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Conference Report

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Noboru Yoshioka, President, Chief Executive Officer, QUICK Corp., kicked off the RI Asia 2016 conference in Tokyo on February 22/23 by saying Japan was a leader in Asia and had laid the foundation for spreading responsible investment around the region.

QUICK, he said, launched an ESG research institution in 2014 and Yoshioka said he strongly felt that Japanese shareholders believed non-financial information would be important for investment going forward. He said: “issues such as global warming and human rights help to find the true value of investments.”

He added that there was a misperception that Japanese companies did not value CSR: “In Japan, it is at a high level. But overseas companies don’t appreciate this,” he said. “There is a gap between perception and reality and that message is not reaching investors fully.”

Martin Skancke, Board Chair at the Principles for Responsible Investment, highlighted an eventful last year’s activities including the Paris climate agreement and the adoption of the UN Sustainable Development Goals. Focusing on Japan, he said that the country’s Stewardship Code had been a catalyst for rapid change on responsible investment in the country: “It’s highlighted the role of investors and companies and how the relationship between investors and companies should be. It gives a strong impetus to look at responsible investment issues generally,” he said.

Skancke revealed that stewardship was starting to expand around Asia, explaining he had been in Korea the night before for a discussion about the country adopting its own Stewardship Code.

Skancke discussed Japan’s giant $1.2trn (€1trn) Government Pension Investment Fund (GPIF) joining the PRI last year, praising it for doing a “remarkable job” in a short period of time.

“It’s established ambitious responsible investment policies, set expectations for its asset managers, revised its investment principles around responsible investment, and joined the PRI asset owner advisory committee,” he said. “We are pleased GPIF is taking leadership at a global level on these issues.”

Day One: 23 February 2016
Panel discussion: Long-term investment - the case for Asset Owners featuring the perspective for different countries, including Japan, Australia and the USA.

Masafumi Hikima, Executive Director for Finance, Sophia University, said the premise of ESG and long-term investing had an affinity with the university’s objective to prepare the future generation.

He said its experience with responsible investment was very short: “Last year, we joined the Global Compact and signed up to the PRI in November.” But, he said, it had started engaging with its asset managers on ESG issues.

Speaking on the same panel, Peter Webster, Director of International Affairs, Member of the Executive committee at Vigeo EIRIS, which provides ESG data to QUICK on Japanese companies, said asset owners would help to drive the responsible investment market in Japan, but also cited a strong market for ESG retail funds in the country. “GPIF has helped create this change – I know of other asset owners in Japan who will join the PRI because of them.”

Priya Mathur, Board Member at CalPERS, talked about developing good responsible investment practices within asset owners. She said it was a dance between the board and the investment professionals managing assets: “It’s important to refresh your thinking periodically,” she said. “You need engagement with board and investment professionals on the value of ESG investing and other factors.”

Hikima said it was not hard to get buy-in from the board when it recently started its ESG journey, but it did spend time on how to incorporate ESG into investing. He explained that some people said ESG should focus on certain areas, while other parts would be traditionally managed. But eventually it was decided that ESG was not a specialized strategy or product, it’s integrated across the whole spectrum of investments.

However, he raised concerns about Japan’s Stewardship Code. “There is a lot of criticism about the substance of commitments, he said. “There needs to be monitoring and oversight. That it is underdeveloped is another criticism.”

He said the Japanese Financial Services Agency (FSA) and Tokyo Stock Exchange (TSE) both reported strong compliance to the principles of the Stewardship Code, but highlighted that it was self-assessment: “Maybe they are being too easy on themselves,” he said.

Later in the discussion, Hikima said there was also an issue that asset managers ‘said’ they ‘did ESG’, but on further digging, they struggled to give specific examples.

Hikima also highlighted a potential conflict around cross holdings - Japanese companies holding the stock of another company - but said progress was being made on the issue.
Minako Takaba, Vice President, Head of Research, Japan, MSCI, said ESG contributed to alpha: “You need data and systems and then the generation of alpha rests on the skills of portfolio managers.”

Tsukasa Kanai, Chief Sustainability Officer, Corporate Planning Department, at SuMi TRUST, said ESG integration was spreading in Japan as more institutional investors in the country wanted to use it for their daily investment work, not just specialized funds. Kanai said it was possible to acquire alpha through ESG but agreed with Takaba that it was fundamentally the skill of the manager and it was difficult to solely credit ESG. He added that for full integration all fund analysts needed to do ESG research.

Will Oulton, Global Head of Responsible Investment, First State Investments, said sustainable alpha didn’t mean much: “You require on the skills and processes of the investment team,” he said. “ESG is part of that, and if you didn’t do it you would have sub-optimal performance.”

He continued: “Primarily, ESG is risk management and avoiding the loser. It also helps in picking the winners.” He talked about recently launching a Japanese equity fund, noting: “We believe a greater understanding of ESG is helping drive performance in that fund.”

Kanai said asset owners in Japan were not really active on ESG, but said GPIF’s moves in the area would be influential. In 2003, it created its first ESG fund and started integration work. But, Kanai noted, ESG growth was sluggish for a long time. Now, through institutional investors, he said it was experiencing explosive growth: “We’ve known its use for a long time, but it’s difficult to implement. There was this pent up frustration but the Stewardship Code broke that loose.”
The changing landscape of fiduciary duty in Japan

Nathan Fabian, Director of Policy and Research, Principles for Responsible Investment said sometimes different legal language was used to describe fiduciary duty but the principles were essentially the same: “There is a duty of loyalty and a duty of prudence which means fiduciaries should act in good faith and with due care, skill and diligence.

“Fiduciary duty is not Japanese law, but the concept is ‘in’ Japanese law and represented in the Stewardship Code.”

Yasumasa Tahara, Director, Corporate Accounting and Disclosure Division, Financial Services Agency described the recently adopted corporate governance code as “revolutionary” for Japanese companies.

But he questioned whether the dialogue was yet “meaningful” between companies and investors. He said one area of discussion was around appointing CEOs: “It’s important to choose a CEO to react to emerging issues. Boards need to be independent and objective to provide oversight.” He said a discussion on the issue was being hosted on its website.
The changing landscape of fiduciary duty in Japan

Chihiro Kawashima, Executive Director, Department of Economic and Social Policy, JTUC-RENGO, the trades union body, explained how since 2010 it had been working on responsible investment for workers capital.

He said its main role was lobbying corporate pension funds to embed responsible investment. He said that GPIF signing up to the PRI was a major step forward. He said that in corporate pension funds there had not been much progress, but “Japan tended to follow authority” and that GPIF’s move could trigger them to introduce responsible investment.

He said that when it started its effort with labour union pension funds some thought responsible investment would mean sacrificing returns for ESG. It revised its guidelines on fiduciary duty – which had originally talked about building a fair and sustainable society - in response: “It was not convincing enough, you need sustainable earnings and a fair and sustainable society,” said Kawashima.

Kazunori Nakatsuka, General Manager, Chief Consultant of ESG Research Center, QUICK Corp. said there was increasing awareness that considering ESG issues was not contrary to fiduciary duty.

Tahara from the Financial Services Agency said generally speaking fiduciary duty was not explicit in Japanese law, but the concept had been discussed for decades in Japan.

He said institutional investors, and especially companies were asking for dialogue on the Stewardship and governance codes. However, he said compliance was low on proxy voting: “Improving transparency is an issue for us,” he said.
The crossroad of Stewardship responsibilities and ESG integration

Renard Siew, Senior Executive at Sime Darby, the Malaysian plantations and energy group, and Adjunct Research Fellow, Centre for Energy and Environmental Markets (CEEM), queried whether the tools available for ESG integration were fit-for-purpose, saying that there were a lot of ESG rating tools with different sets of criteria: “I don’t know if this creates confusion,” he said.

Gregory Elders, Senior ESG Analyst, Bloomberg agreed with Siew: “There is an issue concerning why one company is in some indices and not in others. Transparency works both ways.” Siew also said it didn’t make sense if one company was at the top of the Dow Jones Sustainability Index, and not in another ESG rating. “Where is the consistency in that?” he asked. “There is still a lot of work to do on this.”
Alternative sustainable investment:
Private Equity, Infrastructure and Real Estate

Shigefumi Kuroki, Senior Vice President of Structured Finance Department, Development Bank of Japan, said it often co-invested in infrastructure with funds like GPIF and other major asset owners.

He talked about a current infrastructure investment in a high-speed rail project in France going from Paris to the south west. He said it was important for ESG to be integrated into this project: "It’s long term, in this case 50 years. And it is unlisted, because listed infrastructure is limited. So the consideration of ESG is quite important."

He said the infrastructure development had links with the local community and collaborated with NGOs to protect endangered animals in the vicinity of the rail development.

“We are funding habitats for animals on the track. There is also consideration for employment. We hire local people and will train them to continue in other employment after the project. There are trips for school kids to the construction. We have a website with lots of information disclosure.

He admitted that there had been some negative news but through dialogue with the government and local community it had managed to lead the discussion in the right direction.

He concluded: “Does ESG increase value? It provides downside protection and a higher likelihood a project will become profitable.”

Shunsuke Tanahashi, Chief Executive Officer at Ark Totan Alternative, the fund manager, talked about Japan’s approach to ESG around private equity. He said there were around 4 million unlisted companies in Japan, compared with 35,000 listed companies. He said it was a challenge as each small company was different from other and each company was quite unique and different from others: “It’s a major challenge to understand an ESG approach to private equity.”

He continued that many unlisted companies had low resources and were run by a few people: “Some overseas investors all of a sudden are asking due diligence questions on ESG and small funds don’t know what to do.

He said at Ark Totan, which works as a placement agent, ESG factors were incorporated into the selection process of private equity General Partners (GPs) based on the ESG considerations of Limited Partners (LPs).

Kiyoyuki Tsuchimoto, Director, Senior Executive Office, Tokyo Stock Exchange, concluded the day talking about the progress of the Japanese corporate and stewardship code.

He highlighted the increase in number of outside directors at Japanese listed companies as one notable feature of its implementation.
Day Two: 24 February 2016

Takejiro Sueyoshi, Special Advisor in the Asia Pacific region, UNEP Finance Initiative, spoke in the morning about Japan’s approach to renewable energy.

“It’s been three months since the Paris agreement so it’s still vivid in our memory. On the other hand, it’s still not a hot topic. I’m surprised how Japan received the Paris agreement and minimized its significance. It’s a concern, as the implications on business are so large.”
Green bonds - Asian markets overview

Yoshihiro Fujii, Executive Director, Research Institute for Environmental Finance, panel moderator, said the Asian green bond market had great potential.

Eric Moen, Managing Director and Head of ESG at MSCI, said green bonds in Asia represented 8.6% of the global total: “We hope to see that grow over time,” he said.

Toru Inoue, Vice President, Head of Infrastructure and Structured Finance in Financing Group of Investment Banking Division, Goldman Sachs, said it had tried to offer investors green bond opportunities for infrastructure in Japan but it was difficult to find volume. “There is not much infrastructure development like road building,” he said.

On renewables, Inoue said that since 2013’s Fukushima nuclear accident, there had been rapid development.

“It is a growth sector and we may be able to structure a bond,” he said. “We have started looking at renewable energy products. The majority are solar PV, but we are also looking at wind.”

Inoue recalled an interesting tale where it had a bond, classified as green outside Japan, and it did not realize.

“Bloomberg green bonds had rated one of our issuances and Goldman Sachs in New York pointed this out to us. We didn’t know it was perceived this way. We realized we were a pioneer in offering green bonds in Japan. Now we pay more attention to green bonds! We did not start with structuring a green bond. We started with looking for good investment conditions.”

Junichi Yanai, Head of Investment Planning Department, Taiyo Life Insurance, said there was a supply side issue with green bonds.

Inoue said there was poor understanding in Japan on getting a second opinion for green bond issues. He called on Japan’s Ministry of Environment to consider certification for green bond projects.
SRI is dead; long live ESG integration!

Mariko Kawaguchi, co-CEO, JSIF and Managing Director, Senior Researcher, Daiwa Institute of Research started the debate. She said: “SRI is not dead but it has outgrown its past life.”

Focusing on Japan, Fiona Reynolds, Managing Director, Principles for Responsible Investment, said she expected strong growth in Japan around ESG over the coming years. Going wider to Asia she spoke about a growing middle class across the region creating the development of pension systems. But she added a caveat: “I expect awareness raising across Asia to take some time. Don’t expect miracles overnight.”

When the panel was asked about the various SIFs and membership bodies around sustainable investment, David Harris, Former Board Vice-Chair, UKSIF and ESG Director, FTSE Russell, said it could get confusing: “In the run up to COP21 there were three investor pledges around carbon disclosure. You can’t go to your boss with three pledges. It’s a real problem. We need the members of various initiatives working effectively together and to have clear separate roles. It’s critical for the future to work well together.”

But he added: “I’ll give PRI their due, asset managers lose mandates if they can’t demonstrate effectively they are integrating ESG. That is creating shockwaves.”
Panel discussion - Corporate Governance Code

Koji Watanabe, Head of the Planning Section, Listing Department, Tokyo Stock Exchange, said corporate governance had been making rapid progress. “In Japan, external directors in 2014 represented 21%. Today it is already 48%. Close to half of all listed companies have more than two external directors on the board. We expect 60% of listed companies to have outside directors by June this year.

Takuya Fukumoto, Director, Ministry of Economy, Trade and Industry, said a missing tool with the corporate governance code was a disclosure system. He also said a system to make shareholder AGMs function better was not advanced enough and needed to catch up with international standards: “There needs to be more active dialogue.”

Nonetheless, George Iguchi, Board Governor, ICGN and Head of Corporate Governance, General Manager of Equity Investment Department, Nissay Asset Management Corporation, highlighted concerns with the quality of the growing number of outside, independent directors on Japanese listed boards. “Last year the ICGN wrote a letter to the Japanese FSA about issues over the quality and quantity of outside independent board directors.”

Focusing on corporate disclosure, Koji Watanabe, Head of Planning Section, Listing Department, Tokyo Stock Exchange, said: “Regardless of the audience, easy to understand words must be used when disclosing information.”
Geeta Aiyer, Founder and President of Boston Common Asset Management said that for years outside foreign investors had been raising difficult questions with Japanese companies: “It’s exciting that now you are taking a lead and that we can jointly engage with companies,” she said.

Colin Melvin, Global Head of Stewardship, Hermes Investment Management, revealed that it had just signed a contract with its first Japanese pension fund client: “Hermes EOS will do stewardship and engage with companies on its behalf. It’s an exciting development,” he said.

Tessa Tennant, Project Originator, Call to Action on Climate Finance, said Japan was a leader on responsible investment in the 90s, but it ran out of steam in the noughties: “I hope to see a Japanese revival,” she said.

Future – trends – Can Japan become a leader in responsible investment?
Hiroichi Yagi, Managing Director, Secom Corporate Pension Fund talked about integrating ESG into its investment process. He said: “We issued orders to our asset managers to incorporate ESG. We engage earnestly with ESG investing.”

Secom’s asset allocation in Japanese equities at 32%.

In 2011 it began an ESG related fund. It is entering its 5th year.

“At a low risk we’ve been able to gain a social return every year.”

Yagi added: “We are working on two funds working on structuring and design of the pensions system.”

On governance, he felt: “Companies with good (G) governance usually are doing the (E) Environmental and (S) Social well.”

Concluding on Japanese movement in ESG, Yagi said: “We are at the start point of a new era dawning upon us.”

Etsuya Hirose, Head of ESG Research Center, QUICK Corp. closed the conference, describing ESG as a driving force for the Japanese economy as whole. He highlighted one main theme of the two days of fiduciary duty as a challenge and discharging the duty of independent management.

“There are many challenges and the way to solve this is to understand it’s a long journey to long-term investment.”
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