Formulated on February 28, 2007
Revised on March 1, 2022

Pension Fund Association: "Guidelines for the Exercise of Shareholder Voting Rights"

To fulfill its fiduciary responsibility and stewardship responsibilities, in its direct investments in domestic equities, Pension Fund Association ("PFA") shall exercise its shareholder voting rights with a view to achieving sustainable growth and medium- to long-term enhancement of corporate value of investee companies, thereby enhancing PFA's medium- to long-term return on investments.
In addition to the efficient use of shareholder capital for sustainable growth and medium- to long-term enhancement of corporate value, PFA shall require investee companies to establish appropriate corporate governance structures that respect shareholders' interests, such as ensuring separation of executive and supervisory functions in corporate management and independence of outside directors, in view of the principle of equal treatment of shareholders and the protection of minority shareholders.
PFA shall also require investee companies to take the following actions through constructive dialogue (engagement) with PFA:

- Identify and disclose important issues (materiality) regarding business model sustainability, including ESG factors
- Reduce strategic shareholdings that have issues in terms of capital efficiency and management discipline
- Implement initiatives to ensure the rights of minority shareholders of listed subsidiary companies in cases where both parent and subsidiary are listed companies
- Present basic policies and objectives of business plans and capital policies based on a clear understanding of own capital costs and clarify specific actions to take
- Analyze reasons and causes of a substantial number of votes cast against a proposal presented by the company

In the exercise of specific shareholder voting rights, in principle, PFA shall respect the management decisions of the investee company if its business performance is consistently strong, but shall vote against it if it is determined that there is an impairment to corporate value or corporate governance problems, such as misconduct including violations of laws and regulations, or a long-term decline in corporate performance (if it falls under any of the following performance criteria).

[Performance Criteria]

- Net income losses for the past three consecutive fiscal years
- Net cumulative income loss for the past five fiscal years
- Average return on equity (ROE) for the past five years of below the bottom 25% of the market (except in cases where ROE for any of the past three fiscal years exceeds the market's average ROE over three fiscal years)

In engagement with a company whose PBR has been less than 1 for a long period of time, PFA shall hold dialogue on the enhancement of corporate value.

PFA's specific guidelines and approach for the exercise of voting rights by proposal type are as follows:

1. Appropriation of surplus

In principle, PFA shall support the policies of the investee company, but believes that the distribution of surplus (including dividends and share buyback) should be balanced with future business plans, financial stability, employee compensation and welfare, and directors' remuneration.
PFA shall not be able to make a positive determination in cases where the company has retained more funds than necessary in light of its future business investment plans.
In cases where the board of directors of the company is authorized to appropriate surplus, and PFA determines that there is a problem with the appropriation of surplus as determined by the board of directors, PFA shall vote against the appointment of the director who serves as top executive of the company.

2. Appointment of directors

In principle, PFA shall vote against any proposal for the appointment of a director candidate who has served for three or more years if the investee company falls under any of the performance criteria. Nevertheless, the performance criteria shall not apply to proposals for the appointment of directors who serve as audit and supervisory committee members in a company with audit and supervisory committee.
If misconduct (violation of laws and regulations or antisocial behavior, etc.) occurs in the company during the tenure of a director candidate, and PFA determines, from a comprehensive consideration of the state of net sales and profits, stock performance, social reputation of the company, and the subsequent response as a corporation, that the misconduct has had a material impact on the management of the company, PFA shall vote against a proposal to re-appoint the director candidate in question.
If it is deemed that a director candidate has acted in a manner that otherwise impairs shareholder value, PFA shall vote against a proposal to re-appoint the director candidate in question.
If the company does not appoint more than one outside director, and outside directors do not account for at least one-third of the total number of directors (at least half of the total number if the company has a controlling shareholder(s)), PFA shall vote against the election of the director who serves as top executive of the company. PFA shall not be able to make a positive determination on the re-election of an outside director candidate whose attendance of meetings of the board of directors has been insufficient without a clear indication for the reasons thereof.
Outside directors should be appointed from among candidates who are not at risk of conflict of interest with minority shareholders and who have sufficient qualifications as directors. If it is determined that a director candidate clearly has a conflict of interest with minority shareholders, PFA shall vote against the election of the director candidate in question.
The board of directors should be structured in a way that balances diversity with the proper size and that has an overall balance of knowledge, experience and ability to effectively fulfill its roles and responsibilities. The company should also disclose the skills matrix of directors as well as its policies and procedures for the appointment of directors.

3. Appointment of corporate auditors

After the comprehensive consideration of the state of the company's net sales and profits, stock performance, social reputation, and subsequent response as a corporation due to misconduct that has occurred in the company during the tenure of a corporate auditor candidate, if PFA determines that the misconduct has had a material impact on the management of the company, PFA shall vote against a proposal to re-appoint the corporate auditor candidate of the company.
The independence of outside corporate auditors shall be determined pursuant to the independence criteria set forth by the stock exchange.
PFA shall not be able to make a positive determination on the re-election of an outside corporate auditor candidate whose attendance of meetings of the board of corporate auditors has been insufficient without a clear indication for the reasons thereof.

4. Amendment of the articles of incorporation

(1) Increase in the number of authorized shares
PFA shall not be able to make a positive determination if there are concerns that an increase in the number of authorized shares would substantially dilute existing shareholders' equity value or if there is no convincing explanation for the need thereof.
(2) Change in the number of directors
In principle, PFA shall vote for the reduction of the number of directors, and, in principle, it shall vote for the appropriate increase in the number of directors and the addition of outside directors in line with the expansion of the company. However, it shall make a negative determination toward an increase in the number of internal directors without reasonable explanation.
(3) Term of office of directors
PFA shall be able to make a positive determination on the shortening of the term of office of directors, but not on their extension.
(4) Decision-making body for dividends of surplus, etc.
PFA shall give consideration on a case-by-case basis to the appointment of the board of directors as the decision-making body for dividends of surplus, etc.
(5) Measures to ease the quorum for special resolutions (resolutions to amend the articles of incorporation, etc.)
PFA shall not be able to make a positive determination without receiving specific explanation of reasons for such amendment.

5. Director remuneration

It is preferable that remuneration for directors (excluding directors who are audit and supervisory committee members) responsible for the company's sustainable growth and medium- to long-term enhancement of corporate value include performance-linked remuneration and stock-based remuneration, to maximize medium- to long-term shareholder returns.
In cases where the company falls under any of the performance criteria and it is evident that shareholder value is impaired, it is appropriate that remuneration for directors be reduced.
If remuneration for directors is increased, sufficient grounds for such increase should be explained.

6. Payment of retirement benefits

PFA shall not be able to make a positive determination on the payment of retirement benefits to outside directors and outside corporate auditors.
In cases where the company falls under any of the performance criteria and it is evident that shareholder value is impaired, PFA shall, in principle, vote against the payment of retirement benefits.
If an officer has been involved in misconduct during his/her term of office and has vacated his/her office, PFA shall, in principle, vote against the payment of retirement benefits to such director.

7. Stock-based remuneration plan

In principle, PFA shall vote for the utilization of a stock-based remuneration plan as long as it is appropriate as an incentive to enhance sustainable shareholder value without encouraging excessive risk-taking by management.
Nevertheless, PFA shall vote against a stock-based remuneration plan if there are concerns that such plan may cause significant dilution of share value (5% or more) and impact on shareholder value.
PFA shall not be able to make a positive determination in cases where the relationship between the scope of and thereby selected eligible persons and improvement of business performance is not convincing enough (corporate auditors, trading partners, etc.), or where the transfer restriction period of shares granted under the plan is extremely short.

8. Appointment of accounting auditor

PFA shall not be able to make a positive determination on the appointment of an accounting auditor unless it is given a convincing explanation regarding the independence and qualifications of the accounting auditor candidate.
In cases where an accounting auditor is replaced due to disagreement over audit policy, PFA shall give careful consideration to whether or not the objectivity of the audit can be secured.

9. Share buy-back (setting of buyback framework)

In principle, PFA shall vote for the share buyback.

10. Introduction and continuation of takeover defense measures

In principle, PFA shall vote against the introduction and continuation of takeover defense measures as they have the potential to hamper acquisitions that would increase shareholder value and efficient management and to be used by managers to protect themselves personally, and there is the risk of medium- to long-term impairment to shareholder value.
If takeover defense measures have been introduced without a resolution at a general meeting of shareholders, PFA shall seek for the abolition of such measures through engagement.

11. Capital policy, etc.

PFA believes that, for capital policies such as acquisition, merger, transfer and acquisition of business, company split, and third-party allotment of shares, sufficient explanation should be given regarding the impact of such policies on shareholder value, and it shall vote against such policies that are against shareholders' interests or that impair shareholder value.

12. Other proposals by the company

PFA shall make separate determinations on each proposal based on the basic criterion of whether or not such proposal shall contribute to the medium- to long-term growth of shareholder value.

13. Proposals by shareholders

PFA shall vote against any proposal made by a shareholder if it is determined that such proposal would be contrary to the interests of general shareholders or would benefit only the person or persons who made such proposal. In addition, PFA shall not be able to make a positive determination on a proposal by a shareholder if it is deemed that such proposal is being used exclusively as a measure to solve specific social or political issues.