CALSTRS
HOW WILL YOU SPEND YOUR FUTURE?

California State Teachers'
Retirement System
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July 13, 2017 **VIA email: amane.fujimoto@fsa.go.jp**

Yasumasa Tahara, Director
Corporate Accounting and Disclosure Division
Financial Services Agency (FSA)
The Central Common Government Offices No. 7
3-2-1 Kasumigaseki, Chiyoda-ku, Tokyo, 100-8967 Japan

Re: **Request for Comments on Japanese Disclosure System**

Dear Mr. Tahara:

I am writing on behalf of the California State Teachers' Retirement System (CalSTRS) in response to the request for comment on the Questionnaire on the Japanese Disclosure System. CalSTRS is the largest educator only pension fund in the world, with a global investment portfolio valued at approximately $209 billion as of May 31, 2017.[1] We serve the investment and retirement interests of approximately 914,454 plan participants and their beneficiaries.[2] The long-term nature of CalSTRS liabilities, the composition of its portfolio and the Teachers Retirement Board's fiduciary responsibility to its members make the fund keenly interested in the rules, regulations and reporting requirements that govern the global securities market.

We are active shareholders and invest in more than 8,000 global equity securities valued at approximately $118 billion. Japan represents CalSTRS second-largest equity market exposure behind the U.S. and with an $8.5 billion exposure as of May 31, 2017.

Corporate financial disclosures play an integral role in the capital markets by providing transparent and relevant information about the economic performance and condition of businesses. Financial reporting disclosures are the important lens that shareholders use to perceive and understand the wealth-generating activities of a company. Investors need timely, relevant, complete, accurate, consistent and comparable corporate disclosures in order to evaluate the potential risk and return properties in allocating capital.

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[1] CalSTRS Current Investment Portfolio for the period ending May 31, 2017.
http://www.calstrs.com/current-investment-portfolio

[2] CalSTRS at a Glance, Fact Sheet: http://www.calstrs.com/sites/main/files/file-attachments/calstrsataglance.pdf

In preparing our attached response to the FSA, we utilized the report by "Working Group on Corporate Disclosure" of the Financial Council[3] to better understand and frame our perspective and response. We believe the report provided some important recommendations that the FSA should implement. In addition, we believe further review of the concentration of annual general meetings may be implicit in improving and enhancing corporate financial disclosures. The date of the annual general meeting should be set so that shareholders have enough time to review agenda items; if necessary, for example, annual general meetings may need to be postponed to July and ideally, spread out over a period of 2-3 months.

We thank you for the opportunity to provide CalSTRS perspective as to the importance of timely and robust corporate reporting disclosures which benefit shareholders, the owners of publicly listed companies.

Please find attached our response to the Japan Disclosure System Questionnaire. If you would like to discuss our comments in further detail, please feel free to contact Brian Rice, Portfolio Manager at 916.414.7413.

Sincerely,

Anne Sheehan
Director of Corporate Governance
California State Teachers' Retirement System

[3] Financial Services Association, Report by Working Group on Corporate Disclosure of the Financial System Council, April 18, 2016. http://www.fsa.go.jp/en/refer/councils/singie_kinyu/20160719-1/01.pdf

Q1) Which disclosure documents do you use for your analysis of Japanese companies? For what specific purpose, do you use such documents?

- CalSTRS, as a predominantly passive investor, typically reviews company disclosures in preparation for company engagements. Additionally our fixed income analysts, global equity analysts and external managers utilize the annual securities report (annual report), the quarterly earnings release report, and documents for the annual general meetings and corporate governance report in their active selection and review of Japanese companies.

Q2) Which disclosure document do you want more to be translated into English?

- CalSTRS believes companies should provide full disclosures that are easily understood and presented in plain English and any required corporate reporting should be available and translated for global investors. The Corporate Governance report in particular has typically been one of the more difficult disclosures to find translated into English and available prior to the annual general meeting of Japanese companies.

Q3) Which disclosure documents do you think important? Please list them in order of importance with reasons. If there are any documents you do not think important, please list and elaborate the reason.

- As a perpetual owner of the market, CalSTRS is more concerned with the long-term, rather than short-term financial performance. Given the range of issues that CalSTRS may engage on, companies who publish an Integrated Report have greatly assisted in our company research efforts. Updates on company performance, business strategy, capital allocation, corporate governance, and ESG issues such as diversity and climate change are extremely important areas of focus.

  If the company does not produce an Integrated Report, the Annual Report is reviewed along with the Corporate Governance Report and Sustainability Report if produced.

Q4) Is there any information disclosed in the Annual Securities Report (ASR) you think useful if those are disclosed before the AGM, i.e.in the AGM documents?

- Annual Reports typically provide a more comprehensive overview of the company, from its structure, risk factors, qualitative descriptions on performance and capital expenditures, and company outlooks (i.e. from CEO interviews). Annual Reports are also typically organized for readability. These qualitative disclosures would further help inform our proxy voting decisions if provided prior to the AGM. JFE Holdings latest Annual Report[4] for example provides many qualitative disclosures on industry trends, sustainability initiatives, project management, and employee development. Though it is important to emphasize that corporate disclosure reporting needs to be provided to investors prior to the annual general meeting. Overall, we have found the quality of disclosure in Japan improved but still believe there is an issue of investors not having corporate disclosures prior to the annual general meeting to improve the analysis of ballot items prior to voting.

[4] http://www.jfe-holdings.co.jp/en/investor/library/group-today/2016/pdf/all.pdf

Q5) Do you have any views of the way in which information on corporate governance is disclosed? If you think that at least one document, for example the Corporate Governance Report (CGR), should cover all information related to corporate governance, do you allow this document to refer, or hyperlink, to other documents as the current CGRs often do? Or do you prefer all information should be literally written in the CGR?

- A single source with all pertinent corporate governance information would ease the burden on shareholders reviewing such information. We do not have a preference if the information is disclosed in full within another report or is referenced through a hyperlink as long as the information is comprehensive and easily accessible may assist in eliminating the need to cross-reference multiple documents.
- We also believe it is important to promote the electronic provision of Business report and to expand the scope of documents that can be provided electronically to ensure the timely delivery of information to shareholders prior to the annual general meeting.

Q6) What kind of information do you think should be additionally obliged to be disclosed by companies? Please list them in order of importance with reasons you think each item is necessary.

- Disclosure of cross-shareholdings has been one of the more controversial items in the Corporate Governance Code for Japanese companies, and CalSTRS appreciates FSA's past efforts in analyzing and furthering the discussion on this issue. We believe companies should be required to fully disclose all cross-shareholdings, including those beyond the top 30 holdings, as well providing more detailed disclosure on their economic rationale on each cross-shareholding relationship. It is important to investors that the FSA require full disclosures of all cross-shareholdings since the new Japan Corporate Governance code requires firms to explain their rationale for keeping cross-held shares. As you may know Prime Minister Shinzo Abe agrees that companies maintaining cross shareholdings is "fostering shareholder ties that can undermine accountability and transparency." Companies should also disclose their proxy voting history on these cross-shareholdings, as well as disclose more detail on their top shareholders, particularly in regards to the ultimate beneficiaries behind trust bank holdings.
- Additionally, we ask for details of shareholders including what proportion of their shares are held by other companies for strategic purposes, as many companies still believe it to be acceptable to hold shares of other companies to maintain long-term business relationships, including the securing of contracts for distribution and the stable supply of goods and services. Indeed, some companies have recently announced the formation of new cross-shareholdings as part of an agreement for business cooperation. The widespread practice of cross-shareholdings and strategic shareholdings among Japanese companies is not only an inefficient use of shareholder funds but also may lead to issues which include:

  1) fair competition principles issues because companies are expected to do business with those with whom they have shareholding relationships, instead of those who can offer the best quality of products or services or the lowest price.
  2) The unequal treatment of shareholders because those who hold shares for strategic purposes may receive benefits for their business, while other shareholders, including institutional and retail investors, do not.

3) Cross-shareholdings and strategic holdings may also contribute to poor corporate governance. The holders of such shares tend to support management of the investee companies instead of exercising their shareholder rights appropriately to hold management and the board to account.

We encourage the FSA to encourage companies to adopt current best market practices on cross shareholdings as the need for cross shareholdings in other global countries do not seem to be required to maintain business relationships.

Q7) Followings are some of the items pointed out to be deleted from the disclosure documents? Do you agree with those opinions?

- CalSTRS is mindful of the balance between the amount of required disclosures and the burden placed on companies to produce these disclosures and recommends that the FSA considers the entire disclosure process holistically. CalSTRS recommends the FSA continue with requiring key financial data for the past five years, corporate history as well as disclosing the list of subsidiaries and affiliates. For example, while five-year historical financial data and corporate history is not new and easily obtained through other sources, we believe it is typically not very burdensome on the company to disclose. We understand that subsidiary and affiliate disclosures is more burdensome to disclose, however requiring their disclosure in an audited report acts as a safeguard for shareholders on company structure and provides needed information on the interrelation aspects that may impact specific intercompany transactions . We also agree and support the continued use of XBRL to pull key financial data but believe the FSA needs to be cognizant of whether this information is readily available for investors that do not have access to XBRL reports.

Q8) Is there any information which are not disclosed currently and you think useful if those are voluntarily disclosed by companies? Please list them in order of importance with reasons you think each item is useful. Are there any information which are obliged to disclose and you think should be voluntarily disclosed? Please list them in order of importance with reasons.

- Given the heightened concern amongst foreign investors with regards to capital efficiency at Japanese companies, any information on the company's capital allocation process would be helpful. While cognizant that too detailed information in this area can be detrimental in regards to competition amongst company peers, a high-level overview of the capital allocation process would give shareholder greater clarity and further promote dialogue.

  Independent directors on Japanese boards have been another area of focus for foreign investors. Current efforts by most Japanese companies have centered on adding external or outside directors, who may or may not be truly independent. We would like to see Japanese companies adopt a more global best practice standard for director independence and disclose the criteria utilized when classifying the independence of their directors.
- Additionally, we would recommend companies provide better disclosures on the composition of board members, (gender, race and ethnicity), independence, their skill-sets and how each individual board member contributes to the company's long-term strategy and business plan.
  Companies should also consider disclosing more robust information on human capital management. Ensuring rules-based disclosures on human capital would provide investors

with valuable information about a company's policies on their most important asset, human capital.

Q9) Do you have any views on the recent streamlining of Quarterly Earnings Report (QER)?

- Investors want to ensure we are not losing any reporting that we currently use in our analysis as the FSA works toward streamlining QERs.The required disclosures in the quarterly earnings report should focus on relevance and timeliness for this report to be meaningful to investors. Furthermore this report should be viewed in the context of other required disclosures and the timing of those disclosures to potentially streamline the entire disclosure process, particularly in regards to the quarterly and annual securities report.

Q10) Do you think the quarterly reporting should continue to be obligatory? If the obligation is repealed, is there any item that should be additionally disclosed on a biannual basis? For example, when quarterly reporting was introduced, semiannual disclosure obligation of non-consolidated financial statement was repealed and the format of a semiannual report was simplified; specifically, disclosure items of summary of business result, management issues and R&D were abolished and these matters are required to disclose in the item of MD&A. Do you think that the disclosure requirements of a semi-annual report should be reintroduced, if quarterly reporting is repealed?

- Companies should be regularly reporting to owners and investors the financial performance and drivers of a company's business. We recognize some investors believe that quarterly reporting could lead to short-termism and if FSA repeals, then CalSTRS would expect at least annual reporting before the annual general meeting.

Q11) Do you support the idea of defining the format of the ASR like Japan and the US? What is your views on how information should be presented in the ASR?

- A pre-defined and company-defined format each have their advantages, and in many ways targets different purposes and audiences. Pre-defined formats such as the 10-K in the US allows for easier comparability, and assists shareholders in finding specific information, whereas company-defined formats as you would see in Annual Reports often are structured with readability in mind and are helpful in understanding intricacies within the business.
- We also believe that the FSA recommend improvement of the disclosure of business policies/strategies, Management's Discussion and Analysis (MD&A) of Financial Condition, Results of Operations and Cash Flows. We encourage companies to make additional voluntary disclosures to meet the various information needs of investors which may include environmental, social and governance reporting.