Provisional Translation

Principles Regarding the Disclosure of Narrative Information

Financial Services Agency

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Preface

The report prepared by the Disclosure Working Group of the Financial System Council in June 2018 proposed that a principle-base guidance—which will cover the concept of disclosure, the preferred contents of disclosure, and ways to make such efforts—should be formulated in order to promote corporate efforts to enhance disclosure that is more than just a formal response to the rules.

The Principles, taking into account the above-mention proposal related to corporate disclosure of information, indicate the concept of disclosure, the preferred contents of disclosure, and ways to make such efforts for what is called "narrative information", which is information excepting financial information.[1] Narrative information varies from company to company depending on the company's business conditions and the business environment that it faces. The Principles, however, aim to clarify the concept, etc., of disclosure in the Annual Securities Report with a focus on business policies and strategies, analysis of operating results as well as risk information, which are among narrative information items that enable investors to make appropriate investment decisions and lead to deeper and constructive dialogues between investors and companies.

The Principles indicate the concept of disclosure, the preferred contents of a disclosure, and ways to make efforts for better corporate disclosure, but do not add new disclosure items. People involved in the preparation and release of disclosure documents (for example, management, the persons in charge of preparation of disclosure documents, the head of IR, etc.) are expected to continuously review if the disclosures released are in line with the Principles. Also, the Principles may be helpful when investors have dialogues with companies.

In enhancing corporate disclosure in Japan, efforts to build up appropriate disclosure practices are necessary, in addition to establishing rules and a principle-base guidance for disclosure. From this point of view, the Financial Services Agency intends to raise the overall level of the content of corporate disclosure by making efforts in order to widely share good practices of corporate disclosure with all companies, and also reflecting good practices into the Principles as necessary.

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[1] Corporate disclosure includes a wide range of information provided voluntarily, in addition to statutory disclosures required by laws and regulations and those based on stock exchange rules. Although the Principles are primarily applied to the Annual Securities Report, other disclosures are also expected to take into account in achieving more effective disclosures.

Notes

In the Principles, the term “Items Required by Laws and Ordinances” refers to items which are required to be described by a Cabinet Office Order related to disclosure of corporate contents after amendment in accordance with Cabinet Office Order No. 3 of 2019 (announced and enforced on January 31, 2019).

Amended rules regarding business policies and environment as well as issues to be addressed, etc., analysis by the management of financial conditions, operating results and cash flow status as well as business risks are applicable to Annual Securities Reports for the fiscal years ending after March 31, 2020. Provided, however, that companies may provide descriptions in line with the amended rules for Annual Securities Reports issued in the fiscal year ending March 31, 2020 and later.

I. General Remarks

1.The roles of narrative information[2] in corporate disclosures

1-1. Narrative information supplements financial information and enables investors to make appropriate investment decisions. Also, narrative information promotes constructive dialogues between investors and companies, leading to enhancement in the quality of corporate management. Therefore, narrative information is also important from the point of view of continuous improvement of corporate value.

Companies are expected to engage in robust disclosure, taking into account the functions of disclosure of narrative information.

2.Common items for disclosure of narrative information

【Appropriate reflection of discussions at the board of directors and the executive committee】

2-1. Narrative information should reflect the discussions at the board of directors and the Executive Committee, in order to enable investors to understand the company through the eyes of management.

(Concept)

- Among the narrative information in the Annual Securities Report, in particular, business policies and strategies, analysis of operating results as well as risk information are closely related to the management decisions, and

[2] In general, "narrative information" is, information among the information provided in legal disclosure documents that does not constitute financial information under "Documents on Financial Calculation" as stipulated in Article 193-2 of the Financial Instruments and Exchange Act. The Principles clarify detailed concepts regarding disclosures for business policies and strategies, and analysis of operating results as well as risk information from among descriptive information. However, when describing other forms of narrative information, the Principles should be taken into account in hopes of achieving more effective disclosures.

therefore it is important to reflect appropriately the discussions at the board of directors and the Executive Committee, which carry out management decisions.

▪ **Business policies and strategy, etc.**
An explanation on how companies intend to achieve their business goals, and how they intend to create value in the mid-to long term.

▪ **Management discussion and analysis**
A review of how business performed in the latest term as a result of operating the company according to the business policies and strategy, etc., and an analysis of the causes from the management's point of view.

▪ **Risk information**
An explanation of what is considered important among the risks and uncertainties that may impact business operations during and after the following period from the management's point of view

● Based on disclosure that reflect the discussions at the board of directors and the Executive Committee, investors can learn how the board of directors and executive committee see the present situation of the company and obtain information necessary to understand the details of business policies and strategies. Thus, investors can understand the direction of management in ways that they would not be able to recognize solely from financial information, and predict future management results better.

● In particular, at the board of directors and the Executive Committee,

- how discussions are conducted regarding growth investments/cash reserves/shareholder returns and capital costs, in order to maximize the use of management resources, and
- based on these discussions, what kind of future directions of management are being indicated

are considered important to be appropriately reflected in disclosures.

● From this point of view, for example, in a case where the board of directors and the Executive Committee discuss how the directions and state of financial conditions should be aimed for, it would be considered useful if the details of such discussions are described in full. Making such kind of disclosure may facilitate discussion between management and investors regarding the status of goal achievements, reasons for gaps, etc. Management, based on this, should make timely and appropriate revisions to business policies and strategies when necessary, and include this background in their disclosures.

- The disclosures above will, in addition to enabling investors to make appropriate investment decisions, deepen constructive dialogues between investors and companies and lead to a virtuous cycle of establishing ever better business policies and strategies.

(Efforts for better disclosure)

(1) In order to reflect the discussions at the board of directors and the Executive Committee to narrative information, management should be actively involved in examining disclosure details from an early stage of preparation of disclosure document, and indicate policies regarding disclosures within the company.

(2) In companies where multiple departments such as management planning, finance, legal affairs, and others are involved, the executive in charge should oversee each department so as to ensure consistent disclosures based on the discussions of the board of directors and the Executive Committee in each department, and a system should be established in which the cooperation of the related departments is appropriately obtained.

【Disclosure of Material Information】

2-2. Each company should have its standard to make judgement on materiality of narrative information

(Concept)

- The materiality of narrative information should be judged based on whether or not it is material to investors’ investment decisions. When judging whether or not a piece of narrative information is material to investors’ investment decisions, it is considered important that an examination from many angles which also takes into account the information’s managerial importance according to the management’s point of view be carried out, given that narrative information should appropriately reflect the discussion at the board of directors and the Executive Committee.

- It is important to avoid including too much or not having enough information that is material to investors' investment decisions in the Annual Securities Report. However, materiality to investors' investment decisions is considered as being affected by various factors, such as a company's business conditions, the business environment surrounding the company, and so on.

- Because of this, when disclosing narrative information, each company should decide the order and amount of explanations, etc., regarding each individual issue, event, etc., in accordance with the importance (materiality) that those individual issues, events, etc., will have on its corporate value, operating results, etc.

(Efforts for better disclosure)

(1) Judgements on the materiality of narrative information should take into account in the degree of impact that the matter will have on corporate value, operating results, etc. Also, judgements on the materiality of information related to the company's future should take into account the likelihood of occurrence of the matter.

(2) Narrative information should be provided in such a way so that the reader can understand the materiality of the information, such as by placing it in order from the most important items.

(3) The evaluation of the materiality of narrative information should be reflected into the Annual Securities Report at the time it is submitted. In particular, if a change has occurred to a company's business environment, regardless of the contents of the previous release, the company should appropriately reflect the evaluation of the materiality of narrative information at the time of submission.

【Disclosure by segment】

2-3. In order for investors to understand the overall company through the eyes of management, companies should disclose narrative information in appropriate categories.

(Concept)

- As diversification of corporate management develops, in addition to disclosing narrative information for the overall company, it is important to appropriately categorize business segments and provide in-depth information on those categories according to the actual business management.

- Such disclosure enables investors to understand the business situation in each segment, and also provides investors with basis for investment decisions with regard to
  - what synergistic effects management is aiming to generate through diversification, as well as
  - whether or not management resources are being appropriately, efficiently distributed.

- In doing so, companies should provide explanations that include information allowing investors to understand the appropriateness of the business selection of a company, such as how businesses are selected, how each business is placed in the business policies and strategies, and how unprofitable businesses are being handled.

(Efforts for better disclosure)

In addition to disclosing financial information by segment (reporting segments), robust disclosure, including disclosure by appropriate classification (for example, by business segment or regional segment) which better explains business policies and strategies as necessary, is useful.

【Clear Disclosures】

2-4. Companies should disclose narrative information in a clear way so that its contents can be both easily and deeply understood.

(Efforts for better disclosure)

(1) In order to promote the understanding of narrative information, companies should disclose information in a way that is easy for investors to understand, such as by using supplementary visuals like charts, graphs, and images, and

clearly indicating changes from the previous year.

Note: In cases where explanatory materials of financial results and annual reports are generated, companies may wish to consider using the charts, graphs, and images therein in the Annual Securities Report.[3] In doing so, in addition to adequate disclosure of the information that should be expressed in the Annual Securities Report, it is necessary to ensure that the charts, graphs, and images appropriately supplement the written explanations.

Also, in a case where charts and graphs use figures generated and amended by a company itself, the calculation method and calculation basis should also be explained, and in a case where charts and graphs were made by a third party, the source should be indicated.

(2) In order to make disclosures easy to understand, appropriate headlines and titles should be used, and related information should be put in order.

(3) For example, when comparing previous disclosures such as segment information and KPIs, and in cases where there is a change in an item for which continuity is important, that change should be indicated and its impact should be explained.

(4) Relevant narrative information such as “business policies and strategies” and “management discussion and analysis of financial condition, operating results and the cash flow status” should contribute to an understanding of the whole company by connecting relevant items to each other through, for example, reflecting relevant contents to the other items.

(5) For items that are identical or overlapped, it may be helpful to instruct readers to refer other items in cases where it is believed that this will facilitate the understanding of investors.

[3] Supplementary visuals like charts, graphs, and images—to the extent that they are within the capacity limits for files that can be submitted on EDINET—can be used in the Annual Securities Report to promote the understandability of the content.

II. Itemized details

1.Business policies and environment as well as issues to be addressed, etc.

1-1.Business policies and strategies

Items Required by Laws and Regulations

Companies are required to describe business policies and strategies connecting with the details of the business of their company, in addition to providing an explanation of the recognition of the management on the business environment (for example, corporate structure, the condition of the market in which the company operates, competitive advantages over competing companies, the details of major products and services, customer base, and sales network).

(Concept)

● Business policies and strategies explain how a company plans to achieve its business objectives and how it will increase its corporate value over mid- to long-term periods.

● In order to enable investors to make judgements on the appropriateness and feasibility of business policies and strategies, companies should explain the direction of mid- to long-term corporate activities as well as concrete measures to be executed for the purpose of accomplishing those activities.

● Also, together with business policies and strategies, companies should explain management's view on the business environment, which forms the background for business policies and strategies.

This will enable investors to evaluate:

- the appropriateness of management's view on the business environment, and
- the feasibility of business policies and strategies.

(Efforts for better disclosure)

(1) Out of narrative information, business policies and strategies in particular

form the basis for management decisions, and companies should ensure that:

- management is appropriately involved from an early stage of preparation for disclosure, and
- the discussions at the board of directors and the Executive Committee are appropriately reflected to disclosure.

Note 1. With regard to management involvement, in a case where there is a "CEO message" in annual reports and other disclosure documents, it may be useful to make use of it in the Annual Securities Report. In doing so, while focusing on business policies and strategies, companies should ensure that the components required in an Annual Securities Report are appropriately and adequately included.

Note 2. From the point of view of reflecting discussions at the meetings of the board of directors and the Executive Committee, if there is a medium-term management plan discussed at these meetings, it may be helpful to use the medium-term management plan when explaining concrete measures to accomplish business policies and strategies. In such a case, rather than simply quoting the medium-term management plan, companies should ensure appropriate disclosure of business policies and strategies at the time of disclosure, considering the status of the progress with the medium-term management plan and changes to the business environment that occurred after the formulation of the plan.

(2) When disclosing the business policies and strategies, companies should explain the company-wide policies and strategies and those of each segment that are based on the company-wide policies and strategies. For disclosure of segments, companies should explain how management resources, including capital, will be allocated and invested in order to accomplish concrete measures in each segment.

Note: For business policies and strategies by segment, companies may choose either:

- disclosing them together with the company-wide business policies and strategies, or
- disclosing them together with management discussion and analysis of financial conditions, operating results and cash flow status.

In either case, the information should be provided in association with the overall company's earning structure so that the way segments are positioned in the overall business can be understood.

(3) With regard to the view of the management regarding the business environment (for example, corporate structure, the condition of the market in which the company operates, competitive advantages over competing companies, the details of major products and services, customer base, and sales network), companies should explain it together with management's view on the business environment unique to each segment, in order to enable investors to appropriately understand the business policies and strategies by segment.

Note: With regard to the condition of the market in which the company operates and competitive advantages over competing companies, in addition to these descriptions, the company should also include business policies and strategies that take into account the management's view regarding opportunities and risks based on the company's weakness and challenges as well as changes in the business environment, as seen in a part of the company's annual report.

1-2.Operational and financial issues to be primarily addressed

Items Required by Laws and Regulations

In disclosures of business and financial issues that should be primarily addressed, companies are required to specifically describe the contents of these issues and response policies to them, associating with the business policies and strategies.

(Concept)

- With regard to operational and financial issues to be primarily addressed, companies are required to explain matters that management recognizes as possibly having a material impact on operating results, such as structural changes of the market in which the company operates, or changes to laws and systems that may greatly impact business.

  By disclosing operational and financial issues to be primarily addressed, investors become able to evaluate if management is appropriately and sufficiently aware of issues, and the feasibility of business policies and strategies.

(Efforts for better disclosure)

(1) With regard to operational and financial issues to be primarily addressed, companies may explain them considering the degree to which business policies and strategies are related and the judgement of importance, in order to clarify the materiality of those issues.

(2) Companies may consider providing management's view on the business environment that forms the decisions made to select these operational and financial issues to be primarily addressed.

1-3.Key Performance Indicators (KPIs)

Items Required by Laws and Regulations

If companies use objective indicators (so-called KPIs) to evaluate the status of the progress of their management goals, companies are required to disclose them.

(Concept)

- Objective indicators (KPIs) used to assess the degree of achievement of their management goals may include, in addition to financial indicators such as ROE and ROIC (called financial KPIs), indicators for items that are not financial, such as the contract ratio (called non-financial KPIs). Companies are required to appropriately reflect the KPIs established in accordance with business policies and strategies in the disclosure.

- The disclosure of KPIs is important for investors to understand company's business policies and strategies. Disclosing this information enables investors to evaluate the status of the progress, as well as the feasibility of business policies and strategies.

(Efforts for better disclosure)

If KPIs have been established, the company may consider providing an explanation regarding the indices that measure the degree of achievement of a target, the calculation method, and why those particular indices were selected. Also, the company may consider describing concrete numerical targets for management plans established based on reasonable consideration. If KPIs are established by segment, the details thereof should be disclosed too.

Note: When describing concrete numerical targets for management plans established based on reasonable consideration, items based on a rational judgment that takes into account circumstances which can be foreseen as of the filing date of the Annual Securities Report should be described, and the company may consider including supplementary narrative information as necessary.

2.Business risks

Items Required by Laws and Regulations

Companies are required to describe material risks that management is aware of as having the potential to severely impact the company's financial condition or the cash flow status, together with the explanation of the degree of possibility and time of the occurrence of the risk, the details of the impact the risk will have on operating results if it materializes, and countermeasures against the risk. Also, companies are required to describe material risks in an easily understandable way, taking into consideration the materiality of a risk and its degree of relevance to the business policies and strategies.

(Concept)

- Companies should explain business risks that are considered material from the management's point of view among risks that may have an impact on business operations from the next period onward in order of their degree of materiality.

(Efforts for better disclosure)

(1) In disclosing business risks, rather than listing general risks, companies should describe, in detail, items that may have potential to greatly impact investors'

ability to make judgements, such as unusual fluctuations in the company's financial condition, business performance or cash flow status; a specific dependence on a client, product, or technology; relevant laws and regulations, trading practices, or management policies; the occurrence of a major lawsuit; or important matters concerning executives, major stockholders, or affiliate companies. At such time, to enable investors to understand the situation, companies should provide an explanation that should cover how judgment is made at the board of directors and the Executive Committee meetings regarding the severity of each risk (materiality) according to the degree to which those risks may impact future operating results and their likelihood of occurring.

(2) Regarding the order in which risks are described, the judgement of importance made at board of directors and the Executive Committee meetings should be reflected in accordance with the business environment at the time and based on the degree of relevance to the business policies and strategies.

Note: For companies that established systems or frameworks to identify and manage risks, the materiality of each risk is often discussed through the process of the risk management in the system or framework. In this kind of situation, the company should also provide a description of the relevant system or framework.

(3) Also, companies may consider providing a description in line with the risk classifications used for risk management (for example, market risks, quality risks, compliance risks, etc.).

3.Analysis by the management of financial conditions, operating results and the cash flow status (Management Discussion and Analysis, or MD&A)

3-1.Items in common within the MD&A

Items Required by Laws and Regulations

In disclosing the analysis by the management of financial conditions, operating results and the cash flow status (hereafter management results, etc.), companies are required to provide a concrete, understandable description of the analysis and consideration of the relevant management results from the management's point of view.

In doing so, companies are required to describe the analysis and consideration from the management's point of view (for example, analysis of primary causes of factors having a major impact on management results) by the classifications described in company-wide as well as segment information, associating with the business policies and strategies, and other items described in the Annual Securities Report.

(Concept)

- Analysis by the management of financial conditions, operating results and the cash flow status (Management Discussion and Analysis, or MD&A) involves a look back from the management's point of view regarding the situation of management results in the term under review—which are the outcome of operating the business in accordance with the business policies and strategies—and an analysis and examination of the main causes of increases or decreases in management results.

- Disclosing the MD&A enables investors to increase the degree of accuracy with which they can predict future management results based on a confirmation of the appropriateness of the business policies and strategies formulated by the company as well as the current trends of which the management is aware.

(Reference) U.S. Securities and Exchange Commission guidance on MD&A[4] *(extract)*

MD&A requires not only a "discussion" but also an "analysis" of known material trends, events, demands, commitments and uncertainties. MD&A should not be merely a restatement of financial statement information in a narrative form. When a description of known material trends, events, demands, commitments and uncertainties is set forth, companies should consider including, and may be required to include, an analysis explaining the underlying reasons or implications, interrelationships between constituent elements, or the relative significance of those matters.

For example, if a company's financial statements reflect materially lower revenues resulting from a decline in the volume of products sold when compared to a prior *period, MD&A should not only identify the decline in sales volume, but also should analyze the reasons underlying the decline in sales when the reasons are also material and determinable. The analysis should reveal underlying material causes of the matters described, including for example, if applicable, difficulties in the manufacturing process, a decline in the quality of a product, loss in competitive position and market share, or a combination of conditions.*

Similarly, where a company's financial statements reflect material restructuring or impairment charges, or a decline in the profitability of a plant or other business activity, MD&A should also, where material, analyze the reasons underlying these matters, such as an inability to realize previously projected economies of scale, a failure to renew or secure key customer contracts, or a failure to keep downtime at acceptable levels due to aging equipment.

(Efforts for better disclosure)

(1) The MD&A is not limited to simply being an explanation of numerical increases and decreases in financial information. Management should also provide their evaluations for company-wide or segment information, including current trends of which the management is aware, with regard to:

- major efforts in the term under review,
- results for the term under review,
- in-depth analysis of the background to increases, decreases and its causes, and
- other factors that had particular impact on performance in the term under review.

(2) In the MD&A, when disclosing major efforts in the term under review and evaluations on the results based thereon, the company should also disclose the relation to the KPIs that the company has set. If numerical targets for KPIs have been set, companies may consider describing the status of achievement.

[4] "Interpretation: Commission Guidance Regarding Management's Discussion and Analysis of Financial Condition and Results of Operations"（December, 2003 https://www.sec.gov/rules/interp/33-8350.htm）

3-2. Analysis and examination of the cash flow status as well as information on sources of funds and capital liquidity

Items Required by Laws and Regulations

In disclosures of the analysis and examination of the cash flow status as well as information on sources of funds and capital liquidity, companies are required to provide a specific, understandable description of the management's awareness of trends in capital demands, including funding methods and state of affairs and major uses of capital.

(Concept)

- A company's management is expected to maximize the effective use of assets in order to accomplish the business policies and strategies. Regarding the 'analysis and examination of the cash flow status as well as information on sources of funds and capital liquidity', it is necessary for the management to appropriately provide an explanation of their awareness of these, including the capital demands to execute the business policies and strategies, the funding methods used to obtain such capital, as well as shareholder returns.

- By receiving this kind of explanation, investors will be able to make judgements on:
  - the adequacy of the sources of funds for the company to accomplish the business policies and strategies, and
  - the feasibility of the company's business policies and strategies

- Also, with the disclosure of the above information, investors should be able to understand:
  - management's view toward the balance among growth investment, cash reserves and shareholder returns, and
  - management's view toward capital costs of the company.

(Efforts for better disclosure)

(1) When providing an explanation on management's awareness of trends in capital demands, it would be useful to describe the management's view toward

how the capital that the company obtains is allocated into growth investment, cash reserves or shareholder returns.

(2) Companies should clarify the relationship between expenditures for growth investment and business policies and strategies, including capital expenditure and research and development expense.

(3) Companies should explain their view toward shareholder returns, including target levels, if any. In doing so, companies should clarify the relationship with the dividend policy and other relevant disclosure items.

(4) Companies should provide an appropriate explanation that investors can understand regarding the necessity of cash and cash equivalents on hand, such as specifying their view toward the target amount of funds kept in reserve in case there is an urgent capital demands (for example, X of monthly sales, or a set monthly portion).

(5) Regarding the funding method, companies may consider specific descriptions regarding whether the funds demands are satisfied through business activities, borrowing from banks, or issuing bonds and shares. Also, it may be useful to explain, the policy toward funding (for example, the debt-to-equity ratio[4]) if any.

(6) It may be useful to provide an explanation of the company's definition of and view toward capital costs together with the above details.

Note: Companies may consider various approaches to explaining the cash flow status, such as, for example, a description that takes into account the balance sheet, or a description that focuses on free cash flows. In that case, companies may consider providing a description of the total amount of cash inflow and a breakdown of the major items thereof, and the total amount of cash outflow and a breakdown of the major items thereof (growth investments such as capital expenditure, research and development expense and M&As; shareholder returns) without being limited to the individual descriptive items for the cash flows statement in the financial information.

[4] Calculated by taking the company's interest-bearing debt and dividing it by its equity capital, indicating how many times the company's interest-bearing debt is to its equity capital (shareholders equity).

3-3.Important accounting estimates and the assumptions to which they are applied

Items Required by Laws and Regulations

Companies are required to provide supplementary information to the accounting policy that describes the uncertainties and impact a fluctuation will have on management results regarding important items in the relevant estimates and assumptions from among the accounting estimates and the assumptions to which they are applied when preparing financial statements.

(Concept)

- There is a risk that business performance may experience an unforeseen impact in accordance with the difference between important accounting estimates and the assumptions to which they are applied and the actual results. Amidst attention to increasing estimated factors in accounting standards, companies are required to fully disclose important accounting estimates and the assumptions to which they are applied in order to decrease the occurrences of unforeseen impacts on their business performances.

- What kind of hypothesis the management has established in relation to important accounting estimates and the assumptions to which they are applied is considered to be a matter directly connected to the management decisions. Therefore, it is considered important that the management be involved in the disclosure of important accounting estimates and the assumptions to which they are applied.

(Reference) U.S. Securities and Exchange Commission guidance on MD&A (extract)

When preparing disclosure under the current requirements, companies should consider whether they have made accounting estimates or assumptions where:

- *the nature of the estimates or assumptions is material due to the levels of subjectivity and judgment necessary to account for highly uncertain* *matters or the susceptibility of such matters to change; and*

- *the impact of the estimates and assumptions on financial condition or operating performance is material.*

If so, companies should provide disclosure about those critical accounting estimates or assumptions in their MD&A.

Such disclosure should supplement, not duplicate, the description of accounting policies that are already disclosed in the notes to the financial statements.

A company should address specifically why its accounting estimates or assumptions bear the risk of change. The reason may be that there is an uncertainty attached to the estimate or assumption, or it just may be difficult to measure or value. Equally important, companies should address the questions that arise once the critical accounting estimate or assumption has been identified, by analyzing, to the extent material, such factors as how they arrived at the estimate, how accurate the estimate/assumption has been in the past, how much the estimate/assumption has changed in the past, and whether the estimate/assumption is reasonably likely to change in the future.