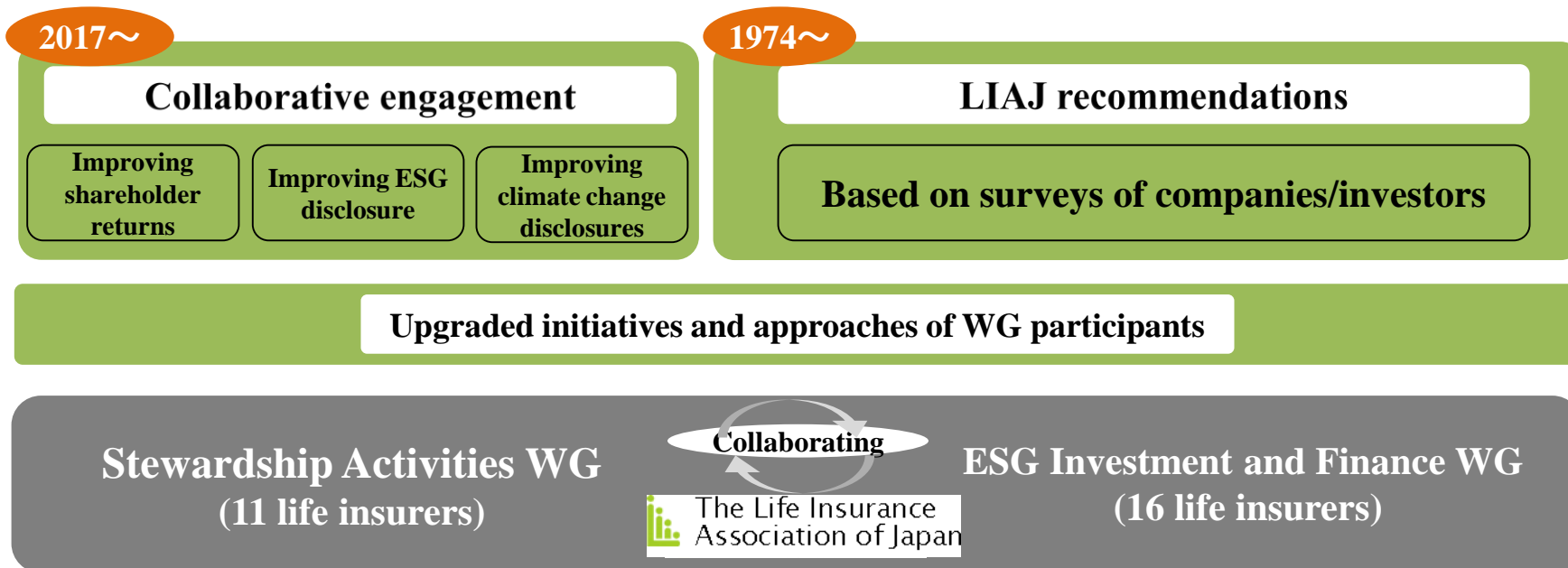


- Working groups on stewardship activities and ESG investment and finance were set up to contribute to equity market reinvigoration and achieving a sustainable society. Continued to publish the LIAJ recommendations (this report) and implement collaborative engagement through both working groups in FY2020.
- Implemented measures to refine and raise the sophistication of activities at each LIAJ member firm in FY2020. Measures included holding joint working group (WG) seminars with Environment (E) and Society (S) themes, such as “Addressing climate change” and “Work style reforms (including digitalization).”
- 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 reinvigoration of the stock market as a whole.

## Equity market reinvigoration/Achieving a sustainable society



## FY2020 policy recommendations

- The number of companies and investors who recognize the importance of digitalization and ESG increased in the survey of companies and investors carried out in FY2020.
- Based on the survey results, the recommendations on enhancing dialogue in FY2020 were revised to recommendations that emphasize digitalization and ESG (sustainability).

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 Provide clearer explanations of proposals with a high dissent ratio	Companies
	② Set ROE targets adjusted for cost of capital and target higher ROE levels			⑨ Greater transparency for shareholder voting processes	Investors
Improving corporate governance	③ Improve disclosures about expectations of external directors' roles 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, including digitalization <small>Revised</small>			⑪ Incorporate ESG initiatives in medium-term management plans	Investors
	Encourage involvement of top management in dialogue			⑫ Formulate ESG investment and finance policies and promote dialogue from medium- and long-term perspectives according to investment strategies	
	⑥ Provide further disclosure of non-financial information, including ESG <small>Revised</small>			⑬ Enhance disclosures about the impact of climate change on corporate activities and encourage the use of this information	Companies
	⑦ Promote dialogue based on in-depth understanding of companies and dialogue on medium- and long-term themes such as management strategies and sustainability initiatives <small>Revised</small>	Investors		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

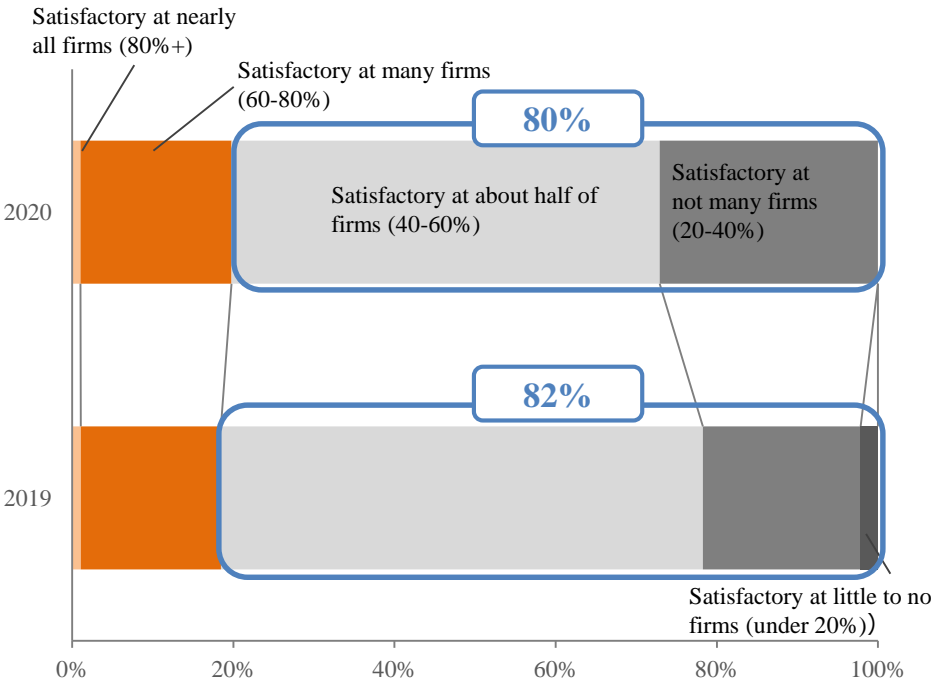
<Survey targets and response rate> Listed companies 42% (508/1,200 companies); investors 54% (108/199 companies)

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

- 80% of investors are not fully satisfied with the level of shareholder returns and dividends. There has been no change in investors' position in this respect before and after the COVID-19 crisis.
- 56% of investors, roughly the same level as in the previous fiscal year, expect firms to offer payout ratios of at least 30% over the medium and long terms. However, the actual payout ratios remained under 30% for 42% of all firms, despite some signs of improvement.

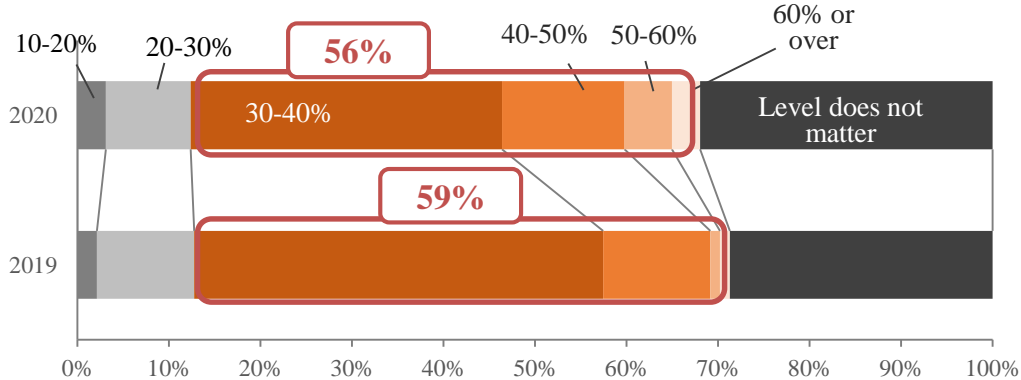
⇒ Increase shareholder returns over the medium and long terms, with a payout ratio of at least 30% after gauging investor expectations through dialogue

【For investors】  
Satisfaction level for shareholder returns and dividends (select one)

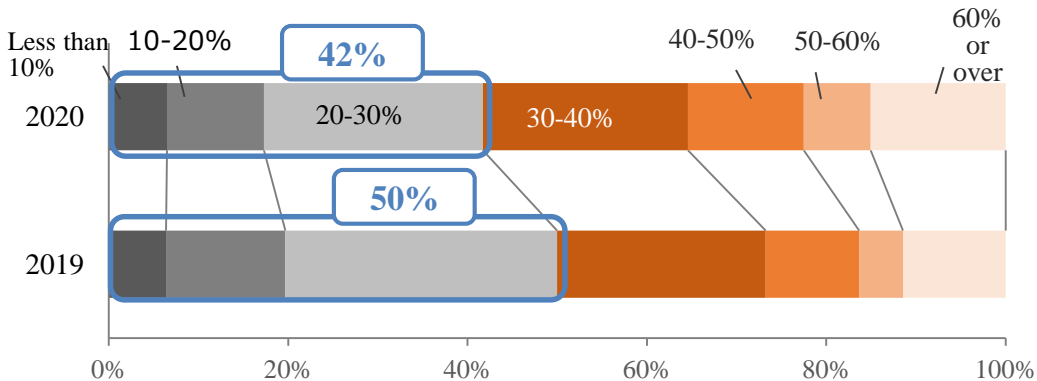


Note: Percentage figures are rounded to the nearest percent, so they will not necessarily sum to 100. The same applies hereafter.

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



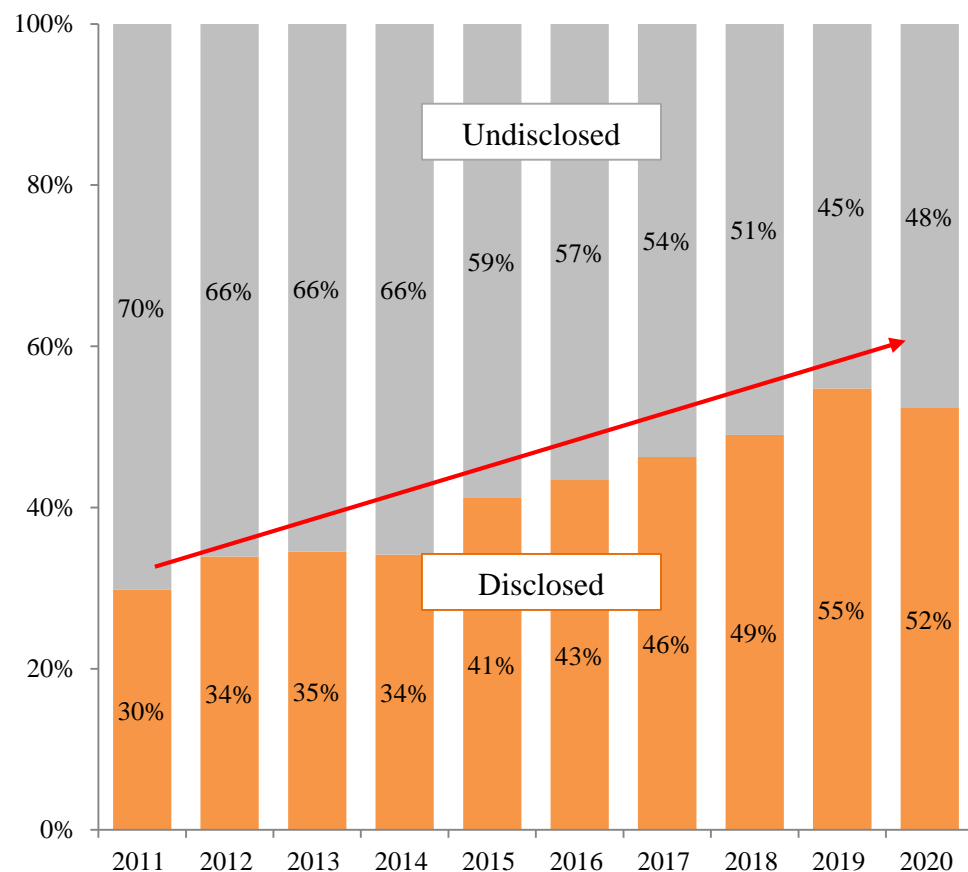
Reference: Distribution of payout ratio for listed companies (actual)



Source: Nikkei QUICK      Note: TOPIX components (excluding unprofitable firms)

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

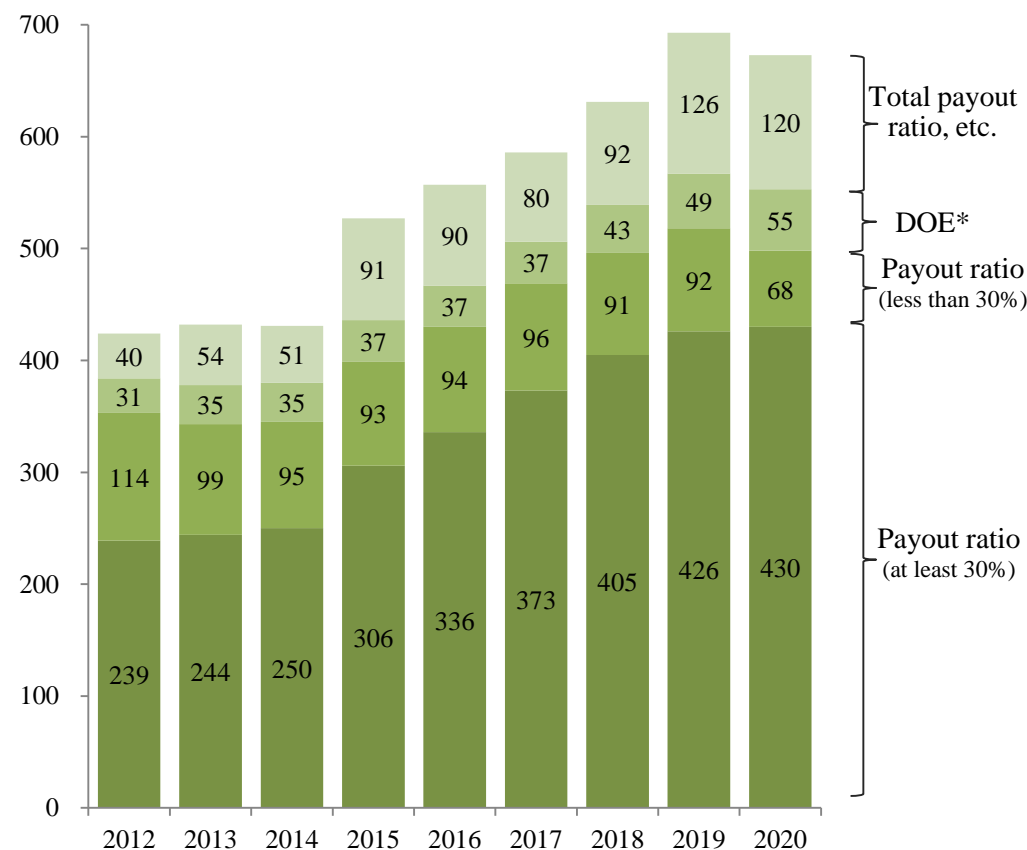
Proportion of firms with official SR targets



Source: LIAJ research

Based on survey of top 1,200 listed stocks by market capitalization

Number of firms disclosing numerical SR targets by target type



Source: LIAJ research

Based on survey of top 1,200 listed stocks by market capitalization

Note: Firms with multiple SR targets are counted for each target

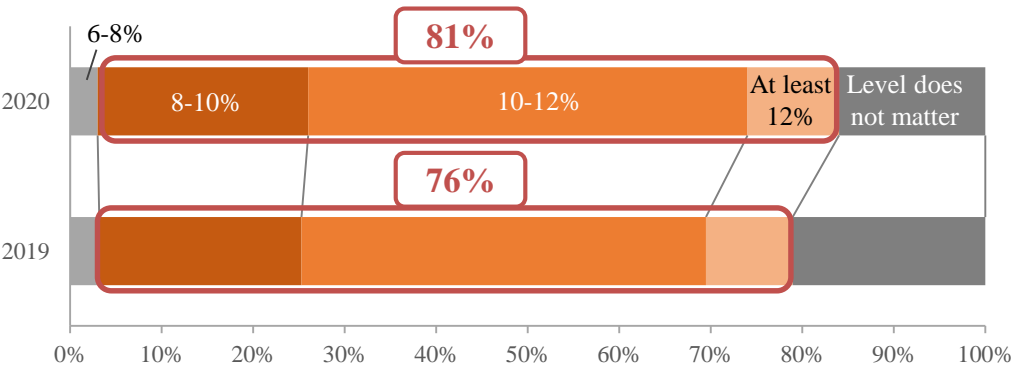
\*DOE: dividend-on-equity ratio

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

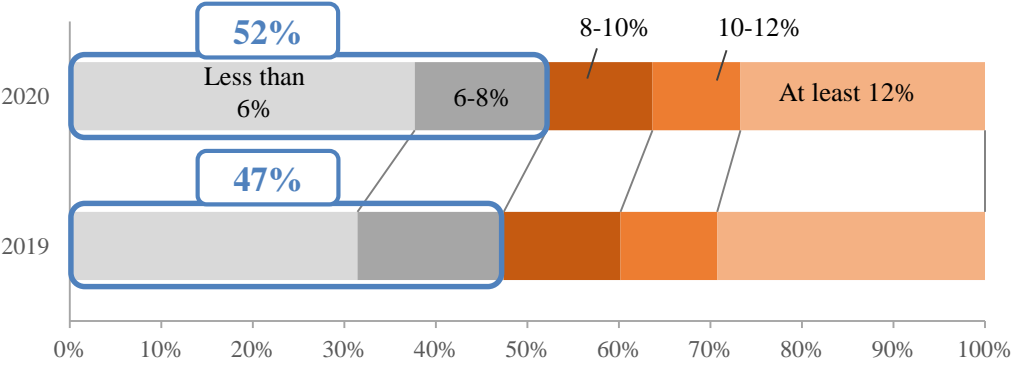
- 81% of investors expect ROE of at least 8% over the medium and long terms, with no change in investors’ position in this respect before and after the COVID-19 crisis. Meanwhile, ROE remains under 8% at 52% of listed firms.
- The ratio of firms that have not calculated their cost of capital (return expected by shareholders) was 38%, indicating no major change from the previous fiscal year. The fact that some firms do not assess their cost of capital remains a reason for 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

【For investors】Desired medium- and long-term level for ROE (select one)



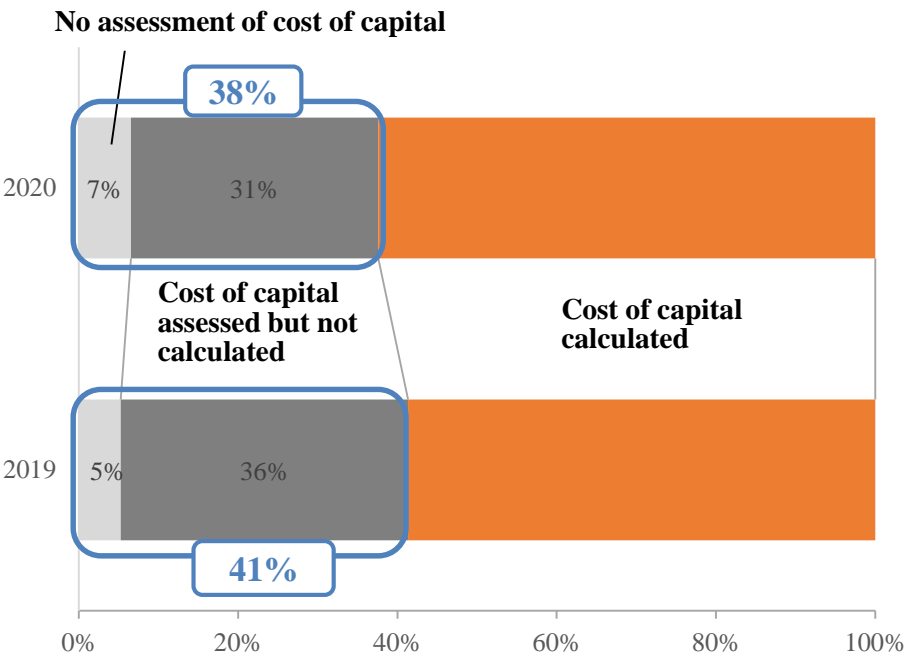
Reference: Distribution of payout ratio for listed companies (actual)



Source: Nikkei QUICK    Note: TOPIX components (excluding unprofitable firms)

【For companies】(select one)

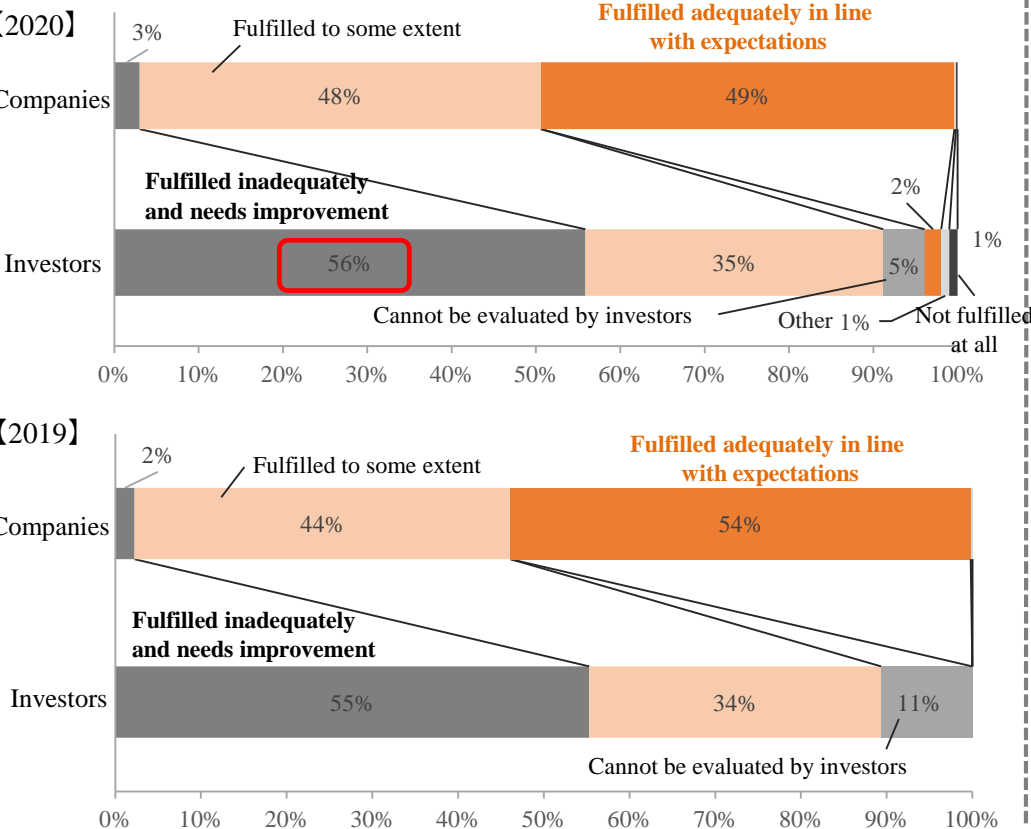
Do you calculate a precise cost of capital (return expected by shareholders)?



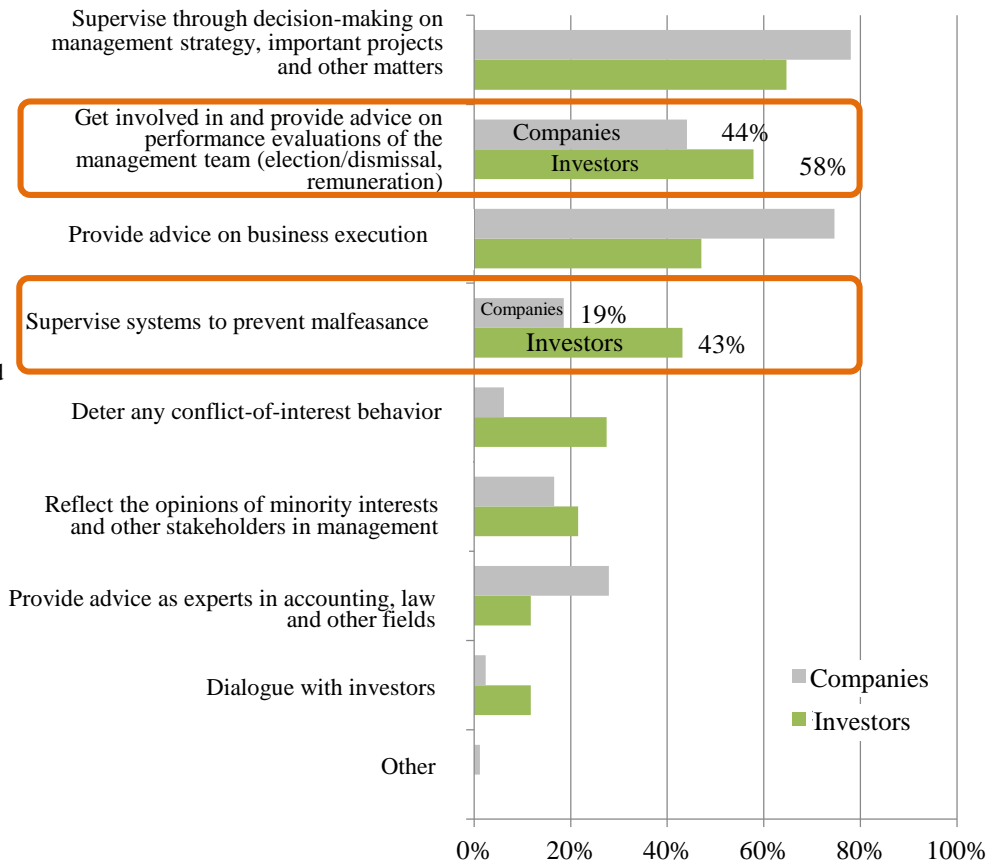
## Recommendation (3): Improve disclosures about expectations of external directors’ roles and their performance

- 56% 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 and advisement on the evaluation of management” and “supervision of systems 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?



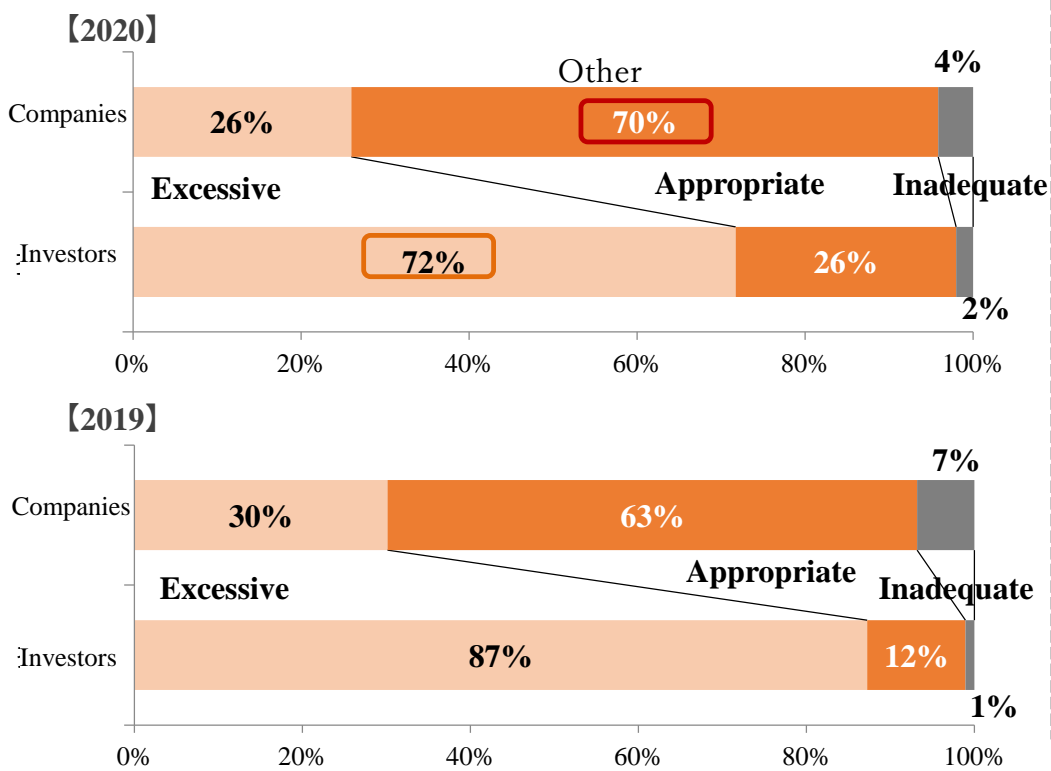
【 For companies/investors 】 (select up to three)  
What roles expected of external directors do you see as particularly important?



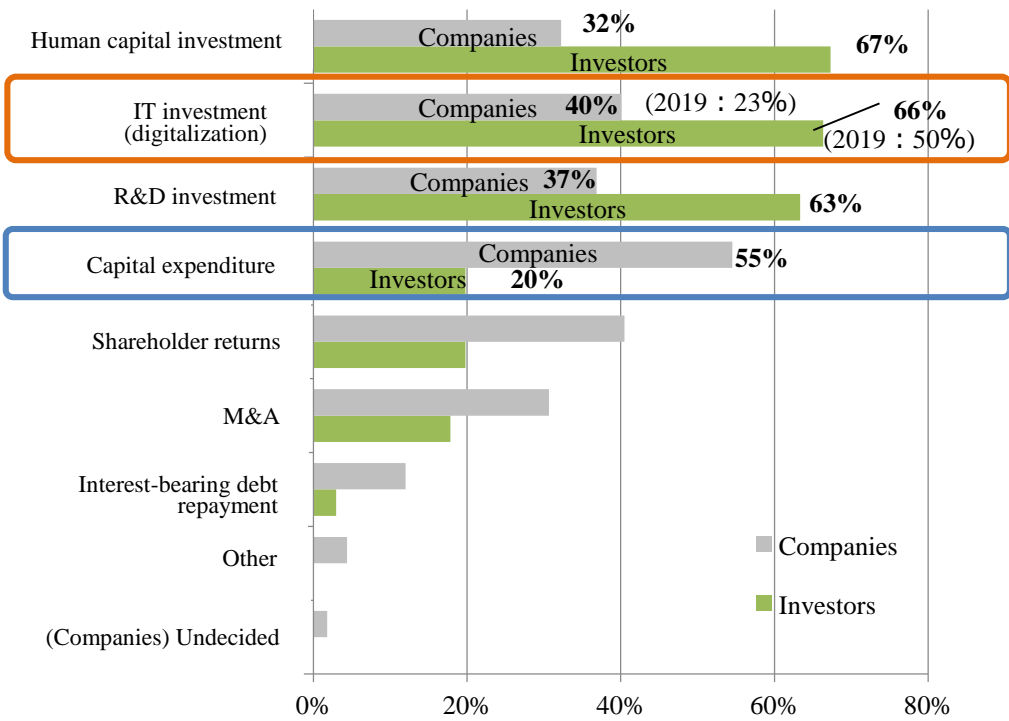
# Recommendation (4): Improve disclosure/dialogue of medium- and long-term investment strategy, including digitalization

- 70% of companies believe the levels of cash balances are appropriate. Meanwhile, 72% of investors see current levels of cash balances as excessive, which indicates a continued gap in perception between investors and companies, while there was a decrease in this percentage from the previous fiscal year amid the COVID-19 crisis.
  - In their medium- and long-term investment/financial strategies, companies see capex as vital, while investors put more emphasis on investments including those in intangibles such as investments in human capital, IT (digitalization), and R&D.
  - Notably, IT investment (digitalization) became a primary item to consider for both companies and investors, with an increase of approximately 20 points in this item year on year.
- ⇒ Target appropriate cash levels, and improve disclosure/dialogue related to medium- and long-term investment strategy, including digitalization

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

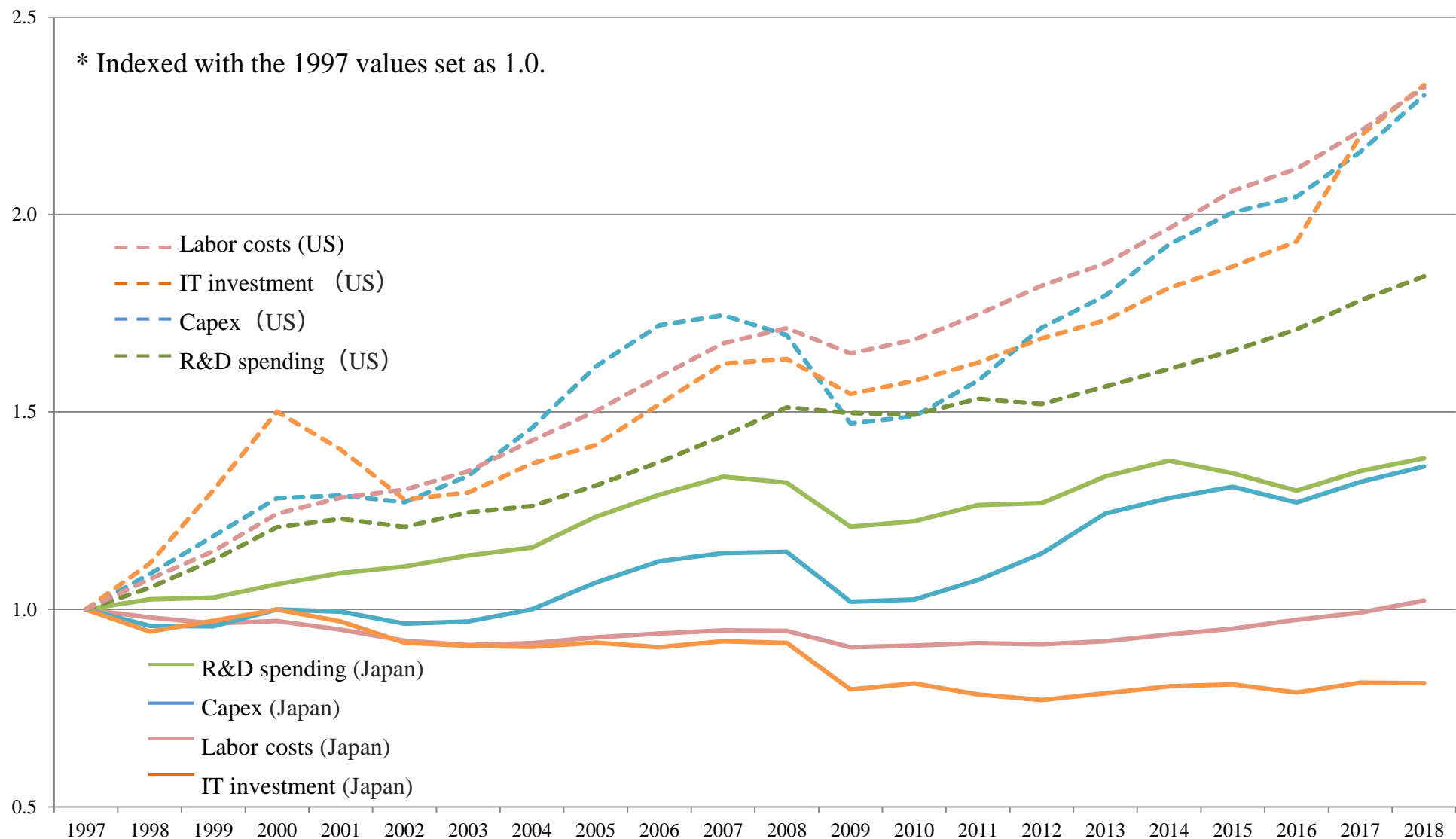


【 For companies/investors 】 (select up to three)  
What do you think are important matters to consider, or should be considered, in your medium- and long-term investment/financial strategies?



\* Apart from the options listed above, 27% of investors emphasized the need to improve the capital mix, while only 17% of companies emphasized this priority.

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





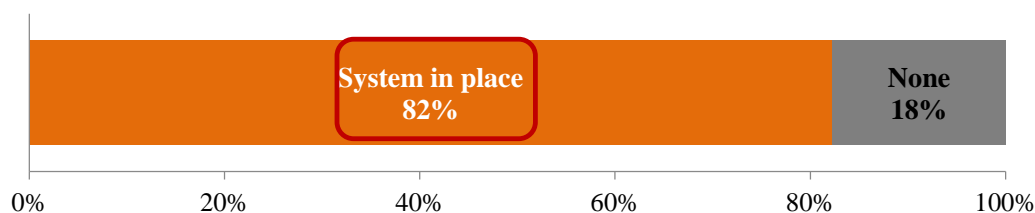
## Recommendation (5): Encourage involvement of top management in dialogue

- 82% 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

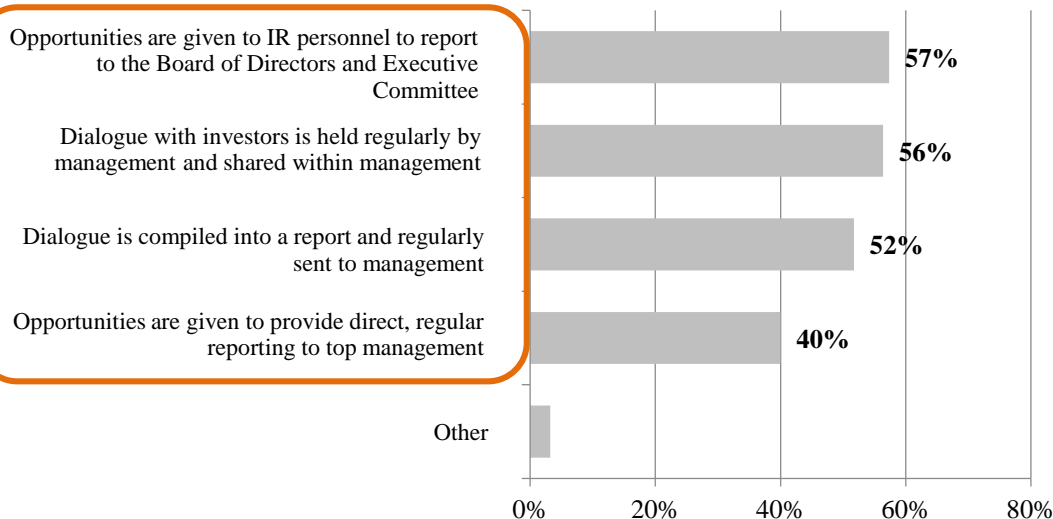
【For companies】(select one)

Do you have a system in place to share dialogue content with management?



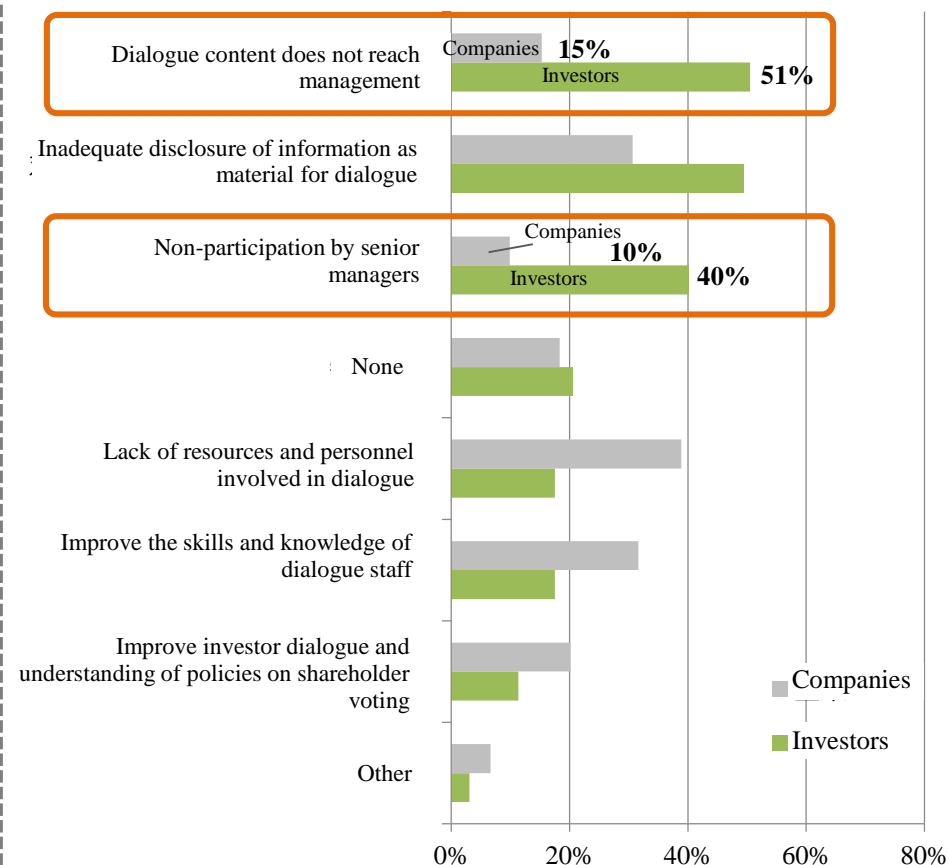
【For companies】(Select multiple)

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?



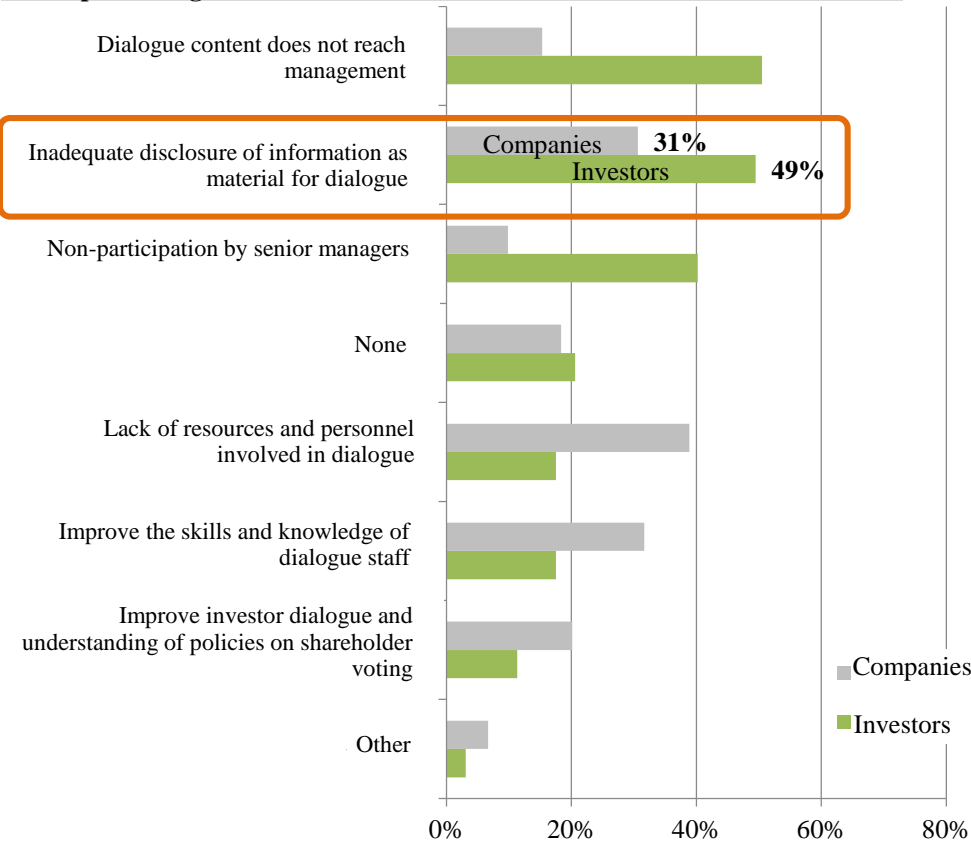
\* Options are based on the written responses of investors.

# Recommendation (6): Provide further disclosure of non-financial information, including ESG

- With respect to dialogue, investors have stronger expectations for companies to disclose information as material for dialogue than assumed by companies.
- Notably, while a lot of investors had previously expected companies to enhance disclosure of “non-financial information on Environmental (E), Social (S) and related issues,” such as “climate change” and “human rights and community,” there was an additional increase of 16 percentage points in these investors compared to the previous fiscal year, making this priority the most strongly emphasized item by investors.

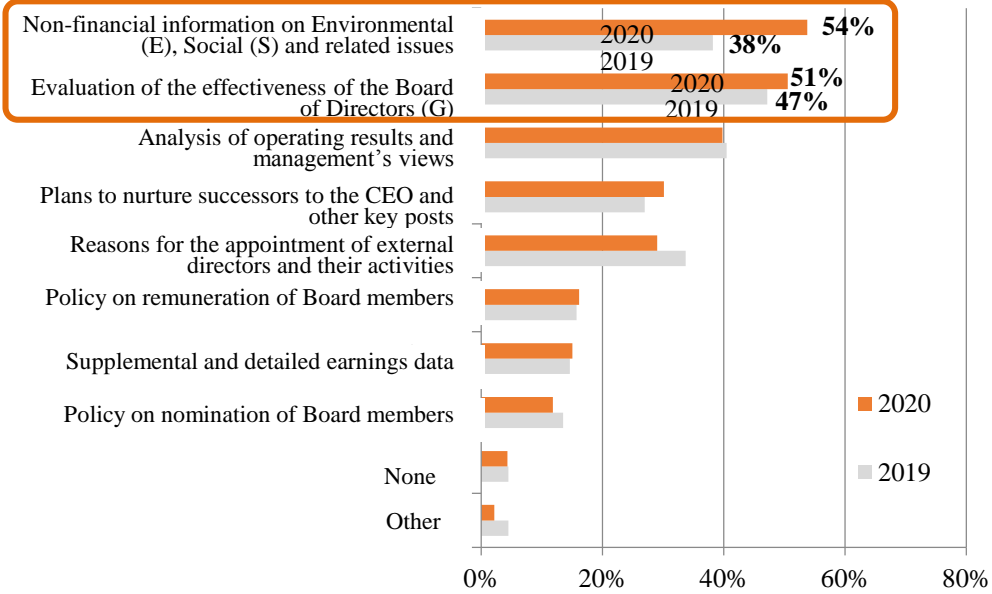
⇒ Provide further disclosure of non-financial information, including ESG

【 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?



【 For investors 】 Major themes for ESG investment and finance (select up to five)

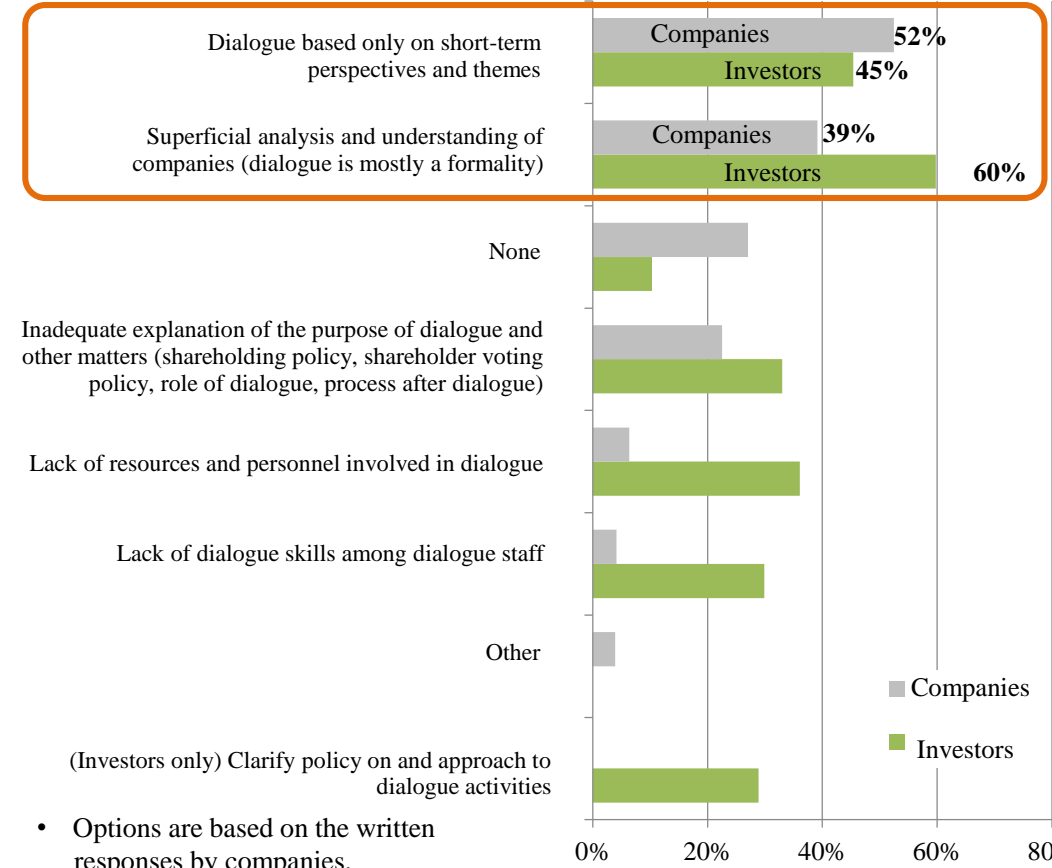
Major themes for which responses increased from the previous fiscal year (top three)		Increase	2019	2020
1	Climate change (E)	+13points	68%	81%
2	Human rights and community (S)	+11ponts	20%	31%
3	Supply chain (S)	+7points	2%	9%

Recommendation (7): Promote dialogue based on in-depth understanding of companies and dialogue on medium- and long-term themes such as management strategies and sustainability initiatives

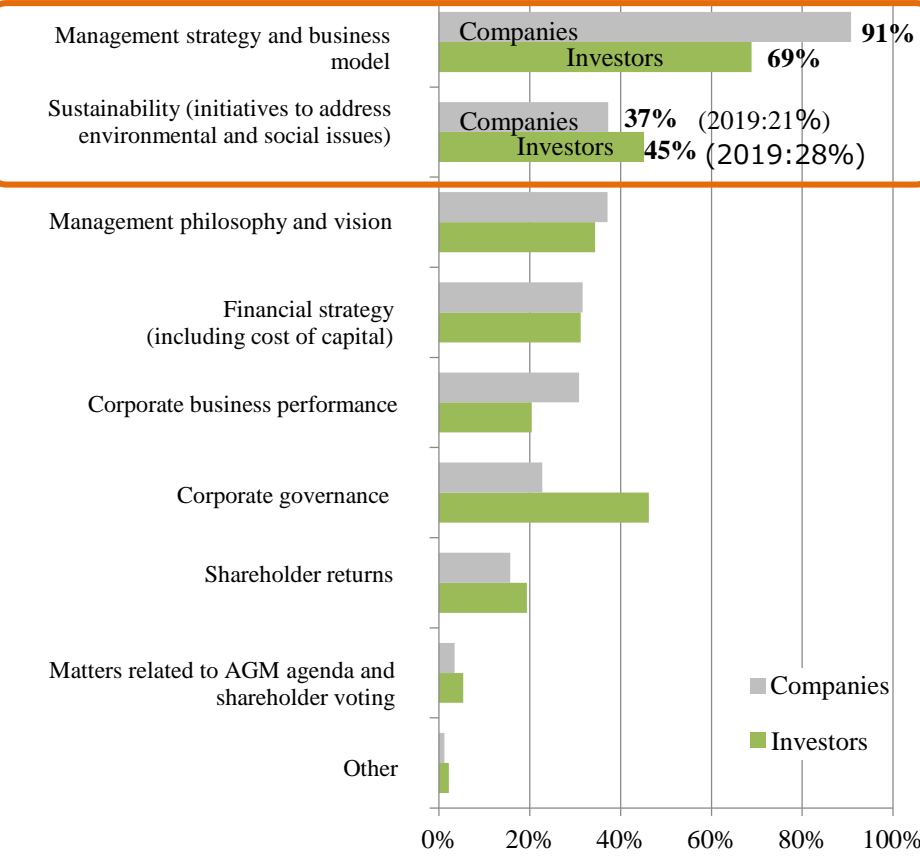
- Both companies and investors feel that the key dialogue-related issues are that dialogue is based on a short-term perspective and there is only a superficial analysis and understanding of companies.
- Both companies and investors believe that dialogue focused on medium- and long-term themes such as “management strategies and business models” is important. In addition, both companies and investors who selected “sustainability” as a response increased by approximately 15 percentage points from the previous fiscal year, making this theme the second most important item.

⇒ Promote dialogue based on in-depth understanding of companies and dialogue on medium- and long-term themes such as management strategies and sustainability initiatives

【 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?



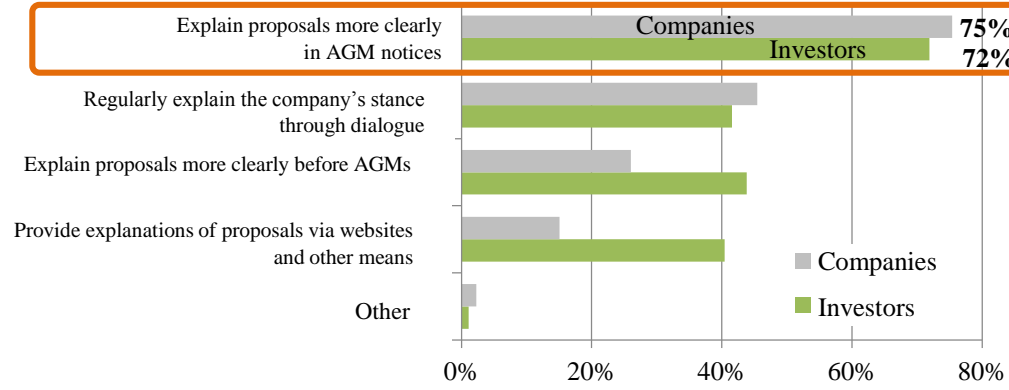
Options are based on the written responses by companies.

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

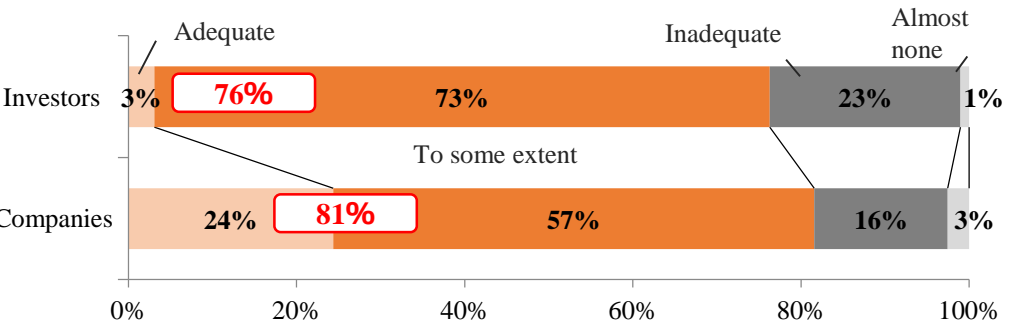
- Companies have been working intensively to provide clearer explanations of proposed agendas in convocation notices. Accordingly, around 80% of both companies and investors feel that explanations on individual agenda proposals have improved to a certain extent.
- That said, investors have stronger expectations 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

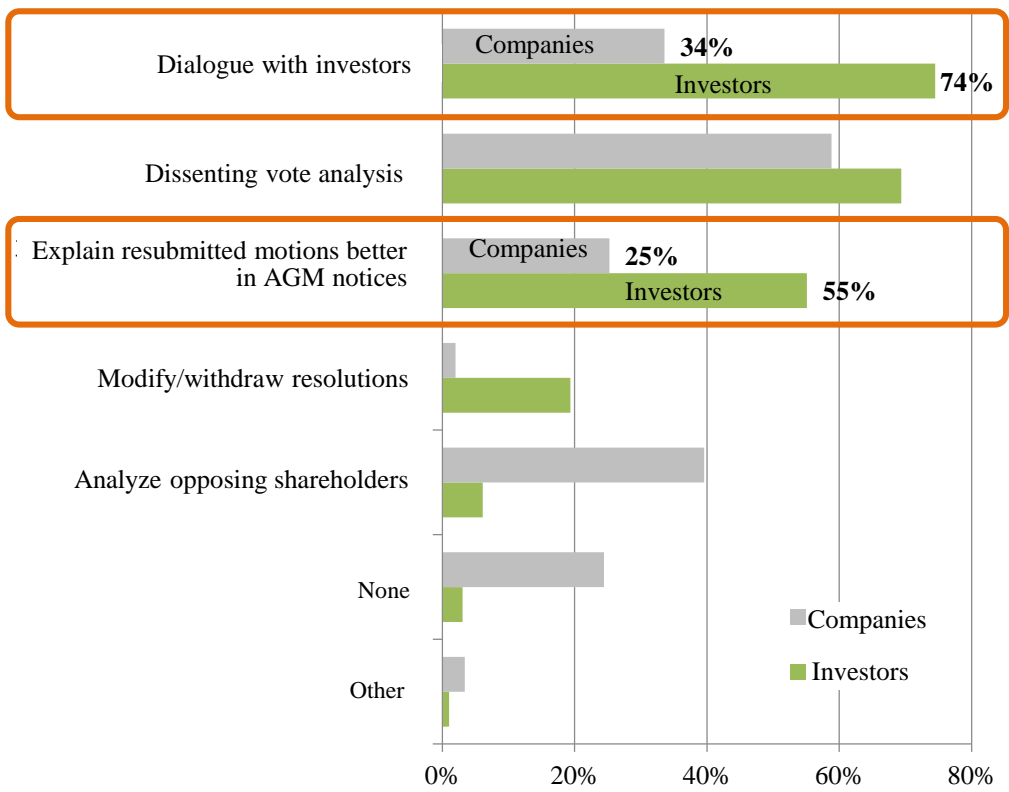
【 For companies/investors 】 (select up to three)  
What intensive measures are being taken and what means would be desirable for companies to provide better explanations of individual proposals?



【 For companies/investors 】 (select one)  
Are explanations of individual proposals adequate?



【 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?

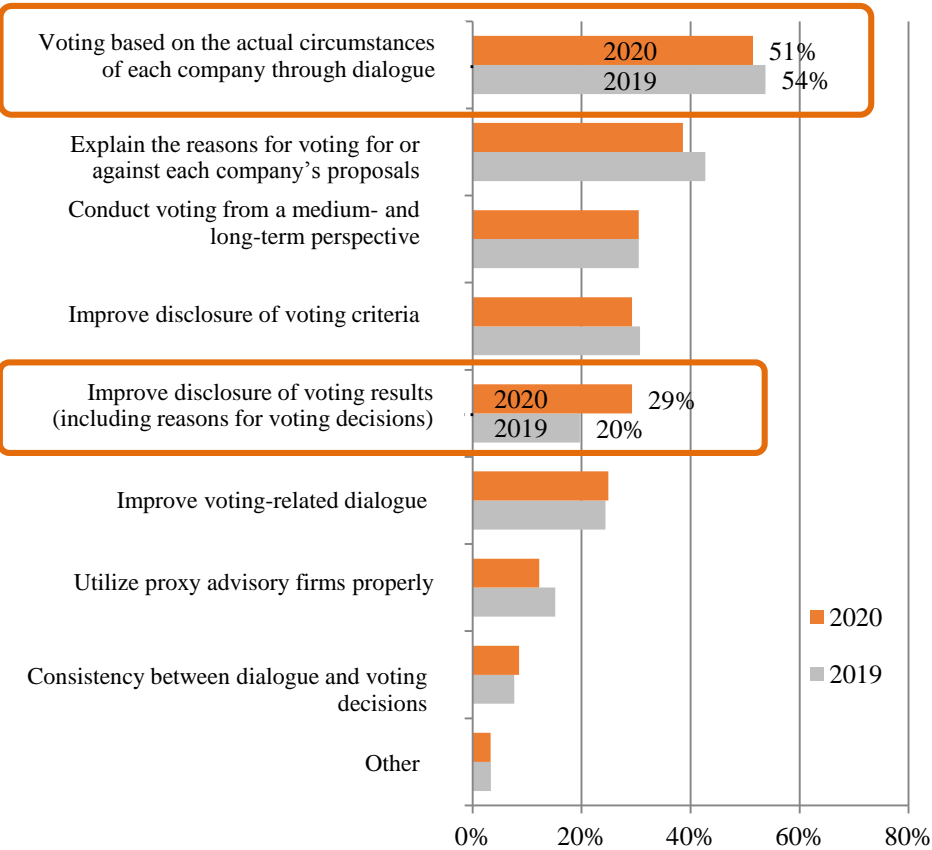


## Recommendation (9): Greater transparency for shareholder voting processes

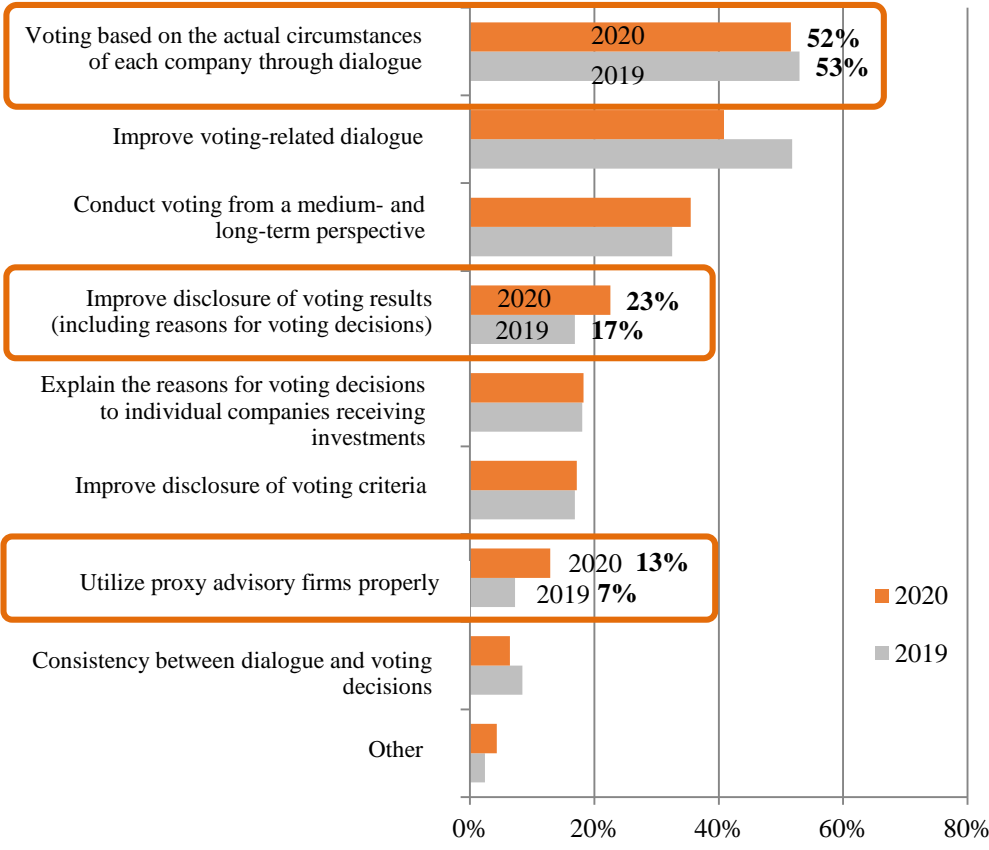
- Around 50% of both companies and investors recognize the importance of voting based on the actual circumstances of each company through dialogue.
- The number of companies and investors who believe it is important to “improve disclosure of voting results (including disclosure of the reasons for voting decisions)” increased from the previous fiscal year. There was also an increase in the number of investors who believe that it is important to “utilize proxy advisory firms properly.”

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

【 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

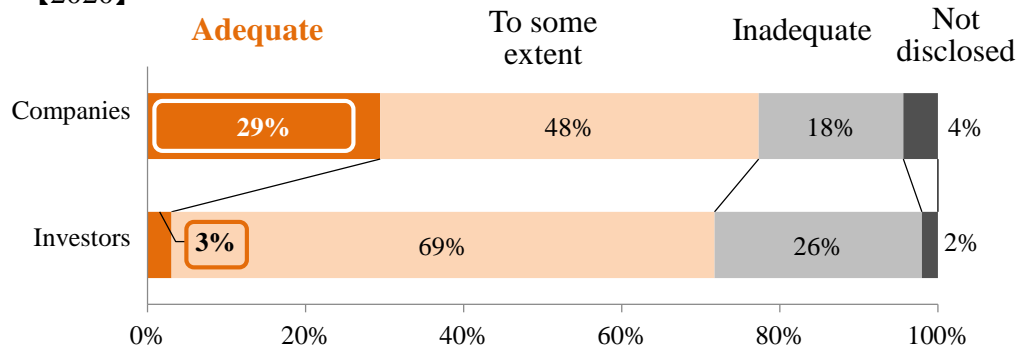
- There remains a perception gap between companies and investors on disclosure of ESG initiatives. 29% of companies believe disclosure is adequate, while only a few investors hold this view.
- Firms often use their website to provide ESG disclosures. However, investors continue to seek ESG disclosures through integrated reports and other means.

⇒ Encourage communication with investors by improving ESG disclosure, using Integrated Reports and other publications, as well as websites.

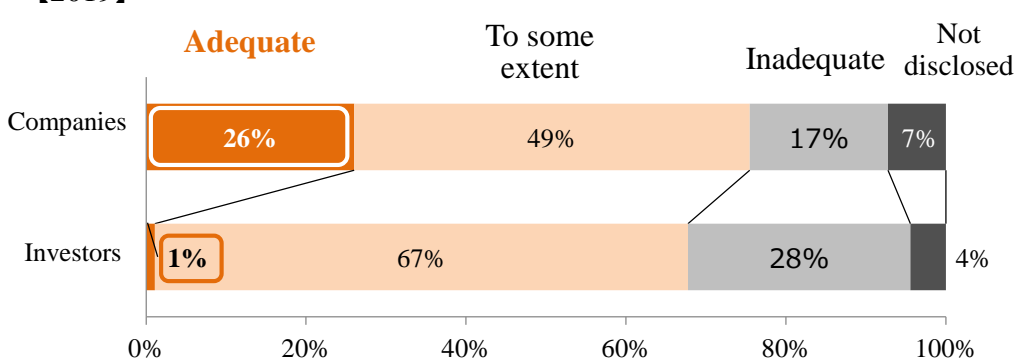
### 【 For companies/investors 】

Is the current disclosure of ESG initiatives adequate? (select one)

【2020】

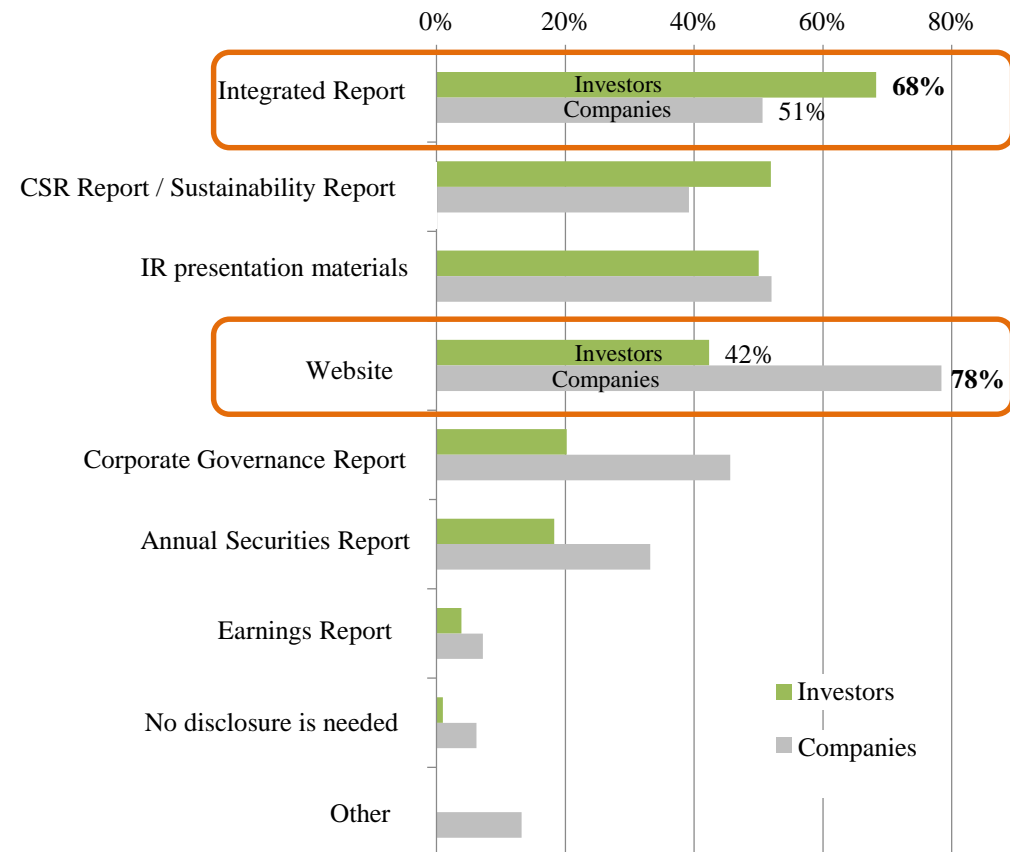


【2019】



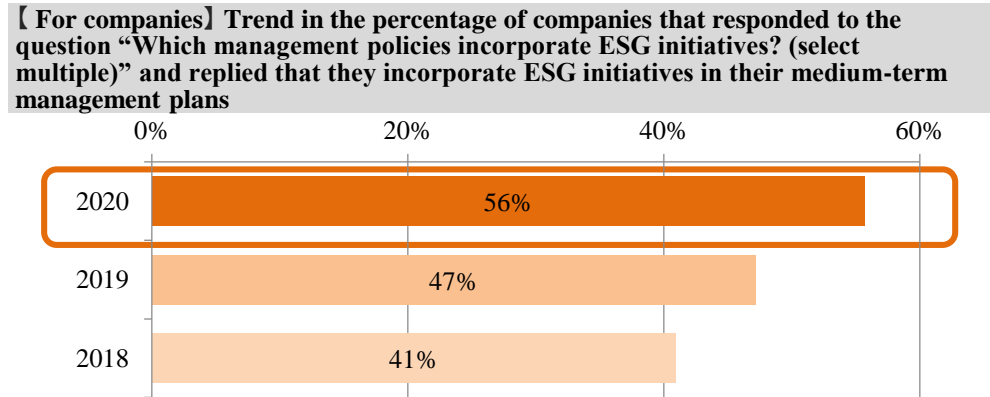
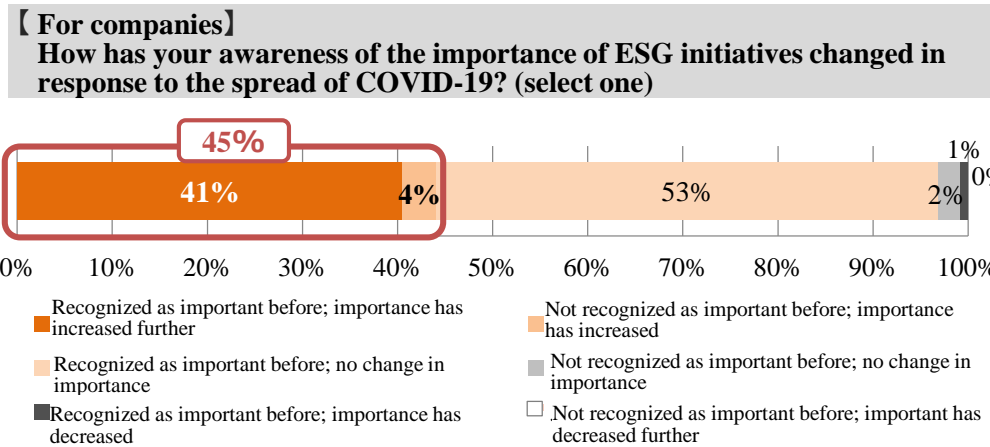
### 【 For companies/investors 】

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



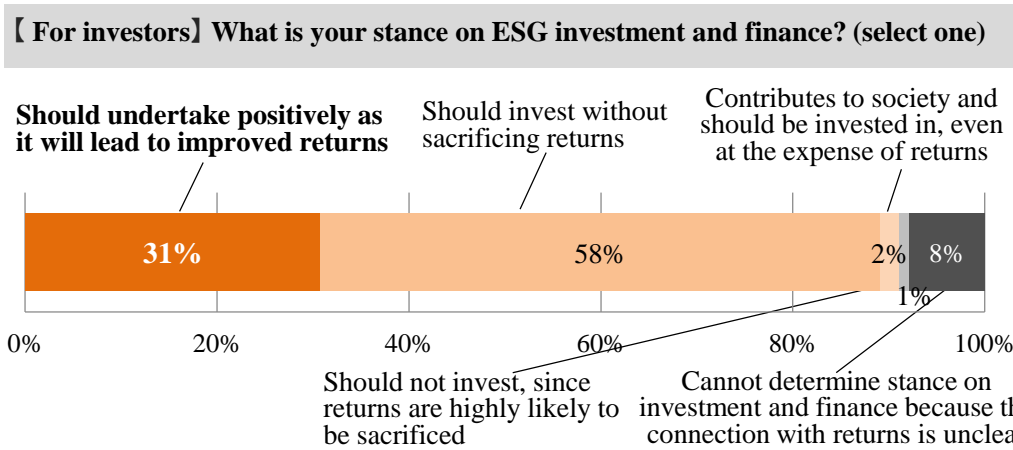
# Recommendation (11): Incorporate ESG initiatives in medium-term management plans

- 45% of companies replied that the importance of ESG initiatives has increased due to the impact of the spread of COVID-19.
  - The ratio of companies that have incorporated ESG initiatives in medium-term management plans still remains at 56%, although the ratio has steadily increased.
  - 66% of investors believe that ESG investment and finance will lead to improved medium- and long-term returns. 31% of investors have taken a positive stance toward ESG investment and finance, based on the belief that it will contribute to improved 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 investors】**  
What impact does ESG investment and finance have on investment performance? (select one)

	2019	2020
Improved medium- and long-term returns	62%	66%
Risk mitigation	19%	19%
No impact	12%	5%
Other	3%	4%
Reduced medium- and long-term returns	2%	3%
Reduced short-term returns	2%	3%
Improved short-term returns	0%	0%
Increased risk	0%	0%



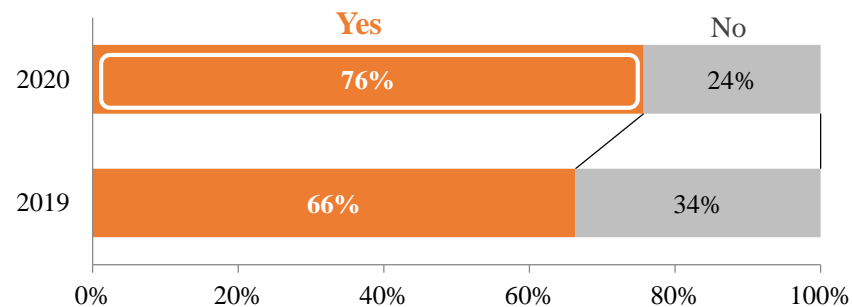
## Recommendation (12): Formulate ESG investment and finance policies and promote dialogue from medium- and long-term perspectives according to investment strategies

- The ratio of investors that implement ESG investment and finance and the ratio of investors that formulate ESG investment and finance policies both increased.
- Around half of firms believe the problem lies in the fact that investors only seek dialogue focusing on short-term themes. Meanwhile, there was an increase from the previous fiscal year in the ratio of companies that said they took, or improved, actions based on dialogue on the topic of disclosure, or on environmental and social themes.

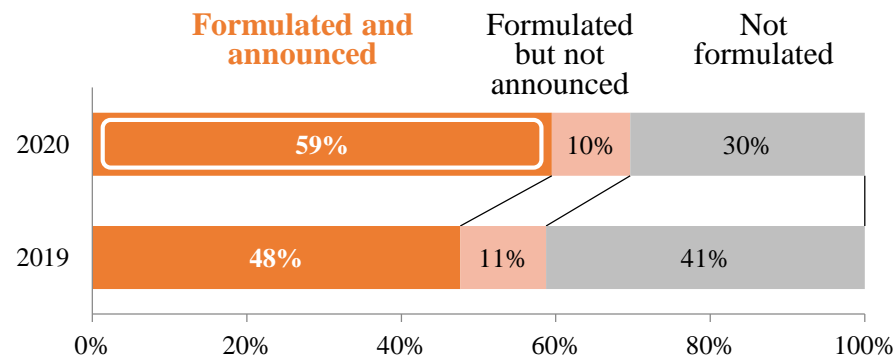
⇒ It will be important for investors to formulate policies, while promoting dialogue from medium- and long-term perspectives according to their investment strategies.

### 【 For investors】

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

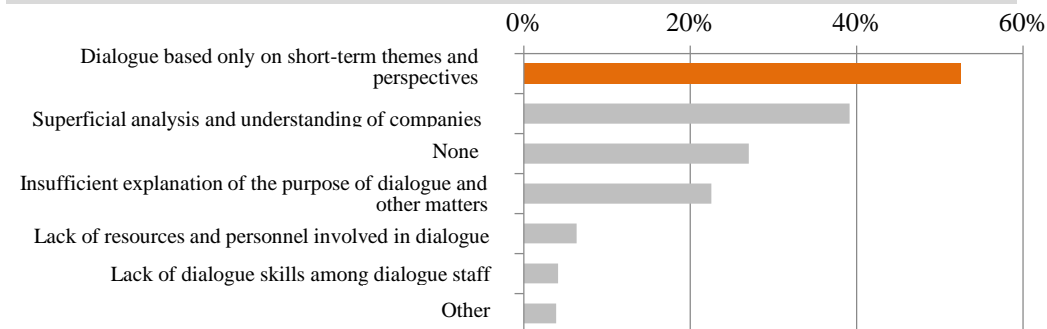


【 For investors】 Have you formulated policies on ESG investment and finance or action plans? (for companies implementing ESG investment and finance, select one)



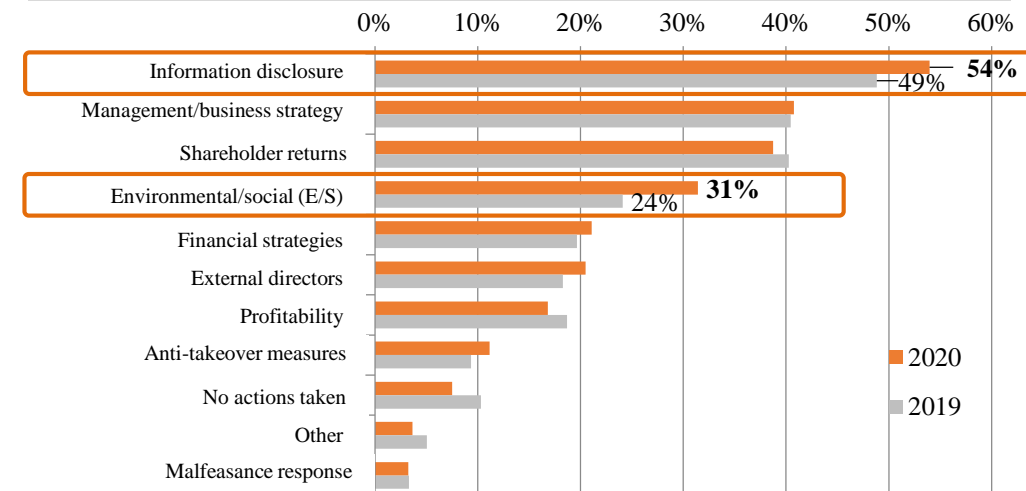
### 【 For companies】

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 disclosures about the impact of climate change on corporate activities and encourage the use of this information

- There were increases in the ratios of both companies and investors who replied that climate change is a major theme in ESG activities. Notably, 81% of investors replied that they emphasize climate change, marking a large increase from the previous fiscal year.
- The disclosure and use of climate change-related information based on TCFD recommendations has advanced compared with the previous fiscal year and is expected to continue to expand going forward.

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

### 【For companies/investors】

What do you consider to be the top five major themes in ESG activities and ESG investment and finance? (select up to five)

#### 【Companies】

2019

1	Corporate governance	75%
2	Climate change	49%
3	Health and safety	45%
4	Safety of products and services	43%
5	Risk management	39%

2020

1	Corporate governance	71%
2	Climate change	55%
3	Diversity	39%
4	Health and safety	39%
5	Safety of products and services	35%

#### 【Investors】

2019

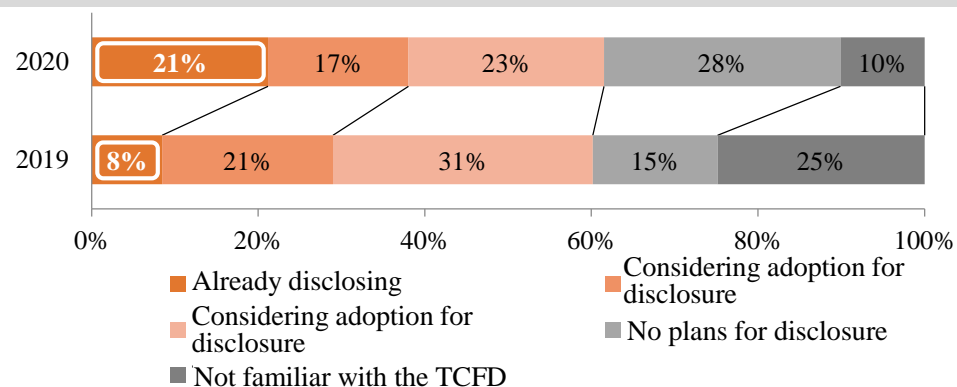
1	Corporate governance	83%
2	Climate change	68%
3	Information disclosure	42%
4	Malfeasance	27%
5	Diversity	27%

2020

1	Climate change	81%
2	Corporate governance	67%
3	Diversity	31%
3	Human rights and community	31%
5	Health and safety	23%

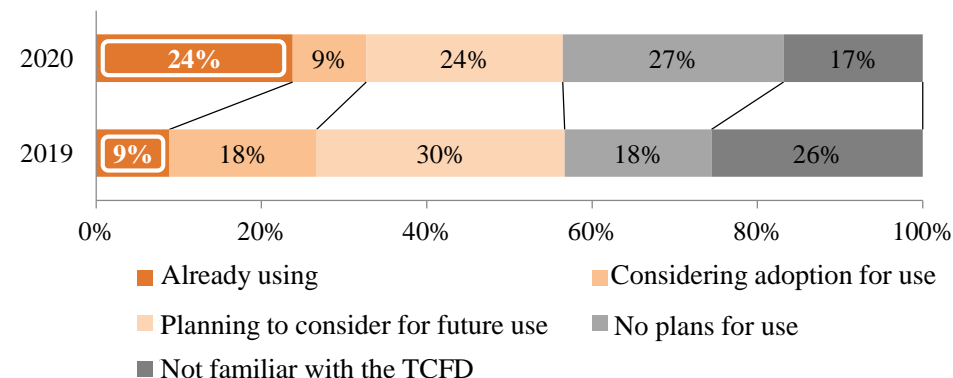
### 【For companies】

Are you considering TCFD-style climate-related disclosures? (select one)



### 【For Investors】

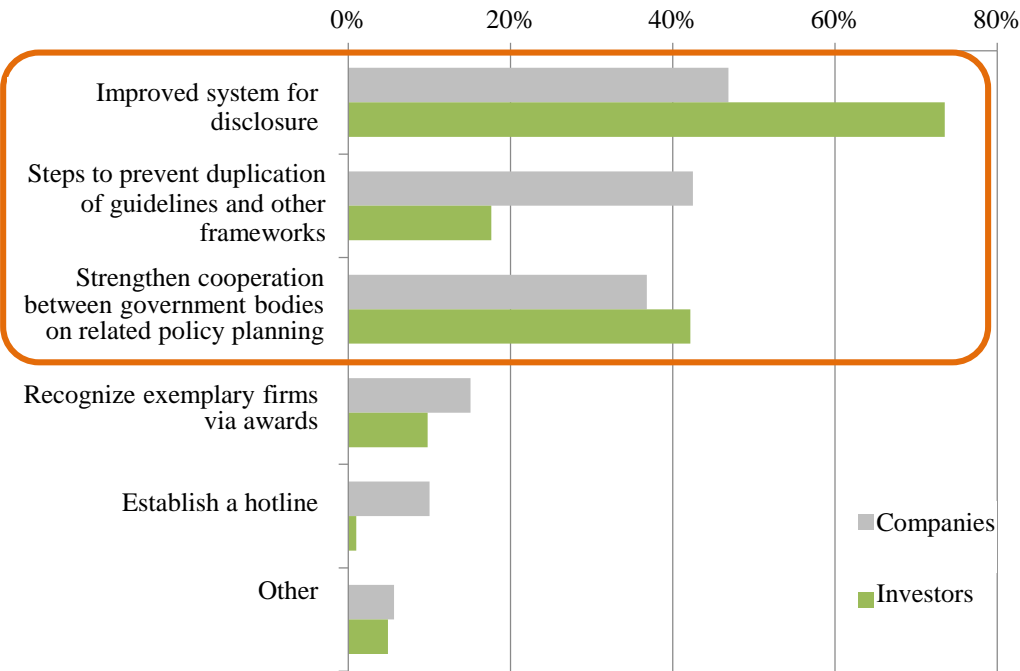
Are you considering using TCFD-style climate-related disclosures in the evaluation of firms or for dialogue? (select one)



# Recommendation (14): Take steps to promote ESG initiatives across government ministries/agencies

- Following on from the previous fiscal year, investors and companies both continue to expect the government to improve the system for disclosures, take steps to prevent duplication of guidelines and other frameworks, and strengthen cooperation between government bodies on related policy planning, in the course of promoting corporate ESG initiatives and ESG investment and finance by investors.
  - Meanwhile, the government has bolstered activities aimed at decarbonization in 2050. It has enhanced cooperation between government bodies through steps such as the establishment of the Taskforce on Preparation of the Environment for Transition Finance, which is held jointly by three government bodies, specifically the Ministry of Economy, Trade and Industry (METI), the Financial Services Agency (FSA), and the Ministry of the Environment.
- ⇒ Continue to 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/investors 】  
What do you expect government authorities to do to promote ESG initiatives (companies) and ESG investment and finance (investors)? (select up to two)



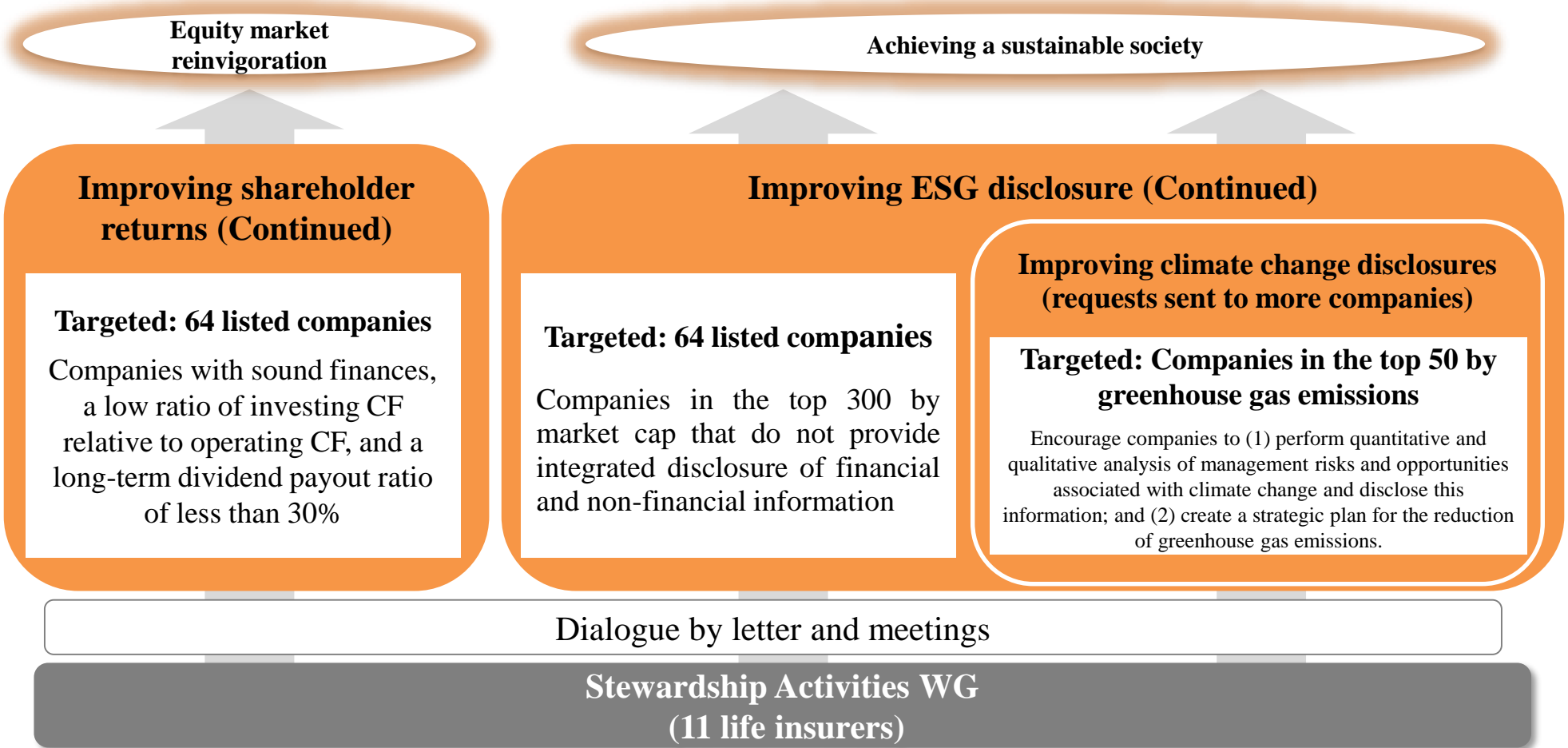
Reference: Government meeting structures and guidelines on ESG promotion initiatives

Ministries/Agencies	ESG Initiative Promotion Council	
Ministry of Economy, Trade and Industry, Financial Services Agency, and Ministry of the Environment	TCFD Consortium	
	Taskforce on Preparation of the Environment for Transition Finance	
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	
	Expert Panel on Sustainable Finance	
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	Green Investment Guidance
	TCFD Guidance 2.0	SDGs Management Guide

Supported efforts by companies to address decarbonization through requests for improving climate change disclosures

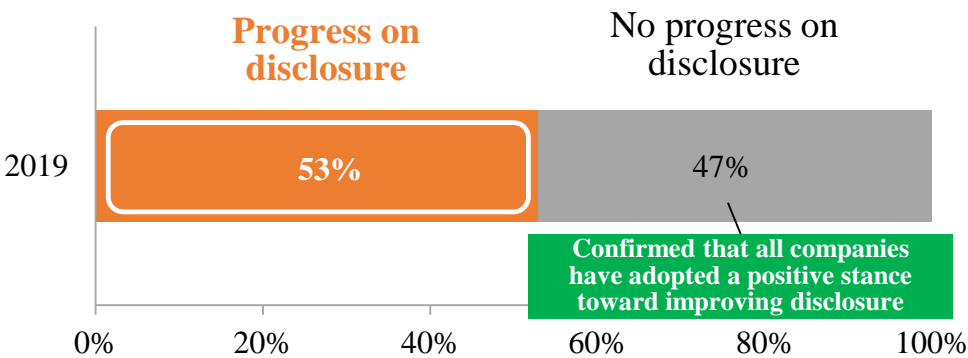
- From FY2017, the life insurers in the Stewardship Activities Working Group (WG) jointly initiated a collaborative engagement campaign to convey their awareness of issues to companies. In FY2020, the campaign targeted 171 listed companies (178 companies in total), while keeping in place the three themes of improving climate change disclosures, improving ESG disclosures and improving shareholder returns.
- Notably, on the theme of improving climate change disclosures, the campaign newly made the following two requests to all companies in the top 50 by greenhouse gas emissions: (1) perform quantitative and qualitative analysis of management risks and opportunities associated with climate change and disclose this information; and (2) create a strategic plan for the reduction of greenhouse gas emissions. In this manner, the campaign helped companies to take further steps and provide disclosure with a view to achieving decarbonization.



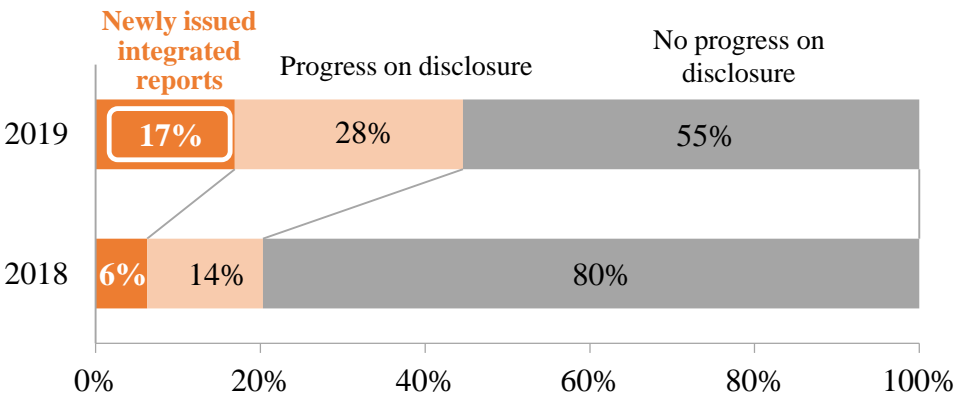
Results of the collaborative engagement campaign in the previous fiscal year

- In terms of improving climate change disclosures, the campaign found that 53% of the targeted companies showed progress on disclosure, and confirmed that all companies that did not show progress on disclosure have adopted a positive stance toward improving their disclosure going forward.
- Looking at improving ESG disclosure, companies that newly issued integrated reports rose by 17% (around 3 times higher than the FY2018 level). In addition, the number of companies that upgraded and improved their ESG disclosure without issuing integrated reports increased to 28% of the targeted companies (around 2 times higher than the FY2018 level).
- With regard to improving shareholder returns, 24% of the targeted companies have met the standard of a dividend payout ratio of 30%, mostly the same as the FY2018 level, despite the COVID-19 crisis.

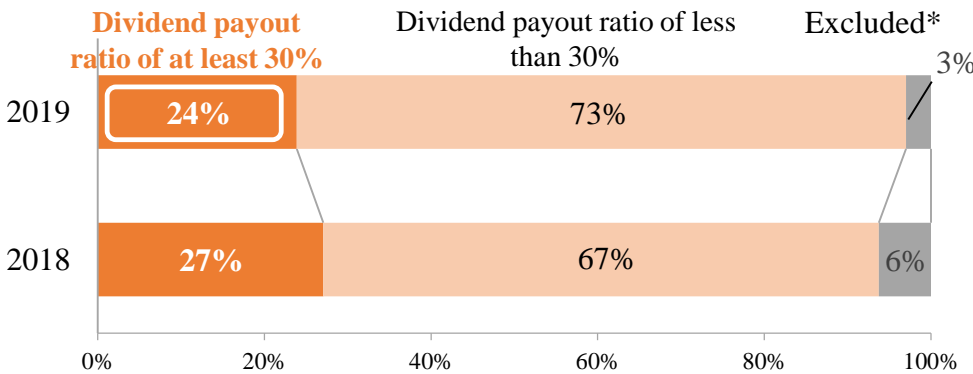
Improving climate change disclosures



Improving ESG disclosure



Improving shareholder returns



\* Companies excluded due to delisting, etc.

(Reference) Status of activities of collaborative engagement in FY2019

Theme	Targeted companies	
Improving climate change disclosures	17 companies	Companies with large amounts of greenhouse gas emissions whose policies on climate change disclosures need to be confirmed
Improving ESG disclosure	67 companies	Companies in the top 300 by market cap that do not provide integrated disclosure of financial and non-financial information
Improving shareholder returns	65 companies	Companies with sound finances, a low ratio of investing CF relative to operating CF, and a long-term dividend payout ratio of less than 30%
Total	142 companies	(149 companies in total)

## Initiatives and approaches conducted or considered by WG participants to improve stewardship activities

- Based on the sharing of activity details among WG participants and interviews with external investors and other experts, each WG participant continuously strengthened its initiatives and approaches.
- Notably, in the current fiscal year all WG participants conducted dialogue to address the spread of COVID-19 and took initiatives to expand stewardship activities beyond domestic listed shares.

Activity details			Comparison with the previous fiscal year	
(Number of WG participants)			FY2019	FY2020
Approach	Organization	• Set up dedicated dialogue team	11	11
	Dedicated staff	• Assigned dedicated dialogue staff	4	6
	Expert committee	• Set up expert committee, including outsiders	5	6
Dialogue theme		• Governance (G) dialogue	9	9(10)
		• Environmental (E)/Social (S) dialogues	11	11
Factoring into investment decisions		• Dialogue findings used in investment decisions	11	11
Conduct dialogue to address the spread of COVID-19		• Dialogue findings used in investment decisions	10	11
		• Conducted dialogue on themes based on the spread of COVID-19, such as work style reforms and digitalization		11
Expand the scope of stewardship activities		• Conducted dialogue via the web and telephone		11
		• Expanded stewardship activities beyond domestic listed shares (action taken in response to the second revision of Japan's Stewardship Code in March 2020)		11

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

## Efforts to strengthen 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.
- Moreover, all WG participants are carrying out investment and finance activities in response to the spread of COVID-19.

### Activity details

### Comparison with the previous fiscal year

		FY2019(16)	FY2020(16)
Approach	Policy	11	12(14)
		11	15(16)
	Organization	11	12(14)
TCFD recommendations	Endorse TCFD recommendations*1	14	15(16)
	Disclose information according to TCFD recommendations	9	11(16)
Main ESG investment and finance methods being used	Engagement (Dialogue)	13	14(16)
	Integration*2	12	15
	Negative screening*3	13	16
Investment and finance activities related to the spread of COVID-19		<ul style="list-style-type: none"> <li>Address consultations on modifying conditions for existing borrowers and tenants at property holdings based on the impact of COVID-19</li> <li>Investments in bonds and other instruments that contribute to COVID-19 response measures, among other related measures</li> </ul>	

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

\*2 Meaning that ESG factors are reflected in the investment process.

\*3 Defining securities for portfolio exclusion from an ESG perspective

\* 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 their understanding of ESG investing and finance and enhance their initiatives/approaches.
- Moreover, in the current fiscal year LIAJ held joint seminars for the ESG Investment and Finance WG and the Stewardship Activities WG on Environment (E) and Social (S) themes such as addressing climate change and work style reforms (including digitalization).

Instructor	Seminar
AXA Investment Managers	• Advanced examples of responsible investing and impact investing
PRI Japan	• PRI's activities
DWS Group	• Trends in ESG investment and practical issues
Ministry of the Environment	• Promotion of ESG finance



<Joint seminars with the Stewardship Activities WG>

Instructor	Seminar
Hitachi, Ltd.	• A new normal in IT for work style reforms
Ministry of Economy, Trade and Industry	• Trends in TCFD disclosures

**Upgrade the initiatives of WG participants**