

Institutional Shareholder Services  
By email [policy@issgovernance.com](mailto:policy@issgovernance.com)

31<sup>st</sup> October 2018

Dear sir or madam,

**Re: Consultation on proposed change to Japan Policy**

We welcome the opportunity to provide our comments on the proposed change to ISS' policy for Japan. Hermes Investment Management is an asset manager with a difference. With £35.3 billion (JPY5.1 trillion)<sup>1</sup> in assets under management, we focus on holistic returns – outcomes for our clients that go far beyond the financial and consider the impact our decisions have on society, the environment and the wider world. Its stewardship team, Hermes EOS, is one of the world's leading engagement resources, advising on £346.3 billion (JPY50.4 trillion)<sup>2</sup>, on behalf of over 40 institutional investors.

We strongly support ISS' proposal to introduce a new independence criterion where both directors and statutory auditors who work or worked at companies whose shares are held by the company in question as cross-shareholding shares would be classified as affiliated outsiders. Hermes EOS have voiced concerns<sup>3</sup> about the practice of strategic (or cross-) shareholdings among Japanese companies as we believe that they could contribute to distorting fair competition, sustaining poor corporate governance as well as inefficient use of capital. Through our engagement with individual companies, we have pressed for a substantial reduction of such holdings while asking for meaningful explanation of the reasons for such holdings where the companies believe the strategic shareholdings are in the interest of shareholders. We have also engaged with regulators, pressing for more stringent disclosure requirements.

Despite our efforts, we think that the speed of unwinding such shareholdings is slow and many companies appear remain reluctant about selling shares of their business partners or lenders. We therefore believe it would be extremely helpful if ISS starts to incorporate shareholding relationships into the independent criteria for directors and statutory auditors, as it would highlight to a number of shareholders an issue which might otherwise be overlooked. Some investors may choose to vote against directors and statutory auditors who represent cross-shareholding partners, which will then send a strong signal to the companies. Even for those who choose not to vote against them, your new policy would be helpful in highlighting the extent of the cross-shareholding practice and its possible impact on shareholder value.

We are also supportive of ISS' plan to use the information on strategic shareholdings disclosed in the annual securities report and the definition used for this reporting.

---

<sup>1, 2</sup> As of 30 June 2018

<sup>3</sup> <https://www.hermes-investment.com/uki/blog/eos/untangling-cross-shareholdings-japan/>

We however strongly encourage ISS to start implementing the new policy from the 2019 season. While we understand your consideration for companies who may wish to revisit their rationales for holding such shares, we believe that companies have had a plenty of opportunities to do so in the past years as the issue of cross-shareholdings is not new. Moreover, the early implementation of the new policy by ISS would encourage companies to revisit their board compositions and appoint more non-affiliated candidates before their 2019 AGMs.

Should you wish to discuss any of these comments, please feel free to contact Sachi Suzuki at [sachi.suzuki@hermes-investment.com](mailto:sachi.suzuki@hermes-investment.com).

Yours sincerely,

Handwritten signature of Sachi Suzuki in black ink, consisting of the characters 鈴木 (Suzuki) and 祥 (Sachi).

Sachi Suzuki  
Associate Director – Engagement  
Hermes EOS