BlackRock

March 2020

Re: Our response to the Japanese Financial Services Agency's (FSA) public Stewardship Code consultation

Background
The Council of Experts on Japan's Stewardship Code (The Council)—convened by the Japan's FSA and the Tokyo Stock Exchange—formulated a Stewardship Code on February 26, 2014 and further revised it on May 29, 2017. On April 24, 2019, The Council published an opinion statement entitled "Recommended Directions for Further Promotion of Corporate Governance Reform." In light of this publication, The Council solicited comments from the public between December 20, 2019 to January 31, 2020.

The proposed changes in the revised code include:
- Sustainability considerations: medium- to long-term sustainability including environmental, social, and governance (ESG) factors, in line with the investment management strategy
- Enhancing disclosures, like presenting the vote rationale
- Application of the Code towards asset classes other than publicly listed equities

Executive Summary
BlackRock supports the intent of the revised Code draft, in particular the revision to the Code to make explicit the importance of sustainability considerations, including ESG factors, material to the long-term growth and value creation of investee companies, and for this to be integrated into investment management strategies. BlackRock is also supportive of enhancing transparency as long as it contributes to constructive engagement with investee companies. On the other hand, while BlackRock understands and supports the aim of the proposal to apply the Code to other asset classes, we believe it is noteworthy that the rights and responsibilities of investors in other securities and asset classes differ significantly from those of shareholders investing in publicly listed companies. Therefore, we believe further discussion may be required to clarify what stewardship activities for investors in other assets besides publicly traded equity will mean in practice and how such activities can contribute to long-term value creation of the investee companies.

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BlackRock submitted the following answers in response to the public consultation:

Question 1-1.
What do you think about the new provision stipulating that "The Code primarily targets institutional investors investing in Japanese listed shares. In addition, the Code may also apply to other asset classes as far as it contributes to fulfilling the stewardship responsibilities mentioned in the heading of this Code." (Preamble: "Aims of the Code"), revising the current Code assuming that institutional investors will invest in Japanese listed equities? And why do you think so?

Question 1-2.
Are there any points to be noted when institutional investors apply the Code to other asset classes? Please provide reasons, if any.

BlackRock response:
BlackRock understands and supports the aim of the proposal to apply the Code to other asset classes, insofar as it contributes to fulfilling the stewardship responsibilities mentioned in the header for this Code. However, it is worth noting that the rights and responsibilities of investors

in other securities and asset classes differ significantly from the rights and responsibilities of shareholders investing in publicly listed companies (e.g. on voting rights, the right to residual assets, restrictions on voting for fixed income investors, liquidity constraints, etc.).

Therefore, we believe further discussion may be required to clarify what stewardship activities (including ESG integration and engagement on material ESG issues) for investors in other assets besides publicly traded equity will mean in practice and how such activities can contribute to long-term value creation of the investee companies. Furthermore, such discussions should take into consideration the inherent differences, rights, responsibilities, and practices of investors in different asset classes, to avoid a 'one-size-fits-all' approach.

Question 2.
What do you think about incorporating issues of "sustainability (medium- to long-term sustainability including ESG factors)" in the Revision Draft? If such a phrase is incorporated, how should it be incorporated? In addition, what do you think about the text of the Revision Draft expecting consideration of this issue in Principle 1 regarding the policy to fulfil their stewardship responsibilities? Please provide reasons, if any.

BlackRock response:
BlackRock supports the revision to the Code to make explicit the importance of considering sustainability issues, including ESG factors, material to the long-term growth and mid- to long term value creation of companies, and for this to be integrated into investment management strategies.

BlackRock believes the impact of sustainability on investment returns will continue to grow. Thus, we are putting forward several initiatives to entrench sustainability at the center of our investment approach, including in relation to stewardship. We believe the text related to responsibility on sustainability issues should be incorporated in the definition of stewardship responsibilities, and placed upfront in the Preamble. Including this text would encourage asset managers, including BlackRock, to enhance stewardship practices, leveraging each asset manager's unique strengths and expertise.

Question 3.
What kind of measures should be stipulated to encourage asset owners, such as corporate pensions, to participate in stewardship activities?

BlackRock response:
We prefer to refrain from commenting on this question.

Question 4.
What do you think about expecting asset managers to explain their reasons of "for" or "against" at proxy voting when they disclose voting results by individual company and agenda basis?
What do you think about Guidance 5-3 in the Revision Draft requesting institutional investors to "disclose the reasons of votes on the agenda of investee companies, either "for" or "against", which are considered important from the standpoint of constructive dialogue with the investee companies, including those suspected to have conflicts of interest or those which need explanation in light of their voting policy?" And why do you think so?

BlackRock response:
BlackRock believes that the most effective means to explain the vote rationale on agenda items considered important (in terms of contributing to constructive dialogue with an investee company), is to share our vote rationale directly and confidentially with the investee company. However various circumstances may make it difficult to explain the reasons directly to investee companies. An alternative method could involve disclosing the votes and a related rationale publicly for the companies that an asset manager is unable to directly engage with. Nevertheless, upon disclosing the rationale in detail, we believe there needs to be careful consideration on

whether such disclosure will contribute to the sustainable growth of the investee company and serve long-term shareholder interests.

BlackRock reiterates that a voting policy should not be comprised of only a mechanical checklist; it should be designed to contribute to the sustainable growth of investee companies. From this perspective, upon analysis and evaluation of the published voting results and the rationale, the following points should be noted:

- Our understanding is that the disclosure of the vote decision on an agenda level was included in the Code in order to mitigate concerns that many managers, that are part of financial groups, may not have adequately managed conflicts of interest in the exercise of their voting rights.
- In cases where there is a potential conflict of interest, any voting decision that may deviate from the proxy voting policy is likely to be viewed sceptically, even if the decision may have been in the best interest of clients. It is often difficult to prove that the vote was decided based on the manager's fiduciary duty and not to further the interests of the asset manager's organisation.
- As a result, we believe there will likely be pressure for certain managers to refrain from making voting decisions that may deviate in any way from the manager's voting policy, even if circumstances may call for an exception. Such pressure may incentivize managers to design their proxy voting policy to be formulaic, as such policies and their application will generally be easier for external parties to understand, even when such voting decisions may not contribute to the sustainable growth of the investee company and long-term shareholder interests.
- It is worth noting that requiring disclosure of vote rationales may reinforce formulaic voting behaviour.

Question 5-1.
What do you think about the creation of the new Principle 8, concerning "service providers for institutional investors", which requests that service providers for institutional investors develop structures for conflicts of interest management etc. (Guidance 8-1), and that proxy advisors develop human and operational resources as well as disclose their voting recommendation process (including the resources) (Guidance 8-2) and exchange views actively with companies upon necessity (Guidance 8-3)? And why do you think so?

Question 5-2.
What are the points to be noted regarding the scope of "service providers for institutional investors" when they include not only proxy advisors and investment consultants for pensions, but also may widely include institutions which have a function to contribute to asset managers and asset owners in carrying out effective stewardship activities? And why do you think so?

BlackRock response
BlackRock supports the creation of Principle 8.
We believe the following practices will contribute to enhance transparency and the accuracy of vote recommendations:

- Requesting that service providers identify specific circumstances that may give rise to conflicts of interest; putting in place a clear policy on how to manage these conflicts effectively; developing structures for conflicts of interest management, and disclose such measures.
- Where appropriate and necessary, requesting that proxy advisors incorporate in their vote recommendations, facts and information obtained through the exchange of views between the proxy advisor and the company, so as to ensure transparency in the vote recommendation process.

Question 6.
Please provide comments and their reasons on revised provisions of the Revision Draft beside the above issues.

BlackRock response (Regarding Guideline 7-4):
BlackRock believes that the results of stewardship activity will not generally be realized or achieved within a single year and could be multi-dimensional, particularly when such activities focus on fundamental issues tailored to each individual investee company. Thus, it should be noted that requiring asset managers to disclose the achievements and outcome of stewardship activities may incentivize such managers to focus overly on issues that may be more easily achievable, or measurable and formulaic in nature, rather than making the effort required to address issues that may be more material but difficult to address and may require multi-year engagement. It also may incentivize asset managers to make claims that an outcome was solely due to their efforts, when the outcome is likely to have been the result of several investors engaging with the companies on the same issue. Thus, when referring to the outcomes of stewardship activities, it is important to consider how these outcomes are linked to enhancement of medium to long-term corporate value and sustainable growth.