CAN THE WORLD'S LARGEST PENSION FUND, JAPAN'S GPIF, BE A RESPONSIBLE STEWARD? STEWARDSHIP RESPONSIBILITY AS ASSET OWNER

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Abstract

The number of institutional investors has seen a marked increase in the past few decades. For the purpose of the long-term economic success of portfolio companies, it is crucial to encourage investee companies to establish better corporate governance structure within them. The U.K. and Japan introduced the Stewardship Code, and the Government Pension Investment Fund (GPIF) of Japan defines itself to fulfill its roles and responsibilities as an asset owner in line with Japan's Stewardship Code. However, passive funds that have occupied a large share of the market have no financial incentive to incur the costs for engagement with investee companies. The purpose of this article is to review the two Stewardship Codes, the stewardship structure, policies of the GPIF that has accepted Japan's Stewardship Code, and to explore how the GPIF fulfills its stewardship responsibility, based on the Japan's Code, requires its external asset managers to comply with its stewardship principles and continuously monitors the stewardship activities of asset managers. The findings are that continually improving stewardship and engagement by utilizing the PDCA cycle, the GPIF can be a responsible steward in the Japanese market.

Keywords: Stewardship Code, Corporate Governance, Passive Funds, Engagement, Asset Owner, Asset Manager

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1. INTRODUCTION

In 2010, the United Kingdom introduced the Stewardship Code in consequence of the global financial crisis of 2008-2009. The Stewardship Code is a set of best practice principles designed to encourage institutional investors to engage in stewardship of their portfolio companies and then it is enforced on a "comply or explain" basis. The Code ultimately aims at fostering the long-term success of investee companies through active engagement by institutional investors. In 2014, Japan has followed the United Kingdom by introducing Japan's Stewardship Code to encourage institutional investors to "enhance the medium- to long-term investment return for their clients and beneficiaries … by improving and fostering the investee companies' corporate value and sustainable growth through constructive engagement" (Financial Services Agency, 2017). Among monetary and fiscal policy reforms introduced by the Abe Cabinet (so-called "Abenomics") and aiming at improving corporate productivity and "earning power", Japan's Stewardship Code was introduced as Abenomics' "third arrow", which included other significant corporate governance reforms (Hill, 2018). This means the aim of Japan's stewardship is more active in terms of economic policy, as compared to the U.K. stewardship. In Japan, the world's largest pension fund, which manages public pension (social security) funds, the Government Pension Investment Fund (GPIF) (Ujikane & Nozawa, 2019), is a part of the national government and subjected to heavy political pressure. The GPIF defines itself as a super long-term investor designed as a part of a one-hundred-year sustainable pension scheme and shall fulfill its responsibilities as an asset owner in line with Japan's Stewardship Code. For the purpose of the long-term economic success of portfolio companies, it is crucial to encourage the companies to establish a better corporate governance structure within it. This legal duty requires directors to promote the long-term success of the corporation for the benefit of shareholders as a whole, however, in doing so, directors must consider the list of stakeholder interests including ESG factors.

The top passive fund managers, such as BlackRock, Vanguard and State Street (the Big Three), hold substantial blocks in a large number of public companies in the United States. BlackRock, with more than $5 trillion assets, is now the biggest shareholder of thirty-three of the FTSE 100 companies. Vanguard, with more than $4 trillion assets under management, is not far behind globally and is growing even faster than BlackRock. It is predicted that they will likely hold more than 50% of the market by 2024 (Hunnicutt, 2017). To some extent, these patterns are also present in Europe. In the increase of institutional investors, commentators have focused on the corporate governance role that institutional investors will play, and carefully analysed their deficiency in improving corporate governance and performance (Black, 1990; Rock, 1991). The commentators have focused on several reasons that will weaken asset managers' incentives to monitor the investee company's management, including collective action problems and fee structure, and such (Fisch, 1994; Rock & Kahan, 2019).

2. SUBSTANCE OF THE TWO CODES AND THE GPIF

2.1. The U.K. Stewardship Code

The U.K. Stewardship Code introduced in 2010 and Japan's Stewardship Code introduced in 2014 and influenced by the U.K. Code are very similar in terms of the contents (i.e., principle of each code) and in terms of the form (i.e., adopting not a regulation approach, but a principle-based approach, in other words, the "comply or explain" approach). The Stewardship Code is intended to encourage institutional investors to be actively engaged in the stewardship of their portfolio companies (Financial Reporting Council, 2012), and, as inserted in the revised Stewardship Code of 2012, to additionally and ultimately "promote the long-term success of companies in such a way that the ultimate providers of capital also prosper" for the benefit of the economy as a whole. As such, the key notions in "stewardship" seem to be the long termism and taking a more holistic view of the well-being and performance of the company.

The Financial Reporting Council (FRC) published the U.K. Stewardship Code 2020 (referred to as the "2020 Code") (FRC, 2020) on 24 October 2019 and effective from 1 January 2020. In a change from the consultation version, the final 2020 Code consists of 12 principles with which asset owners and managers who sign up must comply. The 2020 Code is now targeted at asset owners, such as pension funds and insurance companies, and service providers, as well as asset managers. The FRC states that this will help align the approach of the whole investment community in the interests of end-investors and beneficiaries. In the 2020 Code, environmental, social and governance (ESG) factors play a more prominent role. The introduction to the 2020 Code specifically describes that environmental factors (particularly climate change) and social factors have become material issues for investors when undertaking stewardship and making investment decisions. A new principle, Principle 7, states that signatories are expected to consider material ESG issues, including climate change, as part of their investment, monitoring, engagement and voting activities. Additionally, the 2020 Code defines stewardship as "the responsible allocation, management and oversight of capital to create long-term value for clients and beneficiaries leading to sustainable benefits for the economy, the environment, and society". As such, signatories are expected to take ESG factors into account and to ensure their investment decisions are aligned with the needs of their clients. The consultation version of the definition describes the purpose of stewardship as the creation of sustainable value "for beneficiaries, the economy, and society". The final definition is a compromise of sorts – the purpose of the steward is "to create long-term value for clients and beneficiaries leading to sustainable benefits for the economy, the environment, and society". While governance issues have always been a mainstay of investment stewardship, this 2020 Code also places environmental issues (including climate change), social issues and the economy in apposition to governance as factors of good stewardship. Reporting each year on both stewardship activity and its outcomes is required. As such, signatories must report annually what has been done in the previous year and what the outcome was, along with their engagement with the assets they invest in, their voting records and finally how they have protected and enhanced the value of their investments for the benefit of their clients; and the outcomes these activities have had. Reporting obligations are more burdensome than in the earlier versions of the Stewardship Code, which requires a great focus on communications with clients. Moreover, signatories will be required to explain their organization's purpose, investment beliefs, strategy and culture, and how these enable them to practice effective stewardship; and they are also expected to show how their governance arrangements, resourcing, and staff incentives demonstrate their commitment to stewardship.

To enhance the stability and sustainability of EU companies, in May 2017, the European Parliament and Council agreed to an amendment to the 2007 Shareholder Rights Directive (the "Directive"). The aims of the Directive are to enhance transparency in the investment chain and to hold investors accountable for the amalgamation of environmental, social and governance (ESG) factors in investment decisions, the level and quality of long-term shareholder engagement, and the association of investors' investment strategy and remuneration structures with the medium- to long-term performance. All asset owners and managers operating in Europe will be required to comply with the national laws that will implement the amended Directive. The new policy has a particular focus on increasing transparency and encouraging long-term shareholders' interests. In summary, the amendments include disclosing directors' remuneration, enhancing the transparency of voting and engagement policies of asset managers and voting recommendations of proxy advisors, encouraging the identification of a company's shareholders through intermediaries, and improving shareholders' lapse of a company's related party transactions.

2.2. Japan's Stewardship Code

To revitalize the Japanese economy, the Japanese government is adopting various economic policy measures against the lengthy appreciation and deflation of the yen. With the aim of realizing such policy, in June 2013, the Abe Cabinet approved the Japan Revitalization Strategy, which states that "principles for institutional investors to fulfill their fiduciary responsibilities, e.g. by promoting medium to the long-term growth of companies through engagements (Japanese version of the Stewardship Code)" should be discussed and drafted. To this end, in August 2013 the Financial Services Agency (FSA) established the Council of Experts Concerning the Japanese version of the Stewardship Code. The Experts Council held several discussions to prepare for the principles of stewardship and published "Principles for Responsible Institutional Investors (Japan's Stewardship Code)" (hereinafter, the Code) on February 26, 2014 (The Council of Experts Concerning the Japanese Version of the Stewardship Code, 2014). Under the Code, the FSA is required to publish and periodically update the list of institutional investors who have announced the acceptance of the Code.

2.2.1. Significance of the Code

"Stewardship responsibilities" in the Code refer to the responsibilities of institutional investors to enhance the medium- to long-term investment returns for their clients and beneficiaries by improving and enhancing the corporate value and sustainable growth of investee companies through constructive engagement or purposeful dialogue (The Council of Experts on the Stewardship Code, 2017) based on in-depth knowledge of the companies and their business environment. This Code defines principles considered to be helpful to institutional investors who behave as responsible institutional investors in fulfilling their stewardship responsibilities with due regard to their clients, beneficiaries and investee companies.

The Code furthermore describes as follows: "The function of the board [as defined in Japan's Corporate Governance Code (effective June 1, 2015)] and that of institutional investors as defined in the Code are complementary, and both form essential elements of high-quality corporate governance, which are indispensable in ensuring the sustainable growth of the company and the medium- to long-term investment return for the clients and beneficiaries. With due regard to the roles of both the board and institutional investors, the Code promotes constructive engagement, or purposeful dialogue, between institutional investors and investee companies". Contrarily, the Corporate Governance Code describes as follow: "Companies should fully recognize that their sustainable growth and the creation of medium- to long-term corporate value are brought as a result of the provision of resources and contributions made by a range of stakeholders, including employees, customers, business partners, creditors, and local communities. As such, companies should endeavour to appropriately cooperate with these stakeholders…" and "In order to contribute to sustainable growth and the increase of corporate value over the medium- to long-term, companies should engage in constructive dialogue with shareholders even outside the general shareholder meeting…" Given the manner in which the Stewardship Code and the Corporate Governance Code are demonstrated and constructive dialogue with investee companies is conducted, benefits can arise for a country's investee companies, shareholders, stakeholders, and economic and financial systems. Institutional investors attempt to achieve this purpose by imposing a certain duty to act based on the "comply or explain" principle, although it is not legally binding but based on de facto norms.

The scope of targeted institutional investors under Japan's Code (The Council of Experts on the Stewardship Code, 2017) is as follows:

1. "Institutional investors as asset managers" who are responsible for investing in funds and for investing in a company (such as an investment manager);
2. "Institutional investors as asset owners" who are originators of the funds (e.g., pension funds, insurance companies);
3. Voting advisors, for example, who receive commissioned work from institutional investors.

To hold institutional investors' acceptance of the Code transparent, those who accept the Code are supposed to publicly disclose on their website their acceptance and so on, to annually review and update the disclosed information, and notify the FSA of their website address used to disclose such information. The number of signatories has increased, and at the end of June 17, 2017, signatories provided voting records on an agenda basis. Thirteen out of the 17 signatories are non-Japanese signatories famous for excellent disclosure such as AXA Investment Managers and Henderson Global Investors as asset managers, and CalPERS and Railpen as asset owners. Two years later, the number of signatories as of June 28, 2019

(FSA, 2019), was 251 consisting of 184 (six trust banks and 178 investment managers), 60 asset owners (23 insurance companies, and 37 pension funds), and seven service providers and still increasing.

2.2.2. The 2017 revision

On November 30, 2016, the Council of Experts Concerning the Follow Up of Japan's Stewardship Code and Japan's Corporate Governance Code called by the FSA and Tokyo Stock Exchange published an Opinion Statement entitled "Effective Stewardship Activities of Institutional Investors – To Enhance Constructive Dialogue toward Sustainable Corporate Growth" (hereinafter the Opinion Statement). The Opinion Statement requested institutional investors to engage in an in-depth constructive dialogue with investee companies and proposed a revision of Japan's Stewardship Code. After the Council of Experts on the Stewardship Code discussed revising the Code, the FSA, based on such discussion, prepared and published the revised Stewardship Code in 2017.

2.2.3. Comparison of U.K. Stewardship Code with Japan's Stewardship Code

The Japan's Code is significantly influenced by the U.K. Code of 2012. However, some differences exist between principles of the U.K. Code and those of the Japan's Code. A major difference between the Codes is associated with collective activism. The 2014 Japanese Stewardship Code includes no principle endorsing collective activism, although its 2017 revisions contemplate some form of collaborative engagement between institutional investors. In contrast, Principle 5 of the U.K. Stewardship Code explicitly refers to collective activism by stating that "[i]nstitutional investors should be willing to act collectively with other investors where appropriate". In reality, the U.K. institutional investors have long experienced engagement in a coordinated action, not only to directly influence the corporate management but also to impact the legal rules regulating the balance of power between shareholders and management (Davies, 2015). The FRC has likewise encouraged more alliance between international and the U.K.-based institutional investors as a solution to the low level of equity held by domestic investors (FRC, 2013).

Many people imagined that the same principle as Principle 5 of the U.K. Code will be introduced to the Japanese version of the code. However, the business world voiced its doubt, because for institutional investors to cooperate with other institutional investors and share actions in exercising shareholders' rights is not considered as a form of usual corporate behaviour in Japan. Then, the same principle as Principle 5 of the U.K. Code was not introduced to the original Japanese code (Kansaku, 2016). This omission has partly to do with tradition, the distaste for confrontation and criticism, and just as much to do with the structural reality of the dominance of passive shareholders in Japan. Surprisingly, shareholders in Japan have originally owned quite strong legal rights under statutes (Goto, 2014). These shareholders' rights include statutory rights, among others, to alter the corporate constitution without board consent; to elect directors by a majority vote, and to nominate directors on the company's ballot. However, historically, investor activism has been rare. The most significant reason for suppression and restraint on investor activism has been the existence of cross-shareholding (*"kabushiki mochiai"* in Japanese), which have protected management from outside shareholder influence. Despite the progress in the unwinding of cross-shareholdings of Japanese banks, there has been a concomitant increase in shares owned by other "silent" shareholders, e.g. The Bank of Japan, non-financial corporations, and passive investment vehicles including ETFs and index funds.

2.3. The Government Pension Investment Fund (GPIF)

The GPIF was established in April 2006 as a corporation that manages public pension (consisting of annual welfare and national insurance and excluding corporate annuities and private school mutual annuities) reserve funds. Initially, the fund management department of the Ministry of Finance (the present Ministry of Finance) used to manage pension reserves. However, the Pension Welfare Corporation, established in 1961, took over these reserves. Then, pension reserves were managed by the Pension Funds Management Fund established in 2001, after which the GPIF took over. As such, the GPIF was established as part of the pension reform enacted in 2001 primarily to change the management of public pension fund investments from a trust associated with the Ministry of Finance to new, independent, and professional management, e.g., the GPIF. The public pension premium paid by the people is collected by the Japan Pension Service (started in 2010, the former Social Insurance Agency), which was commissioned by the Minister of Health, Labour and Welfare, and the collected pension funds are deposited by the Minister of Health, Labour and Welfare. After the GPIF began operating, it was commissioned by multiple financial institutions. Pension funds and investment income are used to distribute pension benefits to the people.

With respect to the relationship with the Japan's Code, in 2014, the GPIF made the following announcement: "To maximize medium- to long-term investment return for the beneficiary by improving and fostering investee companies' corporate value and sustainable growth…, GPIF has adopted the Code and will fulfil the stewardship responsibilities" (GPIF, 2014). Based on this statement, the foundation of stewardship activities consists of an investment principle, a policy for fulfilling stewardship responsibilities, and stewardship and voting principles. That is, the GPIF fulfils stewardship responsibilities as an asset owner based on "investment principles" and "policies for fulfilling stewardship responsibilities", and seeks compliance with "stewardship principles" of operation and "voting principles" from asset management organizations. As such, the GPIF finds itself as a sincere enforcer of the Japan's Code.

2.3.1. Investment principles

The GPIF's mission is to contribute to stabilizing public pension programs' operations by earning the investment returns required to secure rigorous pension finances in accordance with the government's fiscal forecasts. In other words, the GPIF's most significant risk is of failing to earn this required rate of return over the long term. The GPIF's investment is made subject to four fundamental principles that describe the GPIF's basic approach to its investing as follows:

1. The GPIF's overarching goal should be to achieve the investment returns required for the public pension system with minimal risks and solely for the benefit of pension recipients from a long-term perspective, thereby contributing to the stability of the system.
2. The GPIF's primary investment strategy should be diversification. The GPIF should acknowledge fluctuations in short-term market prices and achieve investment returns more stably and efficiently by taking full advantage of its long-term investment horizon. At the same time, we will secure sufficient liquidity to pay for the pension benefits.
3. The GPIF formulates the policy asset mix and manages, and controls risks at the levels of the overall asset portfolio, each asset class, and each investment manager. It employs both passive and active investments to achieve the benchmark returns (i.e., average market returns) set for each asset class while seeking untapped profitable investment opportunities.
4. By fulfilling our stewardship responsibilities (including the consideration of ESG factors), we will continue to maximize medium- to long-term investment returns for the benefit of pension recipients.

Since it accepted Japan's Stewardship Code, the GPIF has quickly and aggressively implemented and encouraged these activities, including setting up the Business and Asset Owners' Forum and the Global Asset Owners' Forum and establishing the Stewardship & ESG Division. Moreover, in September 2015, the GPIF has become a signatory to the United Nation's Principles for Responsible Investment (UN-PRI) to express our attitudes regarding ESG issues (GPIF, 2015). The UN-PRI has six principles, and the fourth principle states "We will promote acceptance and implementation of the Principles within the investment industry". The GPIF's plan regarding this principle states "The GPIF asks external asset managers whether they are signatories to the UN-PRI" and "The GPIF ask[s] the signatories to report their ESG activities, and also ask[s] the non-signatories to explain the reason for not signing". Since then, the concept of ESG investment has spread widely throughout Japan. At the same time, the GPIF conducted interviews with all investment management agencies (including re-outsourcers of investments) to which the corporation outsources domestic equity investments regarding the status of the response regarding stewardship activities. As of September 2019, the UN-PRI had 74 signatories, of which 45 are investment managers, 20 are asset managers, and 12 are service providers. In 2006, when the UN-PRI was established, it had five asset managers. However, subsequently, it had one to four asset managers each year, which increased by five to eight each year from 2016. This situation seemed naturally influenced by the UN-PRI signature by the GPIF in September 2015.

2.3.2. Stewardship principles

The GPIF established its Stewardship Principles on June 1, 2017. The GPIF requires its external asset managers for domestic and foreign equity investments to comply with the following Stewardship Principles. If an asset manager decides not to comply with any of the principles, it is required to explain the rationale for its non-compliance to the GPIF (the "comply or explain" principle). To perform its own stewardship responsibilities, the GPIF continuously monitors the stewardship activities of asset managers such as the exercise of voting rights, and actively conducts a dialogue with them. The Stewardship Principles cover the following five principles:

1. *Corporate Governance Structure of Asset Managers.* Asset managers should adopt Japan's Stewardship Code and have a strong corporate governance structure. In particular, asset managers should develop a supervisory system through measures such as appointing outside directors with a high degree of independence to enhance their independence and transparency.
2. *Management of Conflicts of Interest by Asset Managers.* Asset managers should appropriately manage conflicts of interest to put beneficiaries' interests first when conducting activities. Asset managers should classify types of conflicts of interest and develop and publicly disclose a policy for the management of conflicts of interest. Asset managers should manage conflicts of interest through measures such as establishing a third-party committee with a high degree of independence.
3. *Policy for Stewardship Activities, including Engagement.* Asset managers should develop and publicly disclose a policy of their stewardship activities including engagement. They should focus on ensuring that their stewardship policy and activities contribute to medium-to-long-term shareholder value. They should consider non-financial information (including Corporate Governance Reports and Integrated Reports) when engaging investee companies. Given the significance of passive investment of the GPIF equity portfolios, the GPIF's performance depends upon medium-to-long-term sustainable capital market growth. Asset managers for passive investments should develop and effectively implement a suitable engagement strategy for such investments.
4. *ESG Integration into the Investment Process.* The GPIF believes that it is vital to integrate ESG factors into the investment process to promote the sustainable growth of corporate value and better medium- to long-term risk-adjusted returns for the GPIF. Asset managers should consider the materiality of ESG issues and deal with them accordingly. Asset managers should proactively engage with investee companies on critical ESG issues and become a signatory of the Principles for Responsible Investment (PRI).
5. *Exercise of Voting Rights.* Asset managers should exercise voting rights exclusively in the best

interests of the GPIF and its beneficiaries, and exercise voting rights in accordance with the Proxy Voting Principles. When using a proxy advisor, asset managers should conduct proper due diligence before selection. After selection, asset managers should continuously monitor service quality and engage with the proxy advisor as necessary.

2.3.3. Policy to fulfil stewardship responsibilities

The GPIF established the Policy on May 30, 2014, and revised it on September 10, 2015, and August 1, 2017.

The policy consists of the following Basic Policies and Measures on Each Principle of the Code corresponding to them:

1. *Concepts of stewardship responsibilities:*

– The GPIF is a universal owner, an investor with a very large fund size, a widely diversified portfolio across the overall capital market, and a super long-term investor designed as a part of a 100-year sustainable pension scheme. Given such features, the sustainable and stable growth of the overall capital market is essential for the GPIF to secure its long-term investment returns.

– Because the GPIF invests in equities and exercises voting rights through its external asset managers (asset managers), it promotes constructive dialogue (engagement) between asset managers and investee companies. Thus, the GPIF will perform its stewardship responsibilities by promoting engagement between asset managers and investee companies and building a win-win relationship in the investment chain (GPIF, 2018).

– As an "asset owner" defined by the Japan's Stewardship Code, the GPIF is directly engaged in initiatives that it can execute on its own as stated in the item 2 below. Meanwhile, as stated below, the GPIF understands the state of their implementation, conducts appropriate oversight, proactively has dialogue (engagement) with asset managers, and publishes the Report of GPIF's Stewardship Activities for each fiscal year, thus fulfilling its stewardship responsibilities.

2. *Policies concerning initiatives undertaken by the GPIF:*

– The GPIF will fulfil its roles and responsibilities as an asset owner in line with the Code and will promote stewardship activities with a study of appropriate stewardship responsibilities in an attempt to maximize medium- to long-term investment returns for the beneficiary.

– From the viewpoint of fiduciary responsibilities, the GPIF will examine various activities that are intended to maximize medium- to long-term investment returns for the beneficiary.

3. *Policies concerning initiatives conducted by asset managers:*

– The GPIF shall require asset managers for equity investments to comply with its Stewardship Principles and Proxy Voting Principles. Should an asset manager decide not to comply with any of the principles, it is required to explain to the GPIF its rationale for the non-compliance (the "comply or explain" principle).

– The GPIF will continuously monitor the stewardship activities of asset managers, including the exercise of voting rights, and proactively engage in dialogue (engagement) with them.

– During the evaluation of asset managers, the GPIF shall highly value asset managers that are considered to have better-fulfilled stewardship responsibilities, other conditions being the same.

2.3.4. Voting principle

The GPIF established Proxy Voting Principles on June 1, 2017. When exercising voting rights, the GPIF will ask asset managers to do as follows: 1) to develop a proxy voting policy and guidelines to maximize shareholders' long-term interests, which should be publicly disclosed in a way to make clear their basis of judgment; 2) to sufficiently communicate with investee companies to help inform proxy voting decisions and to ensure that all voting rights are exercised with thoughtful consideration; 3) to carefully consider ESG issues when exercising voting rights with the objective of enhancing investee companies' corporate value over the medium- to long-term; 4) to apply careful due diligence when exercising voting rights on proposals that could undermine minority shareholders' interests; 5) to exercise voting rights in accordance with Corporate Governance Codes established by individual countries that investee companies must follow; 6) if asset managers use a proxy advisory service to exercise voting rights and not mechanically follow the advisor's recommendations, it is the sole responsibility of asset managers to exercise voting rights in the best interests of the GPIF and its beneficiaries. In contrast, after the general meeting of shareholders, the GPIF will ask asset managers to do as follows: 1) to publicly disclose all voting records for each investee company on an individual agenda item basis; 2) to explain to investee companies or publicly disclose the voting records and rationale depending on the importance and relevance; 3) to periodically review their voting records and process and make necessary updates to the policy.

2.3.5. The GPIF Stewardship Activities Report of 2018 (GPIF Report 2018)

In March 2017, the GPIF started to call for the application of passive managers for domestic equities to reinforce stewardship activities. The GPIF expects that it would contribute to improving the sustainability of all markets through such activities and diversifying the manner in which stewardship activities are approached. Regarding engagement (communication) with external asset managers, the GPIF has shifted from a one-way annual monitoring model to an "engagement" model, focusing on two-way communication and exchanging views on stewardship responsibilities.

According to the GPIF's assessment of stewardship activities, approximately 90% of its equity is passively managed, and the GPIF invests in a wide range of listed companies. Because the sustainability of the entire market is crucial, the GPIF believes that it is critical for passive managers to implement engagement activities, which would encourage investee companies to increase corporate value and sustainable growth from the medium- to the long-term perspective. Moreover, the GPIF describes that passive managers were assessed in terms of their contribution to the sustainability of the entire market, whereas active managers were assessed in terms of their contribution to increasing the long-term shareholder value of the investee companies. Regarding engagement with index providers, the GPIF believes that the governance of index providers is essential to ensure neutrality and transparency when selecting and evaluating stocks to be included in indices. Consequently, we focused on this governance when selecting ESG indices. The GPIF states that all asset managers for domestic and foreign equities responded that they have taken measures for ESG issues. With respect to the exercise of voting rights, many asset managers make quarterly disclosures to ensure that the announced results will be of use in the dialogue after the general meeting of shareholders. As a result, the GPIF describes its action plans to be taken forward.

2.3.6. Pension Reform Act of 2016

Laws have reformed the corporate governance of the GPIF. In December 2016, the Japanese Diet enacted the Act for Partial Revision of the National Pension Law to Improve Sustainability of the Public Pension System (Pension Reform Act) (Ministry of Health, Labour and Welfare, n.d.). To increase the sustainability of the system and ensure benefits for future generations, the Act intends, among others, that the security function will be strengthened in response to changes in the socio-economic situation and that the GPIF will be reviewed as an organization for safer and more efficient management of pension fund actions. To strengthen the auditing function, the GPIF also introduces an audit committee to audit and monitor both the executive committee and the executive department. Derivative transactions are widely used for risk management purposes by pension funds and institutional investors to control price fluctuation risks, such as exchange rates and stocks. However, given the possibility of speculative transactions, the GPIF prohibits certain derivative transactions (market derivatives transactions, stock index futures transactions among foreign exchange futures transactions) by law (Horie, 2017).

3. LITERATURE REVIEW

This article is subject to the comparative law approach and the law and economics approach.

Managers engaging in activism must assume all of the costs of engagement with investee companies but share the increased returns with their competitors who hold shares in the investee companies (Gilson & Gordon, 2013). Traditional institutional investors understand the costs arising out of exercising their governance rights are purely too expensive, as compared with an increase in performance value realized from such exercise (Coffee, 1991). Thus, institutions are mostly concerned with comparatively better investment performance during relatively short periods while minimizing costs and risks. A passive index fund competes primarily on costs against each other, and as a result, has no financial incentive to assume the costs related to any intervention in the corporate governance of their portfolio companies (Bebchuk, Cohen, & Hirst, 2017).

First, regarding an existing incentive problem, the collective action problem may constrain costly engagement efforts. However, governance improvements are an efficient mechanism for a passive investor's engagement. Passive funds have large portfolio sizes and very limited firm-specific information. Fisch, Hamdani, and Davidoff Solomon (2018) argued that because governance is passive funds' single effective channel to improve underperforming companies, it becomes their comparative advantage. Passive funds cannot withdraw their investment in underperforming companies, whereas they have an incentive to ensure that their portfolio companies should be more sensitive to shareholder demands, moreover, the passive funds' growth causes greater voting power to demand that sensitivity.

Second, costs are a concern. Given their economies of scale, large passive funds can charge lower fees, thereby becoming more attractive to investors. On the other hand, in contrast to previous critics, because passive investors hold the market, they do not need to engage in firm specific monitoring but are more likely to engage in market-wide activities to improve corporate governance. In other words, passive investors can exploit economies of scale to improve governance across their portfolios. Another commentator indicates that the increase in money managers' power is changing the nature of shareholder activism, meaning that they need not resort to aggressive tactics to influence companies' management.

Active funds will benefit from the market-wide governance expertise of passive funds, and passive funds will, in turn, rely on the company-specific information generated by active investors. Thus, passive investors benefit from activists and constrain destructive hedge fund activism, as such mediating their influence. While index funds are locked into their portfolio companies, investors in such index funds can exit by using Wall Street rule. Fisch (1994) suggested that, as such, passive funds compete for investors, not only with other passive funds but also with active funds and that they compete on both cost (i.e., fees) and performance. Fisch et al. (2018) argued that passive funds compete against active funds and that, as a result, passive fund sponsors have an incentive to defuse the comparative advantage enjoyed by active funds. Because of this competition, passive funds will engage in stewardship and, in particular, be willing to improve governance in underperforming companies in their portfolios. Consequently, the total cost of passive investors' effective engagement will be reduced and passive investors are more likely to invest in governance.

Especially during these few years, the relationship between passive funds and activist funds has changed significantly. Activists are increasingly demanding the support of passive investors, which frequently substantially affects the success of activist campaigns (Klingsberg & Bieber, 2018). As a result, activist investors seem to have a more tendency to tailor their interventions to satisfy passive investors by appealing to their longer-term and governance concerns. As such, the interplay between passive and active funds has been enhanced significantly.

Assuming that this argument is true, Fisch et al. (2018), the other influential article, clearly explained that each strong point of a passive fund, which has market-wide knowledge and influence, and an active fund, which has firm-specific knowledge and use power over individual investee companies. Such a feature of passive funds will enable each of these passive funds with large market-scale to effectively advance stewardship. It must be stressed that most passive funds represent long-term investors and, as such, they have an incentive to monitor and steward managers to improve an investee company's governance. However, without the voting rights that a passive fund holds with investee companies, such funds cannot influence investee companies through engagement, dialogue, "voice", because they cannot pressure companies by "exit". Moreover, passive funds, without voting rights that allow them to use their voting power more effectively, cannot influence the voting policies of proxy advisory firms. In this line, Lund (2018) proposed that lawmakers should consider restricting passive funds from voting at shareholders' meetings because passive funds will have harmful consequences for corporate governance, shareholders, and the economy for several reasons. No voting rights, no voice. As such, voting rights are crucial and should not be withdrawn easily.

4. DISCUSSION

The policy and approach to the investment chain are appropriate with respect to Japan's Stewardship Code following the U.K. Stewardship Code. Stewardship responsibility, unlike fiduciary duty, is not a legal liability (i.e., the "comply or explain" principle in Japan), but is still an important concept. When stewardship is demonstrated, constructive dialogue with investee companies can bring benefits to the investee company, shareholders, stakeholders, and the national economy. The conclusions of empirical studies on shareholder activism are not consistent in Japan. A view exists that shareholders appreciate the ability to warn against management deficiencies. In contrast, another voice points out the problem of excessive involvement with corporate insiders by entrusted managers and one-size-fits-all voting based on uniform policies. However, an empirical study found that, by focusing on the stock prices of investee companies in which CalPERS has deeply engaged, medium- to long-term added value has been created through such engagement (five years after the start).

The GPIF holds a large number of voting rights in an individual company and is still a highly powerful entity and has effectively encouraged institutional investors to accept the Japan Stewardship Code. This greatly contributes to the penetration of the Code. However, the GPIF explains that the effect on the stock market is limited because it is an extremely long-term investor, and the effect on the market by disclosing the holdings has not been confirmed (GPIF, 2017). The GPIF does not directly exercise voting rights to ensure that it does not raise concerns that directly affect the management of a business.

As previously observed, the GPIF requires asset managers to exercise voting rights to realize long-term shareholder benefits and to engage in stewardship responsibilities. On the other hand, concern exists over the high rate of passive management. The total market capitalization held by the GPIF as of the end of 2018 was as follows: 38.66 trillion yen in total (for domestic equity only), 3.64 trillion yen for active management (9.4%), and 35.15 trillion yen for passive investment (90.6%). Conducting a dialogue with the investee company is difficult sufficiently because of the cost aspect of passive management, and concern exists that the GPIF, which is mainly based on such passive management, cannot influence the governance of the investee company. The GPIF recognizes this task. With respect to the status of the exercise of voting rights (April to June 2018) by the trustee organizations, approximately 10% of the votes cast for all proposals have been cast against, especially 58% cast against director retirement bonuses proposal, and 91% cast against poison pills (warning type). During the period from 2014 (the year that the GPIF endorsed the Code) to 2018, 7.9% to 10.3% was cast against the proposals. This percent range indicates that a certain degree of opposition was cast and that the institutional investors to which the GPIF has outsourced did not simply vote in favour. Thus, the exercise of voting rights and dialogue with investee companies is not conducted by the asset owner, the GPIF, but by an agency (asset manager) commissioned by the GPIF yet, the GPIF monitors such asset managers. Then, the GPIF is said to have an indirect influence.

According to some studies, the GPIF-owned stocks have a higher governance evaluation than non-owned stocks. However, whether this evaluation has been improved by the investment trustee's approach to investee companies or the GPIF has in the first place selected stocks of companies with high governance is unclear. Even if the latter is the case, from the investee company's point of view, raising these indicators to have the GPIF hold shares is necessary, which may contribute to the improvement of governance as a result.

5. CONCLUSION

The increase of passive investing has been associated with a growth of responsible investing, as shown by the increasing number of signatories to the UN-PRI (Bioy, Bryan, Choy, Garcia-Zarate, & Johnson, 2017). During the rise of institutional investors, in terms of the solution for corporate governance, institutional investors have been viewed as a central accountability mechanism and essential to long-term sustainable corporate growth. Stewardship is more challenging because of regulatory issues, cultural differences, and ownership structures such as cross-shareholdings in Japan. ESG investments will be extended globally, but local governance norms can differ widely. The establishment of a stewardship culture does not happen overnight and requires years of continuous, active investor-led engagement in the region. The GPIF, accepting Japan's Stewardship Code and being a signatory to the PRI, establishes and complies with its stewardship principles and requires its external asset managers to comply with the Stewardship Principles and continuously monitors the stewardship activities of asset managers. As such, the GPIF, as an asset owner, continually improves the stewardship and engagement by utilizing the PDCA cycle. In this sense, the GPIF can be a responsible steward.

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