THE NETWORK FOR
SUSTAINABLE FINANCIAL MARKETS

Response to the call for evidence and information from the "Competitiveness and Incentives for Sustainable Growth: Building Favorable Relationship between Companies and Investors" Project

10 December 2013, originally submitted

17 December 2013, revised to include signatories

Introduction

The Network for Sustainable Financial Markets (SFM) is an international, non-partisan network of finance sector professionals, academics and others who have an active interest in long-term investing. We believe that the recurring crises recently experienced in our financial markets are not isolated incidents. Rather, this instability is evidence that the financial market system is in need of well thought-out reform so that it can better serve its core purpose of creating long-term sustainable value.

We appreciate the opportunity to respond to this call, since we recognise the need to search for more sustainable business systems connected globally. It is good that in Japan finance is less dominant, but this has a downside too. It is of critical importance to balance financial and social objectives. Of social objective – interests – become to dominate, it will destroy economic value creation. If financial objective become to dominant, long term economic value creation will also be destroyed.

The METI project launched in July 2013 is seeking evidence in the consultation for further in-depth discussion in the working groups on corporate value creation, investment chain and short-termism & disclosure. The project plans to release interim report as the results of the discussion early 2014 and publish a final report by the end of March 2014 by incorporating the feedback of the interim report.

We will not discuss all questions in detail, but focus on topics of most concern. For every topic we refer to the questions for which this topic is relevant.

SFM Guiding Principles

I. The Economic and Social Purpose of Markets is to Create Long-Term, Sustainable Value, which Requires the Efficient Allocation of Capital towards that Goal

II. Sustainable Value Creation Requires that Hidden Risks and Rewards be Identified and

Valued

III. Balance Between Short-Term and Long-Term Views is Needed

IV. Market Participants Must Take Responsibility for Their Actions

V. Governance at All Financial Institutions Should be Improved

VI. Better Alignment of Financial Interests is Needed to Reduce Agency Costs

VII. A Coordinated Global Approach is Needed to Better Protect the Financial Markets

SFM website: http://www.sustainablefinancialmarkets.net/

Unique character of Japanese market with long-term ties between companies, employees and other stakeholders

Here we specifically refer to question 2.5, 3, 4.4, 14.1, and 14.2 of the consultation document.

Japanese companies have close ties with employees and other stakeholders for their long-term growth. They stress the significance of corporate value creation and the benefit-sharing with each stakeholder. Therefore they are willing to present their non-financial value such as value creation process and long-term business strategy[1], as well as financial value. These relationships are not aligned with the dominant neoclassical economic thinking that, assuming perfect information, perfect capital markets, and perfect competition, "the market is a separate area of society, apart from social and cultural concerns, in which individual self-interest could be expected to advance both personal and social interests"[2]. We could request more awareness of the social and economic orientation of various governance systems such as the Japanese, not to promote isolationism or worse, socialism, but to develop sustainable long-term investments discussed in the following sections.

Keiretsu relationship and cross-shareholding practice are good examples of the close ties with stakeholders. In the post-war era, they have enabled Japanese companies to conduct long-term management ensuring stable supply of human, material and financial resources[3]. Frequently companies have accepted staff from main financing banks and other Keiretsu companies as their board members and been cross-shareholding relationship with Keiretsu companies. The proportion of shares in the cross-shareholding system was around 50% of the market capitalisation of all Japanese stock exchanges in 1990[4]. The relationships also contributed to minimisation of information asymmetry and misalignment of interest among the stakeholders.

1 Dialogue and difference in viewpoints between companies and investors, Ministry of Economy, Trading and Industry, 2013, P3. http://www.meti.go.jp/policy/economy/keiei_innovation/kigyoukaikei/pdf/A_kikakuiinkai.pdf

2 Williams, Cynthia A., De Graaf, Frank Jan. The Intellectual Foundations of the Global Financial Crisis: Analysis and Proposals for Reform. *UNSW Law Journal*, 2009, 32(2): 390-415.

3 Cross-shareholding, Daiwa Institute of Research, 2011. http://www.dir.co.jp/research/report/esg/keyword/028_cross-shareholdings.html

4 Decline of cross-shareholding, SankeiBiz, 5 September 2013 (access 2 December 2013) http://www.sankeibiz.jp/macro/news/130905/eca1309050600002-n1.htm

While they require cohesion and affiliation of their employees, they abstain from layoffs of the employees in M&A especially in manufacturing industries[5]. This attitude results in slower improvement in productivity and profitability than those by overseas companies[6]. But they prioritise reputation from Japanese society and long-term sustainability over short-term rapid recovery, since they are willing to avoid losing employee morale and recognise the employee as the source of many intangible assets[7]. Additionally the corporate cohesion successfully avoid pay dispute between employer and employees, and between corporate sector and society. High Pay Centre appreciates Japanese executive pay package, provided that actual remuneration level in Europe and the North America is not aligned with the performance of board directors and employees/society expectation. It states that Japanese pay package "focused on the country's stronger tradition of solidarity and humility, and the sense that prosperous companies succeed as a result of collective efforts rather than brilliant individual leadership"[8].

Long-term and integrated thinking of economic and sustainability factors

Here we specifically refer to question 1, 2 and 12 of the consultation document

These Japanese practices are partly required to change on both company and investor fronts. Japanese companies have been criticised for their weak corporate governance and accountability. This coincided with a decline in the cross-shareholding system. The proportion of shares in the cross-shareholding system decreased to 16.8% at the end of 2012[9], while the proportion of shares has increased from 4.7% in 1990 to 28.0% in 2012[10]. The alteration in the shareholder composition demands Japanese companies' more disclosure and actions for the shareholders to confirm the alignment with their interests. The shareholders are vocal on at least two issues. First, executive remuneration of Japanese companies account for around 80% of fixed pay[11] and is potentially misaligned with their long-term value creation commitment. Second, most Japanese companies have not introduced Western committee system in their boards yet, which do not ensure credible corporate governance.

On the other hand, asset owners lack a clear investment objective and competency for long-term investment and therefore mandated asset managers are attached to short-term financial return maximisation. These actions resulted from good shareholder returns until 1990 and their emotional

---

5 Taguchi Hiroyuki, Yanagawa Taichi, Harita Masashi. Impact of M&A on the employment in Japanese Companies. *Public Policy Review,* 2012, 5.8: 581-608. http://www.mof.go.jp/english/pri/publication/pp_review/ppr019/ppr019b.pdf

6 Fukao Kyoji, Ito Keiko, Kwon Hyeog Ug, Takizawa Miho. Cross-Border Acquisitions and Target Firms' Performance. *International Financial Issues in the Pacific Rim: Global Imbalances, Financial Liberalization, and Exchange Rate Policy*, 2008, 2: 347-389. http://www.nber.org/chapters/c6988.pdf

7 Purse Robert, Planning a merger or acquisition? Don't forget the HR implications, real business, 4 November 2013 (access 1 December 2013) http://realbusiness.co.uk/article/24555-planning-a-merger-or-acquisition-dont-forget-the-hr-implications-

8 Leading or Lagging? High Pay Centre, 2013, P17. http://highpaycentre.org/files/Leading_or_lagging_final.pdf

9 Decline of cross-shareholding, SankeiBiz, 5 September 2013 (access 2 December 2013) http://www.sankeibiz.jp/macro/news/130905/eca1309050600002-n1.htm

10 Shareholding statistics by investor type, 20 June 2013 http://www.tse.or.jp/market/data/examination/distribute/b7gje6000000508d-att/bunpu2012.pdf

11 Executive remuneration survey 2012. PricewaterhouseCoopers, 2012, P4. http://www.pwc.com/jp/ja/advisory/research-insights-report/assets/pdf/consulting-executivecompensation2012.pdf

loss aversion attitude since then. The obsession solely with short-term financial return has made asset managers have skewed views that their interests are subordinated to those of companies' clients, employees, business partners such as Keiretsu companies and counterparties of cross-shareholding[12].

However integrated thinking of both financial and sustainability factors are useful for long-term growth of both. Sustainability is defined as "environmental, social and governance [ESG] factors that have the potential to affect long-term value creation and/or are in the public's interest"[13]. Companies and investors should take the integration of ESG factors into corporate competitiveness in the long term for granted. This is the best way to achieve mainstreaming of ESG factors, since the companies are not willing to act on sustainability without a financial imperative. Japanese companies adopt the view of management guru Peter Drucker that business should disregard social responsibility if it could result in a loss of the performance capability of the business[14].

As stressed in the SFM guiding principle, they need to identify and value both hidden opportunities and risks. In terms of opportunity, they should embrace Michael Porter's Shared Value[15] model as well as his traditional Five Forces[16] model regarding corporate competitiveness, since "[c]ompetitive advantage, then, rests not on static efficiency nor on optimizing within fixed constraints, but on the capacity for innovation and improvement that shift the constraints"[17]. IIRC (International Integrated Reporting Council)'s capital model[18] is fully consistent with beneficial components of the traditional Keiretsu relationship, since the model is subject to the following capitals as sources of corporate long-term value creation and inputs to corporate business model: financial capital, manufactured capital, intellectual capital, human capital, social and relationship capital, and natural capital. Japanese companies understand the combination and inter-dependencies of various capitals and potentially could conduct this integrated thinking and reporting.

Regarding risks, they should consider 'black swan' type (ie, low frequency high impact) events, as well as highly frequent low impact negative events normally assumed in the daily risk management practices. ESG factors are closely related to the extreme events such as recent BP's oil spill in Mexico and Fukushima nuclear disaster[19], and required them to have forward-looking viewpoints and

---

12 Dialogue and difference in viewpoints between companies and investors, Ministry of Economy, Trading and Industry, 2013, P3. http://www.meti.go.jp/policy/economy/keiei_innovation/kigyoukaikei/pdf/A_kikakuiinkai.pdf

13 Vision, Sustainability Accounting Standard Board(access 2 December 2013) http://www.sasb.org/sasb/vision-mission/

14 Smith Craig, Drucker on the 'bounded goodness' of corporate social responsibility, Insead Knowledge, 25 June 2010. (access 2 December 2013) http://knowledge.insead.edu/ethics/drucker-on-the-bounded-goodness-of-corporate-social-respon-1254?vid=371

15 Porter Michael E, Kramer Mark R. Creating Shared Value, Harvard Business Review, January 2011. (access 2 December 2013) http://hbr.org/2011/01/the-big-idea-creating-shared-value

16 Porter Michael E. The Five Competitive Forces That Shape Strategy, Harvard Business Review. January 2008. (access 2 December 2013) http://hbr.org/2008/01/the-five-competitive-forces-that-shape-strategy/

17 Porter Michael. Toward a New Conception of the Environment-Competitiveness Relationship. *The Journal of Environmental* Perspectives, 1995, 9.4:97-118.
http://seg.fsu.edu/Library/Toward%20a%20New%20Conception%20of%20the%20Environment-Competitiveness%20Relationship.pdf

18 Consultation Draft of the International <IR> Framework, IIRC, April 2013.
http://www.theiirc.org/wp-content/uploads/Consultation-Draft/Consultation-Draft-of-the-InternationalIRFramework.pdf

19 Preventable Surprises diagnosis framework is suitable for diagnosis and prevention of the extreme events. The framework identifies six

therefore provide them the opportunity of more comprehensive scenario analysis.

Central message could be here: Stability of the Japanese system offers a valuable and rich perspective for ESG-oriented long term investments, but it needs accountability and therefore transparency and stakeholder engagement (including shareholders). The role of committees should be enforced, an ESG committee could be considered.

Corporate investor relations activities targeting long-term investors

Here we specifically refer to question 3, 4.3, 5, 13 and 14 of the consultation document

Japanese companies have a capacity for long-term growth in economic terms with stakeholders. Investor relations (IR) activities for long-term investors ensure steady source of finance despite the declining proportion of cross-shareholding in the market, since corporate short-termism leads just to more short-term oriented investor base, and higher equity betas and as a result higher cost of capital[20]. Management discussion on their ESG factors are useful to contact and keep the long-term investors[21]. However majority companies underestimate the significance of communications on corporate governance, activities for environmental protection, and community engagement[22], even though they recognise the importance of non-financial information such as corporate philosophy, management vision, mid-/long-term business plan, strengths and weaknesses of the business. On the other hand, Tokyo Stock Exchange ranked first in the global major stock exchanges on ESG disclosure of their listed companies[23]. Therefore the problem is a lack of investor-friendly narratives on the ESG issues. We identify three steps to achieve the narratives.

First, board capacity and practice should be more transparent. Board members should have both financial and ESG risk management skills[24] and training potential board members on the skills is necessary[25], since board-level integrated thinking of ESG-financial value link is the best to attract long-term investors. Additionally audit committee partly consisting of independent non-executive directors is beneficial for their credible illustration of corporate long-term growth strategy and

---

drivers of mismanagement: regulatory capture, narrow conception of risk, organisational learning disabilities, leadership failures, weak concern for negative externalities, and shareholder value fundamentalism. (access 2 December 2013) http://www.preventablesurprises.com/diagnosis-and-prevention/the-diagnosis/

20 Brochet Francois, Loumioti Maria, Serafeim George. Short-termism, Investor Clientele, and Firm Risk. Harvard Business School Working Paper 12-072. August 2012.

21 Global Trends in Investor Relations: A Survey Analysis of IR Practices Worldwide – Eighth Edition, BNY Mellon, December 2012, P13. http://www.irs.org.uk/files/2012_BNYM_Global_IR_Survey.pdf

22 Survey results on IR activities, Japan Investor Relations Association, 19 April 2013 https://www.jira.or.jp/jira/jsp/usr/images/pdf/newsrelease_20130419.pdf

23 Trends in Sustainable Disclosure: Benchmarking the World's Stock Exchanges, CK Capital, October 2013, P27. http://static.corporateknights.com/StockExchangeReport2013.pdf

24 Sustainability and Leadership – Competencies for Business Leaders, BSR, October 2012 (access 2 December 2013) https://www.bsr.org/reports/BSR_Sustainability_Leadership_Competencies.pdf

25 Calling upon the LDP to Follow Through on its Campaign Promise to Reform Corporate Governance at Public Companies in Japan, The American Chamber of Commerce in Japan, August 2013 (access 2 December 2013) http://www.accj.or.jp/images/130524_Calling_Upon_FDI.pdf

alignment with long-term investors' interests, since they appreciate the committee's capacity to meet without management present, and have a direct line to both the internal and external auditors[26].

Second, they could conduct IR roadshows on how their ESG performance affect their long-term financial performance both in terms of opportunity and risk management. ESG factors could affect revenue growth, operational efficiency improvement and risk management in their operation and supply chain in both reputational and regulatory terms[27]. CEOs should discuss these issues in relation to their mid-/long-term business strategy.

Finally, they could have more proportion of variable executive pay linked to growth of economic profit and ROIC (Return On Invested Capital) over WACC (Weighted Average Cost of Capital)[28]. Current remuneration by stock options as a mid-/long-term incentives based on TSR (Total Shareholder Return) does not reflect the performance of senior management and board directors, since the market price are linked to companies' short-term earnings guidance and investors psychology, rather than the corporate intrinsic value including their ESG performance. Instead growth of economic profit and ROIC over WACC are more useful key performance indicators for the purpose of corporate sustainable growth. Here we would suggest that variable executive pay has an important signalling function. Modesty is a critical component of leadership here. So variable executive pay should not lead to extreme pay schemes.

Serious agency problem within investment value chain crucial to be solved

Here we specifically refer to question 6, 7, 8, 9 and 11 of the consultation document

We need to discuss Japanese investors, since they are majority shareholders of Japanese companies despite rising influence from overseas investors. This call illustrates an advancement in the recognition of ESG integration in Japan since 2003 when Noboru Terada, former Executive Investment Officer of Japan's Government Pension Investment Fund, said that ESG investment was against fiduciary duty and should be separated from mainstream investment purely based on corporate financial performance. His view had kept institutional investors (except for a few) away from ESG investment in the 2000s, despite the Freshfields Report published in 2005 and despite environmentally positive-screen, long-term focussed and ESG investment funds becoming familiar product for retail investors. We believe the project encourages Japan's asset owners and managers to act on fiduciary duty with sustainability thinking aligned to their beneficiaries' long-term interests.

---

26 The Roles and Functions of Kansayaku Boards Compared to Audit Committees, Asia Corporate Governance Association, October 2013 (access 2 December 2013) http://www.acga-asia.org/public/files/ACGA_Paper_Kansayaku_Audit_Committees_October_2013_English_Final.pdf

27 The Value Driver Model: A Tool for Communicating the Business Value of Sustainability, UNPRI, UN Global Compact, 11 December 2013 http://www.unglobalcompact.org/docs/issues_doc/Financial_markets/Value_Driver_Model/VDM_Report.pdf

28 Burgman Roland, Clief Mark Van. Total Shareholder Value (TSR) and Management Performance: A Performance Metric Appropriately Used, or Mostly Abused, Rotman Institute of Pension Management, 5.2: 26-33 http://utpjournals.metapress.com/content/8326171324053702/fulltext.pdf

We also believe that modernised interpretation of fiduciary duty that “pension investment practices have on both the well being of fund participants and the health of the global economy. It also argues that fiduciaries should adopt pension fund governance practices found to be associated with improved investment performance, better align pension fund service provider incentives with the clients’ long-term interests”[29]. We also argue that “much commentary on investment practices of fiduciaries confuses the interests of service provider agents with the interests of human trust fund beneficiaries”[30].

Although asset owners are the most influential due to their position in the value chain and asset size, their conduct on the fiduciary duty towards their beneficiaries is a huge concern. We summarise some of the main problems with misalignment of interests in the pension fund stakeholder chain:

Main Stakeholders in the Pension Fund Service Provider Supply Chain[31]

Stakeholder	Horizon (Average)	Agency problem	General description
Participants & Beneficiaries	30+ years	Often have/exercise little control over either their contributions or investments.	Are neither involved or knowledgeable, which leads to mistrust in times of financial instability.
Trustees or Governing Board	4 to 6 years	Often union, employer or gov't representatives, with independent representatives in some countries. They are in the position for a limited time and typically have little financial or investment background.	May not have necessary skills and are sometimes driven by other interests (e.g., in the Netherlands employee and employer representatives also negotiate working agreements); financial incentives are usually small.
Investment Managers	1 year	Work on short-term bonuses with clients who generally evaluate performance over 1 to 3 years	Are incentivized by fees set on assets under management and evaluated relative to market benchmarks, which might not reflect pension funding needs.

These are also applicable to Japan. The Government Pension Investment Funds (GPIF) is the world

29 Johnson, Keith L. and De Graaf, Frank Jan, Modernizing Pension Fund Legal Standards for the Twenty-First Century (May 20, 2009). *Rotman International Journal of Pension Management*, Vol. 2, No. 1, 2009. Available at SSRN: http://ssrn.com/abstract=1408691

30 SFM Fiduciary Working Group. Fiduciary Duties of Investment Intermediaries – Comments to the UK Law Commission, July 2013, P4. http://www.sustainablefinancialmarkets.net/wp-content/uploads/2013/07/SFM-Response-to-UK-Law-Commission-on-Fid-Duty-Sigs-Added-15-July-2013.pdf

31 *Based on* Keith L. Johnson and Frank Jan de Graaf, "Modernizing Pension Fund Legal Standards for the Twenty-First Century," *Rotman International Journal of Pension Management*, Vol. 2, No. 1 (2009).

largest public pension fund in Japan. Sure its beneficiaries are current and potential pensioners. However the Ministry of Health, Labour and Welfare stays involved in the formulation and approval of strategic asset allocation[32], which illustrates GPIF believes its fiduciary duty is the alignment with the Ministry's interest.

Additionally GPIF board governors consist of officers from Bank of Japan, Ministry of Health, Labour and Welfare and finance/accounting divisions in the public companies[33]. Provided that the finance/accounting officers engage with capital expenditure and daily accounting, there are no investment professional on the board. One of ten Investment Committee members is a CIO and another is a pension investment officer in public companies respectively[34]. However the unbalance between massive investment in low-yield Japanese government bonds and predictable huge cash out demonstrates its investment has been not aligned with the interest of its beneficiaries.

The GPIF governance style is applied to corporate pension funds in Japan. A senior officer at the Pension Fund Association warns that there is only one in-house asset manager in the most corporate pension funds, and that sponsor companies, board of governors and Ministry of Labour, Health and Welfare strictly regulate the funds' management cost and human resources[35].

Investment Committee of The University of Tokyo Foundation, as an example of foundations, consists of seven heads of departments in the university, a lawyer and advisors of public companies, and incorporated administrative agency. No investment professionals are appointed except Junichi Ujiie from Nomura Holdings[36]. This illustrates that the foundation would aim at efficiently soliciting contributions with appearance of famous figures graduated from the university, not at the improvement in the foundation's investment return. They prioritise loss aversion over adequate return from asset-only portfolio which could take relatively high risk in the dominant finance theory.

A lack of long-term viewpoints in the asset owners leads to short-termism in the mandated asset managers. It resulted in the ignorance of long-term prosperity from integrating ESG factors into investment and stewardship activities. Moreover, they usually use cap-weighted indices as a benchmark, which overweight overvalued stocks fragile to short-term market turbulence. This resulted in stronger bias to short-term investment[37].

Sell-side analysts prioritise daily communications with their asset manager clients over long-term fundamental analyses. Therefore, they adhere to short-/mid-term analyses at the expense of

32 Stewart, F. and J. Yermo (2010), "Options to Improve the Governance and Investment of Japan's Government Pension Investment Fund", OECD Working Papers on Finance, Insurance and Private Pensions, No. 6, OECD Publishing. doi: 10.1787/5kgkmb9v0vhk-en
33 Officers, Government Pension Investment Fund (access 2 December 2013) http://www.gpif.go.jp/about/officers.html
34 Committee, Government Pension Investment Fund (access 2 December 2013) http://www.gpif.go.jp/public/pdf/committee_01.pdf
35 Pension Fund Association presentation slides. October 2013. http://www.fsa.go.jp/singi/stewardship/siryou/20131018/02.pdf
36 The University of Tokyo Foundation 2012 Annual Report. March 2013. http://utf.u-tokyo.ac.jp/result/pdf/result_2012.pdf
37 Arnott Robert D, Hsu Jason, Moore Philip. Fundamental Indexation, *Financial Analyst Journal*, 2005, 61.2: 83-99. http://www.researchaffiliates.com/Our%20Ideas/Insights/Papers/Documents/FAJ_Mar_Apr_2005_Fundamental_Indexation.pdf

long-term analyses of sustainable business models, and material ESG and operational factors. Their reports miss insights and turning points of most companies. The reports are often not critical to the current board and tend to rate 'buy', since they follow earnings guidance and forecasts released by the companies instead of independently creating valuation models and opinions[38].

These practices by asset owners, asset managers and sell-side analysts are the outcome of the dominant Anglo-American model in market regulation and theory. The Turner Review summarised that the financial regulator in the UK had been appreciated its principles-based light-touch approach of financial regulation, based on the theory of efficient and rational markets describing as follows:
"(i) efficient and liquid financial markets deliver major allocative efficiency benefits [by the above means] …
(ii) markets are sufficiently rational as to justify a strong presumption in favour of market deregulation; and
(iii) that even if markets are theoretically capable of irrational behaviour, policymakers will never be able to judge when and how far they are irrational with sufficient confidence to justify market intervention"[39].

We recognise the need for new three regulatory approaches to solve the problems. First, regulators should do the following to modernise pension fund legal standards:

- Recognition of the risks of excessive investment herding behaviour for both the economy and fund participants/beneficiaries
- Emphasis on the duty of impartiality and the need to balance short-term and long-term obligations
- Encouragement fee structures that better align interests of service providers with those of fund participants/beneficiaries
- Confirmation the importance of systemic and extra-financial risks that could affect the short- or long-term well-being of participants/fiduciaries
- Convention of a market-specific best practices commission to develop and maintain general standards aimed at improving the governance practices of pension funds
- Organisation of educational programmes to promote fiduciary professionalism[40].

Second, the introduction of Financial Transaction Tax (FTT) meets the interest of pension fund beneficiaries, since it promotes long-term investment by restricting short-term churning and does not affect future payments to them. We state that "[a] 0.1% FTT is extremely modest compared to the 2% and upwards of pension fund contributions absorbed by costs, and its impact is likely to be felt high

38 Mainelli Michael, Stevenson Jason, Thamotheram Raj. Sell-Side Research: Three Modest Reform Proposals, Network for Sustainable Financial Markets, January 2009. http://www.sustainablefinancialmarkets.net/wp-content/uploads/2009/02/sell-side-paper_19jan09_v5.pdf
39 Lord Adair Turner, The Turner Review: A Regulatory Response to the Global Banking Crisis. Financial Services Authority. 2009 n 2, 40
40 Johnson, Keith L. and De Graaf, Frank Jan, Modernizing Pension Fund Legal Standards for the Twenty-First Century (May 20, 2009). *Rotman International Journal of Pension Management*, Vol. 2, No. 1, 2009. Available at SSRN: http://ssrn.com/abstract=1408691

up the investment chain, not by pensioners”[41].

Finally, accounting standards including IFRS (International Financial Reporting Standards) which do not consider externalities. Employee training should be recorded as not its cost but its capital investment. Corporate CO_2 emissions, pollution and biodiversity destruction should be booked as its cost[42]. The aforementioned economic profit is expected to be an integrated measure of ESG factors into financial measures.

Concluding remarks: regulatory support is a strong incentive for companies and investors towards the long-term and integrated thinking

We appreciate the METI launched this project with its politically strong influence on Japanese companies, since it has responsibility for economic and industry policy, and top-down governance plays well in Japan. Other stakeholders have tried to make corporate conduct more sustainable in the past few years in Japan including “The Guideline on Responsible Investment of Workers’ Capital” by RENGO (Japanese Trade Union Confederation), “Options to Improve the Governance and Investment of Japan’s Government Pension Investment Fund” by the OECD and “The Principles for Financial Action towards Sustainable Society (Principles for Financial Action for the 21st Century)” by Japan’s Ministry of the Environment. But these one-way initiatives made little improvement except as an implied background to the current METI project.

We expect the METI collaborate with the Ministry of Justice and the Financial Services Agency (FSA) to remove the barriers to achieve Japan’s long-term growth. The Corporate Act Committee in the Ministry of Justice discuss the reform of corporate laws including board structure and independent directors. The Council of Experts Concerning the Japan Version of the [UK] Stewardship Code discuss investor stewardship including asset owners’ engagement and voting activities. The top-down governance would clearly be a strong incentive to change activities of companies and investors towards the long-term and integrated thinking.

---

41 Gray Jack, Griffith-Jones Stephany, Sandberg Joakim. No Exemption: The Financial Transaction Tax and Pension Funds. December 2012. http://www.sustainablefinancialmarkets.net/wp-content/uploads/2012/12/No_Exemption.pdf

42 Williams, Cynthia A., De Graaf, Frank Jan and Johnson, Keith L., The Economic Role of Finance: A Contribution to the Kay Review of UK Equity Markets and Long-Term Decision Making November 2011, P14. Available at SSRN: http://ssrn.com/abstract=2084722 or http://dx.doi.org/10.2139/ssrn.2084722

Respectfully submitted,

Network for Sustainable Financial Markets (SFM) Signatories[43]

Cary Krosinsky
Executive Director, Network for Sustainable Financial Markets
Co-Author and Co-Editor Sustainable Investing: The Art of Long Term Performance,
Evolutions in Sustainable Investing, The Short Guide to Sustainable Investing
Lecturer, Columbia University, RFK Center for Human Rights & Justice,
University of Maryland Robert H. Smith School of Business,
Bard College MBA for Sustainability
SASB Advisory Council Member
Principal Advisor, University of Cambridge
Principal, S3 (Sustainability Shareholder Services)
Co-Founder & Director, Carbon Tracker Initiative
Sustainability & ESG Advisor, RLP Wealth Advisors
USA

Keith L. Johnson
Co-Chair, SFM Fiduciary Duty Working Group
Reinhart Institutional Investor Services, Chairman
USA

Dr. Frank Jan de Graaf
Co-Chair, SFM Fiduciary Duty Working Group
Academic and responsible investment specialist
Netherlands

Stephen Viederman
Finance Chair, Christopher Reynolds Foundation
Director, Network for Sustainable Financial Markets
USA

Sean Kidney
CEO, Climate Bonds Initiative
Member, UK Government Capital Markets Climate Initiative
UK

43 Individual signatories support this document in their personal capacities; unless otherwise indicated, organizational affiliations are listed for identification purposes only. Further details on the Network for Sustainable Financial Markets (SFM) are available at: www.sustainablefinancialmarkets.net. Names of non-SFM members are italicized

Kazutaka Kuroda
Social Media Director, Network for Sustainable Financial Markets (SFM)
UK

Mark Van Clieaf
Managing Director, MVC Associates International
USA

William Michael Cunningham
CEO, Creative Investment Research Inc.
USA

Stanislas Dupré
Director, 2° Investing Initiative
France

Toby Heaps
CEO, Corporate Knights
Canada

Dr Hazel Henderson
Founder/President, Ethical Markets Media
USA/Brazil

Nick Kalikajaros
CEO, Ploutos Global Advisory
Singapore

Dr. Matthew Kiernan
Chief Executive, Inflection Point Capital Management
Canada

Karel Leeflang
Managing Director, StrategyPod Consulting
Switzerland

Juan Orus

Freelance Researcher in mortgage finance
Ecuador

Stuart Williams
President, Endobility LLC
Executive Director, Alabaster Jar Foundation
USA