑫ Combined Formulate ESG investment and finance policies and promote dialogue from medium- and long-term perspectives according to investment strategies	Investors
	⑥ New Promote disclosure of non-financial information, including ESG, as material for dialogue	Investors	⑬ New Enhance disclosure about the impact of climate change on corporate activities and encourage the use of this information	Companies Investors	
⑦ New Promote in-depth dialogue from medium- and long-term perspectives according to enhanced corporate analysis and understanding, and investment strategies	⑭ Take steps to promote ESG initiatives across government ministries/agencies		Government		

## Survey on initiatives to enhance corporate value

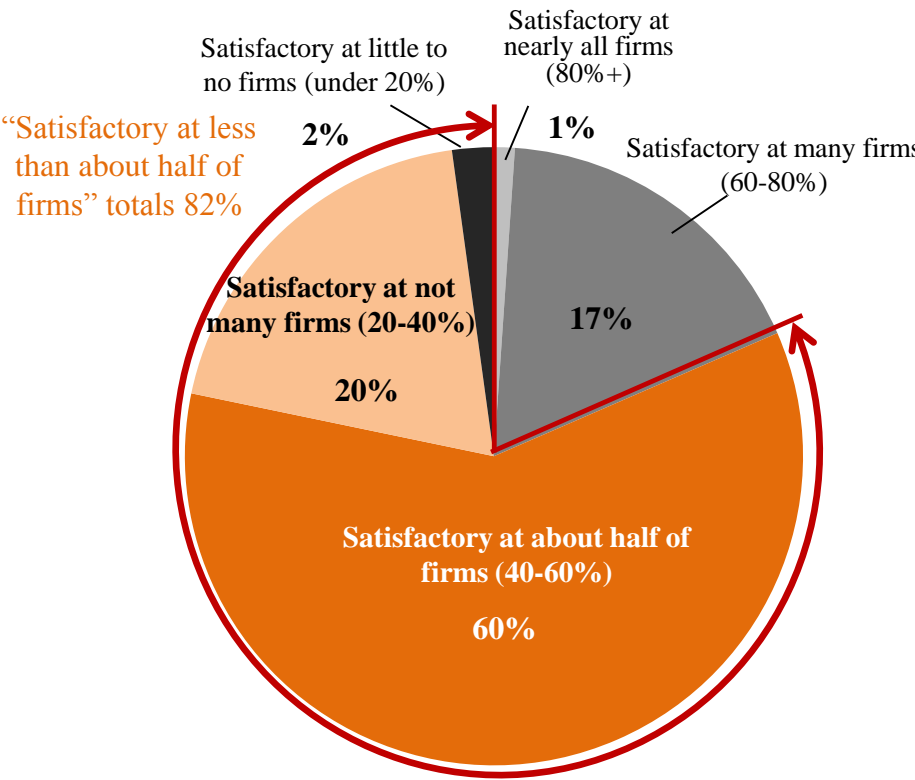
<Purpose> To implement recommendations for equity market reinvigoration and achieving a sustainable society based on results of surveys on initiatives and awareness of companies/investors

<Survey targets and response rate> Listed companies 45% (540/1,200 companies); investors 53% (104/196 companies)

# Recommendation (1): Raise shareholder returns over the medium and long terms (dividend payout ratios of at least 30%)

- 82% of investors are not fully satisfied with current levels of shareholder returns and dividends.
  - 59% of investors expect firms to offer payout ratios of at least 30% over the medium and long terms. However, the actual payout ratios remain under 30% for around half of all firms, despite some signs of improvement.
- ⇒Increase shareholder returns over the medium and long terms, with a payout ratio target of at least 30%, after gauging investor expectations through dialogue

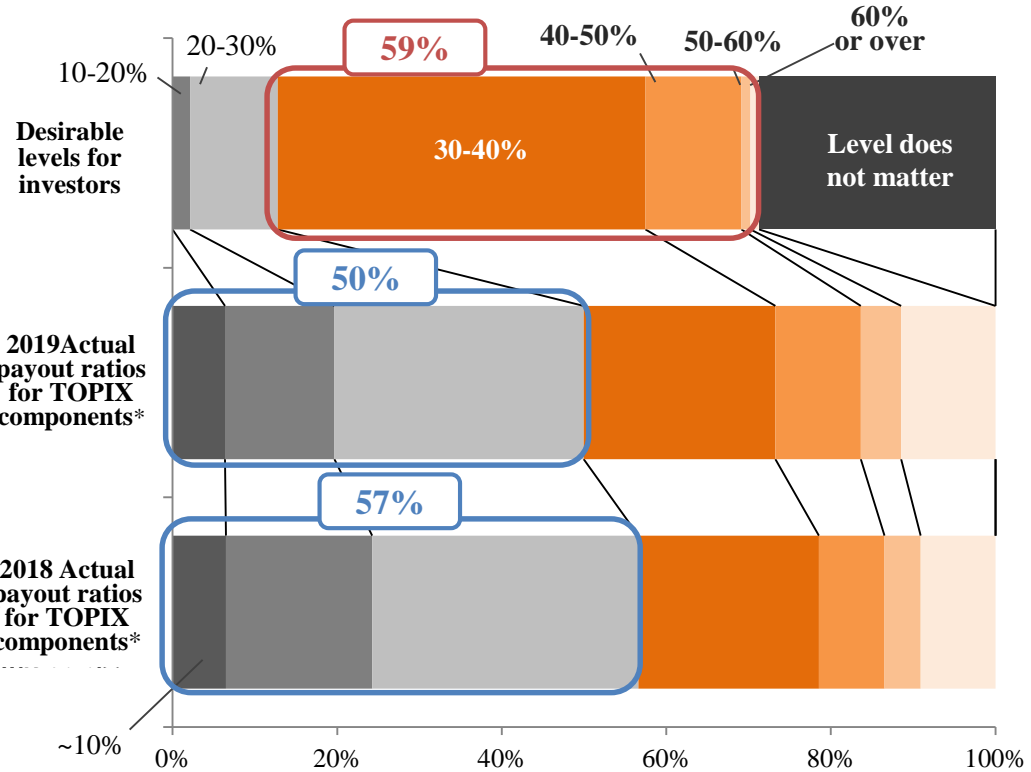
[For investors]  
Satisfaction level for shareholder returns and dividends  
(select one)



Note: Percentage figures are rounded to the nearest percent, so they will not necessarily sum to 100.

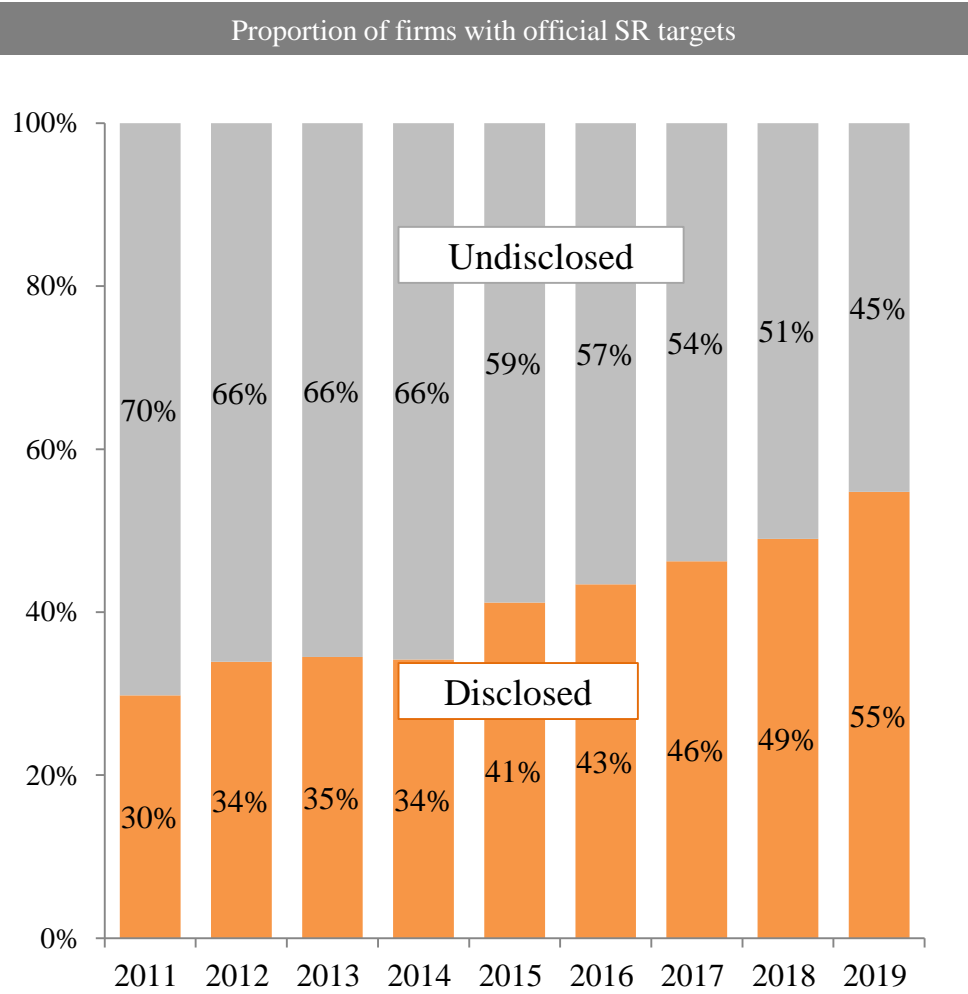
[For investors]  
Desired medium- and long-term level of dividend payout ratios (select one)

Reference: Distribution of payout ratio for companies (actual)

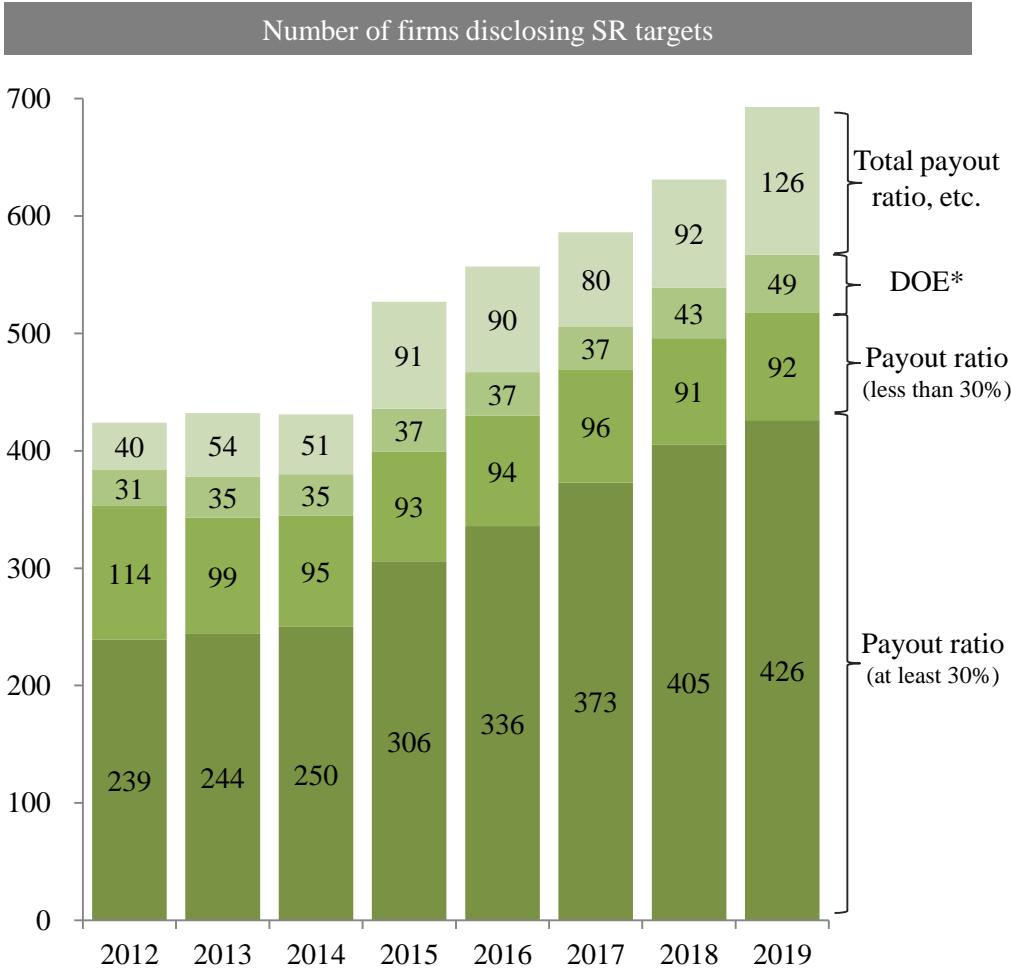


\* Source: Nikkei QUICK  
Note: Excluding unprofitable firms

(Reference) Disclosure of numerical shareholder return (SR) targets



Source: LIAJ research  
Based on survey of top 1,200 stocks by market capitalization



Source: LIAJ research  
Based on survey of top 1,200 stocks by market capitalization  
Note: Firms with multiple SR targets counted for each target  
\* DOE: dividend-on-equity ratio

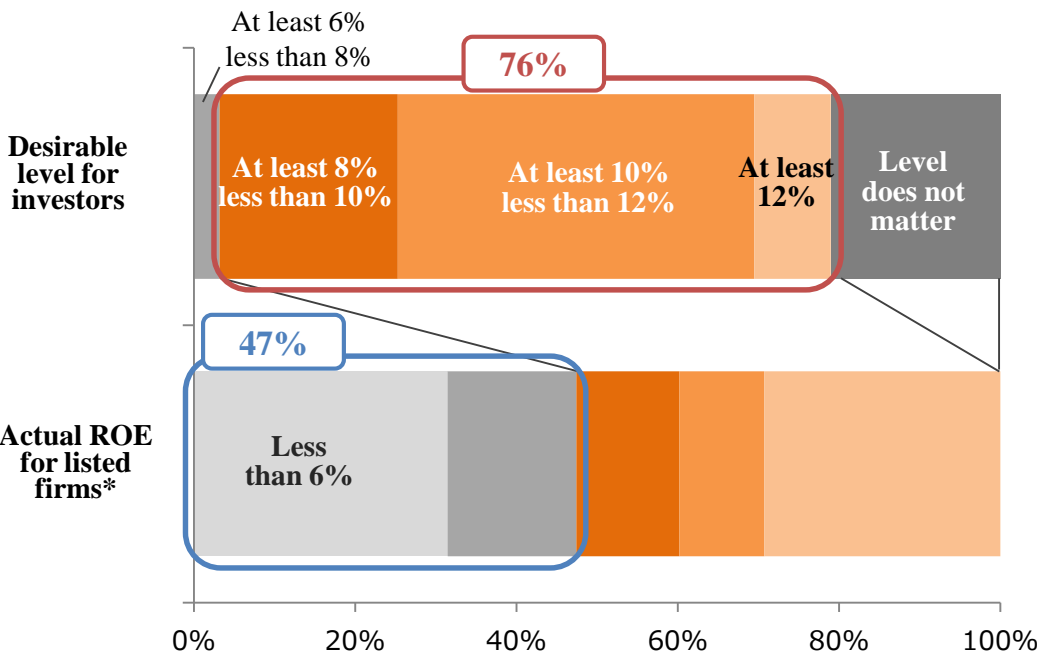
Recommendation (2): Set ROE targets adjusted for cost of capital and target higher ROE levels

- 76% of investors expect ROE of 8%+, yet ROE remains under 8% at 47% of listed firms.
- The percentage of firms that calculate their cost of capital (return expected by shareholders) increased by around 10%. However, 41% of firms have still not determined their cost of capital. This partly explains the gap between investor expectations and the status quo.

⇒Set ROE targets adjusted for cost of capital, eyeing medium- and long-term improvement in ROE levels

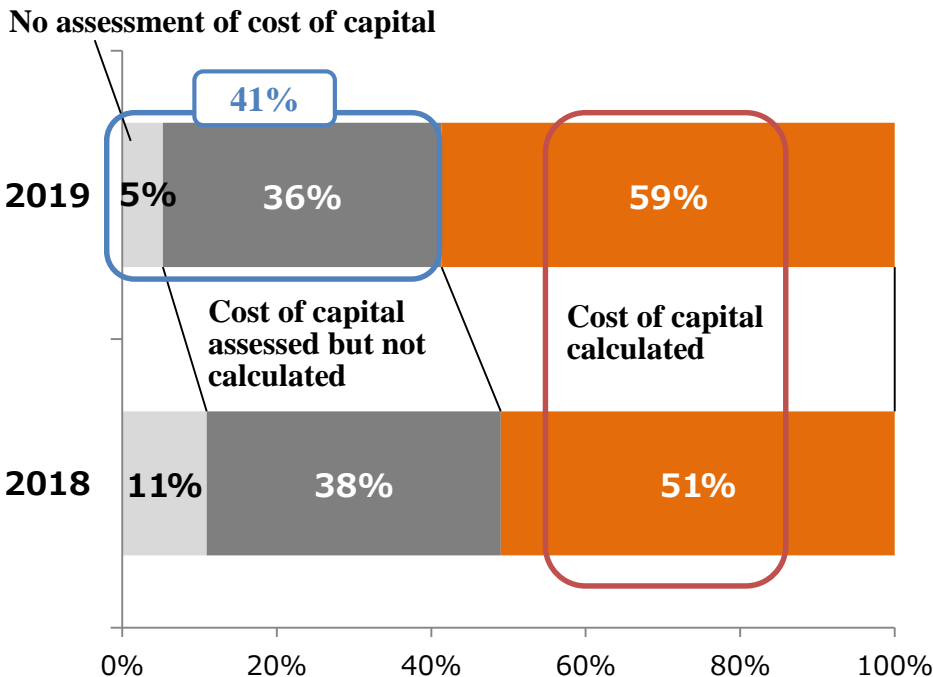
[For investors] Desired medium- and long-term level for ROE (select one)

<Reference> Distribution of ROE levels for listed firms (actual)



[For companies] (select one)

Do you calculate a precise cost of capital (return expected by shareholders)?

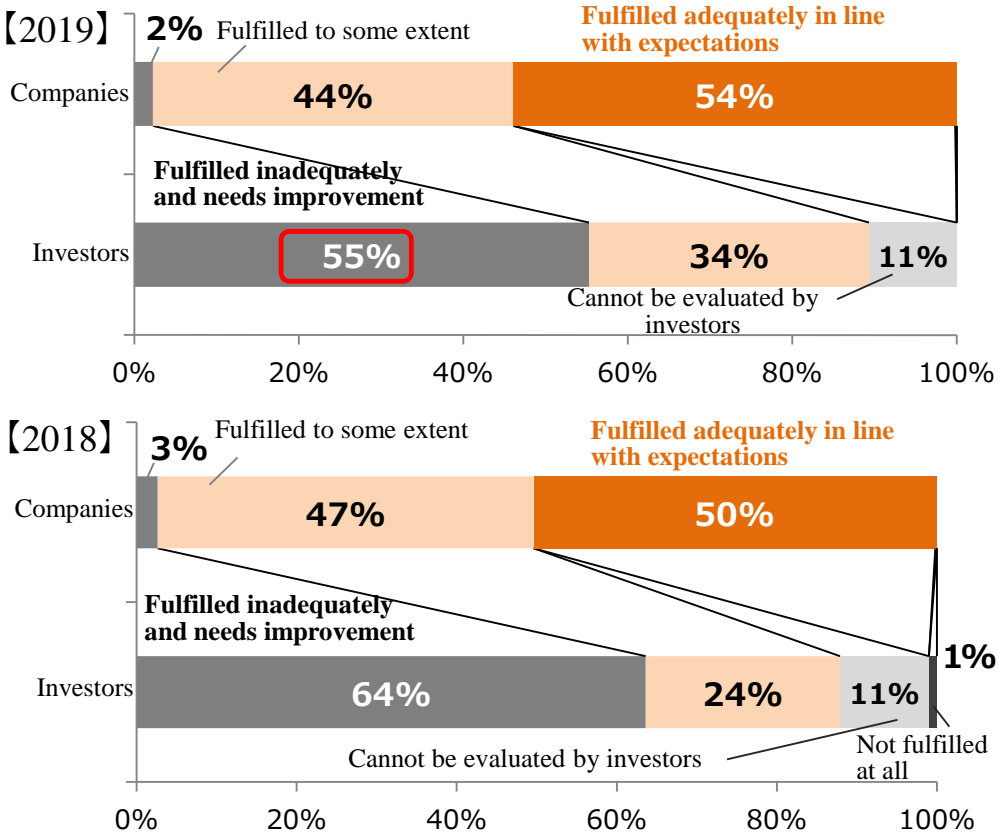


\* Source: Nikkei QUICK  
Note: All listed firms (including unprofitable firms, excluding the financial sector)

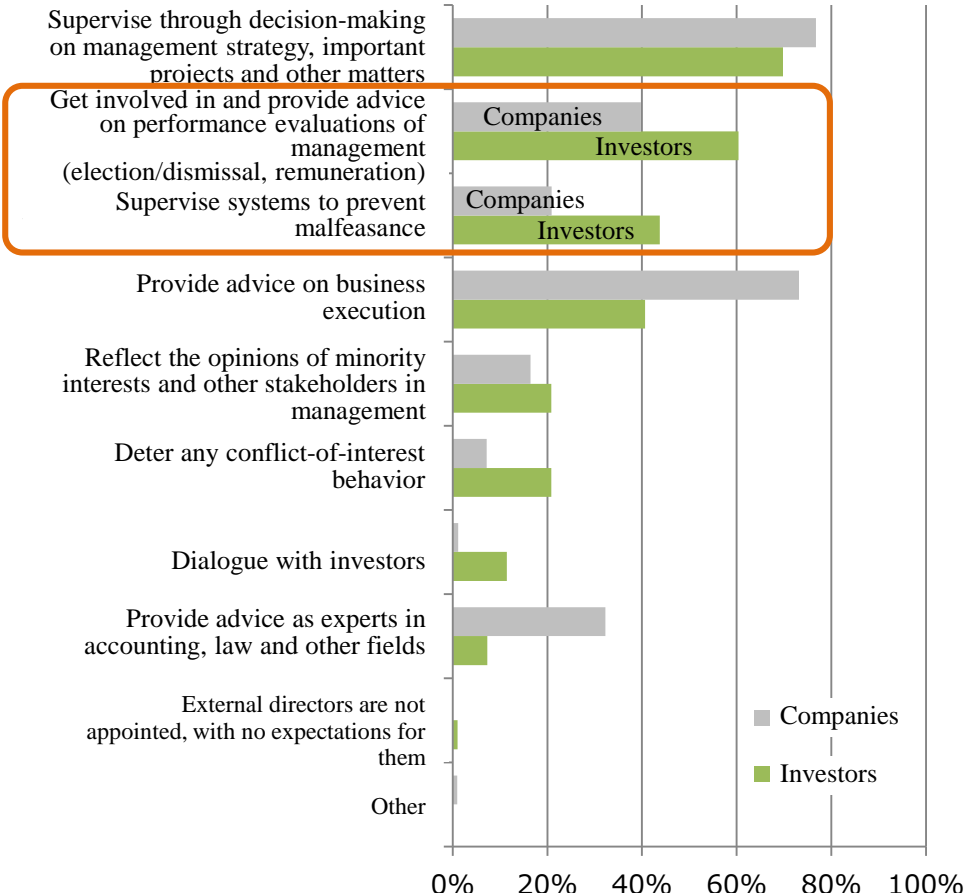
# Recommendation (3): Improve disclosure about expectations of external directors and their performance

- 55% of investors see room for improvement in the roles of external directors, indicating a perception gap between investors and companies on this issue.
  - Notably, investors attach even greater importance than companies to certain roles of external directors, such as “involvement in the evaluation of management” and “supervision to prevent malfeasance.”
- ⇒Improve disclosures about expectations of the roles and performance of external directors, and explain these matters to investors via respectful dialogue

[For companies/investors] (select one)  
Are external directors currently fulfilling the roles that are expected of them (see the diagram to the right)?



[For companies/investors] (select up to three)  
What roles expected of external directors do you see as particularly important?

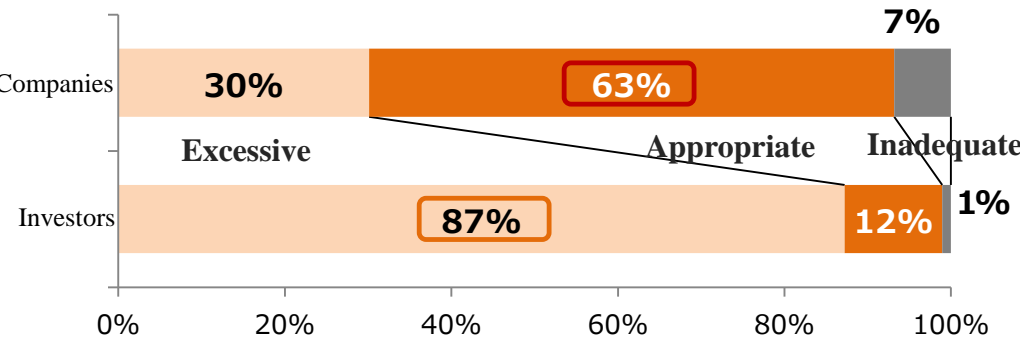


Recommendation (4): Improve disclosure/dialogue relating to medium- and long-term investment strategy

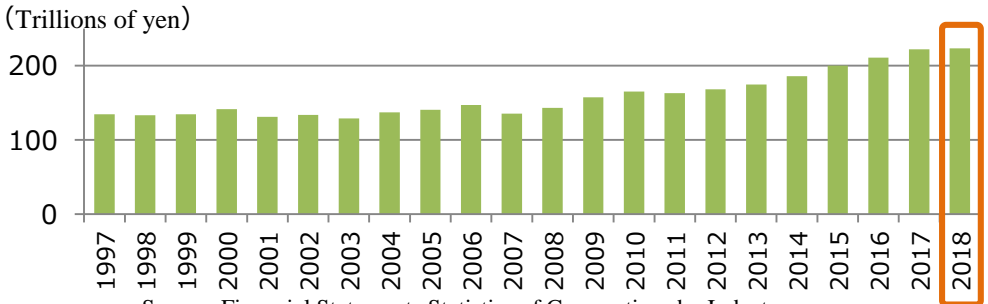
- 63% of companies believe cash balances are appropriate, but 87% of investors see current levels of cash balances as excessive. (In FY2018, cash and deposits stood at historic highs for Japanese firms.)
- In their medium- and long-term investment/financial strategies, companies see capex as vital, while investors put more emphasis on intangibles such as R&D, human capital and IT.

⇒Target appropriate cash levels, and improve disclosure/dialogue related to long-term investment strategy

[For companies/investors] (select one)  
How do you see current levels of cash holdings?

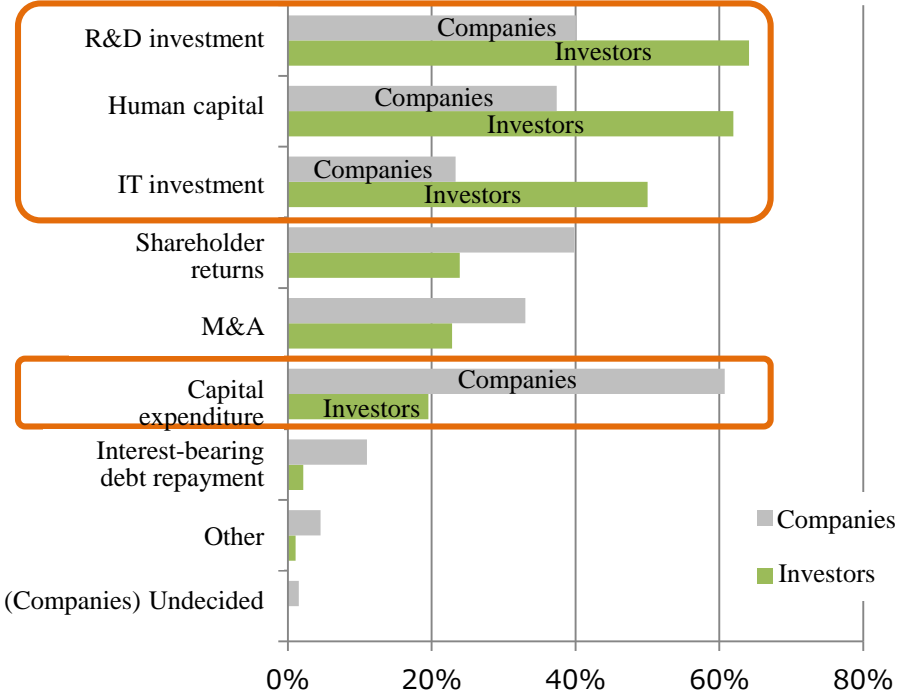


Reference: Corporate cash/deposit balance (actual)



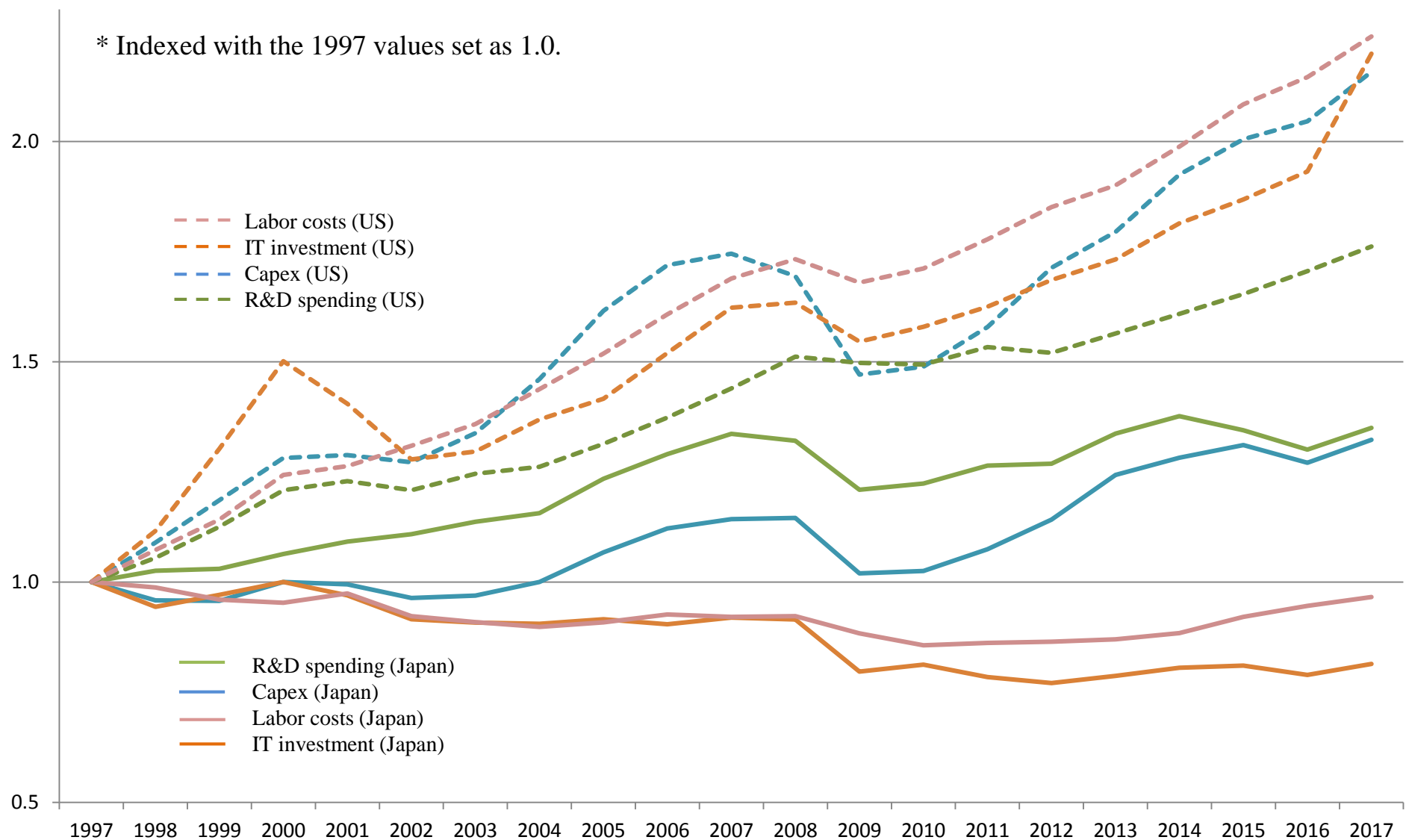
Source: Financial Statements Statistics of Corporations by Industry (excluding financial firms and insurers)

[For companies/investors] (select up to three)  
What do you think are important matters to consider, or should be considered, in your medium- and long-term investment strategy?



\* Apart from the options listed above, 36% of investors emphasize the need to improve the capital mix, while only 14% of companies emphasized this priority.

Reference: Labor costs, IT investment, capex, and R&D spending in Japan/US



Sources: OECD statistics, “Databook of International Labour Statistics” by Japan Institute for Labour Policy and Training, “2019 WHITE PAPER Information and Communication in Japan” by MIC

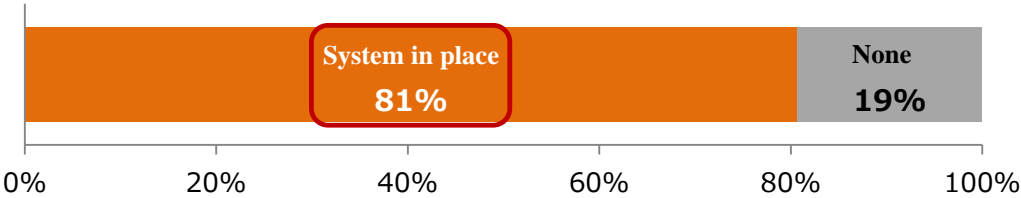


Recommendation (5): Encourage involvement of top management in dialogue

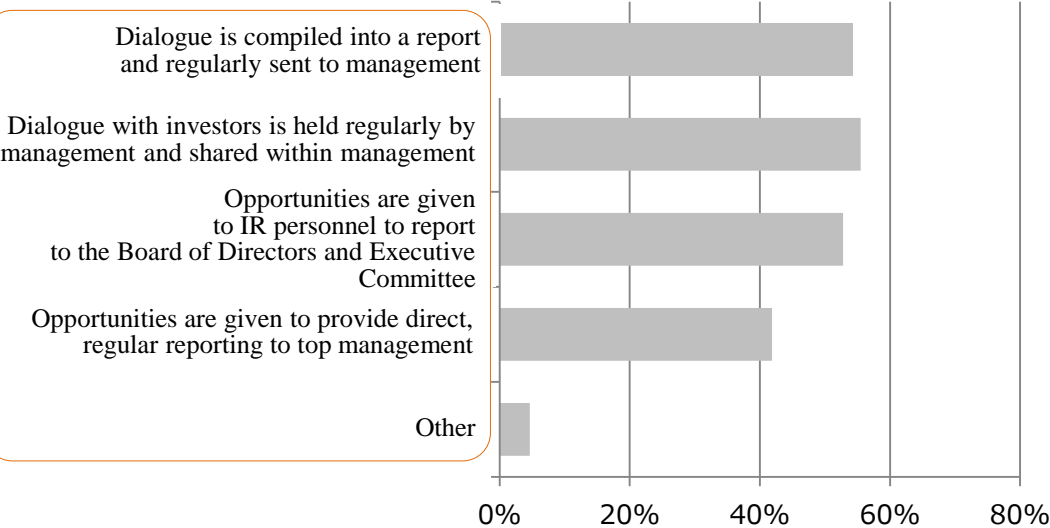
- 81% of companies have systems in place to share dialogue content with management, but investors feel that “dialogue content does not reach management” and there is “non-participation by senior managers.”

⇒Actively involve management in dialogue and provide feedback on the results of sharing dialogue to investors

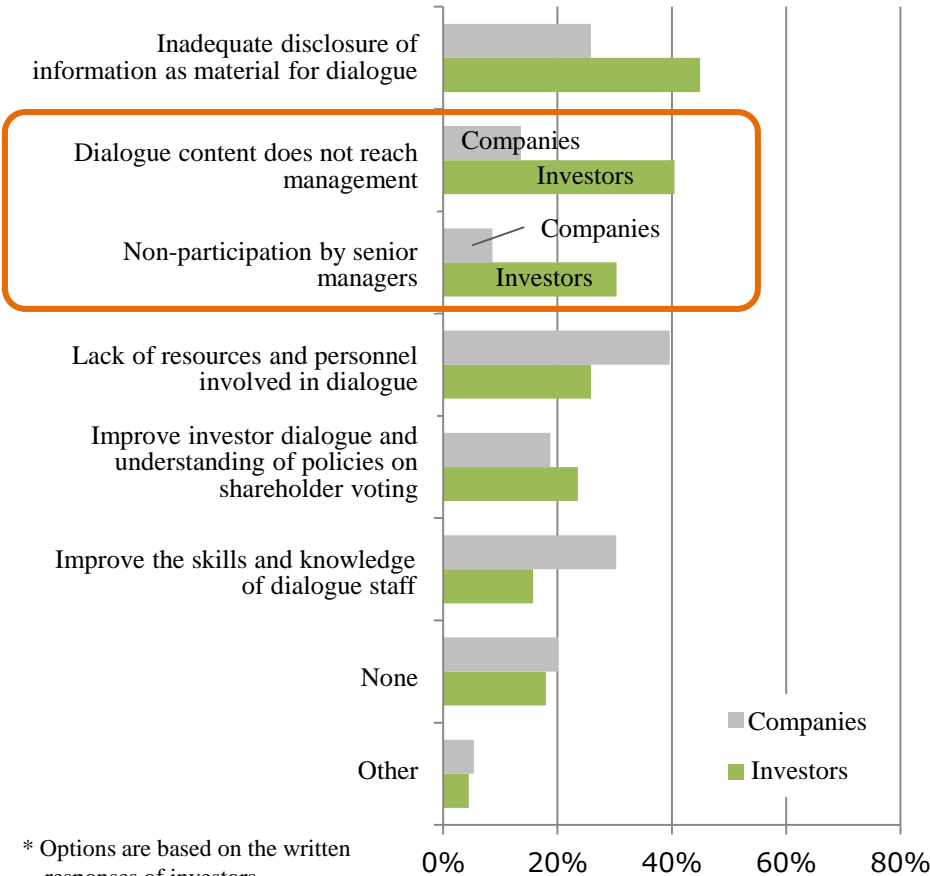
[For companies] (select one)  
Do you have a system in place to share dialogue content with management?



[For companies] (Select multiple)  
System for sharing dialogue content with management, if such a system is in place



[For companies/investors] (select up to three)  
What are the main dialogue-related issues regarding the systems and measures of your company / the systems and measures for companies?

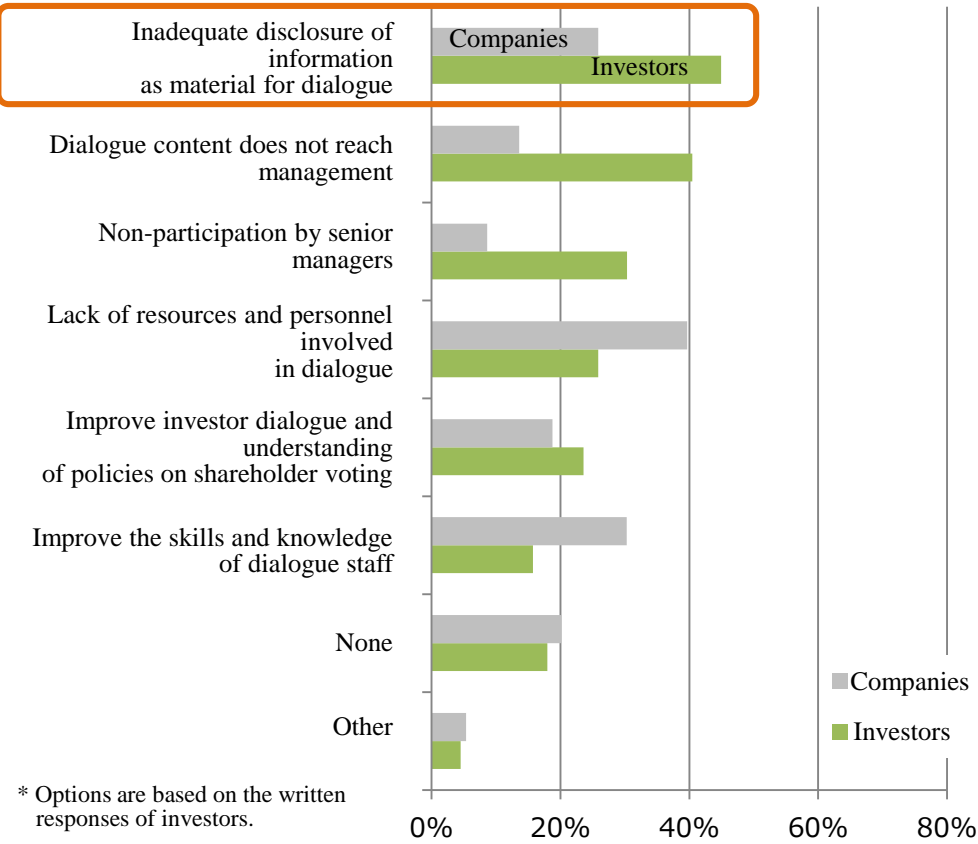


\* Options are based on the written responses of investors.

# Recommendation (6): Promote disclosure of non-financial information, including ESG, as material for dialogue

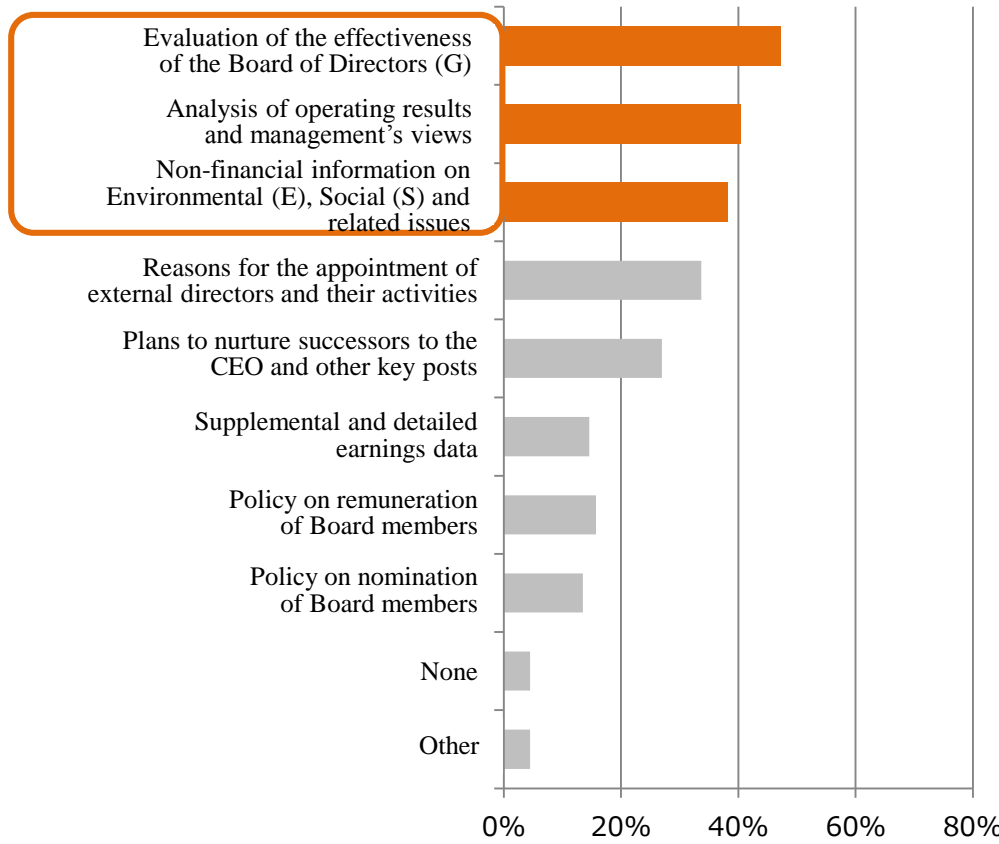
- Investors have stronger expectations for companies to disclose information as material for dialogue than assumed by companies.
  - Investors expect companies to enhance disclosure of “non-financial information on Environmental (E), Social (S) and related issues,” and “evaluation of the effectiveness of the Board of Directors (G)” in addition to providing an “analysis of operating results and management’s views.”
- ⇒Promote disclosure of non-financial information, including ESG, as material for dialogue

[For companies/investors] (select up to three)  
What do you feel are the main dialogue-related issues regarding policies and activities at your company, or the main dialogue-related issues for companies in general?



\* Options are based on the written responses of investors.

[For investors] (select up to three)  
What do you expect companies to do to provide opportunities for dialogue and improve disclosures as material for dialogue?





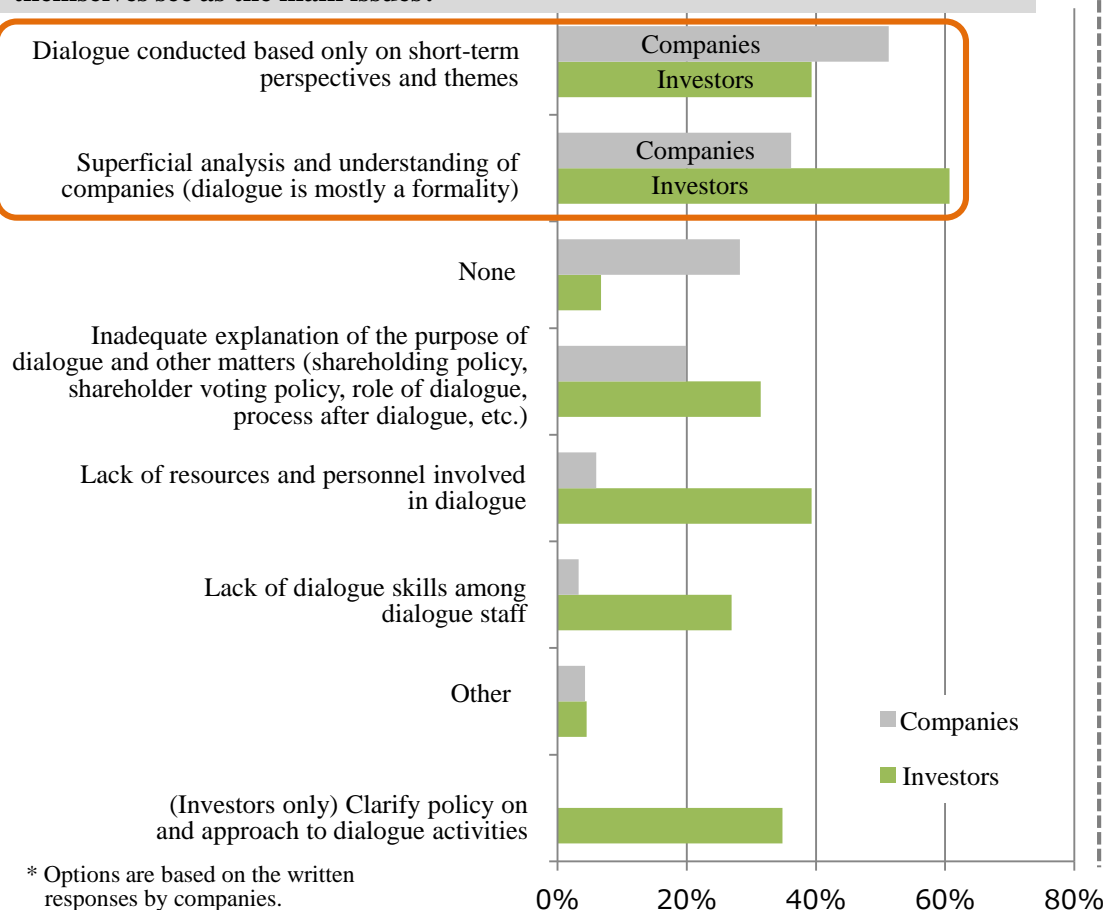
## Recommendation (7): Promote in-depth dialogue from a medium- and long-term perspective according to enhanced corporate analysis and understanding, and investment strategies

- Both companies and investors feel that the key dialogue-related issues for investors are that dialogue is based on a short-term perspective and there is only a superficial analysis and understanding of companies.
- Both companies and investors also believe that dialogue focused on medium- and long-term themes such as “management strategies and business models” is important.

⇒Promote dialogue focused on long-term themes such as “management strategies and business models” according to investment strategies, through deeper corporate analysis and understanding.

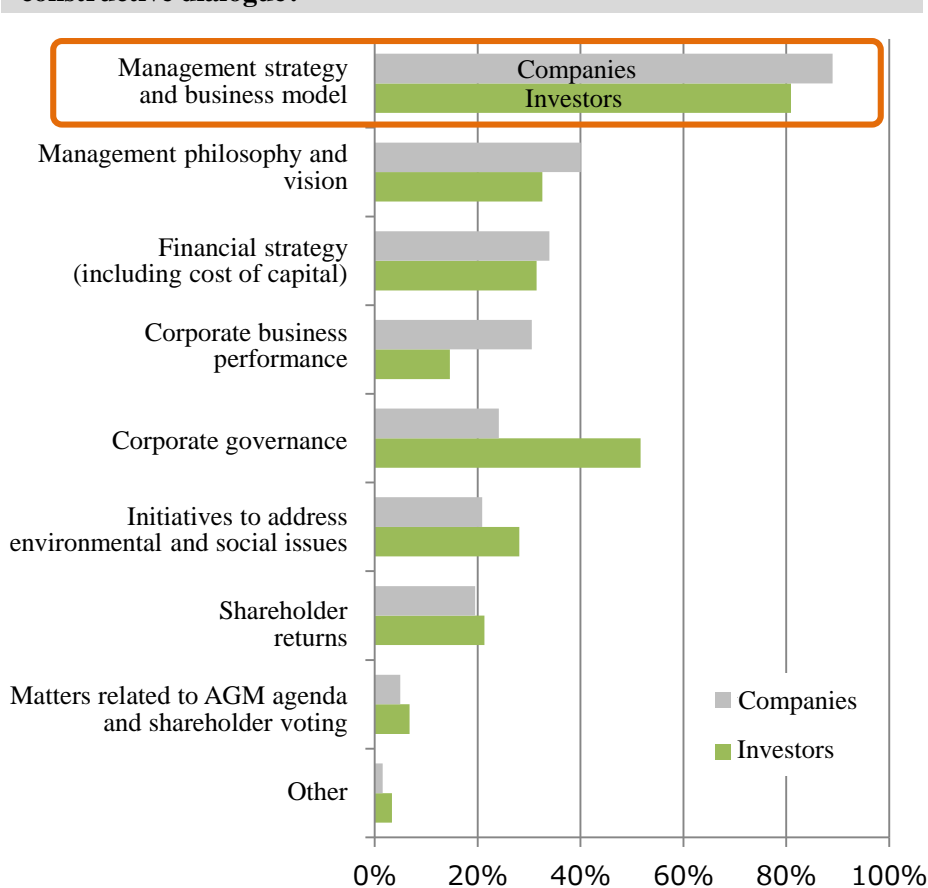
[For companies/investors] (select up to three)

What are the main dialogue-related issues for investors/what do investors themselves see as the main issues?



[For companies/investors] (select up to three)

What themes do you think are important to conduct in-depth, constructive dialogue?

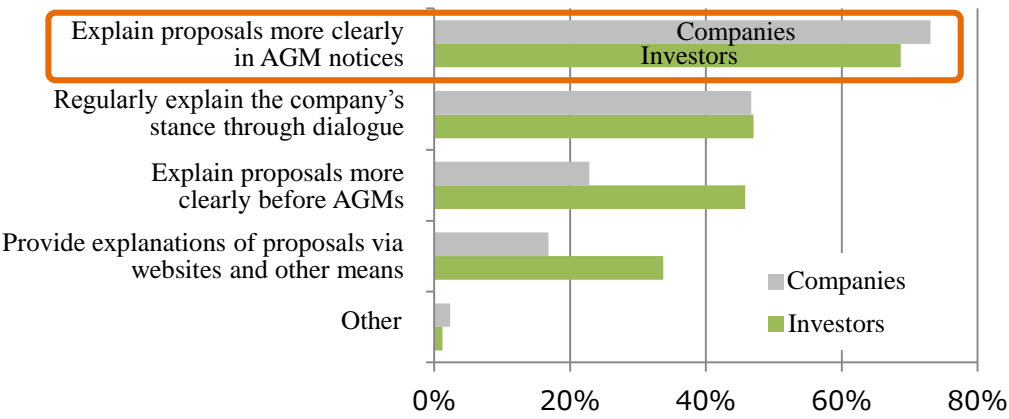


Recommendation (8): Provide clearer explanations of resolutions with a high dissent ratio

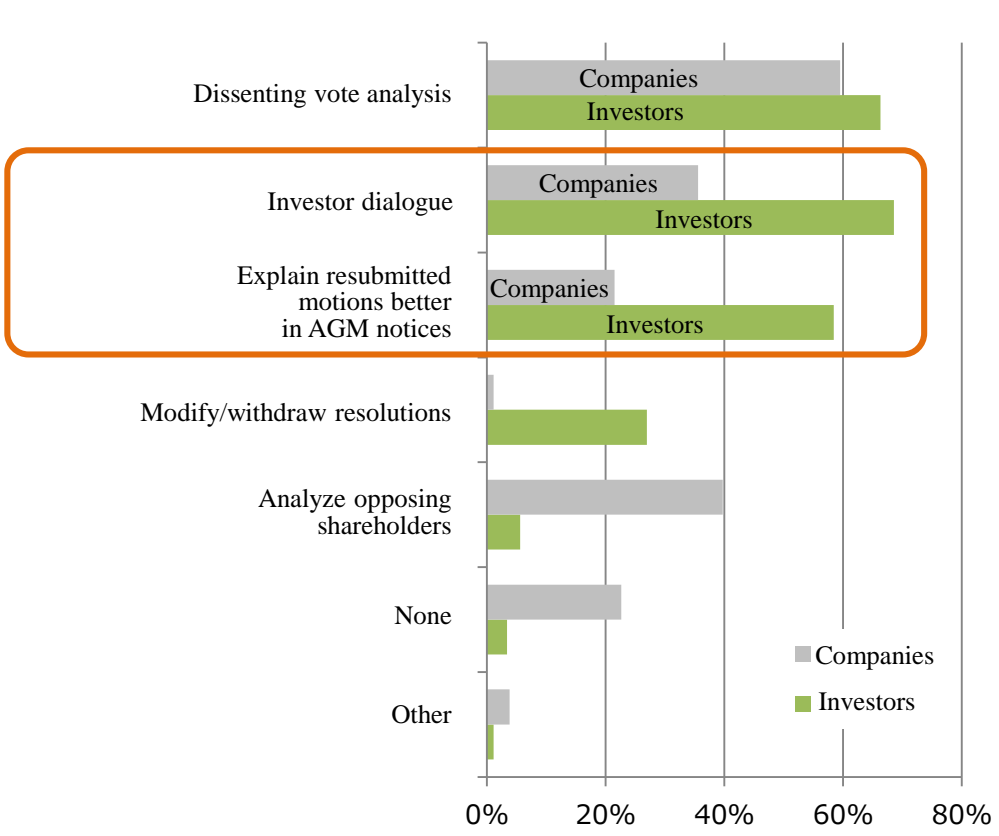
- Companies have been working intensively to provide clearer explanations of proposed agendas in convocation notices. Accordingly, around 80% of both companies and investors feel that explanations on individual agenda proposals have improved to a certain extent.
- That said, investors have stronger expectations than assumed by companies, for companies “to enhance explanations through dialogue and AGM notices” for prior resolutions that had substantial opposition.

⇒Provide better explanations of prior resolutions with high dissent ratios through dialogue and AGM notices

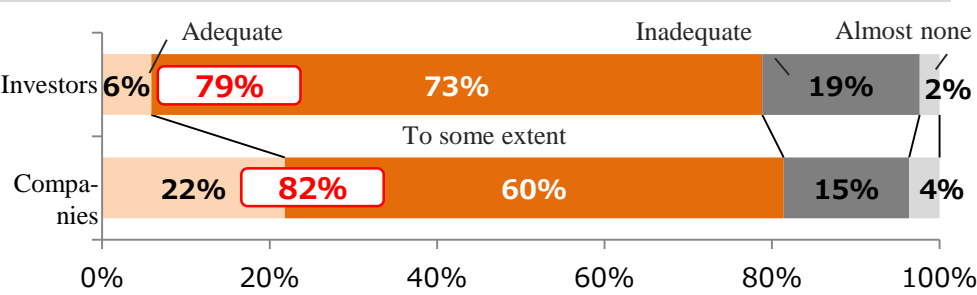
[For companies/investors] (select up to three)  
What intensive measures are being taken and what means would be desirable for companies to provide better explanations of individual proposals?



[For companies/investors] (select up to three)  
What measures do companies take to address prior resolutions that had substantial opposition/and what measures do you expect of companies?



[For companies/investors] (select up to one)  
Are explanations of individual proposals adequate?



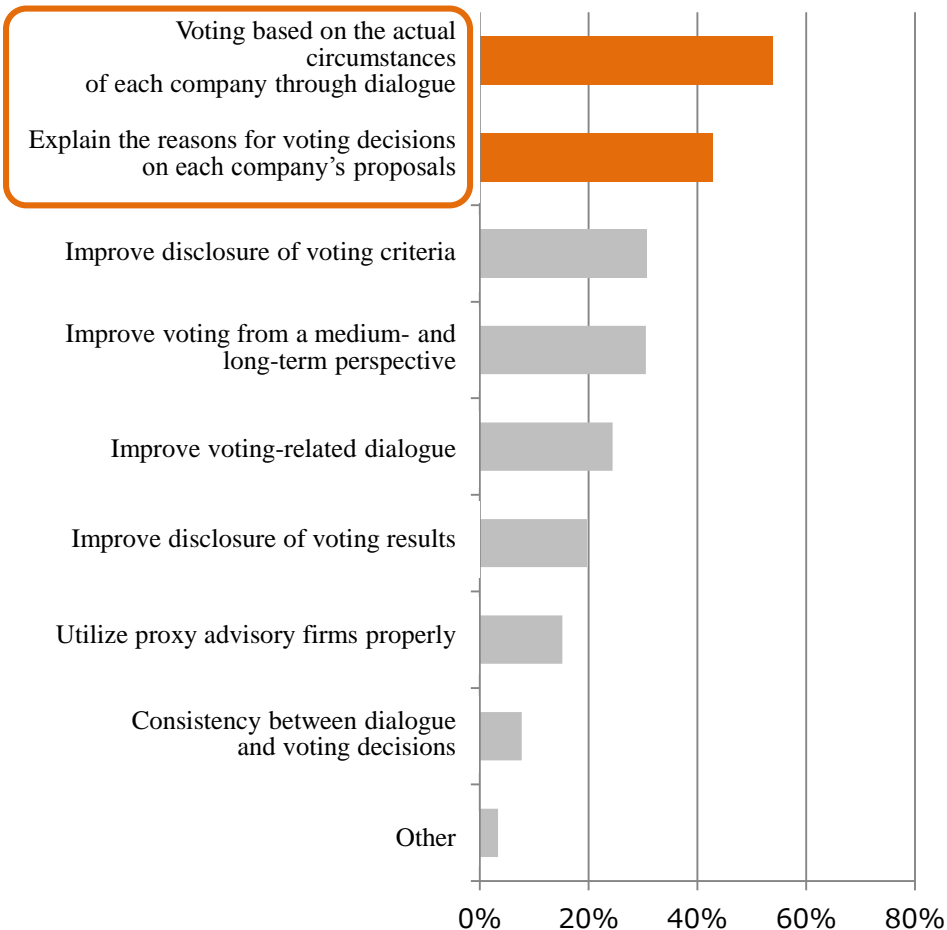
## Recommendation (9): Greater transparency for shareholder voting processes

- Companies expect investors to vote case by case based on the actual circumstances of each company, and to provide better explanations of the reasons for voting decisions on each company's proposals.
- Investors themselves recognize the importance of voting case by case based on the actual conditions of each company and providing better explanations of the reasons for voting decisions on each company's proposals.

⇒ Greater transparency for shareholder voting processes through voting rationale and explaining voting decisions to companies.

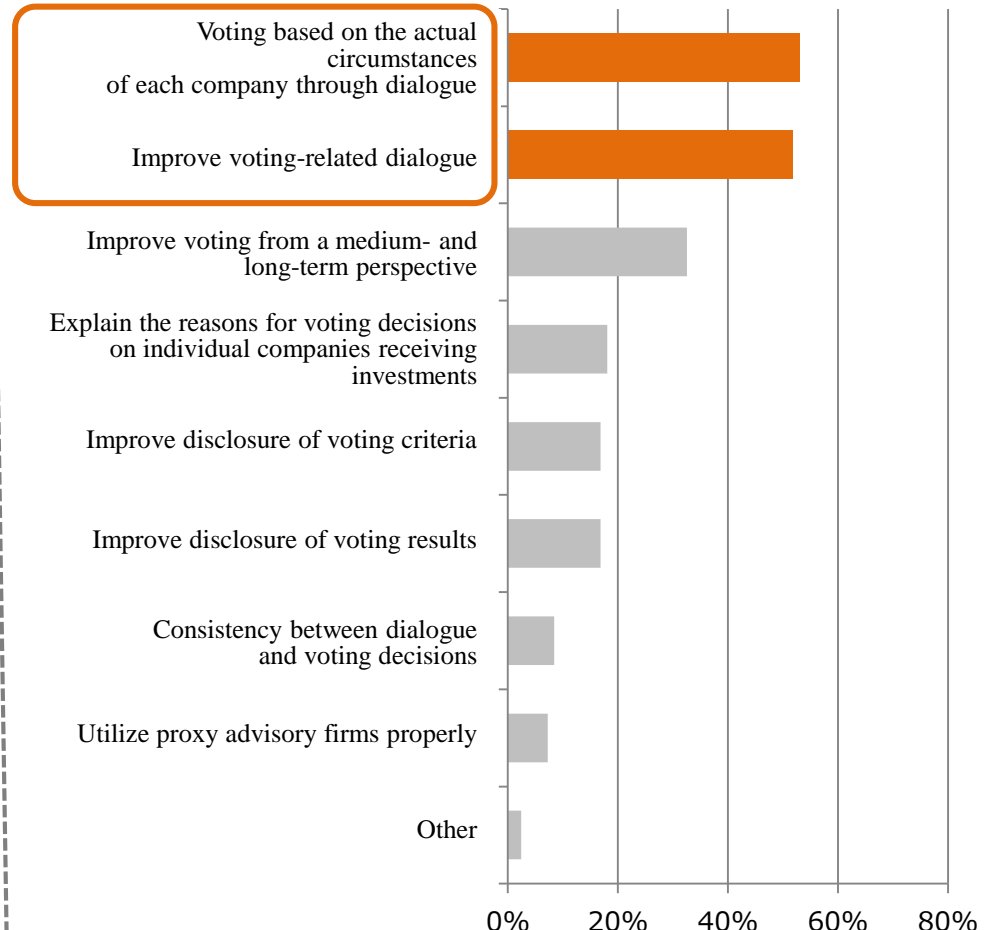
[For companies] (select up to three)

What kinds of improvements do you expect from investors on shareholder voting?



[For investors] (select up to three)

What kinds of improvements do you think will be necessary with respect to your shareholder voting?

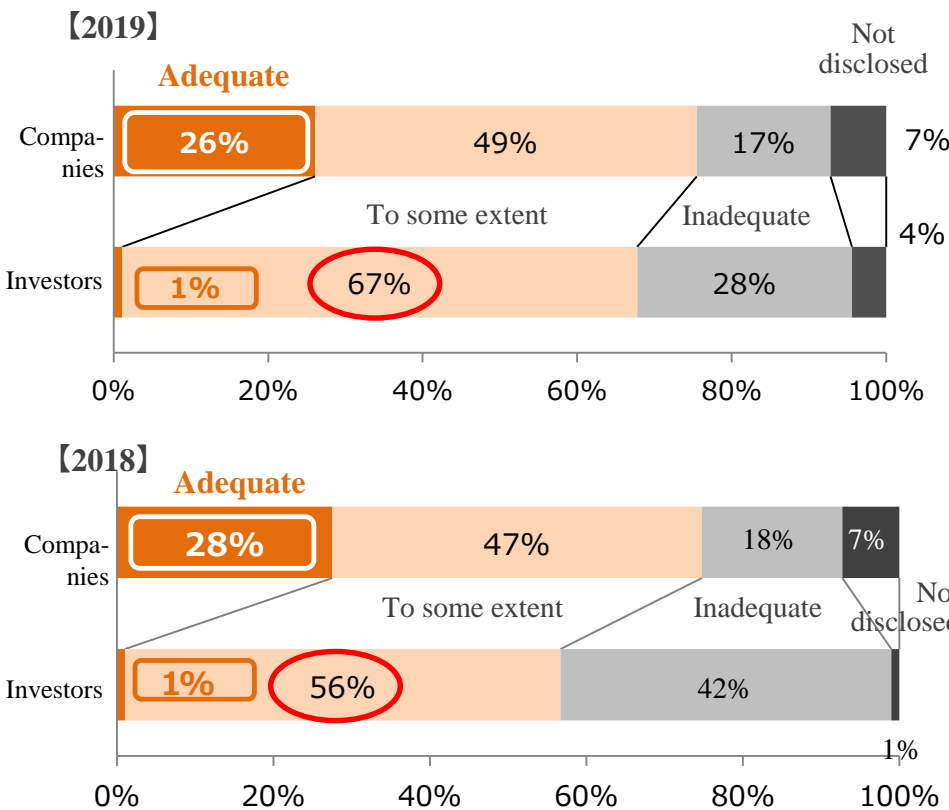


Recommendation (10): Disclose ESG initiatives using integrated reports and other means

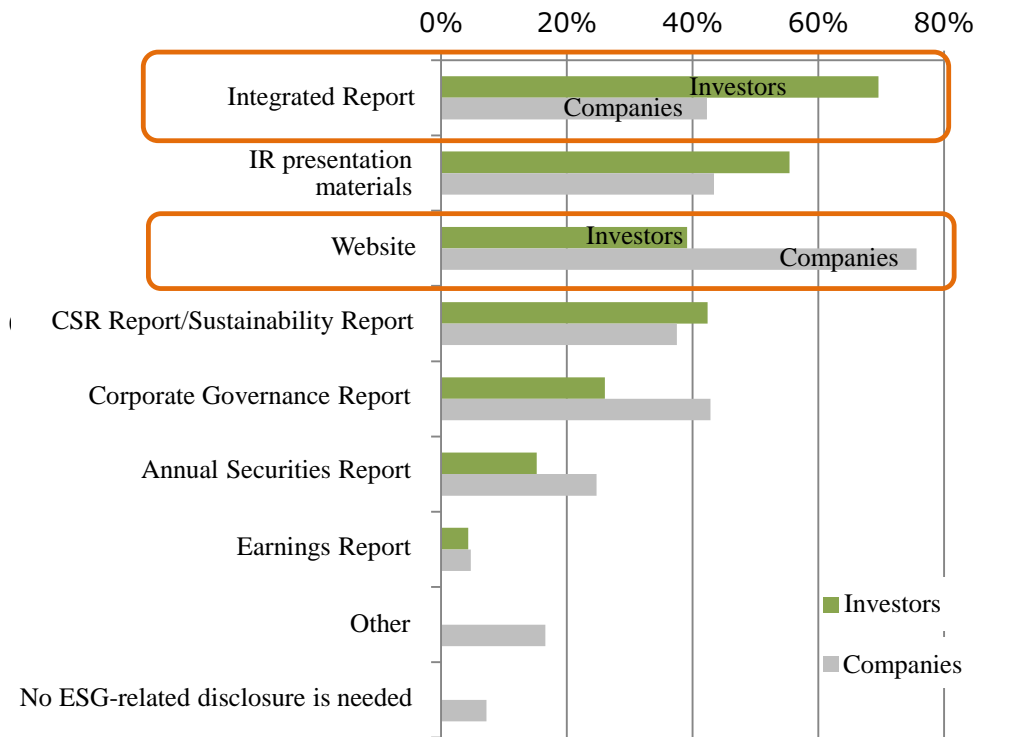
- Investors’ evaluations of disclosure by companies on ESG initiatives have improved.
- There remains a perception gap between companies and investors on the adequacy of ESG disclosure. Around 30% of companies believe that disclosure is adequate, while only a few investors hold this view.
- Firms often use their website as the main medium for their ESG disclosures. However, investors are seeking ESG disclosures through Integrated Reports and other means.

⇒Encourage communication with investors by improving ESG disclosure, using integrated reports and other publications, as well as websites

[For companies/investors]  
Is the current disclosure of ESG initiatives adequate? (select one)



[For companies/investors]  
What kinds of media do you use to disclose ESG initiatives? (select multiple)/Which would you like companies to use? (select up to three)

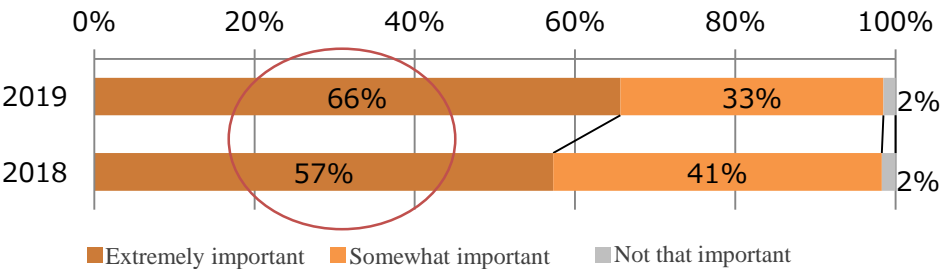


Recommendation (11): Incorporate ESG initiatives in medium-term management plans

- Companies responding that ESG initiatives are extremely important for business and companies incorporating ESG initiatives in medium-term management plans both increased by around 10% compared with last year.
- Most investors believe that ESG investment and finance lead to improved investment gains and medium- and long-term returns.

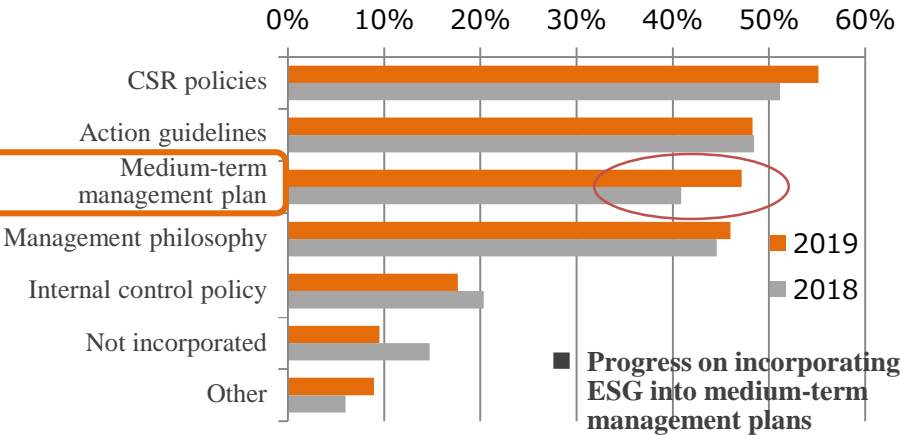
⇒Increase corporate value over the medium and long terms through efforts to strengthen the business-level commitment by including ESG initiatives in medium-term management plans

[For companies] Are ESG initiatives important for business? (select one)



■ Increase in companies responding that ESG initiatives are extremely important

[For companies] Which management policies incorporate ESG initiatives? (select multiple)

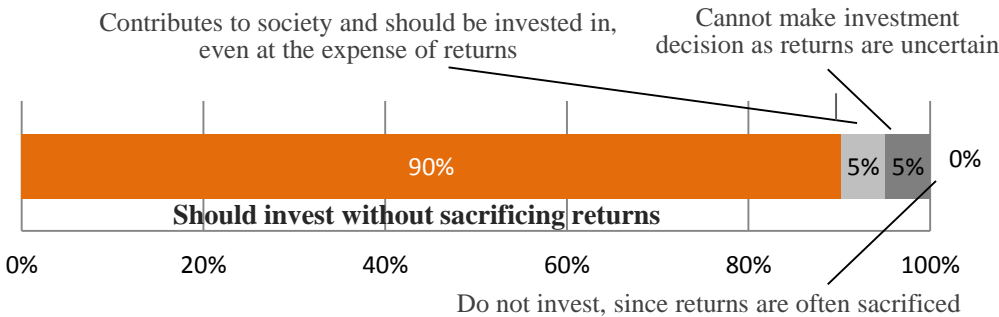


[For investors]

What is the purpose of ESG investment and finance and what impact does it have on investment performance? (select one)

Purpose of ESG investment and finance		Impact on investment performance	
To achieve a sustainable society	60%	Improved medium- and long-term returns	62%
To improve investment gains	53%	Risk mitigation	19%
To fulfill societal demands	45%	No impact	12%
To mitigate risk	42%	Other	3%
To fulfill trustee demands	18%	Reduced medium- and long-term returns	2%
To improve brand value	10%	Reduced short-term returns	2%
Other	3%	Improve short-term returns	0%
		Increased risk	0%

[For investors] What is your stance on ESG investment and finance? (select one)



■ 90% of investors replied that ESG investment should be made without sacrificing returns

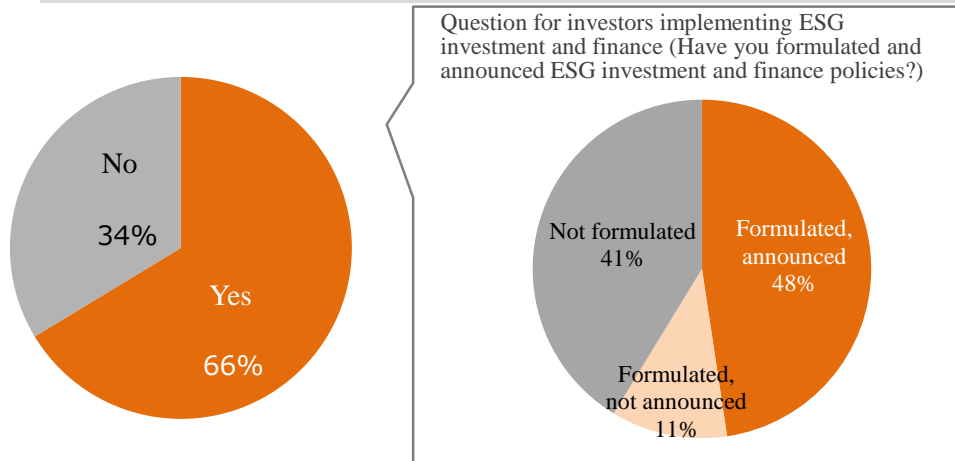
## Recommendation (12): Formulate ESG investment and finance policies and promote dialogue from medium- and long-term perspectives according to investment strategies

- Even investors implementing ESG investment and finance have not yet fully formulated and announced ESG investment and finance policies.
- Around half of firms believe the problem lies in the fact that investors only seek dialogue focusing on short-term topics. Meanwhile, there was an increase from the previous year in the ratio of companies that said they took, or improved, actions based on dialogue on environmental and social topics, or on matters involving external directors.

⇒ It will be important for investors to formulate policies, while promoting dialogue from medium- and long-term perspectives according to their investment strategies

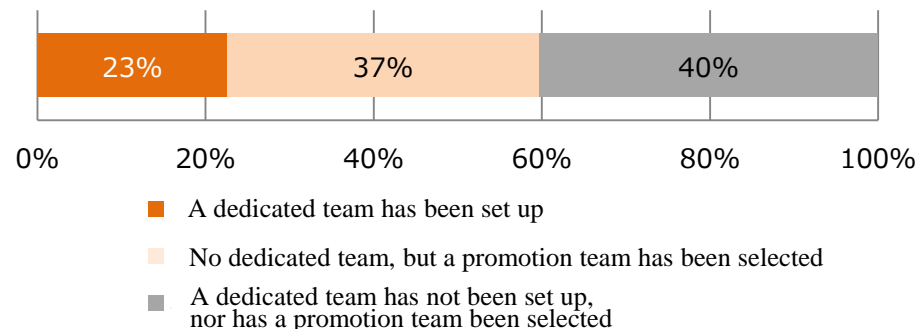
### [For investors]

#### Are you implementing ESG investment and finance? (select one)



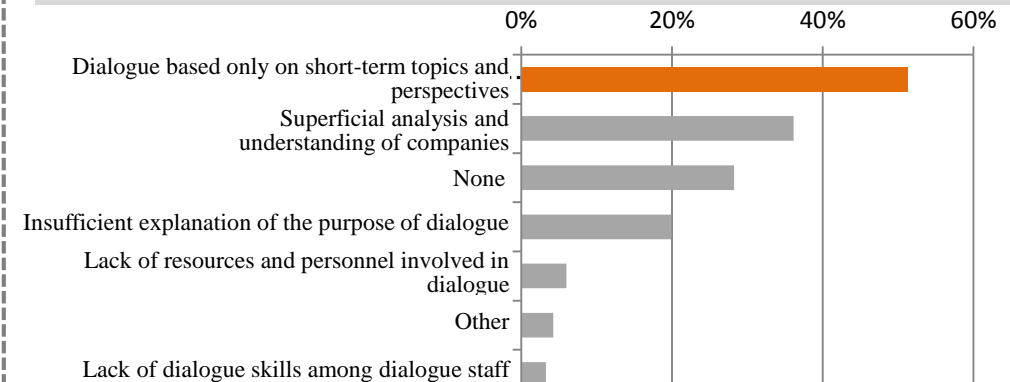
### [For investors]

#### Have you set up a team to promote ESG investment and finance? (select one)

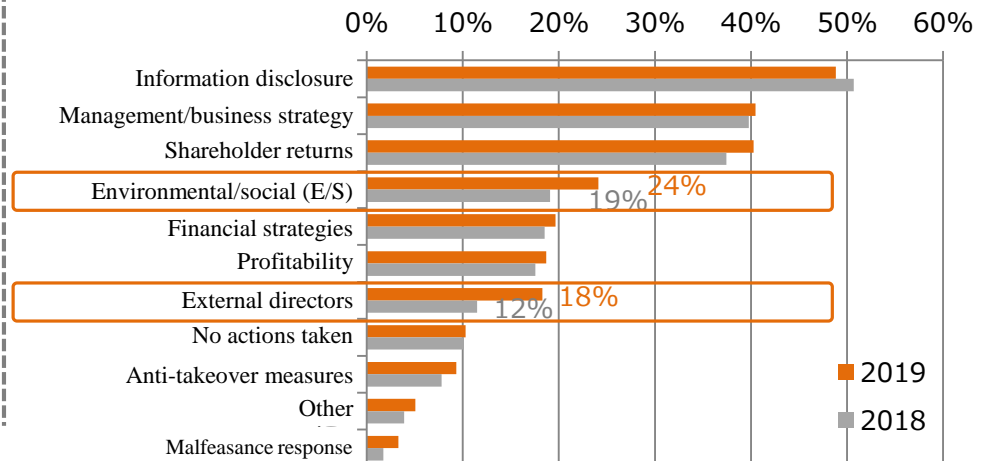


### [For companies]

#### What issues are discussed during dialogues with investors? (select three)



### [For companies] What actions did you take or improve based on dialogue?

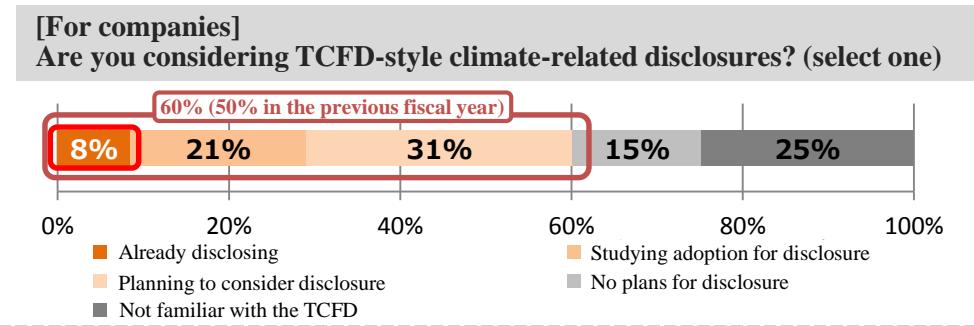
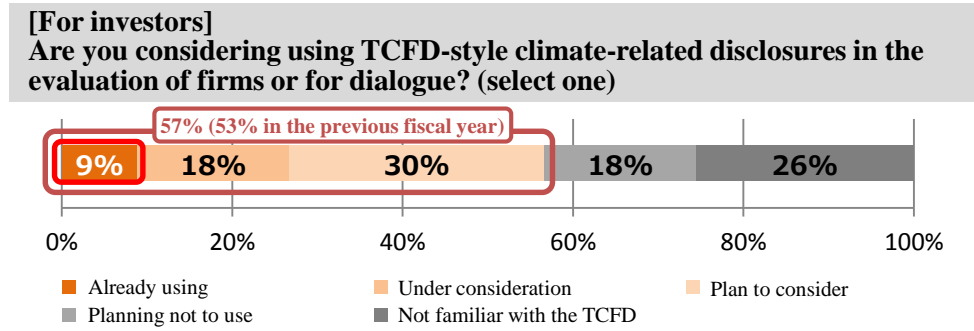
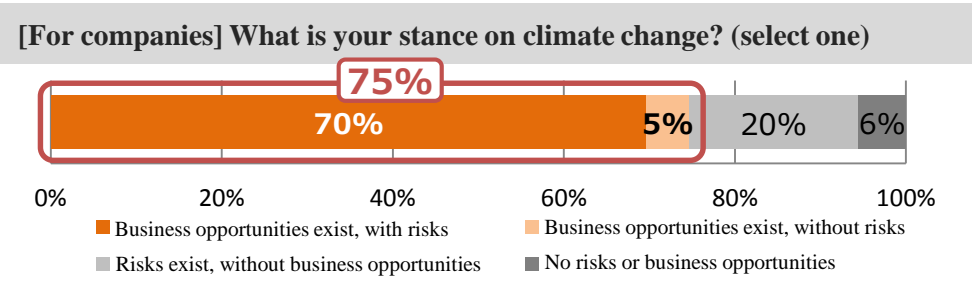
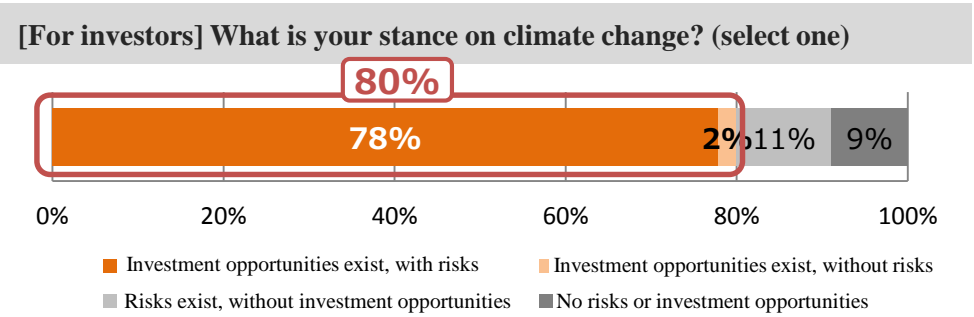




# Recommendation (13): Enhance disclosure about the impact of climate change on corporate activities and encourage the use of this information

- For climate change, 80% of investors say investment opportunities exist, while 75% of companies say that business opportunities exist. Both investors and companies emphasize the opportunities, as well as the risks posed by climate change to corporate activities.
- Consideration of the disclosure and use of climate change-related information based on TCFD recommendations by companies and investors has advanced compared with the previous fiscal year. However, consideration for the disclosure and use of this information has not advanced as much as expected given that both companies and investors recognize that climate change presents opportunities.

⇒Identify risk and capture investment and business opportunities by enhancing companies’ disclosure of climate change-related information and encouraging the use of information by investors



## Reference: Task Force on Climate-related Financial Disclosures (TCFD)

- Taskforce set up under the Financial Stability Board (FSB) at the request of the G20 finance ministers and central bank governors
- Issued recommendations in June 2017 on corporate disclosure of financial risks and opportunities relating to climate change

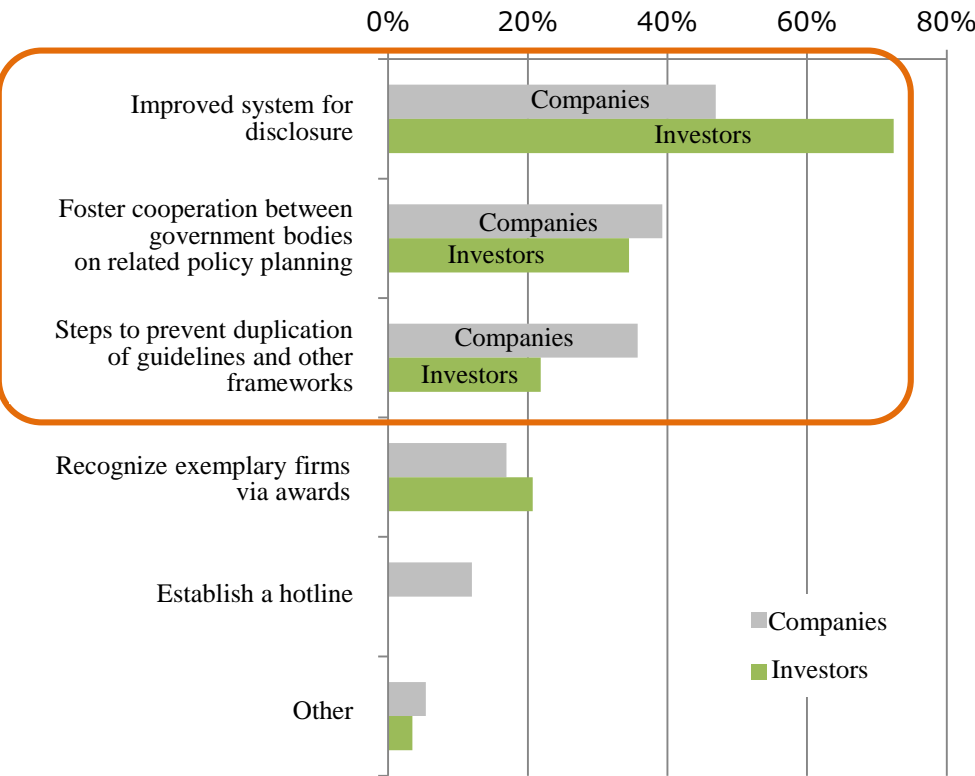
Recommended disclosures	Outline
Governance	The organization’s governance around climate-related risks and opportunities
Strategy	The actual and potential impacts of climate-related risks and opportunities on the organization’s businesses, strategy, and financial planning
Risk Management	The processes used by the organization to identify, assess, and manage climate-related risks
Metrics and Targets	The metrics and targets used to assess and manage relevant climate-related risks and opportunities

## Recommendation (14): Create cross-sectional policies within the government to promote ESG initiatives

- To promote corporate ESG initiatives and ESG investment and finance by investors, investors and companies both expect the government to improve the system for disclosures, foster cooperation between government bodies on related policy planning, and take steps to prevent duplication of guidelines and other frameworks.
- Multiple governmental guidelines and other frameworks exist at each responsible body, despite some steps to foster cooperation between government bodies.

⇒Create policies on the promotion of ESG initiatives across government ministries and agencies, in order to encourage the disclosure of ESG information and ESG investment and finance

[For companies and investors]  
What do you expect government authorities to do to promote ESG initiatives (companies) and ESG investment and finance (investors)? (select up to two)



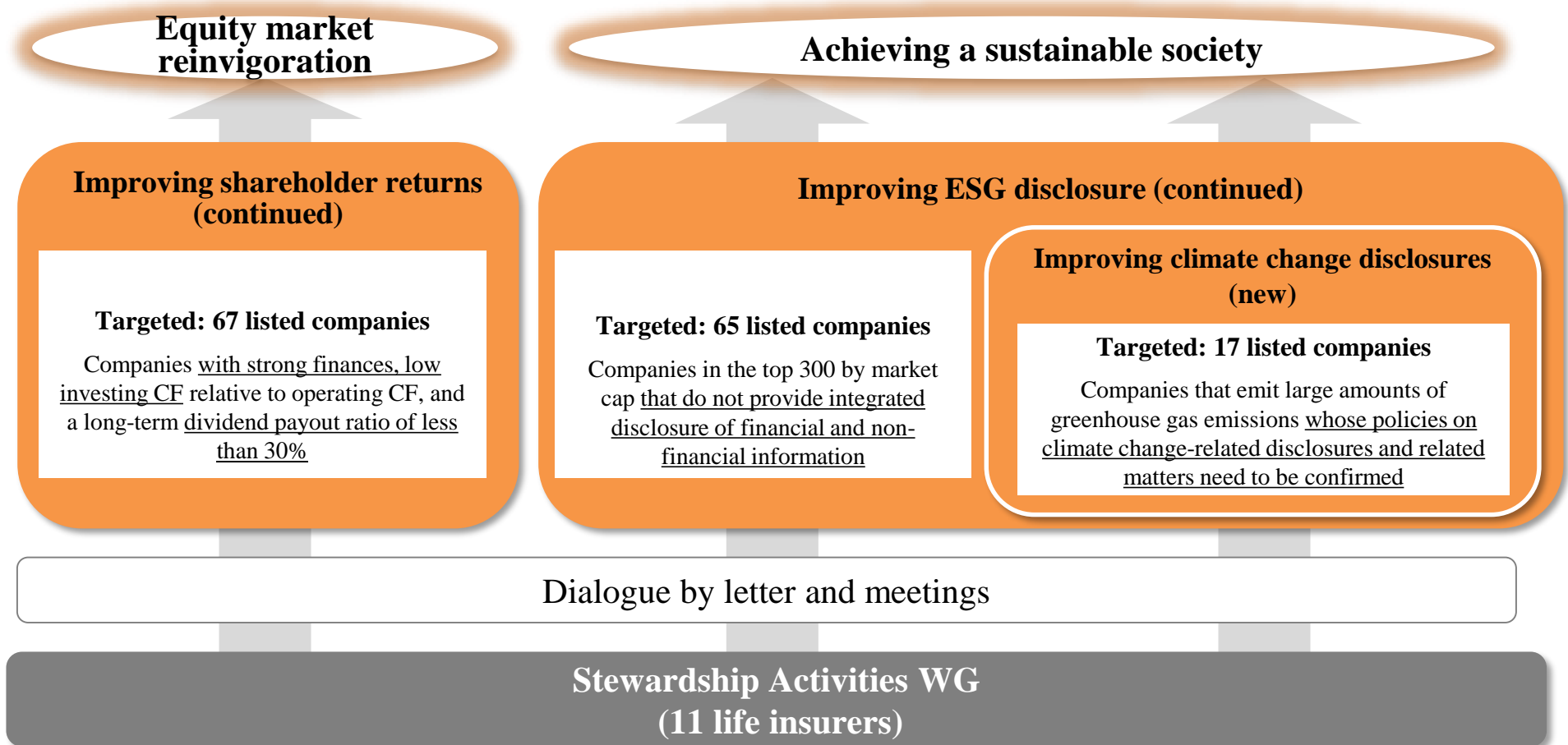
### Reference: Government meeting structures and guidelines on ESG promotion initiatives

Ministries/Agencies	ESG Initiative Promotion Council
Ministry of the Environment	ESG Finance High-Level Panel
	Study Group on Green Bonds and Green Loans
Financial Services Agency	The Council of Experts Concerning the Follow-up of Japan's Stewardship Code and Japan's Corporate Governance Code
Ministry of Economy, Trade and Industry	TCFD Summit
Ministry of Land, Infrastructure, Transport and Tourism	Study Group on ESG Real Estate Investment

Ministries/Agencies	ESG Initiative Promotion Guidelines
Ministry of the Environment	Sustainable Development Goals (SDGs) Application Guide
Financial Services Agency	Guidelines for Dialogue Between Investors and Companies
Ministry of Economy, Trade and Industry	Guidance for Collaborative Value Creation
	TCFD Guidance
	SDGs Management Guide

## Identified “improving climate change disclosures” as a new theme

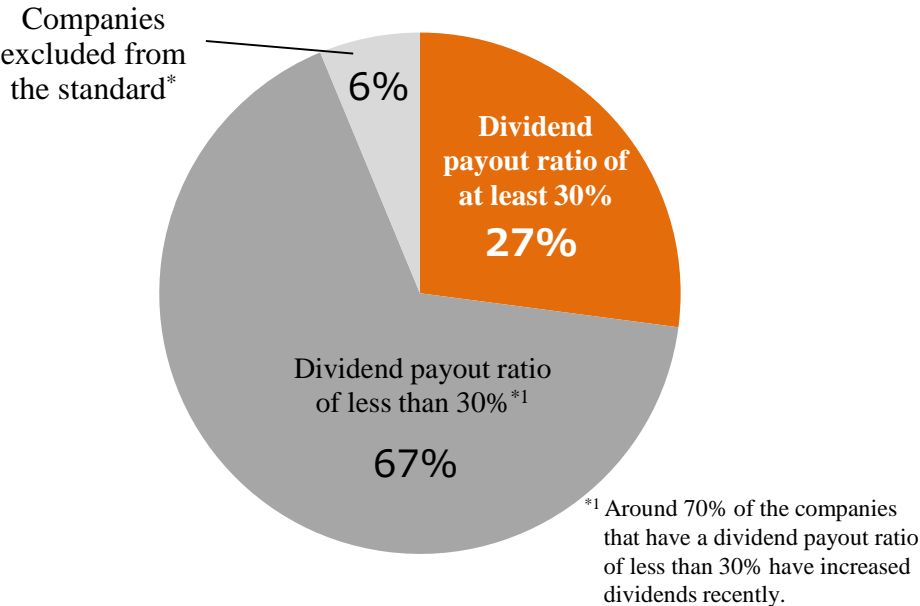
- From FY2017, to help reinvigorate the equity market over the medium and long terms and achieve a sustainable society, the life insurers in the Stewardship Activities Working Group (WG) jointly initiated a collective engagement campaign to convey their awareness of issues to companies.
- In FY2019, the campaign targeted 142 listed companies (a total of 149 companies) on the themes of improving shareholder returns and improving ESG disclosures, which were continued from the previous fiscal year, as well as improving climate change disclosures, which was a new theme.



Results of the collective engagement campaign in the previous fiscal year

- In the previous fiscal year, the collective engagement campaign targeted 107 companies (a total of 112 companies) on the themes of improving shareholder returns (48 targeted companies) and improving ESG disclosure (64 targeted companies).
- With regard to improving shareholder returns, 27% of the targeted companies have met the standard of a dividend payout ratio of 30%, indicating a certain degree of progress.
- Looking at improving ESG disclosure, only 6% of the targeted companies newly issued integrated reports. Together with companies showing progress on the disclosure of non-financial information in environmental (E) and social (S) areas, around 20% of the targeted companies improved their ESG disclosure.

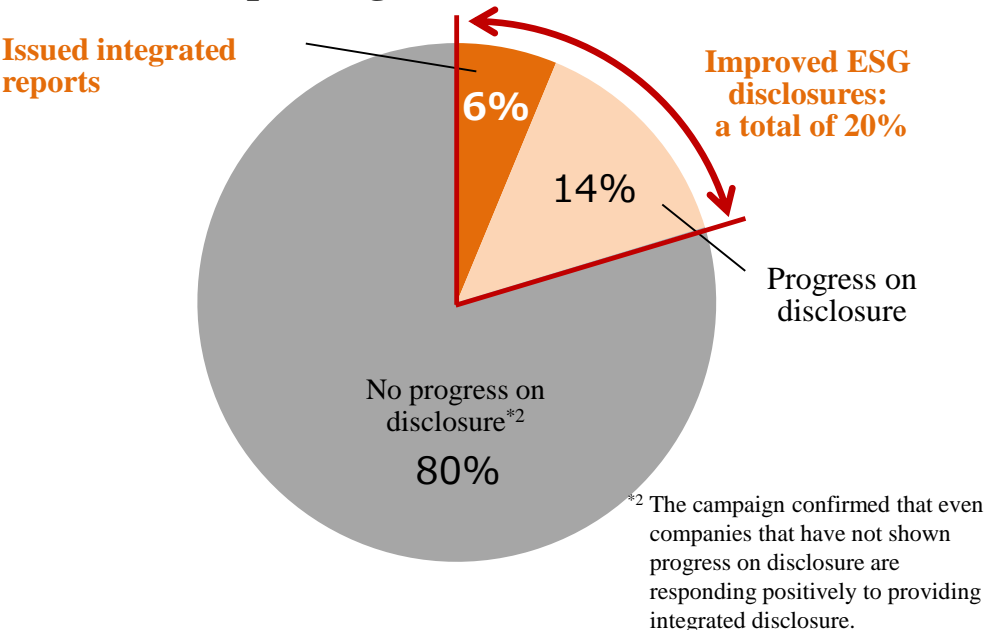
Improving shareholder returns



Targeted companies: 48 listed companies

Companies with strong finances, low investing CF relative to operating CF, and a long-term dividend payout ratio of less than 30%

Improving ESG disclosure



Targeted companies: 64 listed companies

Companies in the top 300 by market cap that can be expected to increase their corporate value by improving integrated disclosures

\* Companies that no longer infringe upon screening standards due to factors such as a decrease in the equity ratio.

## Initiatives and approaches conducted or considered by WG participants to improve dialogue content

- Based on interviews with external investors and other experts and the sharing of best practices among WG participants, each WG participant is promoting efforts to improve E/S dialogues and factor the dialogue findings into investment decisions.

Activity details			Comparison with the previous fiscal year	
			FY2018	FY2019
<u>(Number of WG participants)</u>			<u>10</u>	<u>11</u>
Approach	Organization	• Set up dedicated dialogue team	4	4 (5)
	Dedicated staff	• Assigned dedicated dialogue staff	5	5 (6)
	Expert committee	• Set up expert committee, including outsiders	8	9 (10)
Dialogue topic		• Governance (G) dialogue	10	11
		• Environmental (E)/Social (S) dialogues	6	11
Factoring into investment decisions		• Dialogue findings used in investment decisions	7	10 (11)

\* Figures in parentheses include the number of companies considering implementation in the next fiscal year.

Initiatives and approaches conducted or considered by WG participants

- Each WG participant is conducting interviews with external investors and other experts, as well as sharing information and exchanging views on participants’ initiatives and approaches.
- Each WG participant is pushing ahead with initiatives relating to ESG investment and finance, based on factors such as their respective investment strategies.

Activity details			Comparison with the previous fiscal year	
			FY2018	FY2019
<u>(Number of WG participants)</u>			<u>11</u>	<u>16</u>
Approach	Policy	• Become a signatory to PRI	7	11 (12) <sup>*4</sup>
		• Formulate ESG investment and finance policy	5	11 (15)
	Organization	• Create cross-divisional meeting structures	6	11 (14)
TCFD recommendations		• Endorse TCFD recommendations <sup>*1</sup>	5	14 (16)
		• Disclose information according to TCFD recommendations	0	9 (16)
Main ESG investment and finance methods being used		• Engagement (Dialogue)	10	13 (14)
		• Integration <sup>*2</sup>	8	12 (13)
		• Negative screening <sup>*3</sup>	7	13 (14)

<sup>\*1</sup> Including cases where TCFD recommendations are signed and endorsed at the holding company level and the commitment also covers group companies.

<sup>\*2</sup> Meaning that ESG factors are reflected in the investment process.

<sup>\*3</sup> Defining securities for portfolio exclusion from an ESG perspective

<sup>\*4</sup> Figures in parentheses include the number of companies considering implementation in the next fiscal year.

Interviews on progressive actions to enhance initiatives/approaches

- Participants in the ESG investment and finance WG continued to invite external experts to host seminars to foster understanding of ESG investing and finance and enhance initiatives/approaches.
- Moreover, LIAJ has endorsed the TCFD recommendations. Based on this, LIAJ has adopted addressing climate change as a common theme for the ESG Investment and Finance WG and the Stewardship Activity WG, and has held joint seminars on this theme.

Instructor	Seminar
Professor Mizuguchi (Takasaki City University of Economics)	<ul style="list-style-type: none"><li>Recent trends in ESG investment and finance</li></ul>
Ministry of the Environment	<ul style="list-style-type: none"><li>Recent trends in ESG finance and the Ministry of the Environment’s initiatives</li><li>The Ministry of the Environment’s measures relating to resource recycling of plastics</li></ul>
GPIF	<ul style="list-style-type: none"><li>GPIF and ESG – ESG activity report for FY2018 –</li></ul>
Ministry of Economy, Trade and Industry	<ul style="list-style-type: none"><li>Green finance-related developments (centered on the TCFD Summit)</li></ul>
Nissay Asset Management	<ul style="list-style-type: none"><li>Diverse spectrum of ESG investments, Nissay Asset Management’s ESG investments</li></ul>



<Joint seminars with the Stewardship Activity WG >

Instructor	Seminar
Green Pacific (a total of two seminars)	<ul style="list-style-type: none"><li>Addressing the climate change problem and TCFD</li><li>Key perspectives on dialogue based on TCFD recommendations</li></ul>



Upgrade the activities of WG participants