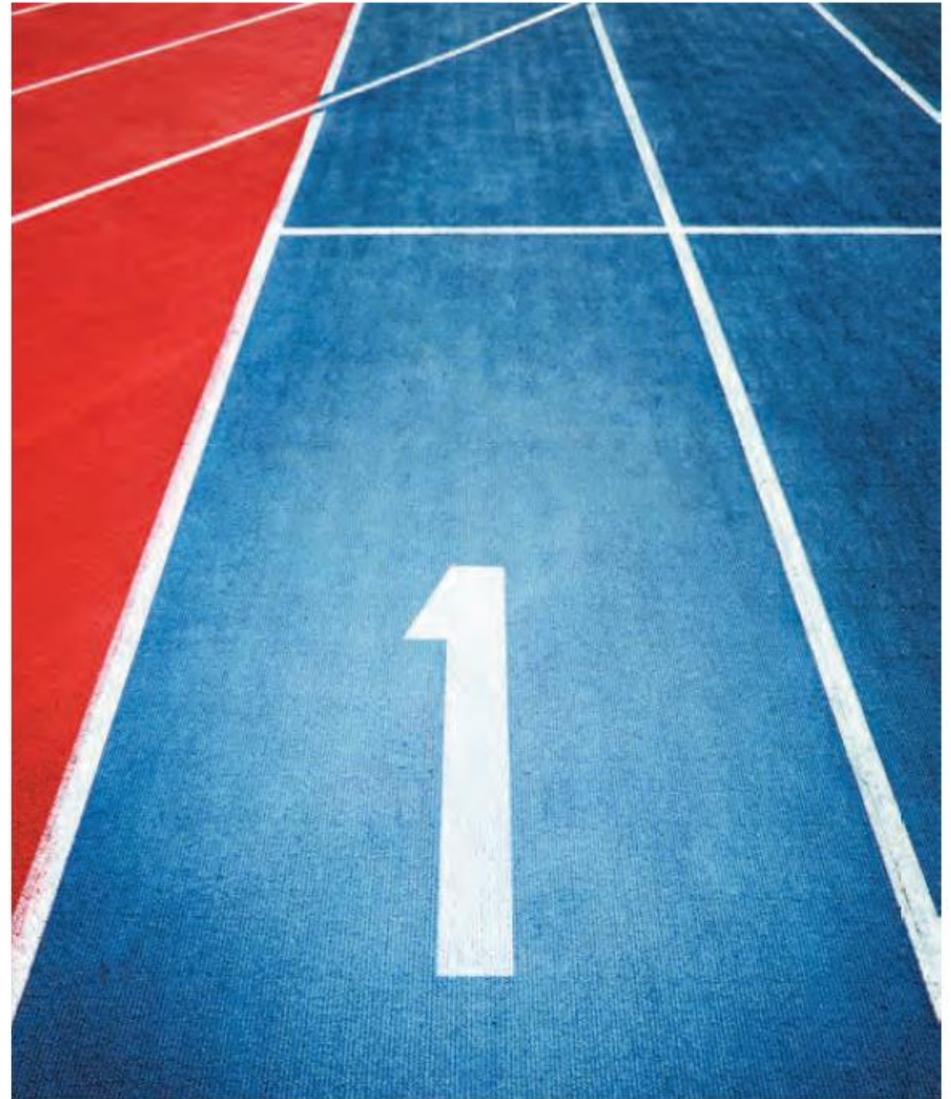


# Asset Management One Stewardship Report 2020/2021



Creating a sustainable future  
through the power of investment



# 投資の力で未来をはぐくむ Creating a sustainable future through the power of investment

お客さまとの信頼関係に裏付けられた「投資の力で」

地球と社会の、お客さまと私たちの、すべての世代にとって豊かな「未来を」

情熱をもって大切に「はぐくむ」

"Creating" with passion and respect.

"A sustainable future" for the planet, society, our clients and future generations.

"Through the power of investment" as a trusted steward of our clients' assets.

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## Introduction to Asset Management One

Headquartered in Tokyo, Asset Management One Co., Ltd. (Asset Management One “AMO”) is a leading asset manager of Japanese institutional assets and offers a broad and diverse range of bespoke investment strategies to some of the world’s largest institutional investors. Our portfolio managers are supported by one of the largest and most experienced research teams. As a long term investor, AMO considers our proprietary research capabilities a cornerstone for generating higher risk-adjusted returns and solid long-term performance.

Asset Management One is owned jointly by Mizuho Financial Group Inc. (51%) and Dai-ichi Life Holdings Inc. (49%) which provides a strong base that is long-term in outlook and financially able to support Asset Management One’s long-term business strategy. Asset Management One was created following an integration agreement signed between DIAM Co., Ltd., Mizuho Trust & Banking Co., Ltd., Mizuho Asset Management Co.,

Ltd. and Shinko Asset Management Co., Ltd. to integrate their asset management functions, effective from 1 October 2016. As of 31 December 2020, AMO’s assets under management are approximately US\$526bn (please refer to Chapter 6 of this report for the AUM breakdown by asset class).

## Corporate Message and Philosophy

Asset Management One is **one of the first in Japan to establish** a dedicated Responsible Investment Group when the firm was formed in October 2016, and has been actively discharging our stewardship responsibilities. In April 2020, AMO newly created a Corporate Sustainability Office (CSO) reporting directly to the CEO, which led a firm-wide initiative and intensive discussions on corporate purpose. A series of meetings, discussions and workshops were held across the entire firm in 2020, including the participation of all members at AMO’s executive management committee. We also invited external experts to host a seminar on the UN SDGs. In

developing and defining our purpose, the management and employees at Asset Management One have debated and discussed extensively about key challenges and issues facing the economy, environment and the society (such as climate change, social inequality, diversity & inclusion and etc.), and reconfirmed the critical importance of the sustainability perspective as a core part of our investment business and stewardship activities.

After long deliberations on our purpose, we published “Creating a sustainable future through the power of investment” as our corporate message, which reflects AMO’s existing reason for being. Rooted in economics and competitive advantage of our business model, this also the result of rethinking the value we add as a committed long-term investor, with the aim of contributing to a sustainable society and the well-being of our clients:

# Chapter 1: Our approach to ESG investment and stewardship

"Creating" with passion and respect.

"A sustainable future" for the planet, society, our clients and future generations.

"Through the power of investment" as a trusted steward of our clients' assets.

Our Corporate Message drives our vision and mission, and defines our values as well as the culture of the organisation. AMO puts the Corporate Message at the core of its strategy. We are committed to achieving sustainable value creation and solutions for key societal challenges, acting as what we expect from our investee companies to perform.

With the strong commitment from the top management, the exercise across the firm in 2020 of rethinking our purpose is instrumental in defining our value proposition, and also inspiring the employees at Asset Management One to work altogether towards the shared purpose and goals.

## Corporate Philosophy

### Mission

Asset Management One provides products and services of the highest standard, as our clients' most trusted partner in the asset management industry. Our mission is to contribute to a sustainable economy and society through asset management for the long-term benefit of our clients.

### Vision

Drawing on our investment capabilities, products and consulting services as a global asset management company providing solutions for our clients' financial needs, we aspire to:

- Be our clients' most trusted and professional asset management company
- Provide products and services of the highest standard, employing our significant expertise for all clients
- Become a world-leading asset management company

### Values



### Corporate Message

Creating a sustainable future through the power of investment

"Creating" with passion and respect.  
"A sustainable future" for the planet, society, our clients and future generations.  
"Through the power of investment" as a trusted steward of our clients' assets.

## Our approaches to ESG investing and stewardship responsibilities

AMO is a signatory of the PRI (the UN Principles for Responsible Investment). We have also been a signatory of Japan's Stewardship Code since it was first introduced in April 2014. We believe it is our fiduciary duty and responsibility to help our clients and beneficiaries achieve their financial and non-financial objectives, to maintain a decent standard of living when they retire and to contribute to a sustainable economic growth through efficient allocation of capital. AMO is strongly committed to acting and performing as a good steward, to preserve and enhance value for the assets entrusted by our clients. Through

integrating material ESG considerations in the investment process and actively conducting purposeful engagement with investee companies, we aim to achieve the risk-adjusted return objectives for our clients over the medium and long-term, while at the same time contributing to the environment, economy and the wider society.

The three key principles that underpin AMO's ESG & sustainable investment and stewardship activities are:

- We aim to achieve higher investment returns for clients over the mid- and long-term, by integrating material ESG analysis and conducting active engagement
- We contribute to the solutions and achievement of the UN's Sustainable Development Goals (SDGs)
- We put a focus on the upside potential opportunities, not least from the risk management perspective

## ESG integration and active engagement

We believe that active and constructive engagement with investee companies plays a vital role in driving positive changes for value creation and sustainable growth. We focus more on the quality and effectiveness of our engagement dialogues. Meanwhile, in addition to the investee companies, we also proactively engage with policymakers, regulators, industry associations and other stakeholders, in policy advocacy to promote best practices. Where appropriate, we collaborate with other investors in order to enhance the effectiveness of engagement. We regard voting as a part of the engagement process, and in exercising our voting rights, we intend to reflect the progress and results of our engagement as well.

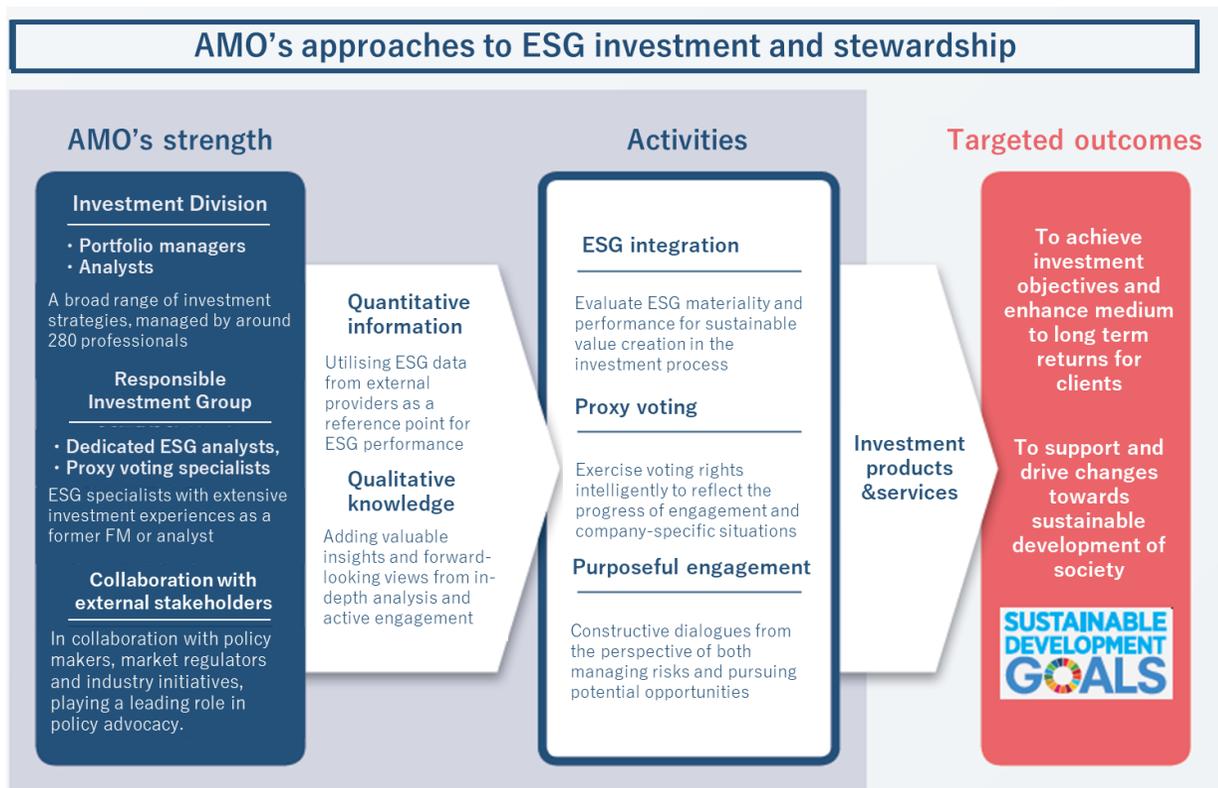
We integrate considerations for material ESG factors in our investment process across all strategies and asset classes. AMO approaches to ESG as an enhanced analysis of companies, on top of conventional financial analysis and evaluation, to better understand companies' risk

and return profiles and their long-term performance prospects. The investment analysts and portfolio managers at AMO are committed to adding value through a bottom-up approach to forming an in-depth understanding of company-specific financial and ESG performance including their direction of travel, using quantitative ESG data as well as qualitative insights from engagement. Meanwhile, some of our investment strategies adopt a negative screening approach. And in principle, AMO does not invest in companies that are involved in manufacturing of cluster munitions, anti-personnel mines, chemical and biological weapons.

Following the Japan's Stewardship Code recommendations, we publish a self-assessment on our stewardship approaches, activities and outcomes each year, to review the effectiveness of stewardship performance with an aim for continuous improvement. The results are available at: [http://www.am-one.co.jp/img/company/36/20190528\\_stewardship\\_details.pdf](http://www.am-one.co.jp/img/company/36/20190528_stewardship_details.pdf) (in Japanese).

# Chapter 1: Our approach to ESG investment and stewardship

AMO puts client interests first, and always seeks to act in the best interests of clients and beneficiaries. We therefore have put a robust governance structure and process in place (for details, please refer to Chapter 2 of this report in relation to Principle 2 of the UK Stewardship Code). Given the ownership and group structure of Asset Management One, we have also implemented a robust policy and established procedures to identify, prevent and manage conflicts of interest that may arise in our stewardship activities. With regards to how we manage conflicts of interest, more detailed explanations are provided in Chapter 3 (in relation to Principle 3 of the UK Stewardship Code).





**Akira Sugano**  
**President & CEO**

## ***Addressing environmental and social issues becomes ever more vital***

Covid-19 has had a significantly adverse effect on public health and economy in Japan as well as in other countries. We are still facing unprecedented challenges in transforming into a new society brought by this pandemic, in the midst of seeking a balance between the infection controls and revival of the economy. Indeed, Covid-19 should serve as a wake-up call for sustainability of the social and economic development, compelling companies to embed and transform business models to ensure that they survive and prosper in a post-pandemic world.

Asset Management One (AMO) announced its stewardship activity plans in May 2020, including our stewardship commitment impacted by the Covid-19 pandemic from the medium to long term perspective. The Covid-19 pandemic has reconfirmed the importance of key S (social) issues, as well as E (environmental) issues. Therefore, it is becoming ever more vital to step up our stewardship efforts in engaging with

companies for solutions to address the key environmental and social challenges, and to accelerate transitions towards a more resilient and sustainable society.

## ***Committing to ESG investment and stewardship with a global perspective***

In the mid-term business plan at Asset Management One, drawing on our breadth and depth of expertise as a leading Japanese asset manager, our missions were set to (1) provide comprehensive solutions and services of high standard, (2) become our clients' most trusted partner, (3) serve for the well-being of our clients and beneficiaries, and (4) contribute to the sustainable development of society. Our thinking and approaches to ESG investment and stewardship activities are in alignment with our missions and values.

During the last few years, we further enhanced ESG integration and active engagement for other asset classes beyond listed equities. In accelerating our ESG investment

and stewardship activities, we focus particularly on applying the global perspectives and standards. Many key environmental and social challenges, such as climate change, are a global issue and presents with the systemic and complex nature. To address such unparalleled risks and challenges, we believe that a global perspective and collaboration is essential. AMO has been actively participating in the global investors' collaborative engagement initiative "Climate Action 100+" since it was launched in 2017, and together with a prominent public pension fund in the US, we are co-leading the ongoing engagement with a major Japanese automotive company. In December 2020, AMO joined as a founding member of the Net Zero Asset Managers initiative, launched by 30 leading investor signatories globally. AMO was the only participant from Japanese asset management firms. We believe that asset managers have a pivotal role to play within the investment chain towards achieving the Paris Agreement goal. Through this global initiative, we will be working in collaboration with our clients and other

stakeholders around the world, to achieve the target-based net zero goal by 2050 and to build a sustainable future for the planet and society.

### ***Enhancing corporate sustainability initiatives at Asset Management One***

In April 2020, we newly set up a Corporate Sustainability Office as a strategic unit, aiming to further enhance our approaches to sustainability and value creation as a business, leading by example and performing as what we would expect from our investee companies. Asset Management One was the first asset management company in Japan that have signed up for the RE100 initiative and committed to 100% renewable electricity. Promoting a culture of diversity and inclusion is another key aim that we continue to work towards. Despite the tangible progress, we regard our efforts towards sustainability as a journey for continuous improvement.

During 2020, we also had extensive discussions and debates across the entire organisation about

our corporate purpose (our raison d'etre in the society). In the rapidly changing environment, it is critical to rethink and reflect our purpose, which would define our missions and drive our values. The Covid-19 crisis has ascertained the significance and urgency of addressing key ESG issues. With a global perspective, AMO is strongly committed to leading and accelerating our efforts to promote sustainability and drive positive impact on environmental and social solutions for sustainable development of the economy and society.

## **Governance structures and processes for effective stewardship**

AMO has established an internal process using a systematic approach to planning for stewardship and engagement activities, identifying priority themes and engagement targets by taking into consideration the market and company-specific circumstances. The key ESG and sustainability themes and topics are reviewed annually. In addition, AMO believes voting responsibly is an important part of our fiduciary duty. We therefore have dedicated internal resources responsible for voting activities globally, while using proxy service providers to assist in the administrative process by implementing AMO's customized proxy voting guidelines.

The overall ESG investment approaches at AMO and stewardship activities are overseen by the Responsible Investment Committee (chaired by the CIO), reporting to the Board of Directors of Asset Management One and to the board's Audit and Supervisory Committee with a majority of independent outside directors. The Responsible

Investment (RI) Committee meets on a quarterly basis. AMO has also put a monitoring process and reporting framework in place in order to escalate related matters to the Board and to the Audit and Supervisory Committee. The Audit and Supervisory Committee members attend the RI Committee meetings when required, to discuss and ensure robust accountability and to oversee effective operations of the RI Committee. In the next Chapter of this report about how we manage conflicts of interest, additional details of the governance structure and processes at AMO with regards to the oversight and accountability for effective stewardship are further explained and depicted with an organisational chart. We believe that the existing governance structures and processes for stewardship and investment at AMO are robust, which support the solid outcome and enable continuous improvement. We also carry out and publish a self-assessment annually with regards to our stewardship policies, activities and improvement, following Japan's Stewardship Code recommendations.

## **Extensive and experienced resources for stewardship activities**

ESG integration and active engagement with investee companies is an essential part of Asset Management One's responsible investment and stewardship approaches. While we utilise the ESG information from multiple external ESG research providers (including MSCI, Sustainalytics, RepRisk, Refinitiv, ISS-Climate and OWL) as useful information and references, we are also aware of certain inherent limitations of such ESG data and scores particularly with regards to the qualitative assessment or the forward-looking aspects of ESG performance at a company (additional explanations on our thinking and on how we use third-party ESG data are also provided in the Chapter 7). We believe the quality of responsible investment and stewardship activities lies in the clearly defined aim to add value, a holistic and integrated approach, as well as professionals with the right expertise required for ESG materiality analysis and in-depth engagement dialogues with companies. Further to our experienced investment

# Chapter 2: Governance, processes and resources

managers and global sector financial analysts, AMO has established a Responsible Investment (RI) Group in 2016, one of the first of its kind among Japanese asset managers. Currently, the RI team has 14 ESG analysts and specialists (as of December 2020) based in Tokyo and London. What has truly differentiated AMO in our resources is that the majority of our dedicated ESG and responsible investment specialists have had decades of extensive investment experience as a former portfolio manager or financial analyst. This not only helps us communicate and work effectively with the investment teams on ESG integration, but also enables AMO to incorporate our ESG analysis and materiality considerations with a holistic view and investment perspectives when engaging with investee companies about their long-term sustainable performance.

Asset Management One carries out engagement and other stewardship activities extensively in Japan with the investee companies. Meanwhile, we have also appointed and work closely with the London-based EOS at Federated Hermes, a

leading stewardship services provider with long-established practices and resources, for AMO's engagement activities globally outside our home market in Japan. We believe this arrangement is highly complementary to AMO's own strength and in-house expertise in Japan, and has reflected our strategic thinking and belief of the importance of collaborating with other investors in tackling sustainability and ESG matters on a global scale.

## **Performance management and incentives to encourage effective stewardship and a long-term focus**

In defining and approaching to sustainable and responsible investment at AMO, we take into account material ESG factors in the process of investment analysis and decision-making. We also actively engage with investee companies to encourage positive changes and achieve impact. Through integrating material ESG considerations and proactive engagement, we aim to achieve the risk-adjusted return objectives for our clients, while at the same time contributing to the

environment, economy and the society.

Given a very wide range of AMO's investment mandates, strategies and styles, we do not impose on a simple or prescriptive set of ESG metrics when assessing related performance of the professionals in their relevant roles. The assessment on materiality of ESG factors and sustainability risks requires in-depth knowledge and qualitative insights of a company, including its business model, competitive positioning, business and operational strategies, capital allocation strategies, management quality and track record, as well as the dynamics of the industry and sector where it operates. Therefore, we believe that the ESG and sustainability considerations need to be implemented effectively using a holistic approach that would fit properly in each fund strategy's investment objectives, philosophy and process, but not as a box-ticking exercise.

Our performance evaluation on investment professionals involved in active strategies is comprised of the performance achievement for

## Chapter 2: Governance, processes and resources

each fund as well as its contributions to the overall organisational objectives. As a firm-wide policy, portfolio managers and financial analysts are expected to integrate material ESG considerations with an aim to achieve their performance objectives over the long term. Furthermore, investment professionals at AMO are also expected to actively participate and contribute in the continuously enhanced efforts and related initiatives across the entire organisation led by the Corporate Sustainability Office. Meanwhile, the ESG analysts and specialists of the Responsible Investment (RI) Group at AMO conduct a large number of stewardship and ESG engagement activities on behalf of our clients with passive investment mandates in the Japanese market. To measure and monitor the progress of each engagement, AMO has developed a proprietary milestones system. The progress of engagement milestones has been used as one of the RI group's evaluation measures. Other KPIs also include their contributions to the intelligent voting activities, ESG thematic research and ESG integration at

AMO, communications with clients and other stakeholders, public policy advocacy and etc.

In order to further promote effective stewardship and the focus on long-term value creation, as well as to enhance ESG integration firm-wide, the tone from the leadership and a strong organisational culture that facilitates continuous development is essential. At the headquarters of AMO in Tokyo, in 2020 we established a Corporate Sustainability Office reporting to the CEO. In accelerating our efforts to tackle key environmental and social challenges, in 2020 AMO also established a sustainability investment team (SIT) in the Equity Investment Division. The SIT is dedicated to conduct comprehensive and thematic research for investment in companies with sustainable growth potentials and providing solutions for material environmental or social issues. We believe such initiatives and enhanced collaborations across the organisation would further enable us to apply our stewardship and sustainability philosophy more effectively in the investment process and daily operations, to achieve long-term performance for

our clients and make solid contributions to the society as a whole. As part of our professional and continuous development, in 2020 we have arranged various training events, including a firm-wide SDGs seminar with an external expert speaker, ESG investment training sessions for new graduate joiners, ESG integration policies and practices for investment professionals, ESG investing seminars for AMO clients facing staffs and etc. On an ad-hoc basis, the Responsible Investment and ESG specialists at AMO also conduct small group meetings with the portfolio managers and analysts to discuss the specific ESG issues and ESG integration matters in relation to their respective investment strategies and portfolios.

# Chapter 3: How we manage conflicts of interest

Asset Management One puts client interests first and always seek to act in the best interests of clients and final beneficiaries, through our stewardship approaches and activities. We have put in place a robust policy and established procedures to identify, prevent and manage conflicts of interest that may arise. Our policy and how we identify and manage conflicts of interest is published and available on AMO's website\*.

AMO's policies aim to cover all potential and perceived conflicts of interest, in particular those that may arise from business relationships and transactions in which AMO, the parents (Mizuho Financial Group or Dai-ichi Life Holdings) or other affiliated group companies are involved. We identify the types of transactions that may lead to conflicts of interest and review them regularly. In the process of conducting stewardship activities, AMO has introduced policies and measures for proxy voting matters in order to protect client interests and benefits. It includes (1) isolating information, (2) restricting personal transfers, and (3) establishing an independent Proxy Voting Advisory Council. Firstly,

we endeavour to isolate information flows regarding proxy voting (between the persons in charge and any other employees or external persons). To effectively implement related policies, AMO also set up an internal control and monitoring system whereby the Compliance Department check and verify the proxy voting results. Secondly, with regard to appointing persons who exercise proxy voting rights, we put a restriction on personnel transfers between Asset Management One and its parent companies. Thirdly, AMO has established a Proxy Voting Advisory Council, of which the majority of members are independent outside directors.

Chaired by the Chief Investment Officer (CIO), the Responsible Investment (RI) Committee was established to oversee the management of conflicts of interest and the implementation of stewardship policies. AMO also has a monitoring process and reporting framework to escalate related matters to the Board of Directors, and to the Audit and Supervisory Committee with a majority of independent directors.

When exercising our voting rights of shares held at the investment funds that AMO invests and manages, we have predetermined and publically disclosed Proxy Voting Guidelines for Japanese and for non-Japanese global equities respectively. With regards to the most important items on proxy agendas that may involve potential conflicts within the parent or group companies, AMO also utilises a third-party proxy provider for voting recommendations. In addition to this, after seeking independent opinions of the Proxy Voting Advisory Council, the Responsible Investment Committee will examine and discuss thoroughly before any voting decisions are made. To further enhance the oversight of managing conflicts of interest, key voting results are reported to the Board and the Audit and Supervisory Committee.

Senior management at AMO believes that putting clients' interest first and gaining trust from our clients is the foundation for a sound and sustainable business as an investment manager, as well as for serving the trust from all other stakeholders.

# Chapter 3: How we manage conflicts of interest

Through implementing an effective governance structure and culture, including oversight of the Board and the Audit and Supervisory committee, alongside the establishment of the Responsible Investment Committee and the Proxy Voting Advisory Council, Asset Management One has been able to operate and perform its stewardship activities independently from the parent and other group companies, and manage any conflicts of interest properly and effectively.

\*Note: AMO's policies of managing conflicts are available at: <http://www.am-one.co.jp/static/mgntcnflctsints.html> (in Japanese); <http://www.am-one.co.jp/english/information/voting/> (English summary for proxy voting activities)

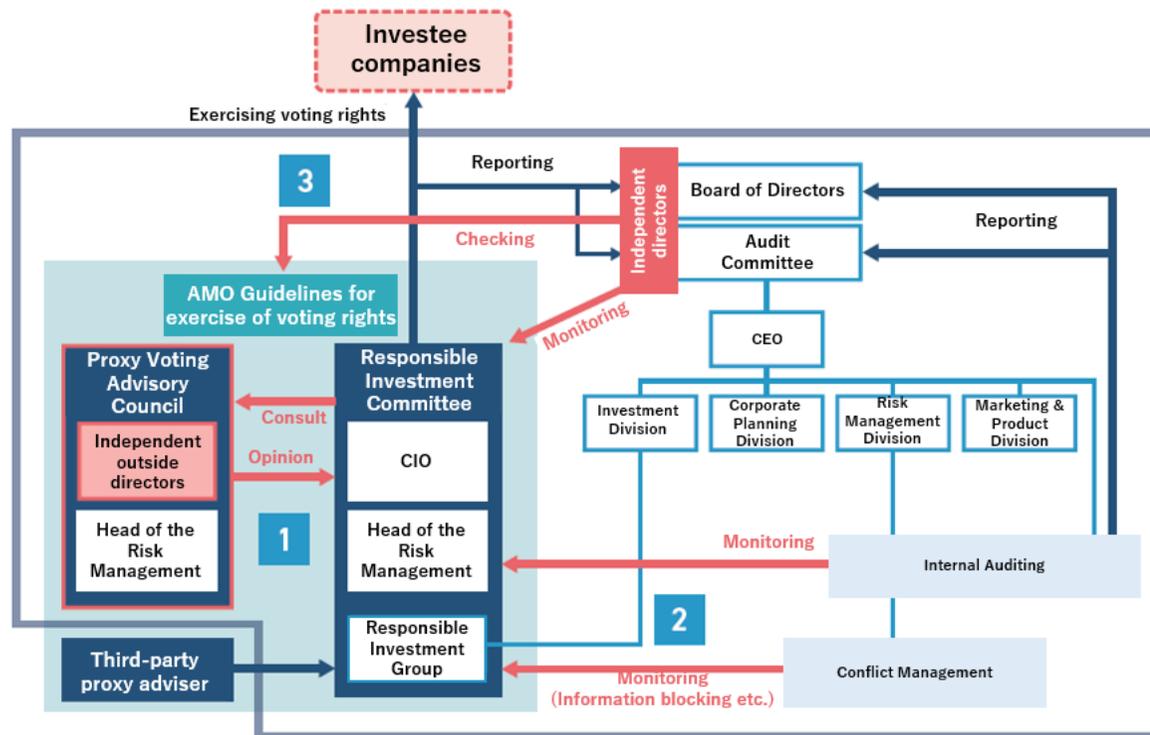
## **Case study: voting at the 2020 AGM of Mizuho Financial Group**

Mizuho Financial Group Inc. is a parent company of Asset Management One. At the latest AGM of Mizuho Financial Group in June 2020, there were

a number of shareholder proposals put forward for shareholder vote. The shareholder resolutions requested amendment of articles to disclose a plan outlining the company's business strategy to align investments with the Paris Agreement goals (Item 5), and to set threshold of at least 1000 letters (instead of the current 400 letters) if the company is to set a letter limit on rationales for shareholder proposals (Item 6). Applying the AMO policies and procedures in place for managing the conflicts of interest, we first sought the voting recommendations by a third-party proxy provider (ISS) on related resolutions at the AGM, and also sought independent opinion of the Proxy Voting Advisory Council (of which the majority members are independent outside directors). This was further followed by thorough discussions at the Responsible Investment Committee. We therefore believed that supporting these two shareholder resolutions would be in the best interest of all shareholders of Mizuho Financial Group. As a result, AMO decided to vote in favour of both of the shareholder proposals (Item 5 & 6) at the 2020 AGM of Mizuho Financial Group.

# Chapter 3: How we manage conflicts of interest

## Managing conflicts of interest at Asset Management One



1

Regarding proxy agendas that involve potential conflicts within the parent or group companies, AMO utilises a third-party proxy provider's recommendations. After seeking independent opinions of the Proxy Voting Advisory Council (of which the majority are independent directors), the Responsible Investment Committee discusses thoroughly before any voting decisions are made.

2

One of the effective measures that AMO has adopted for managing conflicts of interest is to isolate information flows, with regards to proxy voting matters, between the persons in charge of exercising voting rights and other employees. We closely monitor the information flows.

3

AMO publishes its Proxy Voting Guidelines including the criteria for decisions on voting items at shareholder meetings. The Guidelines is reviewed annually. The revisions are reported to the Audit and Supervisory Committee (with the majority of independent directors), and examined at the Responsible Investment Committee.

# Chapter 4: Addressing market-wide and systemic risks

## Climate Change is a priority theme in Asset Management One's investment and stewardship activities

Since 2017 AMO has identified climate change as one of the top priority themes in its stewardship activities. Given the systemic and highly-correlated nature of climate risks, in terms of both physical and transition risks, the challenges are unprecedented and requires a holistic approach to understand and identify a wider range of possible impacts (including the direct and indirect impact). The challenges are multifaceted and are affected by many interacting factors. As climate change can have knock-on effects across sectors and regions, through the inter-connected socioeconomic and financial systems, it also requires alignment and collaboration for solutions. We believe that all actors – the governments, investors, companies, individuals and civil society – have an important role to play in this context. As a leading investment manager in Japan, Asset Management One is strongly committed to being at the forefront of efforts to tackle the severe

climate change challenges.

In our stewardship commitment and approaches, (1) we integrate the materiality considerations for climate change and other ESG factors, from the perspective of both risks and opportunities, into our investment process, and (2) we carry out intensive engagement dialogues with investee companies, to seek a strategic approach to climate risk management and concrete actions on low-carbon transition. In 2020, we have identified six priority ESG themes including climate change (more details are provided in the Chapter 9 of this report, with regards to how we have identified the priority themes). Across these themes, we focus on a total of 23 topics for engagement in relation to strategy and ESG issues, among which there are six environmental related issues including climate change, deforestation, water resource, biodiversity, pollution & waste management, and energy resources. Most of the themes and topics identified are interdependent, reflecting systems thinking which we believe is vital to understanding climate science and addressing climate change.

Furthermore, as part of our stewardship activities, AMO has been actively participating and contributing to various climate-related initiatives in Japan and globally, such as:



We publicly expressed our support to the TCFD (Task Force on Climate-related Financial Disclosures) in March 2019.

As a key member of the Steering Committee of the Japan TCFD Consortium (<https://tcf-consortium.jp/en>), which was established with the initiative of leaders of the industry and the academia, backed by the METI (the Ministry of Economy, Trade and Industry), the FSA (the Financial Services Agency) and the MoE (the Ministry of the Environment) to promote quality disclosures on climate-related information in alignment with the TCFD framework, AMO made a major contribution to the publication of the Guidance for Utilizing Climate-related Information to Promote Green Investment (“Green Investment

Guidance”) by the TCFD Consortium in October 2019.

As of 27 January 2021, over 1,700 companies and institutions globally have expressed their support for the TCFD, including 340 companies and organizations from Japan which represents the highest number of supporters among all countries in the world.



**Climate Action 100+**

AMO is one of the few Japanese asset managers who have signed up for the global investors’ collaborative engagement initiative Climate Action 100+ (<https://www.climateaction100.org/>) since it was launched in December 2017. We have been actively participating and contributing to the group engagement with a selected number of companies in Japan and globally (more details are included in the [Chapter 10 of this report](#), in relation to Principle 10 of the UK Stewardship Code). From 2019, we have further enhanced our efforts in this initiative. Together with an US-based public pension fund, AMO has been co-

leading the CA100+ group’s engagement with a major Japanese automotive company.

### **The Net Zero Asset Managers Initiative**

In December 2020, 30 leading asset managers (representing over US\$9 trillion of assets under management) around the world launched the Net Zero Asset Managers (NZAM) initiative (<https://www.netzeroassetmanagers.org/>). AMO is the only Japanese asset manager who joined this initiative as a founding member of signatories. To address the systemic challenges and risks of climate change, we believe that asset managers should play a key role in the investment chain, in order to achieve the Paris Agreement goals. We therefore have committed to working in collaboration with our asset owner clients, other asset manager signatories and stakeholders towards achieving the net zero goal by 2050.

We will also set an interim target for 2030, to be announced by the COP26 in November 2020, for the proportion of assets to be managed in line with the net-zero goal. Asset Management One

has also been appointed as a member of the NZAM’s Advisory Group.

### **Other policy advocacy activities**

To appropriately assess climate risks and opportunities in investment and capital allocation decisions, good practices in corporate reporting and disclosures is critical. AMO is the first Japanese asset manager who joined the SASB’s (Sustainability Accounting Standards Board) Standard Advisory Group by sector, contributing to standard setting and promoting best practices of sustainability reporting. We have also participated in a number of the UK FRC’s (Financial Reporting Council) Financial Reporting Lab’s projects, such as the Climate-related Corporate Reporting project in 2019, and shared our views for its Climate Thematic Review in 2020. AMO was a member of the Advisory Group for the FRC’s recent project on Future of Corporate Reporting. The London-based Asset Management One International, a fully owned subsidiary of

# Chapter 4: Addressing market-wide and systemic risks

Asset Management One, is a member of the Investment Association (IA) in the UK. Together with other investor members we actively participate in related discussions and engagement at the IA's Sustainability and Responsible Investment Committee and at the Company Reporting and Auditing Group (CRAG).

## **Partnership with EOS at Federated Hermes**

Since 2017 AMO has appointed and partnered with the London-based EOS at Federated Hermes ("EOS") for stewardship and engagement activities in ex-Japan global markets. EOS is a leading stewardship services provider with long-established practices and resources, using a systematic approach to engagement. On behalf of its clients, EOS carries out a substantial number of engagement with companies globally with regards to climate change and other key ESG matters ([https://www.hermes-investment.com/ukw/wp-content/uploads/2020/02/eos-engagement-plan-2020-2022\\_public.pdf](https://www.hermes-investment.com/ukw/wp-content/uploads/2020/02/eos-engagement-plan-2020-2022_public.pdf)). This partnership has also provided Asset Management One with another solid

platform for collective efforts together with other global asset owners and asset managers, to address the systemic and complex challenges of climate change and to make positive impact.

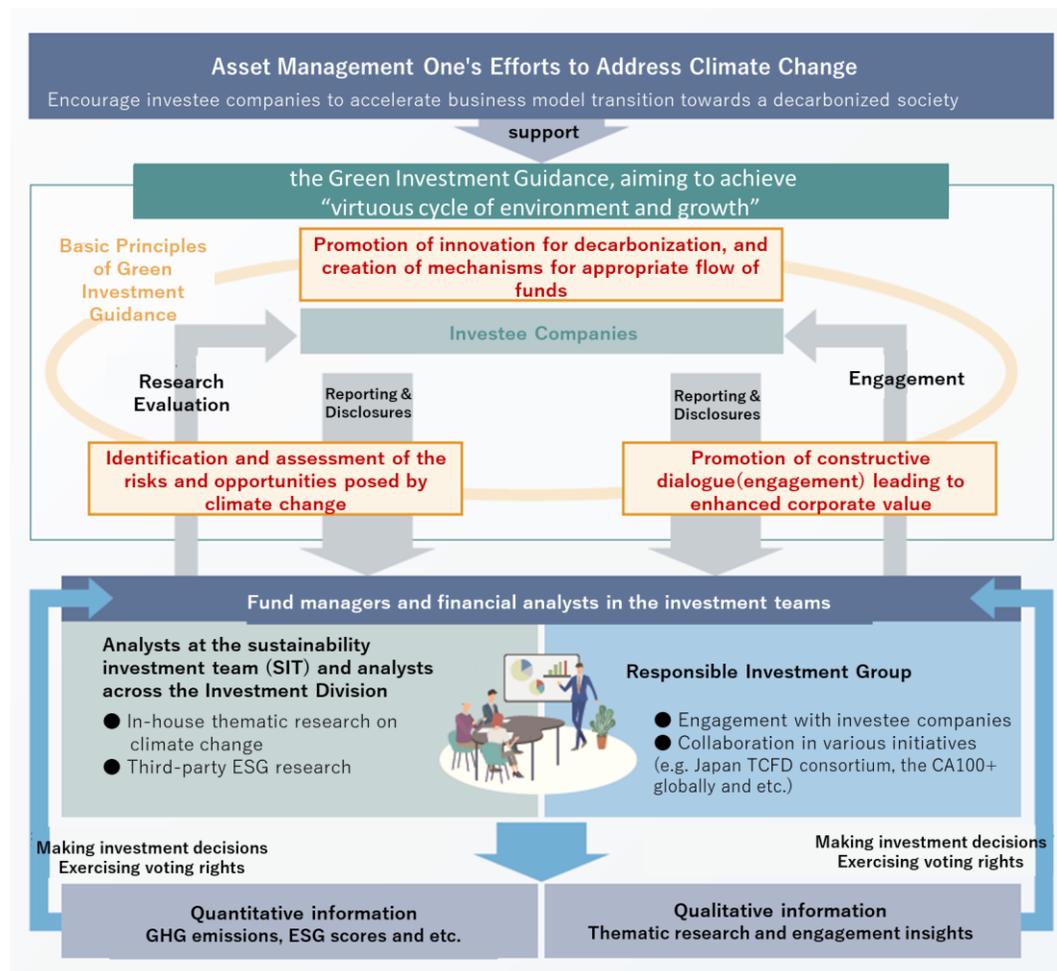
# Chapter 4: Addressing market-wide and systemic risks

## Tackling Climate Change: how we approach at AMO

Asset Management One (AMO) encourages investee companies to accelerate the transition of business models towards a decarbonized society. We support the three basic principles of the Green Investment Guidance, published in October 2019 by the Japan TCFD Consortium, with an aim to promote and achieve a virtuous circle for environment and economic growth. The ESG and responsible investment specialists at AMO, working closely with the Sustainability Investment Team (SIT) as well as other sector analysts and portfolio managers, have carried out a large number of engagement activities with investee companies on their climate change strategies and low-carbon transitions.

As a leading Japanese investment manager, AMO also actively participates and contributes to various climate related initiatives both in Japan and globally, working collaboratively with other investors and stakeholders for solutions to the unprecedented climate challenges.

The analysts at the SIT are specialized in conducting thematic research on climate change, providing in-depth sector analysis of climate-related opportunities and risks. In addition to quantitative information, such as GHG emissions and ESG scores, the comprehensive in-house research capability and insights gained from the active engagement with companies have also been well utilised by the portfolio managers and analysts in the process of investment analysis and decision-making.

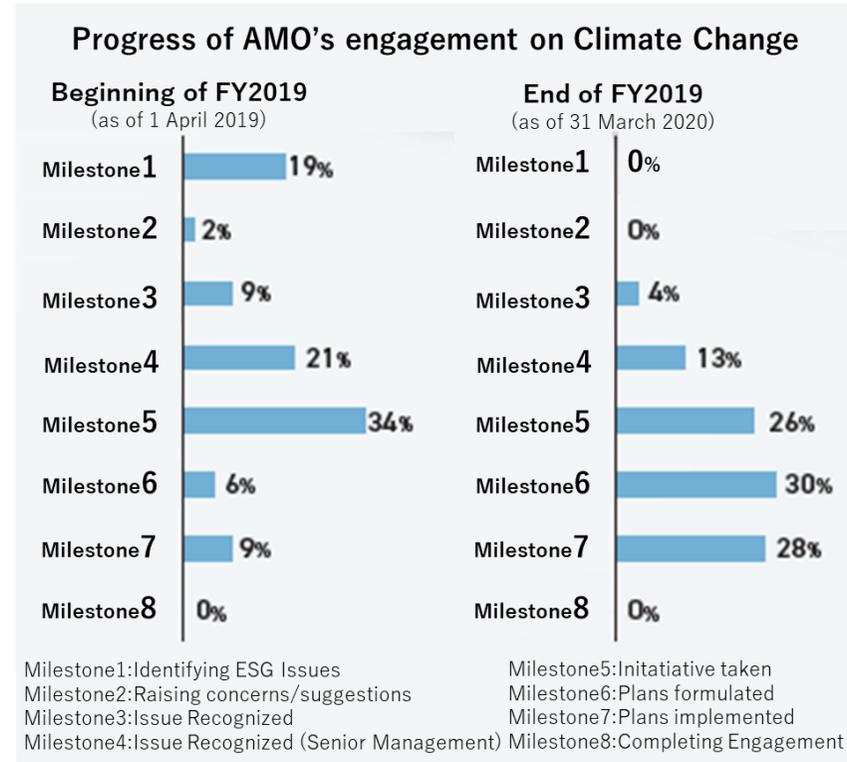


# Chapter 4: Addressing market-wide and systemic risks

## Climate change as a priority theme for engagement

At AMO we have selected climate change as a priority engagement theme since 2017, and have been proactively engaging on this topic with a large number of investee companies in Japan and globally. As shown by the chart of milestones progress, we are pleased that many companies in Japan have steadily moved into a phase of making more concrete plans or implementing the plans set out.

In our engagement dialogues, we are not only seeking the reduction of GHG emissions, but also strongly encourage investee companies to think proactively and strategically about the transitions of their business model to be compatible with the decarbonised society.

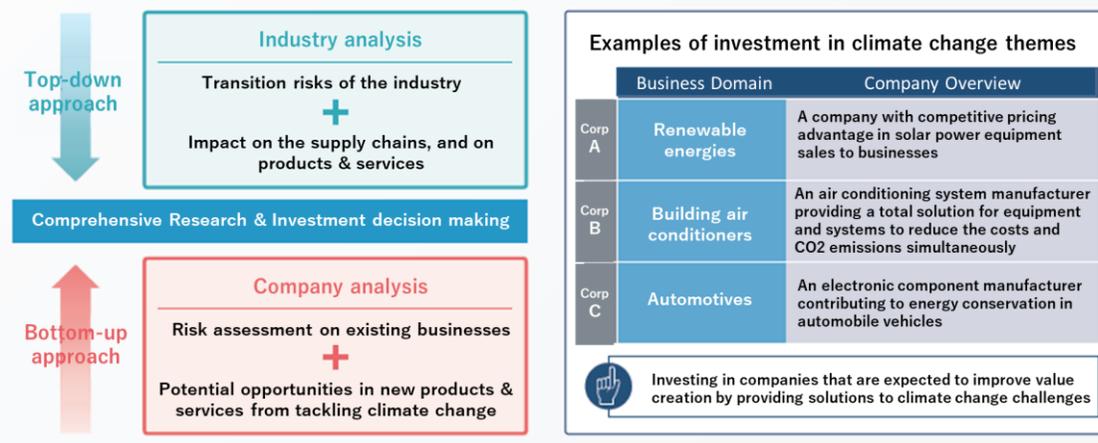


# Chapter 4: Addressing market-wide and systemic risks

## Case Study: Climate change approaches in equity investment

In order to conduct solid analysis and identify the associated risks and opportunities facing companies in relation to climate change, comprehensive researches on each industry and sector, combined with the detailed bottom-up analysis of companies using both quantitative data and qualitative insights to form a holistic and forward-looking view, are essential. At AMO, the analysts of the newly established Sustainability Investment Team (SIT), the sector analysts in equities investment teams and the ESG/responsible investment specialists all work together to tackle the sheer scale of challenges posed by climate change risks and to identify the low-carbon transition pathways, using both top-down and bottom-up approaches for thorough analysis. Such an extensive in-house research capability and expertise underpins our investment decision-making across all active strategies at Asset Management One.

### Two perspectives in investment analysis and decision-making



### The top-down approach to climate change thematic research

Amid the rapid development around the world of recognising and tackling the impact of climate change, such as strengthening the criteria for the SBTs (science-based targets), applying the EU taxonomy and etc., the time horizon for climate related strategies to evidently effect a company's business model is becoming shorter. We analyse not only the direct impact of climate change on an investee company, but also the knock-on

effects on its supply chains, products and services provided.

For instance, upon analysing and forecasting the potential economic impact (including its time horizon) of CO2 emissions reduction from the fossil fuels and the scaling up of carbon removal technologies, we further conduct research on the effect over existing businesses as well as on the demand for new products and services that may help resolve climate change issues.

## **The bottom-up research and engagement by equity analysts**

The equity analysts at AMO evaluate not only the associated risks of each company's existing businesses, but also the potential opportunities in its products and services relating to climate change solutions. In particular, for sectors that are more profoundly affected by climate change (such as the electric power sector and etc.), we carry out a simulation analysis of GHG emissions for Scope 1 to Scope 3 respectively over the long period of time, by taking regulatory policies development into account as well, to assess the significance of risks and potential business opportunities for the sector and for each company operating in the sector. Meanwhile, in collaboration with ESG analysts and specialists, the equity analysts of active investment strategies also proactively engage with investee companies on climate change and capital allocation strategies to realise business opportunities and unlock the upside potentials.

## **Utilization of a wide range of quantitative and qualitative information**

When we evaluate a company's performance and engage on climate related matters, we not only examine the quantitative information that are available, such as its GHG emissions data or ESG scores, but also leverage on a substantial amount of qualitative knowledge we have built up from the company's track record and its narrative reports (including the integrated report) as well as from the insights accumulated in continuous engagement dialogues. We also utilize related ESG information from external providers and research institutes. All information are made available for portfolio managers and analysts at Asset Management One to be able to incorporate material considerations into their investment analysis and decision-making .

# Chapter 4: Addressing market-wide and systemic risks

## Case Study:

### **A joint engagement undertaken by Fixed Income Investment and Responsible Investment teams**

In considering the sustainability of investee companies, addressing material environmental and social issues is a common engagement objective for both bondholders and shareholders. The fixed income investment group and ESG specialists at the responsible investment group are also working together to collaboratively engage on related issues. While an increasing number of green bond issuances comes out in the market, we believe there is still a significant room for improvement at many Japanese companies in setting specific CO2 emissions reduction targets, improving related disclosures and governance practices.

As for an example, in 2020 the two teams have jointly engaged with a company in transportation sector (Company T) which had issued a green

bond for institutional investors for the first time in the sector, planning for using the proceeds to purchase new facilities and invest in solar power facilities to accelerate its efforts to address climate change. While the credit analyst held extensive engagement dialogue with the company about the use of funds raised from this green bond, its financial strategies and cash flows management for repayments, our ESG specialists examined and sought for improvement in the company's corporate governance approaches to sustainability including setting a 2030 target for CO2 emissions reduction and adopting measures

to monitor the progress. As a result, after the green bond was issued in November 2019, we are pleased that Company T has set out its CO2 emissions reduction target and established a new Sustainability Committee, comprised of the CEO and the presidents of the subsidiaries, to further enhance its sustainability strategies and efforts. Meanwhile, with an aim to align the goals across each group companies and to tackle the climate issue systematically, it also launched a new Sustainability Actions Council and established the Sustainability Promotion Department as well.



## Our approaches to the TCFD through stewardship activities

### Governance

- Asset Management One (AMO) has established its responsible investment and stewardship principles, with clearly defined aims and approaches to ESG investment. In line with the principles and objectives, we actively engage with investee companies and integrate material ESG factors into the investment analysis and decision making process. Climate change has been identified as one of AMO's priority ESG themes in stewardship activities and investment considerations, from both risk management and investment opportunity perspectives. We aim at achieving sustainable value creation and risk-adjusted returns over the long term. All our stewardship activities and outcomes are regularly reported to and overseen by the Responsible Investment Committee, the Board and the Audit and Supervisory Committee with

a majority of members being independent outside directors.

- In 2020, AMO newly established a Corporate Sustainability Office reporting directly to the CEO, to further strengthen collaborations across the organisation and to enhance stakeholder communications. We are committed to continuous learning and improvement in our stewardship and investment activities relating to climate change, by working with external experts as well.

### Strategy

- In addition to the physical risks such as natural disasters caused by climate change, we recognise that the transition risks facing companies, due to tightened environmental regulations and structural changes of demand, would have a profound effect on businesses and assets. Meanwhile, we believe there are great opportunities for those companies, that can provide technologies & services to mitigate

climate-related risks or that implement solid climate strategies to proactively tackle climate challenges, would largely benefit from both business operational and the reputational perspectives.

- Through our investment strategies and stewardship activities, AMO aims at playing a leading role in supporting and encouraging companies to accelerate the transition towards a sustainable business model compatible with the low carbon economy. This includes that (1) we are committed to incorporating climate-related factors of material risks and opportunities into the investment process, (2) we actively engage with investee companies to seek better climate-related disclosures and also work with the wider stakeholder groups in public policy advocacy initiatives, and (3) we plan to develop more lineups of climate solutions or other ESG thematic investment products and services for investors.

## Risk Management

- We utilise various sources (including corporate disclosures, ESG scores and information from multiple external providers, our in-house research capacity and expertise, as well as insights from engagement activities) to identify and evaluate climate-related risks of each company, with a focus on the materiality assessment of both physical and transition risks. We also continue engagement dialogues with selected investee companies, using a holistic and forward-looking approach, which we believe is important in effectively identifying, assessing and managing the related risks.
- AMO actively participates in various collaborative initiatives in Japan and globally (such as the Japan TCFD Consortium, Climate Action 100+, and the Net Zero Asset Managers initiative), working together with other investors and stakeholders. As a major Japanese asset manager, we are committed to taking a leadership role in tackling climate

challenges and implementing solutions.

- The investment professionals at AMO utilise quantitative data (such as GHG emissions data, ESG scores and etc.), as well as qualitative information and insights from comprehensive research and engagement activities, for integration of material ESG factors into the investment analysis and decision making process and for exercise of the voting rights. All our stewardship activities (including climate-related activities) are reported to the Responsible Investment Committee at AMO.

## Metrics and Targets

- For both listed equities and fixed income assets managed in-house, we calculate and analyse a number of GHG emissions indicators (including total GHG emissions, weighted-average carbon intensity) as well as other climate-related risk indicators, using the methodologies of external provider (ISS-

Climate). We are continuously monitoring related metrics and indicators, and committed to tackling related climate issues through proactive engagement with investee companies.

## ❖ **Analysis of major climate-related risk Indicators**

The results of climate-related risk indicators, such as the total GHG emissions and the weighted average carbon intensity, are showing that our investment portfolios for both equities and fixed income assets are well positioned to have a lower risk exposure in comparison to their respective benchmarks. Meanwhile, a breakdown of total GHG emissions by industry reveals that the utilities and materials sectors account for a significant amount of the total GHG emissions in all four asset categories. Therefore, we hold more intensive engagement dialogues with relevant companies in these sectors, seeking further enhanced efforts to reduce GHG emissions and to accelerate a shift towards renewable energies.

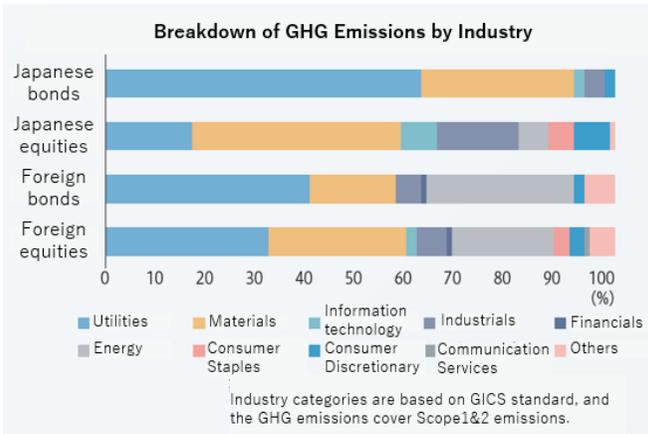
# Chapter 4: Addressing market-wide and systemic risks

## Climate-related risk indicators : AMO portfolios vs Benchmarks

	Total GHG emissions (Scope 1-3t CO2e)		Weighted average carbon intensity (tCO2e/million U.S. dollars)	
	AMO	BM ratio	AMO	BM ratio
Japanese bonds	9.6	75%	377.8	73%
Japanese equities	53.0	92%	91.3	97%
Foreign bonds	1.6	93%	220.6	92%
Foreign equities	9.0	64%	157.7	78%

### Benchmark(BM)

Japanese bonds : corporate bond composites only within NOMURA-BPI (all composites)  
 Japanese equities : TOPIX(total return)  
 Foreign(ex-Japan) bonds : corporate bond composites only within Bloomberg Barclays Global (all composite)  
 Foreign(ex-Japan)equities : MSCI-KOKUSAI(JPY-dominated)

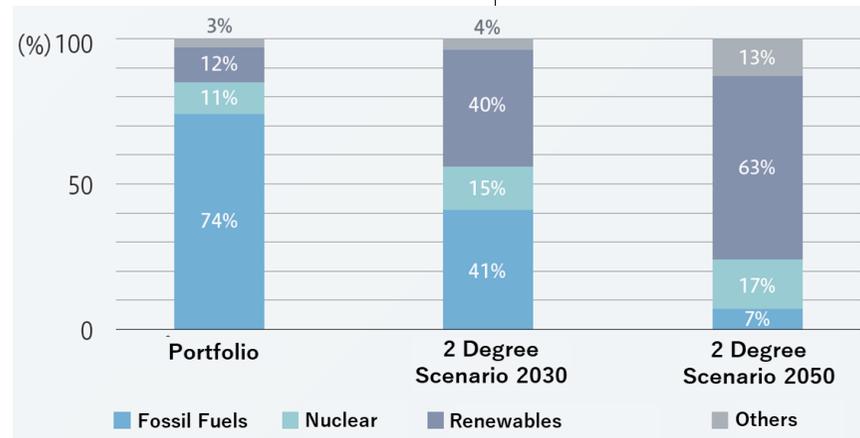


## ❖ Climate change related risks

Using a bottom-up approach, the research analysts at AMO assess the materiality and significance of physical risks caused by extreme weather events and etc. on investee companies.

With regards to the transition risks, in order to analyse and estimate the potential future costs to be incurred by energy transformation or other factors, we have made a comparison of the energy mix between a hypothetical investment portfolio at AMO (by aggregating all four asset

categories - Japanese bonds, Japanese equities, foreign bonds and foreign equities – that are currently managed in-house) and the targets under the IEA's 2 Degree Scenario for 2030 and 2050 respectively. As shown in the graph, the results indicated that the current portfolio exposure still presents a relatively high weight in fossil fuels. Therefore, we plan to further enhance and accelerate our efforts to promote and engage on the proliferation of renewable energies.



## ❖ Scenario analysis of transition pathways

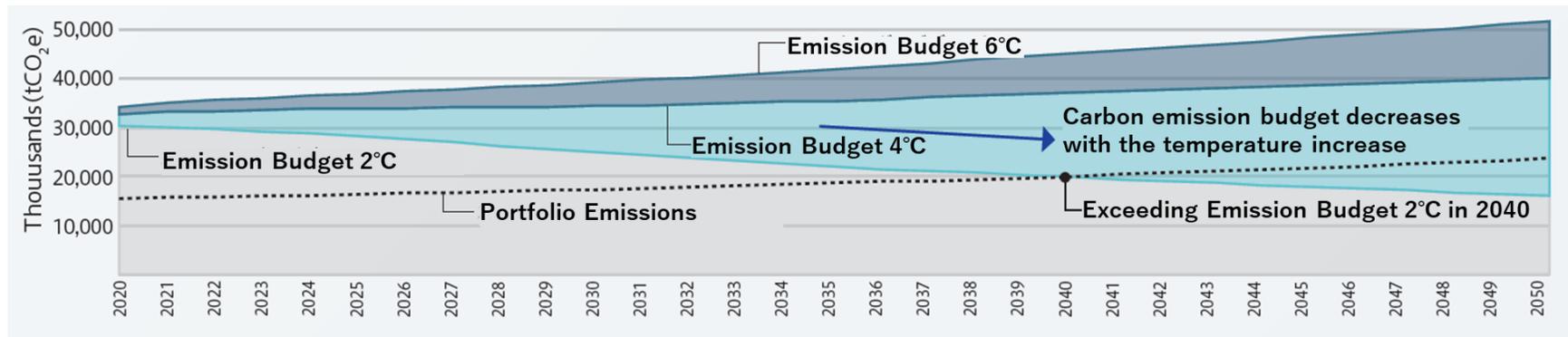
Using the ISS-Climate methodologies, we generated a forecast for the investment portfolio's total GHG emissions (Scope1) through 2050. We then compared it with the respective carbon budgets (GHG emission allowances) under the three temperature scenarios in the IEA's report for the 6° C, 4° C and 2° C increase respectively.

The results indicated that the current GHG emissions of our hypothetical (aggregated) portfolio has appeared to be lower than the carbon budget for any of the IEA scenarios.

However, given the emission allowances would decrease as the temperature rises, the portfolio's

carbon emissions would likely exceed the carbon budget limit set under the 2° C scenario of Paris Agreement by 2040. As such, we are very much committed to continuously reducing the GHG emissions in our portfolios through active engagement with investee companies.

Portfolio Emission Pathway vs. Climate Scenarios



## Our responses to Covid-19\*

The Covid-19 pandemic has had a significantly adverse effect on public health and the economy in Japan as well as other countries. Pandemics also show a systemic attribute, in that the direct manifestations and knock-on effects spread fast across an interconnected world. In this regard, we are also facing unprecedented challenges for transforming into a new society brought on by this pandemic. To respond to such unparalleled uncertainties and challenges associated with the pandemic, AMO announced its stewardship philosophy and activity plans in early May 2020 ([http://www.amo.co.jp/pdf/news/210/20200508\\_pv\\_J.pdf](http://www.amo.co.jp/pdf/news/210/20200508_pv_J.pdf)).

It also clarified and confirmed our stewardship commitment from a medium- to long-term perspective, to fulfilling our responsibilities as a leading asset manager in Japan. As imminent actions, we have been proactively engaging with investee companies to identify the impact of Covid-19 and encourage companies to operate

with careful and thorough considerations for various stakeholders including their customers, employees and the wider society. We took a step to implement the AMO Voting Guidelines more pragmatically, especially for the related AGM agenda on capital allocation or election of directors (which in normal circumstances are subject to certain quantitative performance criteria for a supporting vote), with an aim to support investee companies' financial health and solvency towards recovery from this pandemic. As such, engagement dialogues about assessing and mitigating risks and considered voting rights exercise have been a primary focus at our immediate actions in response to the Covid-19 crisis in the year of 2020.

Meanwhile, it is also increasingly important for us to share longer term expectations and step up our efforts in addressing other key environmental and social challenges, by engaging with investee companies for solutions and transitions towards a more resilient business model and sustainable society. For instance, building a resilient supply

### Responses to the crisis and recovery from Covid-19

- Impact assessment on short-term performance
- Engagement on considerations for employees' health & safety, customers, suppliers and local communities in companies' capital allocation and business decisions

### Medium to long term strategies beyond the crisis

- Turning the current challenging environment into opportunities for enhanced sustainability and resilience, through engagement on key ESG topics

#### Environment

- 1 Climate Change
- 2 Circular Economy

#### Social

- 3 Human Capital Management
- 4 Digital Transformation(DX)
- 5 Supply Chain Management
- 6 Regional Development in Japan

#### Governance

- 7 Capital Allocation
- 8 Effectiveness of the Board
- 9 Risk Management

## Chapter 4: Addressing market-wide and systemic risks

chain, reforming towards more diversified and flexible work styles, and constructing robust IT systems to enable such transformations are key priorities facing many Japanese companies. This is becoming more pressing than ever during this Covid-19 period and beyond, in an aging society with the accelerating decline of Japan's population. In addition to the five priority ESG themes that we had identified and selected in the previous years (including Climate Change, Human Capital Management, Regional Revitalization, Supply Chain Management, and Circular Economy), in 2020 we also added Digital Transformation (DX) as a new priority theme in our AMO stewardship and engagement activities. In our published document of AMO stewardship approaches in relation to the Covid-19, we also set our expectations for three key areas of corporate governance practices in the continuous dialogues with companies, including capital allocation, board effectiveness and leadership, and risk management.

# Chapter 5: Review of policies and processes

As a long-term investor, it is Asset Management One (AMO)'s belief that sustainability and ESG performance of investee companies are a critical factor for consideration in the process of our investment analysis and decision making. Among a broad range of sustainable and responsible investment strategies and approaches, we believe that (1) ESG materiality analysis and sustainability considerations in the investment process and (2) quality of active ownership activities (voting and engagement) to bring positive changes are two key cornerstones to good stewardship responsibilities.

The importance of material ESG considerations and active engagement is about investment and long-term value creation. AMO approaches to ESG factors as an enhanced analysis of companies, on top of conventional financial analysis and evaluation, to better understand companies' risk and return profiles and their long-term financial performance prospects. From the investment perspectives, whilst ESG overviews of a country or a specific industry provide helpful

information on key material factors to some extent, we are much committed to adding value through a bottom-up approach, utilising extensive analysis and in-depth understanding of company-specific ESG performance including their direction of travel. Active ownership activities, through voting and engagement with management and the board of investee companies, have enabled us to exercise shareholder rights responsibly and appropriately on behalf of our clients. This also allows us to better understand the leadership quality of a company, as well as the effectiveness of its implementation of ESG policies and real performance in sustainable value creation.

As detailed in the Chapter 2 of this report with regards to the stewardship governance and processes at AMO, the overall ESG investment and stewardship policies and activities are overseen by the Responsible Investment Committee (chaired by the CIO), reporting to the Board of Directors and to the board's Audit and Supervisory Committee (with a majority of members are independent outside directors). The

Responsible Investment (RI) Committee meets on a quarterly basis. The review of stewardship policies and processes is being undertaken periodically. Following the Japanese Stewardship Code recommendations, AMO also carries out an annual self-assessment on our stewardship policies and activities, and the results are published each year. For a summary of our latest assessment: [http://www.am-one.co.jp/img/company/36/20190528\\_stewardship\\_summary.pdf](http://www.am-one.co.jp/img/company/36/20190528_stewardship_summary.pdf). And for the detailed results of this stewardship assessment: [http://www.am-one.co.jp/img/company/36/20190528\\_stewardship\\_details.pdf](http://www.am-one.co.jp/img/company/36/20190528_stewardship_details.pdf).

As for a case study of our reviewing process and commitment to continuous improvement, in the Chapter 9 of this report, we present a chart which illustrate AMO's basis policies and the process of engagement approaches using the framework of PDCA (Plan-Do-Check-Action) Cycle. We also apply this PDCA thinking in our approach to the self-assessment of stewardship policies and activities.

## **Case Study: using the PDCA Cycle to support continuous improvement**

AMO offers a wide range of strategies including both active and passive mandates of Japanese equities. We are strongly committed to our stewardship responsibilities and accountability for all assets entrusted by clients and beneficiaries. Engagement is intended to put our stewardship role into effect, with an aim to achieve the risk-adjusted returns in the investments, through encouraging and helping investee companies to deliver sustainable growth and value creation.

### **Plan:**

- For FY2020 (starting from 1 April 2020), we have identified six priority ESG themes and a total of 23 engagement issues.
- We reviewed and selected priority engagement companies for both active and passive investment strategies, respectively.
- We established an engagement plan for each

year at the beginning of the fiscal year, following the check and review of the Responsible Investment Committee.

### **Do:**

- We engage with investee companies, including dialogues with a wider range of companies beyond the list our priority targets.
- We are invited to present to the company management or the boards, with a proprietary material of our company-specific analysis.
- We proactively participate and contribute to policy related discussions and initiatives, working closely with other stakeholders.

### **Check:**

- We adopt a proprietary eight-milestone system to monitor and measure engagement progress and outcomes.
- We collaborate between different teams at

AMO to share information and to discuss engagement matters regularly.

- All engagement activities are reported to and discussed at the Responsible Investment Committee quarterly meetings. Activities are also reported to the Board regularly.

### **Act:**

- We seek views and suggestions for continuous improvement in stewardship, from both the internal and external stakeholders.
- We exercise voting rights intelligently to reflect the progress and the forward-looking views through our engagement.
- The key points identified in our self-assessment each year are to be addressed in the planning process for the following fiscal year.

# Chapter 5: Review of policies and processes

## Results from external evaluation

### 1. The survey among Japanese companies

The results of a survey with Japanese companies\*, published in June 2020, with regards to the stewardship activities by investment managers,

showed that Asset Management One (AMO) is highly recognised and valued by its stewardship approaches and activities. The survey had 15 assessment items, out of which AMO were ranked as the top manager at 14 items. In addition to the top position of overall activities, the areas where we have gained a particularly high recognition include: (1) making thorough preparations for dialogue, (2) identifying and sharing key issues, (3) carrying out dialogues with various divisions of the company, and (4) providing helpful feedbacks and follow-ups. These results have provided us with an assurance about the quality and effectiveness of our stewardship approaches and activities.

\*Note: the survey was conducted by Mizuho Research

Institute with listed companies of the 1<sup>st</sup> Section of Tokyo Stock Exchange. 177 companies responded to the survey, which required companies to list the top three investment managers for each assessment items. There are a total of 117 investment management firms (including both Japanese and overseas firms) which were on the list for evaluation by the companies. The full survey results and report are available at: [https://www.mizuho-ri.co.jp/publication/sl\\_info/pension/pdf/pension\\_news202006.pdf](https://www.mizuho-ri.co.jp/publication/sl_info/pension/pdf/pension_news202006.pdf)

### 2. The 2020 PRI assessment

Signatories of the UN PRI (Principles for Responsible Investment) report on their policies, activities and approaches to responsible investment each year. The PRI reviews and assesses each organisation's credentials both on an individual and on a peer comparison basis to give an official PRI rating for each module for the year. As a signatory of the UNPRI, we are strongly committed to embedding the PRI's six principles in our investment process and stewardship activities. As indicated by the table of PRI scorecard summary, in 2020 Asset Management One received the highest A+ rating for all

modules (i.e. direct investment managed in-house) including Strategy & Governance, and Active Ownership. From the previous year of 2019, we have made a good progress in assessment modules for the fixed income investment.

PRI Scorecard Summary

	2020
<b>Strategy &amp; Governance</b>	A+
<b>Listed Equity - Incorporation</b>	A+
Screening	A+
Integration	A+
<b>Listed Equity - Active Ownership</b>	A+
Engagement	A+
Proxy voting	A+
<b>Fixed Income – SSA (sovereign, supranational, agency)</b>	A+
<b>Fixed Income – Corporate Financial</b>	A+
<b>Fixed Income – Corporate Non Financial</b>	A+
<b>Fixed Income – Securitised</b>	A+

# Chapter 6: Stewardship reporting and communications

AMO believes transparency and being accountable to clients and beneficiaries is of great importance in discharging our stewardship responsibilities and carrying out responsible investment activities. Meanwhile, we are also conscious that there are occasions when publicly disclosing all details of our activities, especially with regards to the cases of ongoing engagement with individual companies, can be counterproductive to achieving the aimed objectives.

We provide periodic reports, quarterly and annually, to institutional clients with detailed investment performance and stewardship activities. We also meet with major clients to update and explain our thoughts, approaches and activities on a yearly basis or at a frequency of their choice. In our passive investment mandate for Japanese equities, aiming at both quantity and quality of our engagement activities, AMO adopts a “milestones” approach to setting engagement objectives as well as tracking the progress and outcomes which are also reported to our clients.

At Asset Management One, the approaches to ESG integration and materiality considerations for sustainability and long-term performance are implemented to reflect and align with each active strategy’s investment objectives and process. The overall activities and performance of each strategy are being reviewed and reported to the clients regularly. In addition, we respond to the due diligence and ad-hoc inquiries from clients on our stewardship and responsible investment activities. Considering the ever changing and evolving nature in ESG related areas, the access to our ESG analysts and specialists at AMO is also made available if the clients require a further in-depth discussion on particular topics or issues. Given the growing interest of Japanese institutional clients and investors in sustainability and the latest ESG development globally, we also speak at various seminars or webinars and publish thought leadership papers or newsletters to share our knowledge and insights of related topics.

For continuous improvement, we believe that a

two way communication is important. We therefore also consult among clients to seek their views, so as to better understand their expectations and needs, and to ensure that the assets are well managed in alignment with their goals and inspirations. Furthermore, in our annual review of AMO policies, processes and the criteria for identifying and selecting key ESG themes and issues, we are also taking into consideration the views and expectations of our clients and beneficiaries.

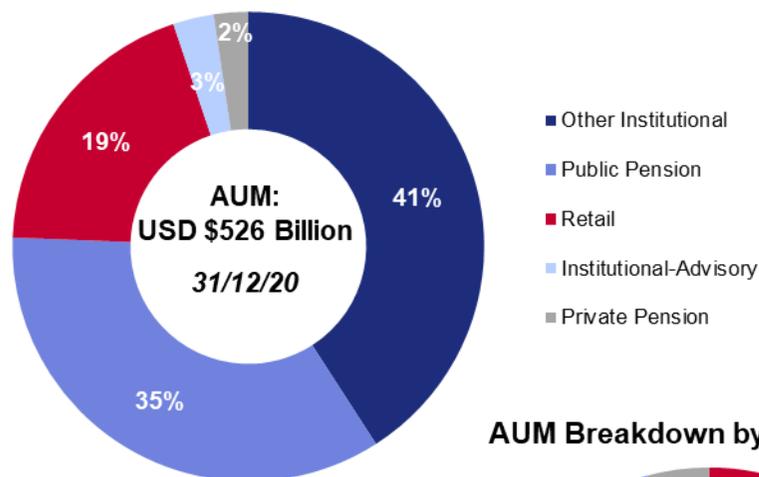
In a broader approach and effort, Asset Management One is one of the Steering Committee members of the Japan Stewardship Initiative (JSI), launched in late November 2019. Through this initiative and platform, we are taking a leadership role in encouraging continuous dialogues across the investment chain, promoting best practices of stewardship and improving related communications. The JSI also provides us with a helpful and supporting platform to work together and exchange views with asset owners.

# Chapter 6: Stewardship reporting and communications

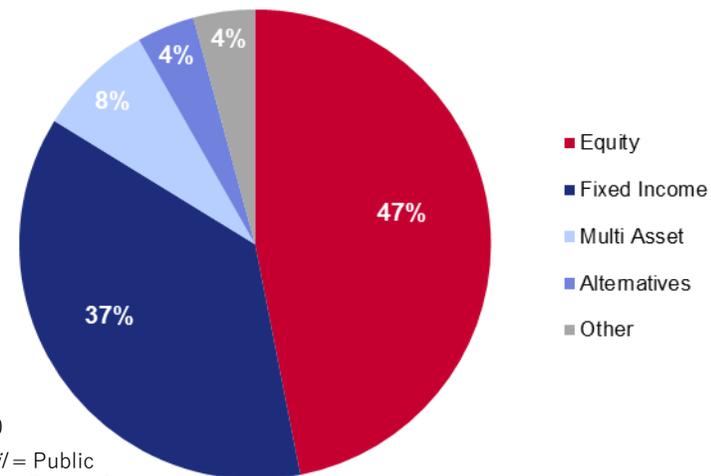
We look to continuously enhance our efforts to be transparent and accountable to our clients and beneficiaries, and in the public arena when appropriate. In addition to our reporting and accountability to clients, we have also responded to surveys and questionnaires conducted by various stakeholder groups or organizations, with regards to our sustainable and responsible investment activities.

The newly established Corporate Sustainability Office at Asset Management One in April 2020 is also committed to further enhancing transparency and our external communications with other stakeholders and the wider society.

**Total AUM by Investor Type**



**AUM Breakdown by Asset Class**



Source: Asset Management One Co., Ltd. as at 31 December 2020

Note: Chart shows breakdown of total AUM by investor type *Retail* = Public Investment Trusts; *Other Institutional* = Non-Japanese, Institutional Pooled & Other

# Chapter 7: Our approach to ESG integration

## ESG integration at AMO

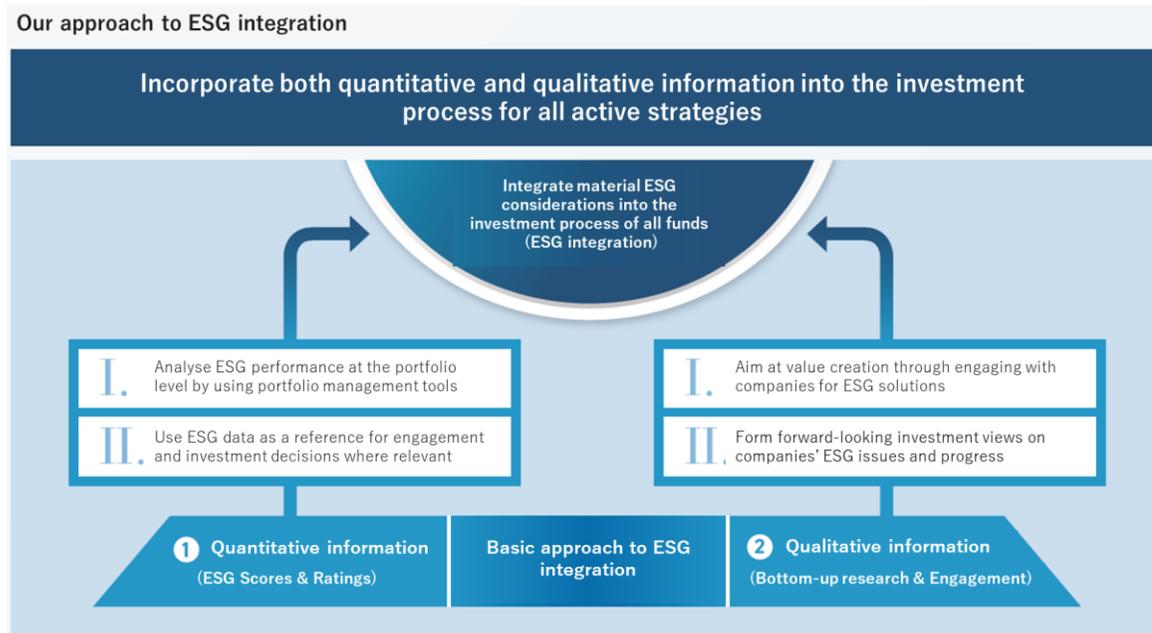
It is critical for investment management companies to grasp the big picture of economic development and social changes in the future, and meanwhile, to form an in-depth understanding of our portfolio companies and

investment targets in accordance with each investment strategy. We believe companies that are able to create value for a sustainable and inclusive society would strive to succeed and grow over time. Therefore, it is increasingly important for companies to manage ESG issues effectively. As a long-term investor, we regard

integrating material ESG considerations as an essential part of our investment analysis and decision-making process.

In order to evaluate the efforts that companies make to achieve sustainability and to carry out the assessment across a wide range of asset classes, it is crucial for us to adopt a systematic and holistic approach to analysing the ESG performance of investee companies.

We have developed a proprietary database and system, using a variety of external providers' ESG scores and rating information. In addition to such a quantitative framework, we believe that the qualitative knowledge and insights based on in-depth understanding of companies and a bottom-up analysis of company-specific materiality issues is essential in achieving the objectives and risk-adjusted returns aimed for each investment strategy. Therefore, our ESG analysts, equity analysts and fixed income analysts all carry out required materiality assessment for individual



# Chapter 7: Our approach to ESG integration

companies and for investment strategies from their respective perspectives. Consequently, at AMO we adopt a holistic approach to ESG integrations, taking into account both quantitative information (such as ESG scores and ratings) and qualitative insights (also through proactive engagement with investee companies) into the investment process of all investment strategies. When we integrate material ESG considerations, we focus not only on the downside ESG risks of companies, but also on upside potentials of their business opportunities.

## ESG integration across asset classes

In April 2020, we established a Sustainability Investment Team (SIT) at the Equity Investment Division, with the aim of further strengthening our proprietary research and investment capacity for thematic topics and companies which have the significant potential for leading the transformation towards a more sustainable and inclusive society. This is another new initiative at AMO to continuously enhance our ESG investment capabilities in active investment, in pursuit of

sustainable value creation and to achieve solid long-term performance for our clients and beneficiaries.

The ESG integration and considerations in the investment process at AMO apply for all investment funds and asset classes, including fixed income investment strategies, not least public equities that we manage in-house. Meanwhile, we are also expanding our approaches of applying ESG integration and sustainability considerations to the areas of alternative investments, and to the indirect investments (which are managed externally), by assessing and monitoring the funds' ESG performance in the process of due diligence and at regular assessment afterwards.

A couple of case studies that explain the interactions and demonstrate the value of collaborations between the different teams at AMO are provided in the [Chapter 4](#) and [Chapter 9](#) of this report.

## The ESG approach at listed equities

- ***ESG as enhanced analysis of growth potentials and valuation***

As an active equity funds manager, we take into account ESG factors mainly in two aspects of investment analysis. Firstly, we consider the ESG impact on growth potentials. Despite the expansive monetary policies have been undertaken by the central banks globally over an extended period of time, it appeared to have had little impact on the growth of aggregate demand. The economic system and society is seeking innovation and new business models, in order to solve various key challenges. This has become even more evident in the midst of Covid-19 pandemic times. Therefore, we believe that the perspectives and analysis of ESG issues and the UN SDGs play a critical role in achieving the economic growth potentials as well.

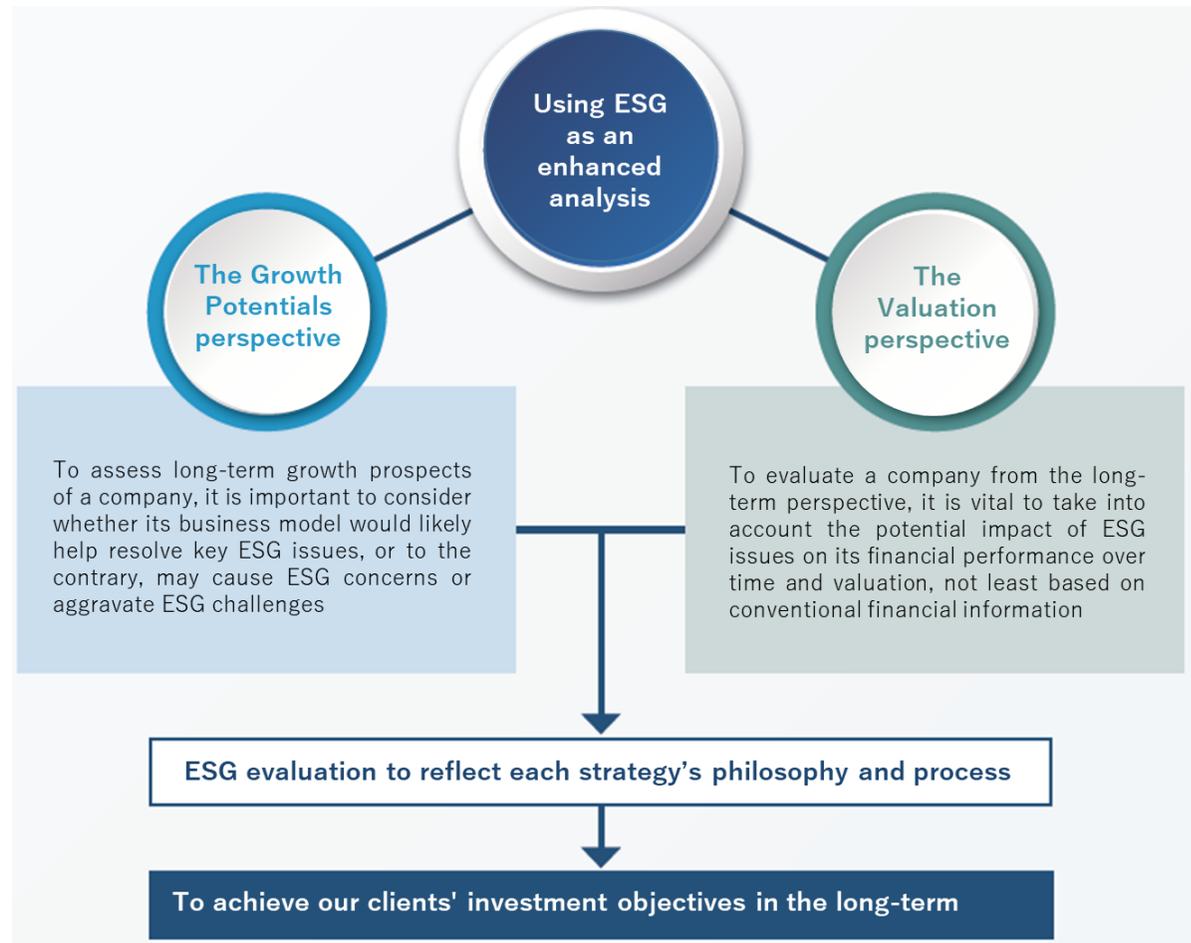
Secondly, we consider the ESG factors from the valuation perspective. Climate change and other environmental challenges (natural resources,

# Chapter 7: Our approach to ESG integration

waste and etc.), and the social problems such as inequality that have been further unveiled during this pandemic, are becoming more imminent issues to tackle. Such themes and issues also underscore the importance of ESG risk analysis and risk management. The potential and high risks from key ESG factors would likely result in a higher risk premium, and therefore have a negative impact on a company's valuation over the medium to long term.

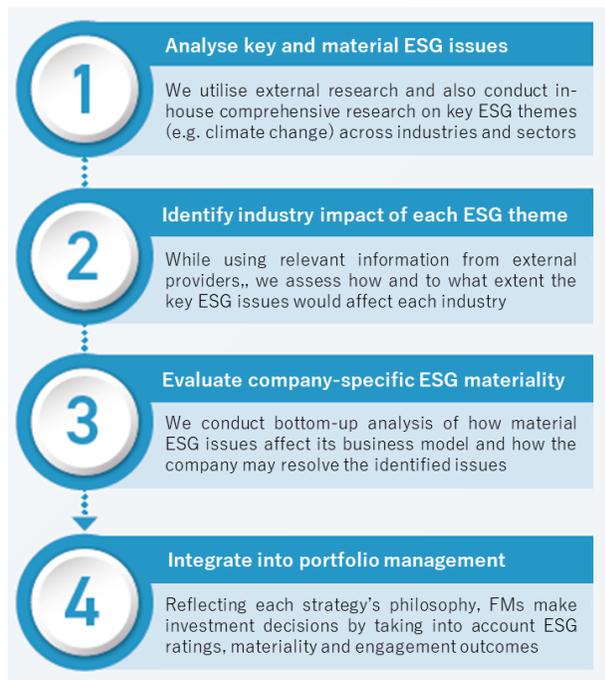
In light of each company's ESG performance and risk management, we have developed proprietary methodologies to evaluate companies' ESG materiality and growth potentials, which are factored into our company analysis and valuation models of active equity strategies.

## ESG Integration at listed equities



# Chapter 7: Our approach to ESG integration

- ***Incorporating ESG into the equity investment decision-making process***



In general, ESG assessment tends to be linked with business risks surrounding ESG issues. At AMO we think the business models that help to

resolve key ESG challenges will likely offer great opportunities for a steady growth in the future. Therefore, in our analysis for active equity strategies, we focus more on the upside potentials from the business opportunities perspective, not least on the downside risks.

When carrying out ESG analysis, we need to identify material ESG issues relating to a specific company's business model and to the sector where it operates. For instance, while the materiality of climate change is a dominant issue for automobile manufacturers, human capital management can be more critical to convenience stores or other franchise chains. Some ESG issues such as climate change, social inequality and waste management are often relevant across different industries. In collaboration with external think tanks, ESG analysts and equity analysts at AMO work together to conduct research about the current circumstances, prospects and possible solutions for key ESG issues across industries and sectors. Although the key ESG factors may affect a variety of sectors, the

magnitude of the impact and the time horizon varies. For example, the electric power sector is considering phasing out coal-fired power plants with low-efficiency by 2030 to tackle climate change. On the other hand, the automobile industry companies need to urgently and strategically respond to regulatory changes, given the EU regulations on CO2 emissions have been tightened from 2020 and are expected to be further strengthened in the future.

AMO has one of the largest investment research resources among Japanese asset managers, comprised of experienced equity analysts and ESG analysts, which represents our strength in active strategies. In addition to analysing company businesses including their competitive positioning and challenges facing, our analysts and portfolio managers also meet and actively engage with management and board directors of companies to bring out meaningful changes and real solutions for company-specific ESG issues. We believe that a bottom-up approach is important in this regard, by taking into

# Chapter 7: Our approach to ESG integration

considerations the individual company's circumstances and the industry dynamics, when analyzing and engaging with companies on tackling material ESG issues and achieving sustained profits and growth.

## ESG integration in credit analysis and fixed income investment

As a responsible steward for our clients' assets, we are also committed to solid ESG analysis and materiality considerations in the process of fixed income investments. We have adopted a well-defined and systematic approach to credit analysis of company issuers, incorporating a bottom-up ESG assessment combined with proactive engagement activities.

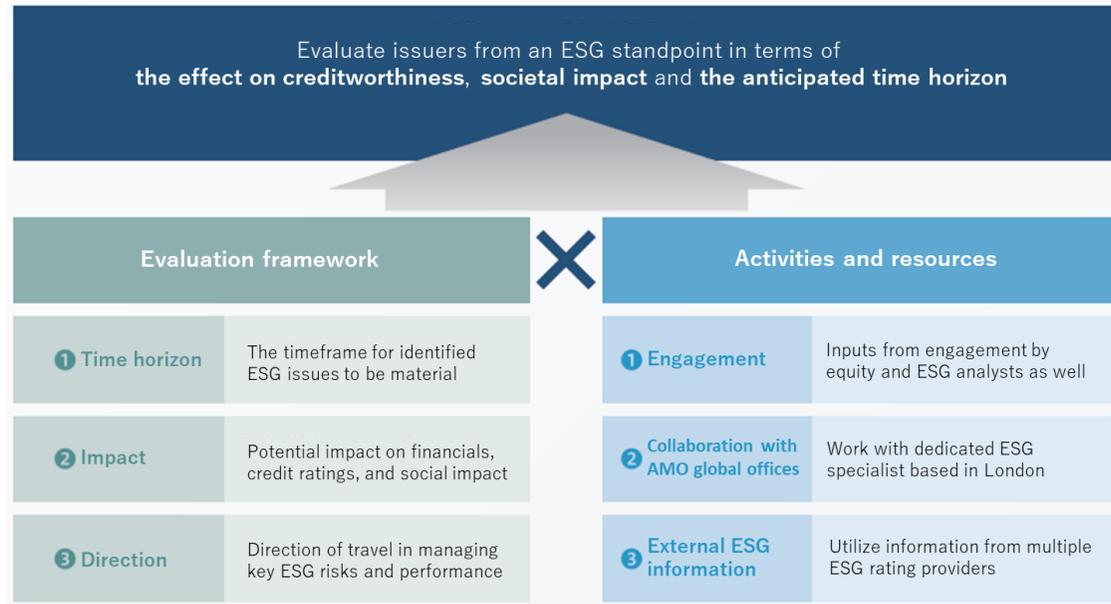
Our strong capability in credit analysis in Japan, undertaken by long experienced credit analysts, provides AMO with a unique competitive advantage. The credit analysis is supported by our extensive qualitative insights of non-financial factors through frequent communications and

active engagement with issuers, in addition to the quantitative financial indicators.

We do not regard or evaluate ESG factors as

a box-ticking exercise in our investment process. Instead of mechanically excluding companies from the investment universe only for a low ESG

### ESG integration using a proprietary analysis framework and focusing on impact on issuers' creditworthiness



score, we adopt a holistic approach in our decision-making process for the respective funds, paying attention to and analysing the ESG impact on B/S forecasts and financial stability that may affect the issuer's credit. For example, in cases where the credit spread of a company has excessively widened due to some scandal or wrongful incident, however, by thoroughly analysing the company from the credit perspective on its remedial response and measures, if we think the credit spread would likely reverse to be tightening, we would regard the case as an opportunity for positive changes at the company and for upside investment returns. Therefore, we believe that the "direction" assessment in our credit analysis framework is an important step in understanding a company's direction of travel and forming a forward-looking view for the ESG integration approach at our fixed income investment strategies.

## Case Study:

### **ESG integration in fixed income strategies**

As for ESG evaluation in corporate bonds, corporate governance is often regarded as the most important factor to consider. However, we believe that key environmental and social issues will also likely have significant effect on a company's business sustainability and on stability of its future cash flows, especially given the increasing awareness of related risks in society.

#### ***- A retail company in Japan -***

On the back of labor shortages and wage increases in Japan, there is a growing concern that some franchise businesses may have health and safety issues at work, potentially abusing their superior market position. However, we think the business model in retail businesses would likely change and this current situation may pose significant risks and negative impact on the

company's profitability over the time.

As retail businesses are an indispensable part of people's daily life in the supply chain of consumer goods, it may take a while for such ESG related risks to become material to the relevant company's financial performance (which is shown in our assessment on "time horizon" under the ESG analysis framework). However, given the trend of a declining population, aging business owners, and the intensified competition from new entrants or online retailers, we think this identified issue relating to labour standards and health & safety will expose the company to substantial business risks over the medium term, which has been reflected in the "direction" assessment of our ESG analysis.

## ESG initiatives in indirect investment

The Multi-Manager Investment Group of the Strategic Investment Division and our subsidiary, Asset Management One Alternative Investments (AMOAI), have enhanced our approaches to ESG integration into the areas of indirect investments. From the viewpoint of CSR, we are focused on launching ESG's strategies which are managed externally. In addition, our monitoring process for external managers takes into account the ESG perspectives.

### 1) Incorporating ESG considerations into the selection and evaluation process

When we select new external managers, and monitor the existing strategies, we make it a rule to research their approaches to ESG & responsible investment by reviewing their policies and actions including voting activities. Those approaches are integral parts of our selection and evaluation. For some products, we meet the external managers in person to know the details of their approaches to stewardship.

## 2) Strengthening ESG initiatives in the indirect investment areas

### A) Expansion of externally managed ESG related products

- In 2020, we launched, for retail investors, an equity strategy managed by external managers who weigh ESG during the investment process, following the same kind of products for institutional investors.
- We will continue to expand the range of the ESG's strategies in order to meet growing demands among the retail investors.

### B) Evaluation of external managers and strategies

- As shown in the chart, we have improved the list of evaluation criteria. To evaluate from the perspective of ESG and responsible investment, we monitor stewardship policies, approaches to ESG & responsible investment by external managers, and disclosures. We will also encourage continuous improvement in their

approaches through proactive communication with the external managers.

#### Evaluation of external managers and funds

##### Evaluation of external managers

We have expanded the list of evaluation criteria for ESG and responsible investment, to include monitoring the following items and evaluating the degree of improvement

- Stewardship policies and resources
- Outcomes
- Activities and initiatives undertaken
- Disclosures

##### Dialogues with external managers

We discuss with external managers to encourage continuous enhancement of their approaches and activities

### 3) ESG is a key and an integral part of assessment process in the alternative investments.

We have also started incorporating ESG considerations into our assessment process for selecting new investment funds and monitoring existing portfolios in the area of alternative investment, such as private equities, private debts, real estates, infrastructure, hedge funds and etc.

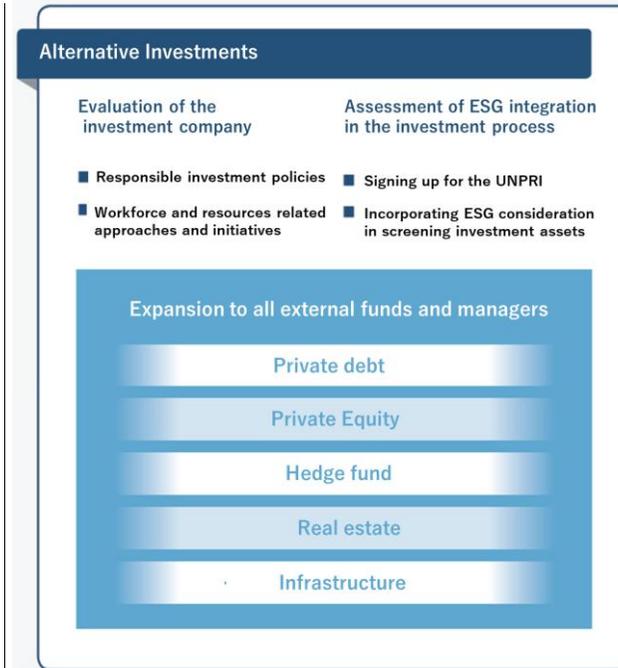
# Chapter 7: Our approach to ESG integration

To evaluate from the ESG perspective, we research the external managers in detail. Specifically, we check their policies, activities, and actions by employees for responsible investment. We believe those points are integral parts in assessing them.

In addition to evaluate the external managers, we assess the ESG integration in the strategy level as well. In order to do that, we have discussions with not only investment teams, but also responsible investment teams.

We have already taken this assessment approach for some of external managers, and strategies, and we will expand this to all strategies going forward.

Meanwhile, the Operational Due Diligence Group, which sits in Asset Management One Alternative Investments (AMOAI), is also actively undertaking various initiatives to further enhance our efforts and capability of evaluating ESG and the SDGs related performance.



## ESG initiatives at AMOAI

- ***We incorporate ESG considerations in managing infrastructure debt funds***

Asset Management One Alternative Investments (AMOAI), a wholly owned subsidiary of Asset Management One, manages infrastructure debt funds which invest in project finance debt to infrastructure projects (electricity, water, gas and etc.) that are essential to local communities and the economies. In addition to incorporating ESG into the investment and monitoring process, we aim to contribute to the achievement of the United Nation's SDGs by selectively investing in infrastructure projects that build and improve infrastructure assets that are essential to people's lives, such as electricity, water and etc., in order to help realize a sustainable world through infrastructure investments.

We believe that ESG is one of the key risk factors in infrastructure projects with long investment horizons. Therefore, when making

# Chapter 7: Our approach to ESG integration

investment decisions, we evaluate the potential impact of the large-scale infrastructure projects on the environment and local communities, and invest only in the projects that have appropriate policies and measures in place to comply with Equator Principles.

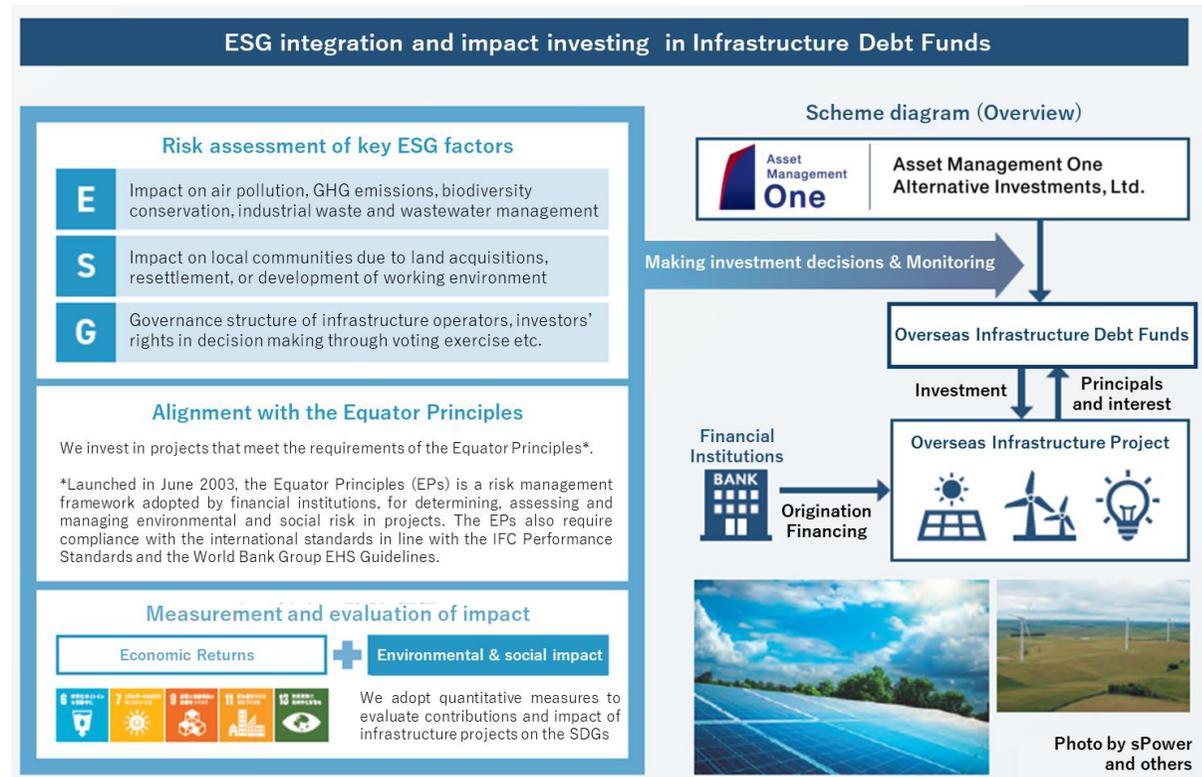
## ***We assess and measure the impact of our infrastructure investment***

Based on the concept of impact investing, which aims to create positive environmental and social impacts as well as economic returns, we incorporate the measurement and evaluation of the quantitative and qualitative impact of infrastructure projects into our investment and monitoring processes.

For example, for investments in renewable energy projects, we quantitatively calculate the amount of CO2 reductions from the projects, compared to the base emissions in the country where the projects are located, and report the results to our investors. We will continue to provide better value

to our investors through proactive communication. Going forward, we aim to further contribute to achieving SDGs by enhancing communications

with investee entities that operate the infrastructure businesses to expand creation of positive environmental and social impacts.



# Chapter 8: Monitoring of service providers

Asset Management One (AMO) retains the Institutional Shareholder Services (ISS), mainly for the ex-Japan global markets, to assist with certain administrative matters and provide research on proxy items at shareholder meetings. We also subscribe Glass Lewis's proxy research on shareholder meetings, as an alternative view when additional considerations are required for some cases. However, we have dedicated internal resources in place to undertake voting activities and voting decisions globally, in accordance with AMO's custom proxy voting guidelines and in-house views. The appointment of proxy services providers follows thorough due diligence reviews performed on an annual basis. When there are voting items that may present potential or perceived conflicts of interest relating to the parent or affiliated group companies, we look to consider ISS' inputs and recommendations as a third-party opinion. In the meantime, as described in this report about how AMO manages conflicts of interest (Chapter 3), the Responsible Investment Committee of AMO will further discuss and seek an independent advice from the

Proxy Voting Advisory Council which is comprised of a majority of independent outside directors.

In the process of ESG integration and active engagement with investee companies, AMO utilises a multiple number of external ESG research and data providers (including MSCI, Sustainalytics, RepRisk, Refinitiv, ISS-Climate and OWL Analytics). We use the ESG data and information provided by external ESG research firms as reference points or for flagging issues. While the development of increasing ESG data and information is helpful to some extent, we are fully aware of the inherent limitations of such ESG data and scores, particularly with regards to qualitative assessment or the dynamic forward-looking aspects of ESG performance at a company. And often we observed a relatively low correlation of the ratings or scores between major providers. Therefore, we intend to understand and pay a close attention to the different focuses and methodologies among ESG data providers, seeking explanations of their assumptions or estimates when needed. AMO believes it is an integral part of our stewardship responsibilities to

be able to put such raw ESG data and information from external service providers into meaningful contexts, and apply it properly to fit in purpose for the diversified range of our investment strategies. We monitor and engage on a full range of issues relevant to long-term investors, including individual companies' strategies, operating performance, capital allocation practices, risk management, corporate governance and culture matters, alongside other key ESG issues. Our internal analysis of material ESG issues and investment insights, through regular and proactive engagement dialogue with companies, has enabled us to monitor and assess the quality and progress of the companies' overall performance more effectively, using a holistic and forward-looking approach.

## **Case Study: Monitoring of services**

AMO carries out engagement and other stewardship activities extensively at our home market in Japan. Meanwhile, since 2017 we have retained EOS at Federated Hermes ("EOS") as our engagement services provider for ex-Japan

## Chapter 8: Monitoring of service providers

global markets. EOS represents a global client base of institutional investors and has a substantial engagement expertise as well as established process for engagement activities on behalf of its clients. Asset Management One and other clients of EOS are asked for a feedback each year on the engagement priority areas as part of its annual review of the EOS Engagement Plan. We also have had many other opportunities to exchange thoughts and discuss expectations, such as at the bi-annual Client Advisory Council events, via the client advisory board or our relationship manager at EOS. Throughout the year of 2020, AMO also joined a selected number of EOS engagement meetings and dialogues with investee companies together. In addition, EOS provides us with various updates, periodic reports (quarterly and annual reports) and case studies on its activities throughout the year. As such, we are able to continuously monitor the progress and outcomes, as well as to discuss engagement matters especially relating to the companies on AMO's priority engagement targets list.

# Chapter 9: Engagement for sustainable value creation

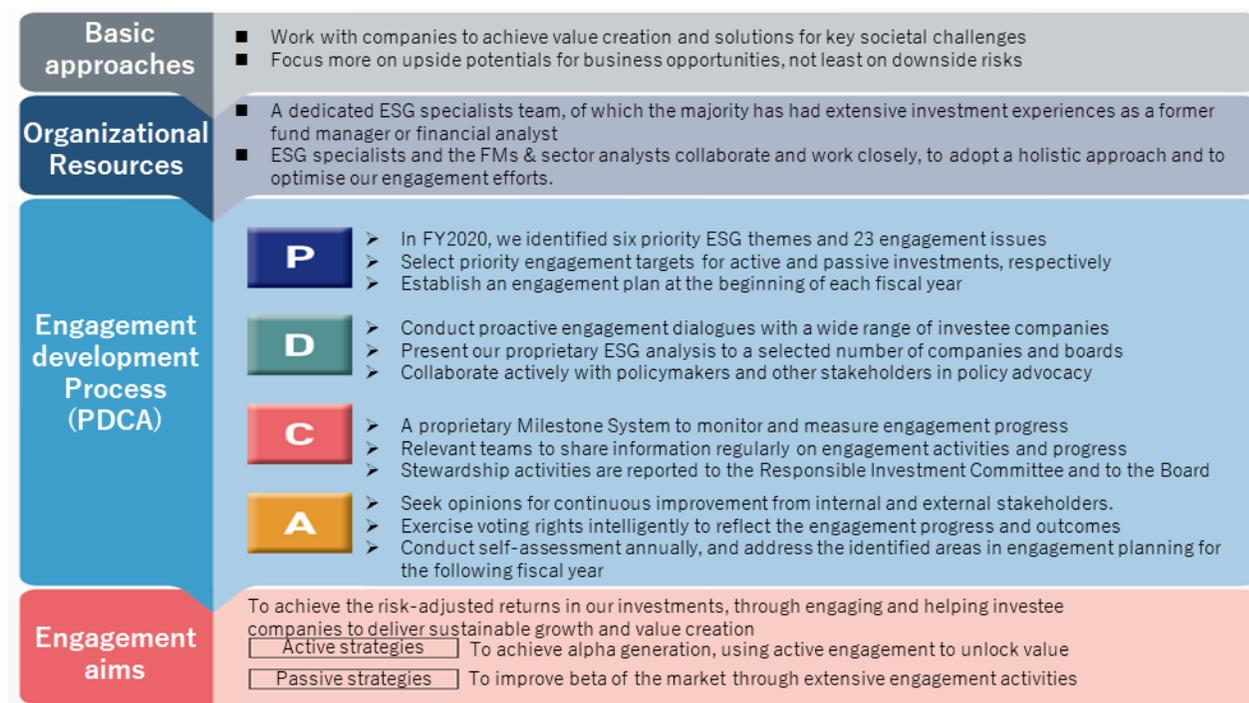
## Our engagement approaches

It is our fundamental belief that shareholder engagement approaches and efforts should be value-driven, by taking into account the economic and sustainable contexts, to deliver long-term performance for our clients and beneficiaries leading to sustainable benefits for the economy, the environment and society.

At Asset Management One (AMO) we have established a coherent approach to our engagement strategy and activities, demonstrated by well-defined objectives, professional resources and continuous improvement process using the PDCA (plan-do-check-act) framework. As a leading asset manager in Japan, AMO believes it is important for us to play a key role in the investment chain. Therefore, in addition to our extensive engagement with investee companies, we also actively participate in public policy discussions and advocacy initiatives. We work closely with Japanese policy makers (such as the Ministry of Economy, Trade and Industry, the

Ministry of the Environment and etc.), market regulators, industry associations as well as other stakeholders including academic and research institutes, to contribute from long-term investors' perspectives and to promote best practices.

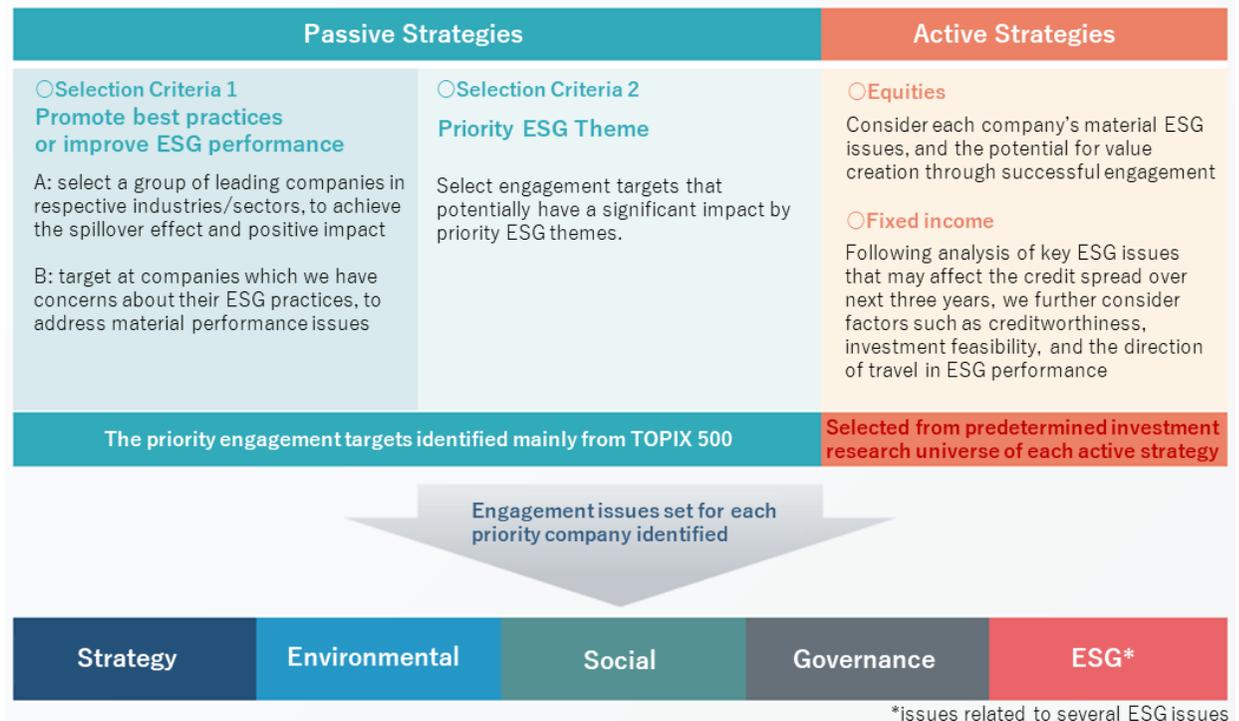
AMO offers and manages a wide range of strategies including both active and passive mandates of Japanese equities. We are strongly committed to our stewardship responsibilities and accountability for all assets entrusted by our clients and final beneficiaries.



## Engagement Planning

We identify and select priority issues and engagement targets, by giving thorough considerations to the different type of investment strategies, with clearly defined aims respectively. For instance, as shown in the chart, for AMO's active strategies, we aim at achieving the alpha generation and focus mainly on company-specific ESG issues using a bottom-up approach when we consider and select the engagement target companies. Meanwhile, in our stewardship activities for passive equity strategies, we are committed to improving the overall Japanese market performance (aiming at a higher beta), through actively engaging to drive positive changes and solutions for some common practices and behaviors that we think may obstruct long-term performance and value creation of the companies.

## Selection of the priority companies and issues for our engagement



## Engagement Management

AMO is committed to continuous improvement of our engagement activities, with a focus on quality dialogues and positive outcomes. To monitor and measure the engagement progress, AMO has developed a proprietary eight milestones system. As shown in the milestones progress chart, during the previous year of 1 April 2019 to 31 March 2020 (i.e. FY2019 in Japan), we have made a clear progress and achieved positive outcomes in our overall engagement activities.

In particular, on issues relating to climate change and ESG strategy & management, many companies have moved to set out concrete plans (Milestone 6) or have started implementing the plans (Milestone 7). Since the beginning of the year, the number of new engagement cases (Milestone 1) and interactions on strategy, board governance and circular economy related topics has increased, which we plan to continue engaging with the selected companies on these issues to seek actions and positive changes.

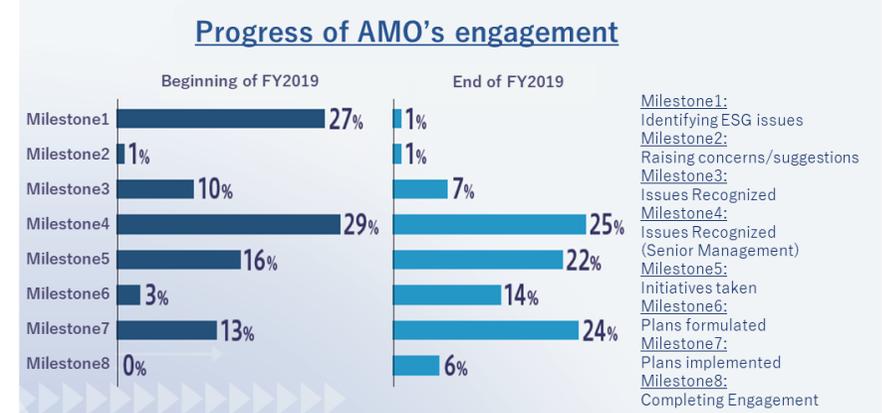
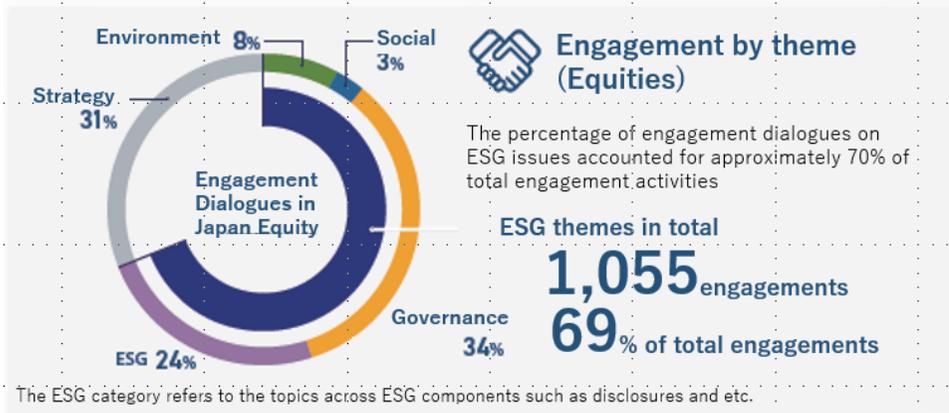
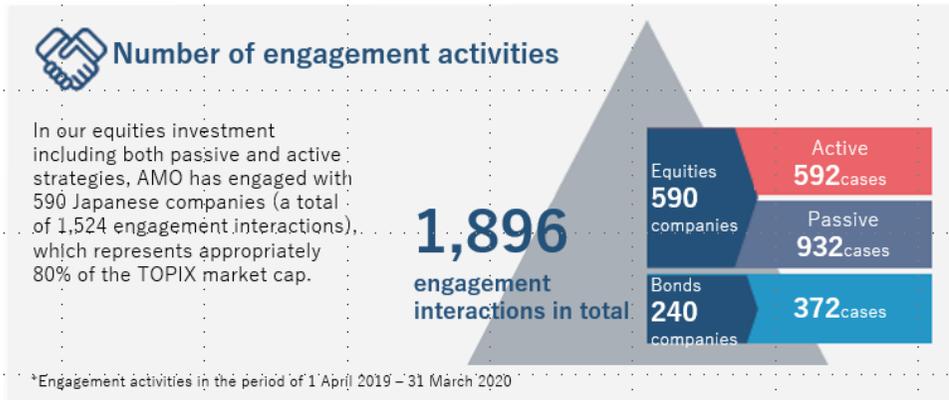
From 1 April 2020, we have taken a number of new steps, such as (1) including “Digital Transformation (DX)” as a new ESG priority theme for engagement, (2) reviewing the list of priority target companies, focusing more on the

effectiveness of engagement, and (3) planning to further accelerate our engagement efforts on climate changes strategies and solutions.

### Asset Management One Engagement Management System



## Engagement activities and outcomes at a glance (in Japan)



# Chapter 9: Engagement for sustainable value creation

## Six priority ESG engagement themes

At Asset Management One, we have identified the following six priority ESG themes, which we believe have a significant impact on value creation over the medium to long term. These themes are also largely in alignment with the SDGs.

 <p><b>Climate Change</b></p>  <p><b>Why it is selected as a priority theme</b> Despite the growing awareness of climate risks and increased number of companies supporting TCFD, a discrepancy still exists among Japanese companies in tackling climate change. We believe there are significant potentials for investors to drive positive changes through engagement.</p> <p><b>How we approach to engagement</b> While some businesses would likely have a positive externality, there are companies that need to work more proactively to overcome negative externalities. We focus on the companies' climate strategy, low-carbon transition pathway and solutions designed to achieve sustainable value creation.</p>	 <p><b>Supply Chain</b></p>  <p><b>Why it is selected as a priority theme</b> With advancement in globalization, companies are expected to manage their supply chains more effectively, implementing responsible purchasing and solutions for key environmental and social issues. Investors should help raise awareness and seek best practices along the supply chains.</p> <p><b>How we approach to engagement</b> We focus our active engagement efforts particularly on major companies positioned at the upstream of inter-connected industry value chains, expecting to generate substantial spillover effects. We think this would help achieve positive outcomes especially for market-wide challenges along the supply chains.</p>
 <p><b>Human Capital Management</b></p>  <p><b>Why it is selected as a priority theme</b> The importance of addressing human rights and improving work environment has been recognised more than ever. Amid increased labour shortages, the need of "work style reform" has become an emerging and critical issue for sustainable growth of Japanese companies.</p> <p><b>How we approach to engagement</b> We engage on human rights related issues in line with the international standards and norms, mainly from risk management perspective. Meanwhile, we also engage proactively on companies' work style reforms, including working hours or inequality associated with employment status, and on improvement of productivity as a result.</p>	 <p><b>Circular Economy</b></p>  <p><b>Why it is selected as a priority theme</b> To achieve sustainable development, it is vital to encourage transformation to a circular economy that embraces 3R ("reduce, reuse and recycle"). It requires a rethinking of current economic systems in society and lifestyles. Investors should examine related initiatives and seek better disclosures.</p> <p><b>How we approach to engagement</b> There is still room for improvement among some Japanese companies in actions and accountability. We engaged with such companies to seek a clear commitment and strategy to improve sustainability performance and investor communication in relation to their contributions to the circular economy.</p>
 <p><b>Regional Revitalization</b></p>  <p><b>Why it is selected as a priority theme</b> Japan is facing challenges of a declined birthrate with aging population. How to revitalize regional economies has become a major social issue. We believe investors should play a key role in driving positive changes towards regional sustainability and the vitality of Japanese society as a whole.</p> <p><b>How we approach to engagement</b> We are expanding the scope of engagement targets to include some railway and power companies, not least regional financial institutions. We actively seek plans and actions aiming to enhance value creation, through making contributions to the revitalization of regional and local communities.</p>	 <p><b>Digital Transformation</b></p>  <p><b>Why it is selected as a priority theme</b> Facing the "2025 Cliff," it is critical for companies to respond to digital transformation strategically. Integrating digital technologies across business areas would enable new value propositions and innovation. Investors can play a role to encourage the self-transformation for sustainable growth.</p> <p><b>How we approach to engagement</b> As a new priority theme added in FY2020, we first identified and started engaging with a group of Japanese companies which have indicated the DX awareness. Such an approach allowed us to focus on proactive reforms and to encourage digital transformation for continuous value enhancement.</p>

# Chapter 9: Engagement for sustainable value creation

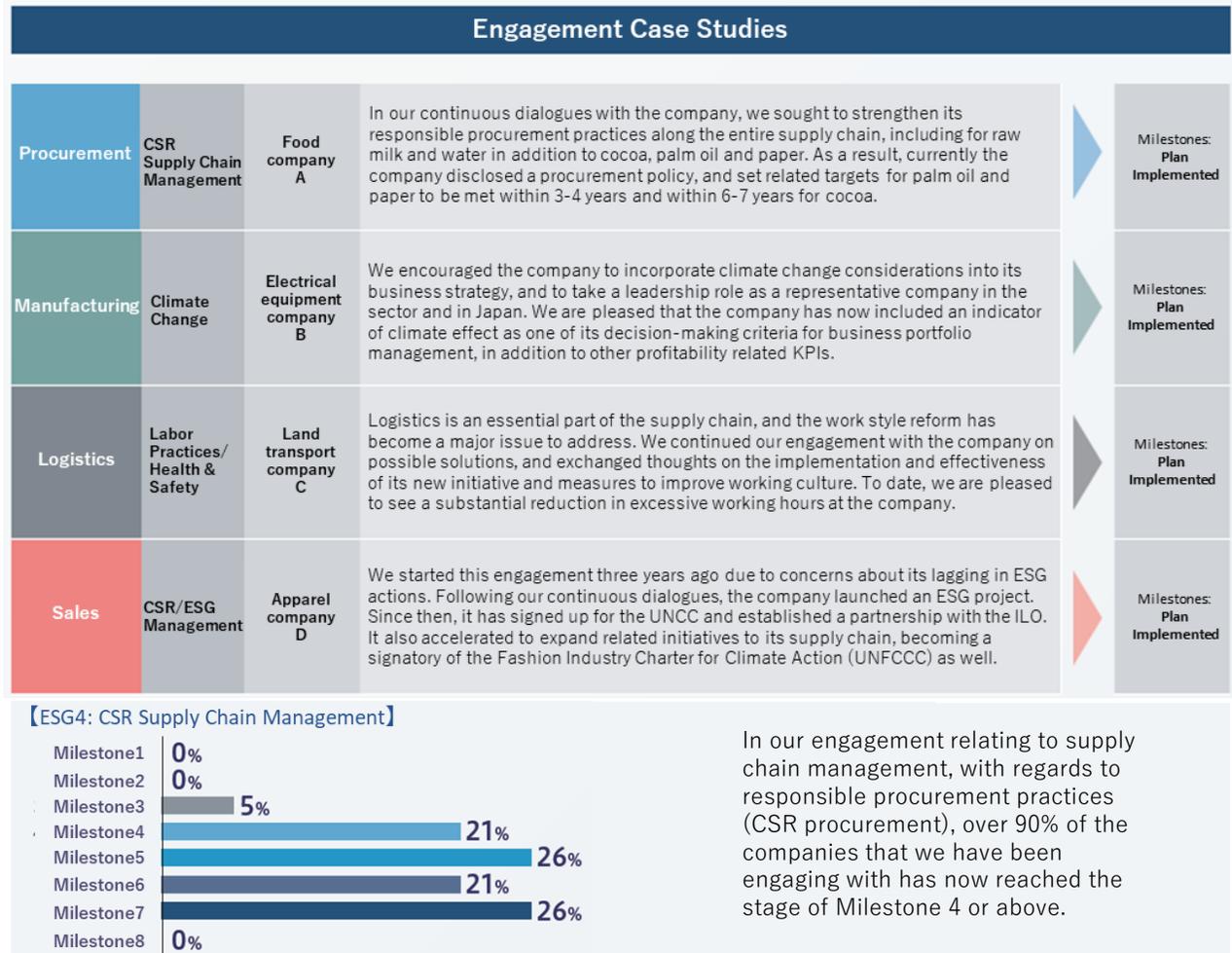
## Case Study 1

### Supply chain management

It is becoming more important to understand and appropriately manage the increasingly complex supply chains accompanied by diversified consumer needs, and to assess whether companies' approaches and practices would lead to the expected solutions for key environmental and social issues.

Meanwhile, the global pandemic of Covid-19 has revealed weakness and disruption risks of the supply chains management. Companies are expected to rethink of building a more resilient and flexible system to manage their supply chains.

We plan to further accelerate our engagement with companies on this key theme to encourage more transparency along supply chains, by utilizing digital technologies such as AI/IOT and etc., and to seek actions and positive changes that lead to the sustainable value creation.



# Chapter 9: Engagement for sustainable value creation

## Case Study 2

### Engagement collaboration across teams

Various groups and teams across AMO collaborated and held joint engagement dialogues with a major Japanese pharmaceutical company (Company A), at the time when it made a large-scale acquisition, with a focus on creating long-term value and ensuring financial stability.

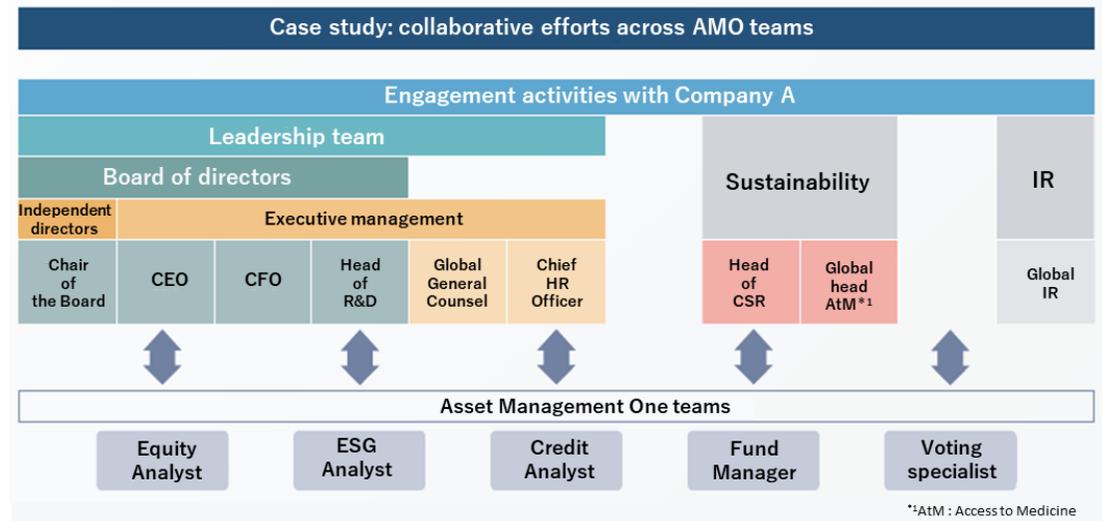
Both the equity investment and fixed income investment teams, as well as the ESG specialists at AMO, engaged jointly with the senior management and the board of the company, including meetings with the CEO and an independent director of the board.

As a result, we were able to form a long-term and holistic perspective on this case, and reflected our views from the engagement activities in our proxy voting decisions. In addition, we provided a feedback to the CEO, explaining AMO's view and the rationales behind our voting decisions, and

further exchanged thoughts about enhancing its corporate governance practices.

In April 2018, the company made an offer to acquire an overseas company (Company X), which was the historically largest M&A deal in Japan with an offer of over JPY6 trillion. Not only about the substantial amount of acquisition price, there were also concerns about the goodwill and intangible assets exceeding shareholders equity which may lead to a significant deterioration of

the company's financial health. Therefore, we carried out a comprehensive engagement with Company A, participated by the ESG/responsible investment team from the perspective of corporate governance, the equity investment team with a focus on business strategies, and the fixed income team mainly examining and engaging from the viewpoint of the company's financial stability over time.



# Chapter 9: Engagement for sustainable value creation

In the process, we held dialogues with the senior management and board members, including the CEO and an independent director of the board. We also carried out detailed discussions with various executives in key positions of the company. Following the engagement dialogues, we were able to make informed and considered voting decisions at the shareholder meeting. Afterwards, we also followed up with the company to share our views and sought for further improvement in its governance practice.

## - Engagement follow-ups and next steps -

Following its acquisition of Company X, AMO has continued our engagement with the company. In addition to the continuous dialogue on related business strategy and financials, we have also held proactive engagement on non-financial performance and related strategy, such as its policies and approach to the global initiative “Access to Medicine (AtM)” to improve access to life-saving medicines in developing countries, and also on the enhancement of management

accountability upon the M&A completion. We think the company has steadily implemented plans and acted on its promises, although further efforts to address the key challenges in improving its financial health are still required. As a long term investor, we’re much committed to monitoring the progress and continuing our constructive dialogues with the company.

### ● Engagement actions with company A

Timeline	Engagement Topics	Company representatives
Oct 2018	<b>On takeover offer (EGM)</b>	CEO, the chair
Jul-Aug 2019	<b>On CSR/ESG management</b>	Head of CSR, Global head of Access to Medicine
Nov 2019	<b>Capital management and R&amp;D plans post-acquisition</b>	CEO, CFO, Head of R&D
Jun 2020	<b>Governance practice, executive remuneration</b>	CEO, Global General Counsel, Chief HR Officer

## Case Study 3

### Engagement in active equity strategy

#### - Engagement Objectives -

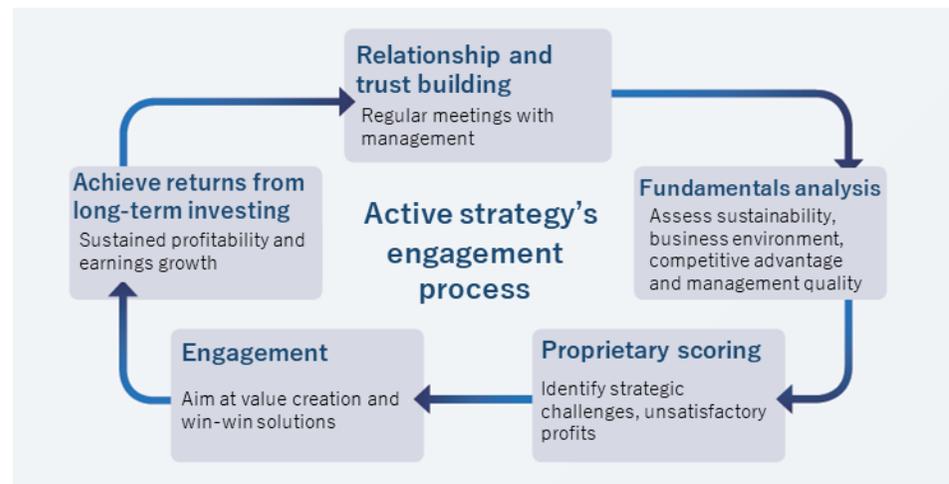
A Japanese company (Company B), operating in the healthcare services sector, has developed a niche market for inpatient services and has achieved high growth to date. On the back of the increasing needs for related services and structural changes in the society, we invested in the company in its early growth stage following a thorough analysis and conviction about the company's substantial business potentials. Meanwhile, we started engaging with the management, with an aim of further strengthening its organisational foundation and resources for continuous expansion, in order to ensure that the growth is to be sustainable.

#### - Engagement Actions -

Given the management ambition for sustained growth, we think the company's ability to

effectively implement organisational reforms in response to continuous business expansion is essential. Specifically, we have carried out engagement dialogues on a quarterly basis and evaluated the company's progress as well as the next steps, with regards to (1) its plan for the next-generation human capital development aiming for future growth, (2) the sharing and standardisation of business process in the manual operations to support growth stability,

and (3) the implementation of required organisational systems and measures in order to efficiently manage the rapidly expanding operations. Such engagement dialogues helped us form in-depth understanding and a forward-looking view about the company. There was a period of time when the discrepancy of speed appeared at the company between its business growth and organisational reforms, resulting in a declined productivity.



*Note: This chart illustrates the engagement process of one of Japan Equity Mid- and Small Cap Growth Strategies.*

However, through our continuous engagement dialogues, we have gained reassurance about the company's future growth strategy as well its strong commitment to a coherent approach and plans in place to ensure effective implementation.

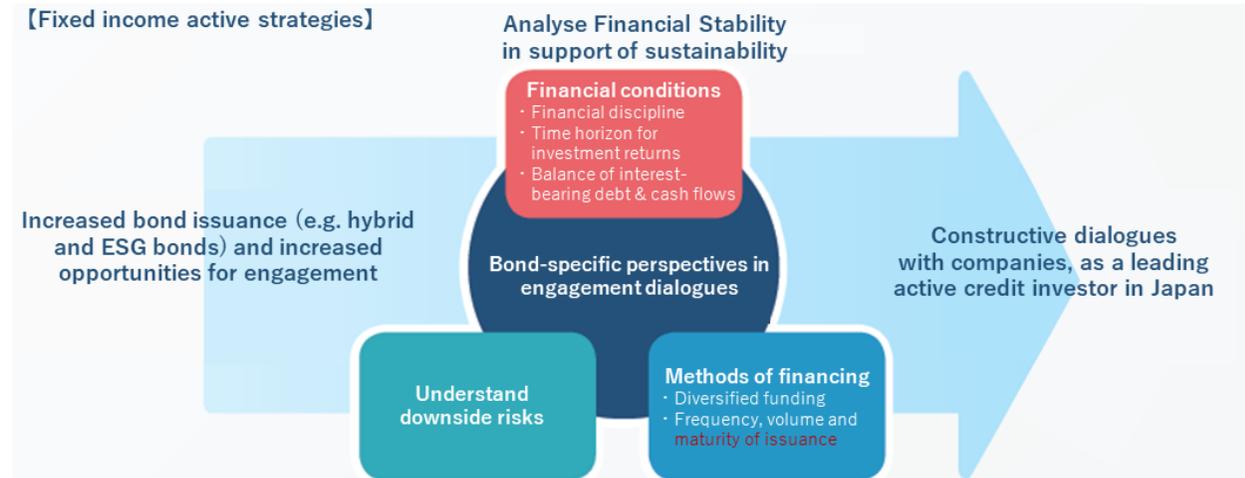
## - Engagement Outcomes -

The company has implemented a number of sustainability related initiatives to support its business growth, including (1) human capital development by establishing educational programs and talent support systems, (2) introduction of a new profit management system, and (3) systemization of back office functions. We believe that such steps and steady progress have led to the company's significant growth over the past few years. The management has also demonstrated a strong commitment and is expected to achieve continuous growth over the medium-term in both value-added services for existing businesses and the further expansion into new business domains.

## Engagement in fixed income

From the perspective of fixed income active strategies, we expect to increase returns and reduce risks of the investment. In order to better understand investee companies' financial stability prospects to ensure sustainability, we have actively carried out numerous engagement dialogues with companies, with a focus on their financial strategies and also on ESG assessment.

With regards to some unique aspects and approaches of fixed income assets, we carefully examine key financial conditions such as the balance of interest-bearing debts and cash flows, the time horizon for returns on investment, any potential downside risks that may affect the company's creditworthiness or have a significant social impact, and financing methods (including type, frequency, issue volume, maturity and etc.).



While having no voting rights per se as what the shareholders do, as a leading active credit investor in Japan, AMO has had the privilege and increasing opportunities to engage directly and constructively with investee companies to share our views and encourage positive changes. This is supported by a higher openness to engage with bondholders among Japanese companies, and also by the latest development of growing market for hybrid bonds and ESG related bonds.

An example of our engagement activities in fixed income investment strategies, as a joint engagement with the ESG specialists team on climate change matters, is presented in the [Chapter 4](#) of this report. Below is another case study of AMO's engagement efforts from the perspectives of fixed income investment.

## **Case Study 4**

### **Engagement with an electric power company**

In order to maintain and upgrade infrastructure

facilities, major electric power companies have frequently issued corporate bonds for financing. However, there is an increasing need than ever for sustainable financing sources, on the back of an intensified competition resulting from electric power system reforms and the increase in capital investment in response to the stricter regulations on nuclear power. As such, the company has also demonstrated the awareness and willingness to strengthen dialogues with bond investors. At our engagement meetings with the company, we discussed various topics relating to the issue volume, frequency, timing and maturity of the bond, from bond investors' perspective and from the sustainable financing point of views.

We further raised a number of other key issues and exchanged thoughts on the company's (1) responses to intensified competitions, (2) the implementation of safety measures for nuclear power generation, (3) steps to improve resilience against obsolete facilities and the increased natural disasters of typhoons and storms, and (4) business diversification. In addition, we

highlighted the importance and discussed the company's climate change strategies and approaches, including the transition to renewables, safely restarting the nuclear power plants, applying new technologies for coal-fired thermal power, as well as its preparations for new environmental regulations. We will continue to monitor the company's progress in related areas.

### Constructive engagement is essential

It is our belief that well-governed companies, supported by actively engaged shareholders with a long-term perspective, will deliver superior risk-adjusted returns over the long term. Through our engagement, AMO aims to form in-depth understanding and a holistic view of the investee companies. The purpose of stewardship and engagement is to protect and improve long-term value for clients and beneficiaries, by encouraging companies to achieve sustained profitability and growth, leading to sustainable benefits for the economy, the environment and society. Therefore, we believe that two-way dialogues and constructive discussions with investee companies, based on mutual trust and understanding of the perspectives from each other, is essential. In this regard, individual engagements conducted privately and confidentially are often more effective, especially given considerations for different market's environment and individual company's specific circumstances. We do not regard shareholder engagement as micro-

managing companies, and there is no "one-size-fits-all" approach to be effective in engagement activities. As a long-term investor, Asset Management One (AMO) is committed to engaging and working with investee companies to achieve positive changes and identify solutions for the key ESG challenges facing each company and the society as a whole.

### Collaboration for effectiveness

We also recognise the benefits for greater influence and effectiveness by acting collaboratively with other investors where appropriate, and are willing to work with like-minded investors in this regard. The overarching aim of engagement efforts is to preserve and enhance the value of assets entrusted by our clients and beneficiaries. Therefore, collaborative engagement by itself is not the purpose, but the enhancement of effective engagement for positive changes is. We therefore consider our approaches to each individual engagement on a case-by-case basis, being conscious of the issues concerned,

regulatory matters, and the different market practices including cultural related aspects (e.g. where companies in some markets, especially in Japan and other Asian markets, may still perceive such an approach as confrontational), in order to act in the best interest of our clients and to ensure the quality and effectiveness of our engagement outcomes.

There are occasions or cases in particular where certain market-wide issues exist and require a more coordinated approach and public policy advocacy to address shared concerns. Therefore, we actively contribute to related discussions and working with other global investors at various formal and informal investors groups. AMO is an active participant and member of a number of global investor groups or coalitions, including the International Corporate Governance Network (ICGN) and the Asian Corporate Governance Association (ACGA), and is a signatory of the UN-supported Principles for Responsible Investment (PRI). AMO has signed up for the Montréal Carbon Pledge, making the commitment to

# Chapter 10: Collaborative engagement for effective stewardship

measure and publicly disclose the carbon footprint of our investment portfolios on an annual basis, and was the first asset management company in Japan to join the global initiative RE100 aiming to achieve 100% renewable electricity. We have joined the 30% Club Japan Investor Group, acting as a board member of the group, to promote diversity and inclusion in our engagement activities. Meanwhile, AMO's appointment and partnership with the London-based EOS at Federated Hermes (EOS) for stewardship and engagement activities in the ex-Japan markets has also provided us with a solid platform to collaborate with other like-minded institutional investors globally.

AMO is one of the few Japanese asset managers committed to the global investors' engagement initiative "Climate Action 100+" (CA100+) since its initial launch in 2017, actively participating in the ongoing collaborative engagement with selected companies globally. To tackle the unprecedented climate change challenges towards achieving the Paris Agreement goal, we

believe that joint and collaborative efforts among investors on a global scale is critical, and is likely to be more effective in engaging on such a complex and

systematic issue to achieve speedy progress and tangible outcomes.

## Our collaboration with other investors and stakeholders

	Global	Japan
ESG	Signatory of:  Principles for Responsible Investment	 JSIF  JSI Japan Stewardship Initiative
Environmental	 TCFD TASK FORCE ON CLIMATE-RELATED FINANCIAL DISCLOSURES Signatory of:  PRI Montreal PLEDGE Principles for Responsible Investment Net Zero Asset Managers initiative	 Climate Action 100+  TCFD Consortium
Social	 access to medicine FOUNDATION  FAIRR A COLLIER INITIATIVE	 30% Club GROWTH THROUGH DIVERSITY
Governance	 ICGN International Corporate Governance Network	 ACGA
Disclosure	 SASB International <IR> Framework	 ESG Disclosure Study Group

## Case Study: Climate Action 100+

(<https://www.climateaction100.org/>)

Climate Action 100+ (CA100+) is a global investors-led initiative to seek and ensure that the world's largest corporations take necessary actions on climate change. As a group we engage with companies on improving climate governance, cutting emissions, and strengthening climate-related financial disclosures. Launched in December 2017, the work of the initiative is coordinated by five regional investor networks: the Asia Investor Group on Climate Change (AIGCC), Ceres, Investor Group on Climate Change (IGCC), Institutional Investors Group on Climate Change (IIGCC) and Principles for Responsible Investment (PRI). Under this initiative, Asset Management One has been joining the group engagement as a collaborating investor with seven companies globally. In Japan, AMO is one of the co-lead investors for the CA100+ group engagement with a major Japanese automotive company, as well as actively collaborate in the engagement activities with another major Japanese company.

Below are some highlights of our collaborative activities with the CA100+ and outcomes in 2020.

Rio Tinto: together with other investor members of the CA100+ engagement group, we had discussions and meetings with the chair of the board as well as other senior executives of the company on a regular basis over the past years. Joint activities in the year of 2020 include:

- Meeting with the chair (March 2020)
- Climate and water seminar, hosted by the CEO (April 2020)
- Meeting with senior executives on AGM matters (April 2020)
- Meeting with senior executives on progress of climate strategy (September 2020)
- Meeting with senior executives on climate reporting (December 2020)

Following the intensive engagement activities carried out by the CA100+ group since 2018 (a total of four meetings with Rio Tinto that we have

joined in 2018-2019 as well, of which three meetings were with the chair), we have gained an in-depth understanding and qualitative insights of the company's approaches to climate change and the continuous progress of its low carbon transition strategy. In particular, Rio Tinto has taken steady steps to work with partners - including its customers - to reduce the carbon footprint across its value chain. For example, in September 2019, Rio Tinto signed a partnership MoU with China's largest steel producer China Baowu Steel Group and Tsinghua University, enhancing its efforts to develop and implement new methods to reduce carbon emissions and improve environmental performance across the steel value chain. Taking into consideration the company's steady progress made so far and the leadership's commitment to tackling the climate challenge issues and low-carbon transition, we were able to support the management by exception at the AGM of Rio Tinto Ltd in 2020 with regards to a shareholder proposal for setting the scope-3 emissions target.

Given the increasing development around the world towards net zero emissions, including the latest pledges of the Chinese government to achieve its net zero ambition by 2060 and of other major governments in Asia (Japan and South Korea by 2050), we will closely monitor the progress and outcomes of Rio Tinto in its efforts and initiatives of further reducing the scope-3 emissions and continue our constructive dialogues, collaboratively with the lead and other supporting investors of this CA100+ engagement group.

**Hon Hai Precision Industry:** headquartered in Taiwan, Hon Hai (also known by its trade name Foxconn) is the world's largest contract electronics manufacturer. The company's customers include Apple, Cisco, Dell and etc. In addition to actively participating and contributing to the discussions among the CA100+ investors, in 2020 we also joined the group's engagement dialogues with the company in May and in early November, to seek concrete plans for reducing carbon emissions, setting related targets and

strengthening climate-related disclosures. We are pleased that, following the CA100+ engagement calls, Hon Hai announced its policies to align with the Paris goals and to aim at the net-zero GHG emissions by 2050 across the value chain. The company's statement (<https://www.honhai.com/en-us/press-center/press-releases/latest-news/473>) referred to its collaboration with the CA100+ engagement group and the requests of the investors. Hon Hai has also made the commitment to further improving climate-related governance and to reporting in line with the TCFD.

## Net Zero Asset Managers initiative

(<https://www.netzeroassetmanagers.org/>)

On 11 December 2020, 30 leading asset managers (representing over US\$9 trillion of assets under management) around the world announced the launch of the Net Zero Asset Managers (NZAM) initiative. AMO is the only Japanese asset manager who joined this initiative as a founding member of signatories, and has been appointed as a member of the Advisory Group. Tackling the climate challenges is a global effort that requires commitment and collaboration. We believe that asset managers have a key role to play within the investment chain towards achieving the goals of the Paris Agreement. As part of the initiative, we have committed to working in collaboration with asset owners clients, other asset manager signatories and stakeholders to achieve target-based net zero goal by 2050. We will also set an interim target to be announced by the COP26 in November 2020.

## EOS' activity in collaborative initiatives

AMO has appointed and partnered with EOS at Federated Hermes (EOS) for global engagement activities in the ex-Japan markets. The Client Advisory Council (CAC) meetings twice a year provide a helpful platform and the opportunities to discuss with other global institutional investors on ESG and stewardship related matters. We have participated in joint engagement with a selected number of investee companies at the CAC events as well. Given its pioneer and leading position in global stewardship activities, EOS also represents its clients in a significant number of collaborative engagement and policy advocacy initiatives. For example, under the Climate Action 100+ (CA100+) initiative, EOS has been leading or co-leading at 27 engagements globally and is involved in another 14 engagement cases as a supporting investor. For case studies of how EOS facilitate collaborative engagement on climate change, please refer to the following article: <https://www.hermes-investment.com/ukw/eos-insight/eos/climatecasestudy/>.

# Chapter 11: Escalation of stewardship activities

## A structured approach to engagement

We monitor and engage on a wide range of issues relevant to long-term investors, including individual companies' strategies, operating performance, capital allocation practices, risk management, corporate governance and culture matters, alongside other key ESG and sustainability issues. Our general approach to engagement is to encourage an in-depth private dialogue over time, as from our extensive knowledge and practical experiences, we believe that engaging constructively and confidentially with company management and the board is often more effective to achieve positive outcomes. As a long-term responsible investor, we therefore prefer to work with individual investee companies for solutions and seek remedial measures through continuous engagement. However, we also recognise that there may be instances where a company does not respond or act constructively over a prolonged period of time. Under such specific circumstances, we may need to escalate our engagement efforts to raise growing concerns and to bring out positive changes.

Asset Management One (AMO) does not have a prescriptive or pre-determined written guidelines for escalating engagement activities. In practice, however, we adopt a structured approach and have established processes to continuously progress engagement, and to make qualitative assessments in line with our responsible investment principles and defined investment disciplines for each strategy. With regards to measuring and monitoring the engagement progress, AMO has developed a proprietary milestones system. The detailed eight milestones (please see further details in [Chapter 9](#) of this report) outline steps and objectives for each ESG issue at each company engagement.

In the process of our engagement, the escalated actions taken often involve individual meetings with senior executives, board members and non-executive directors (which we also promote as a best practice and strongly encourage companies to provide shareholders such board access, especially in the Japanese and other Asian markets where this is not yet a common practice). In addition, we exercise voting rights at

shareholder meetings to enforce and reflect the progress as part of our engagement escalation process. Some examples of our voting activities in relation to engagement are presented in the following [Chapter 12](#) of this report. Finally, for active investment strategies, we monitor the development of each investee company on an ongoing basis and may decide to divest from the shares when justified, in order to protect the interest of clients and beneficiaries.

As for further possible steps to escalate our stewardship activities to achieve the objective of protecting our clients' interest and value creation, where appropriate we may also consider discussing and working with other like-minded long-term institutional shareholders, as detailed in the [Chapter 10](#) of this report with regards to AMO's collaborative engagement activities. However, the collaborative engagement in and of itself should not be the purpose; instead, the effectiveness of engagement should be the aim. Therefore, we carefully examine the unique situation of individual engagement issues concerned, and take into account the local market

# Chapter 11: Escalation of stewardship activities

and regulatory environment especially in Japan and other Asian markets where some constraints for investors' collective activities do exist.

In light of cultural aspects, shareholders raising concerns publicly or filing shareholder proposals at some markets in Asia may also result in counterproductive or unintended consequences, because such actions are often being perceived by companies as a hostile approach. Therefore, although we do not entirely exclude such options as one of the escalation strategies when necessary and appropriate, as a responsible and long-term owner of companies, AMO generally does not make our individual engagement cases public if it may undermine the trust, especially when a company's management or the board shows their willingness to continue dialogues and acknowledges the need for changes.

## Escalating engagement in global markets

In addition to our internal ESG and responsible investment specialists team, AMO has appointed

and partnered with EOS at Federated Hermes (EOS), a London-based stewardship services provider, for our engagement activities in ex-Japan global markets. We have been working closely with EOS since 2017. Given its leading position and long established practices of engagement globally, EOS has put in place a comprehensive program and process to select and prioritise engagement issues. Each year it reviews and publishes a three-year EOS Engagement Plan on a rolling basis ([https://www.hermes-investment.com/ukw/wp-content/uploads/2020/02/eos-engagement-plan-2020-2022\\_public.pdf](https://www.hermes-investment.com/ukw/wp-content/uploads/2020/02/eos-engagement-plan-2020-2022_public.pdf)), which provides details on the priority areas (as directed by all clients collectively) and an overview of its approach to engagement. In the process of finalising this engagement plan, clients' thoughts and expectations were sought and discussed through surveys and at the bi-annual Client Advisory Council meetings. The updates and periodic reports that we receive on a regular basis have allowed us to monitor the engagement activities and progress as well.

EOS regularly escalate engagements where the company is not receptive to engagement, no progress is being made, or progress is too slow. The steps in relation to escalations include (1) attempting engagement at a more senior level, (2) sending letters to the board of directors, (3) collaborating with investors or other stakeholders, (4) taking actions at shareholder meetings (e.g. making a statement, filing shareholder resolutions), or (5) publishing open letters, and etc. With some specific case examples, the escalated engagement steps and outcomes of EOS engagement on behalf of its clients have been explained in more details at the article published by EOS (Page 13-14). (<https://www.hermes-investment.com/ukw/wp-content/uploads/2019/10/hermes-eos-public-engagement-report-q3-2019.pdf>).

## Voting policies and process

In principle, Asset Management One (AMO) exercises voting rights for the shares it holds on behalf of clients.

- AMO believes that voting responsibly is part of our fiduciary duty and exercises it intelligently as an important mechanism to voice concerns or encourage companies to strengthen governance and sustainability performance, with an aim to achieve long-term value creation and sustainable growth.
- We regard voting as an integral part of the process of our engagement dialogues with investee companies, and aim to reflect the progress of ongoing engagement into our voting intentions where appropriate.
- In certain circumstances, a comprehensive assessment and thorough discussions are carried out at the Responsible Investment Committee and its sub-committee (“Exercise

of Voting Rights Committee”) before we make final voting decisions. The [Chapter 3](#) of this report also provides with details of how we manage conflicts of interest in the process of proxy voting activities at AMO.

AMO has set out its policies of exercising voting rights, disclosed at <http://www.am-one.co.jp/english/information/voting/>. The AMO Proxy Voting Guidelines for Japanese equities, ex-Japan overseas equities, and real estate investment trust (REIT) are published respectively at: <http://www.am-one.co.jp/company/voting/>. These Guidelines detail our voting criteria for individual resolutions and explain the rationales behind our voting decisions.

As opposed to applying the Guidelines rigidly, we are also committed to a pragmatic approach to voting activities where appropriate, by addressing individual company’s specific circumstances and avoiding a simple box-ticking exercise. Such an approach is particularly important when AMO has material shareholdings, or when the proposals are

contentious or would have a significant impact on our clients’ interest. We pay additional attention to these occasions and conduct intensive internal discussions, often following the engagement conversations with relevant companies, before we make the final voting decisions.

As also described in the [Chapter 8](#) of this Report, AMO retains Institutional Shareholder Services (ISS) to assist mainly with certain administrative matters and provide research on proxy items at shareholder meetings. We also subscribe Glass Lewis’ proxy research to get alternative views when needed. However, AMO has dedicated internal resources to undertake all voting activities and decisions globally, in accordance with AMO’s own customised proxy voting guidelines and in-house views. Unless we receive a specific voting instruction on particular shareholder meetings or items from the clients, AMO casts votes as a house. And the Responsible Investment team acts to execute the final votes, following the principles of AMO Voting Guidelines and internal discussions where required.

## Disclosure of voting results

The detailed voting decisions made by AMO for Japanese equities are fully disclosed on a quarterly basis and are publicly available at <http://www.am-one.co.jp/company/voting/> for every shareholder meeting and for each of the resolutions that we voted on. We also disclose the rationales behind our voting decisions. Meanwhile, when requested, we provide with more detailed explanations to clients regarding companies of their interest.

A large proportion of our clients' investment in non-Japanese equities are held in passive investments around the world. We report and provide to our clients with a summary of the voting results, as well as the rationales of our voting decisions when requested, for non-Japanese holdings, together with our other stewardship activities on a regular basis.

## Our expectations for companies

In relation to election and re-election of the board of directors (or statutory auditors) in Japan, we have set out detailed voting criteria and also communicated with companies about our expectations, such as:

**Board structure** – the independent outside directors who represent all shareholders (including minority shareholders) interest are best positioned to oversee management performance and hold management accountable. As the direction of travel over the mid- and long term, AMO expects Japanese boards to have a majority of outside directors. Until the end of FY2020, we have voted against the election of a company's representative directors if the board has no two or more outside directors, or if outside directors are not comprised of 20% or more of the board. We review this criteria annually. Taking effect from 1 April 2021, we have raised the threshold requirement to 25%, and are also considering further strengthening this requirement for one-third of outside directors at the board from April

2022 onwards.

**Independence of outside directors** – we expect the proposed candidates to be able to act as an independent representation for all shareholders, demonstrating no conflicts of interest with the company. Specifically, we examine whether he or she is registered with the Stock Exchange as an independent director for the company. We also expect an outside director candidate has had no track record of being employed by the company's large shareholder (with 10% shareholdings or more) or an affiliated group company for the past ten years; otherwise, we will vote against the appointment in principle.

**Attendance of board meetings** – in principle, if an outside director (or an outside statutory auditor, under the traditional Japanese two-tier board system) candidate's attendance of the board meetings were less than 85%, we are generally unable to support his or her re-election unless the company provided a convincing reason in the engagement dialogues.

# Chapter 12: Exercising rights and responsibilities

**Board diversity and accountability** – we generally expect boards to consist of executive and non-executive directors, who have more diversified skills and perspectives from a variety of professional or cultural experiences, not least from the perspective of gender diversity, to facilitate active discussions and constructive challenges at the Japanese boardrooms. In discussing key voting items with regards to a company's governance practices, we also strongly encourage direct engagement meetings and dialogues between the appointed outside directors and shareholders, which is still a rare practice in Japan.

## Voting case studies

### Company A: A regional Bank

#### - Voting considerations in Covid-19 –

Following AMO Proxy Voting Guidelines for Japanese equities, with regards to voting on board election, statutory auditors board election (under the traditional Japanese two-tier board system) and executive remuneration, we examine and take

into account individual company's performance based on a set of financial indicators and criteria, such as:

- I. Net loss and zero dividends for three consecutive years
- II. Reduced shareholder capital by over 50% from the previous year
- III. Insolvency (excess liabilities over assets)
- IV. ROE among the lowest 1/3 quantile of listed companies (in the TSE 1st section) for three consecutive years
- V. For three years, net cash ratio\* over 25%, ROE among the lower 1/2 quantile of TSE 1st section listed companies and PBR below 1.0 at the fiscal year-end
- VI. For three consecutive years, total shareholder return ratio below 30% and ROE below 8% (excluding net loss-making companies)

\*Net cash ratio is defined as: (cash deposits + short-term investment securities – interest bearing debts)/total assets

If a company failed in any of the financial performance indicators above, we generally oppose the re-election of management (i.e. executive directors who have been sitting at the board for three years or more). At the time of AGM in June 2020, there was a regional bank in our holdings that had failed to meet the ROE criteria. In light of the critical situation of Covid-19 pandemic times, however, we made our voting decisions not based solely on the financial performance standards or on the prospect of a turnaround in the near future.

In this case, while making it clear about the key principles of AMO voting guidelines, we actively engaged with the management and assessed whether it had implemented expected steps and approaches to support employees, business customers and local communities. We believe regional banks which have a large number of small and medium-sized enterprises as their

# Chapter 12: Exercising rights and responsibilities

business customers or partners are fulfilling a critical role (with no immediate substitutes) for their respective regions during this pandemic crisis times. We therefore supported the current management by exception in 2020. Meanwhile, an outside director of this company had not fully met AMO's requirement for the number of board meetings attendance. In our engagement conversations, the company provided a convincing reason for the lower attendance rate over the past year. Also, given the previous track record of this candidate's board attendance, we were able to support the proposed re-election at the AGM. We plan to continue our engagement dialogue with the company about its performance recovery, corporate governance practices and other sustainability related matters going forward.

## Company B: A food & beverage company

### - Shareholder proposal –

At the AGM of 2020, the company received a shareholder proposal with regards to its strategy and portfolio management, requesting a focus on its core businesses. We met with the filing

shareholder to form a solid understanding of the rationales behind this proposal. Meanwhile, we held engagement dialogues with the CEO of the company and also with an outside director of the board to better understand their perspectives as well. Following further intensive discussions internally at AMO, we concluded our views on the company's ongoing strategy and did not support this shareholder proposal. However, we voted in favour of the shareholder's proposals for nominating some of the independent directors to the board, with an aim to enhance checks-and-balances and board accountability. We held a follow-up discussion with the CEO after the AGM, providing a feedback on our voting decisions and the rationales behind. The management was very responsive and also indicated its willingness to continue the engagement dialogues with the AMO teams on a regular basis.

## Company C: A machinery company

### - Takeover defense scheme –

The company introduced a takeover defense scheme in 2007, which since then has been

renewed on a regular basis. We do not believe it is in the interest of shareholders to support the continuous renewal of such a takeover defense measure. Therefore, AMO had voted against the related resolutions at the AGMs in the past. Meanwhile, we have intensively engaged with the company over a long period of time, seeking abolishment of the takeover defense scheme. As a result, we are pleased that the company has finally taken a positive step and decided to abolish this scheme in May 2020.

# Chapter 12: Exercising rights and responsibilities

(Voting activities: 1 July 2019 – 30 June 2020)

## Japan

Voting items	For	Against	Total	% vote Against
Election/Removal of directors	14930	2697	17627	15.3%
Election/Removal of auditors	2065	425	2490	17.1%
Election/Removal of accounting auditors	63	0	63	0.0%
Directors' remuneration <sup>*1</sup>	759	63	822	7.7%
Payment of retirement benefits	0	149	149	100.0%
Appropriation of retained earnings	1498	7	1505	0.5%
Company reorganization <sup>*2</sup>	40	0	40	0.0%
Takeover defense	11	85	96	88.5%
Other proposals for capital policy <sup>*3</sup>	65	4	69	5.8%
Amend articles of Incorporation	481	13	494	2.6%
Other proposals	1	1	2	50.0%
Proposals by the company	19913	3444	23357	14.7%
Proposals by shareholders	22	184	206	89.3%

\*1 "Directors' remuneration" includes revision of the amount of directors' remuneration, stock acquisition rights, performance-linked remuneration and executive bonus, etc.

\*2 "Company reorganization" includes the merger, transfer or acquisition of business, share exchange, share transfer and company split, etc.

\*3 "Other proposals for capital policy" includes share repurchase, legal reserve reduction, capital increase through third party allotment, capital reduction, reverse stock split, and issuance of class shares.

## Global ex-Japan Markets

### < Management proposals >

Voting items	For	Against	Total	% vote Against
Election of board directors	19,694	1,882	21,576	8.7%
Routine business items	10,928	422	11,350	3.7%
Capital practices	4,333	736	5,069	14.5%
Remuneration	3,301	814	4,115	19.8%
Reorganization/M&As	2,025	448	2,473	18.1%
Takeover defense schemes	291	11	302	3.6%
Other items	86	1	87	1.1%
Total	40,658	4,314	44,972	9.6%

### < Shareholder proposals >

Voting items	For	Against	Total	% vote Against
Election of board directors	748	184	932	19.7%
Routine business items	167	83	250	33.2%
Governance-related proposals	127	30	157	19.1%
Remuneration	37	33	70	47.1%
Environmental-related proposals	33	30	63	47.6%
Social-related proposals	9	13	22	59.1%
Other items	76	71	147	48.3%
Total	1,197	444	1,641	27.1%