資料1

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The Working Group on Corporate Disclosure of the Financial System Council
Financial Services Agency
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THE CENTRAL COMMON GOVERNMENT OFFICES No. 7

Re: Corporate disclosure

We welcome the opportunity to provide our comments on this consultation.

Hermes Investment Management (Hermes) is an asset manager with a difference. With ¥5.2 trillion ($46 billion)[1] 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. Hermes' stewardship team, Hermes EOS, is one of the world's leading engagement resources, advising on ¥51 trillion ($454 billion)[2] on behalf of over 40 international institutional investors. The views expressed in this communication are those of Hermes EOS and do not necessarily represent the views of all clients.

In Section 1, we describe some of the drivers of enhanced corporate disclosure, such as the UK Strategic Report. Section 2 looks at the contents of the Strategic Report, including its recently proposed revisions as an example of enhanced narrative disclosure. We go on to discuss the recommendations of the Task Force on Climate-related Financial Disclosures. In Section 3, based on disclosures available or required in the UK, we suggest some additional reporting requirements for Japanese companies. Section 4 discusses specific corporate governance disclosure issues particularly pertinent to Japan, as we encourage enhanced transparency in the areas of cross-shareholdings, capital management and remuneration. In Section 5, we argue in favour of Japanese companies producing more English translations of disclosure materials for the benefit of foreign investors.

1 Drivers of enhanced corporate disclosure

As technology has revolutionised communication and information sharing, the global economy has become more interconnected, with the world's businesses, finances and people inextricably linked, as evidenced by the global financial crisis. Meanwhile, in the last 35 years, the market value of companies has shifted from a price based largely on tangible assets to a greater emphasis on intangible assets such as intellectual capital, research and development, brand value and natural and human capital. These assets, however, are not universally reported on or assessed in financial reporting. A proposed answer to the above evolution has been the push for more integrated reporting, as it

[1], [2] As at 31 December 2017, exchange rate: $1 = ¥113.00, mid-rate as at 31 December 2017

provides a more holistic approach to a company's value-creation story, incorporating financial and sustainability information.

In that respect, we welcome the enhanced level of disclosure by many Japanese companies over recent years and we have noticed a strong interest among Japanese companies in integrated reporting. Elsewhere also, regulatory disclosures have supported this move towards integrated reporting, with companies in the UK publishing the Strategic Report and the EU adopting the Non-financial Reporting Directive.

Elements of the UK Strategic Report are relevant to the Japanese disclosure system. In particular, the upcoming revision to the Guidance of the UK Strategic Report will encourage more meaningful disclosure of how the board has discharged its duty to a broad range of stakeholders (employees, customers, suppliers and others). It emphasises a focus on purpose (why a company exists) and the inclusion of long-term systemic risks such as climate change.

2 Enhancing narrative information: The UK's Strategic Report and climate-related disclosures

2.1 The FRC's guidance on the Strategic Report

In June 2014, the Financial Reporting Council (FRC)[3] published its Guidance on the Strategic Report (the 'Guidance'). The purpose of the Strategic Report is to provide a company's shareholders with a holistic and meaningful picture of its business model, strategy, development, performance, position and future prospects. The Guidance outlines the content of the Strategic Report as required by the Companies Act 2006, and includes communication principles that emphasise the qualities of good financial reporting. The Guidance also encourages companies to focus on the application of materiality to disclosures, to be innovative in the structure of information and to improve clarity and brevity of information.

The Strategic Report should have the following characteristics: <u>be fair, balanced and comprehensible, be concise, have forward-looking orientation, include company-specific information, and link related information in different parts of the annual report.</u>

The content elements – **strategic management**, **business environment** and **business performance** – for the Strategic Report set out in the Guidance are derived from the Companies Act 2006, and include a description of the company's strategy, objectives and business model.

In addition, the Strategic Report should include an explanation of <u>the main trends and factors affecting the company, a description of its principal risks and uncertainties, an analysis of the development and performance of the business, and an analysis using key performance indicators.</u> Disclosures about <u>the environment, employees, social, community and human rights issues are required when material</u>. There is also a requirement to include <u>disclosures on gender diversity.</u>

2.2 Revisions to the Strategic Report

The FRC has recently published proposed revisions to its Guidance. The proposed amendments reflect the legislative changes arising from the UK implementation of the EU Non-financial Reporting Directive, and aim to strengthen the link between the

[3] The Financial Reporting Council (FRC) is the UK's independent regulator responsible for promoting high quality corporate governance and reporting to foster investment. The FRC sets the UK Corporate Governance and Stewardship Codes and UK standards for accounting and actuarial work; monitors and takes action to promote the quality of corporate reporting; and operates independent enforcement arrangements for accountants and actuaries. As the Competent Authority for audit in the UK the FRC sets auditing and ethical standards and monitors and enforces audit quality.

purpose of the Strategic Report and the director's duty under section 172 of the Companies Act 2006 (duty to promote the success of the company). The update also reflects the new European Securities and Markets Authority (ESMA) Guidelines on Alternative Performance Measures[4], which are increasingly used within the Strategic Report.

Some of the more significant amendments/additions to the above mentioned content elements for the Strategic Report include:

- A focus on **purpose**, ie, why a company exists. The company's strategy describes the intended means of fulfilling its purpose. Together they provide an overview of why and how the company aims to generate and preserve value.
- How the company engages with major **stakeholders** and takes their views into account when making significant strategic decisions.
- An explanation of the values, behaviours and **culture** that the company seeks to uphold.
- The nature of the key resources and **relationships** on which the company's success in the long term depends.
- A description of how its **allocation of resources** will support the achievement of the company's strategy.
- Reflecting the enhanced disclosures with respect to the environment, employees, social issues, human rights and anti-bribery and corruption.
- A discussion on how the company's strategy and business model might change in response to long-term systemic risks, for instance risks arising from **climate change** or risks arising from changing technology.

2.3 Task Force on Climate-related Financial Disclosures' recommendations

On climate change, we welcome the recommendations of the Financial Stability Board's Task Force on Climate-related Financial Disclosures (TCFD). As a representative of long-term shareholders, we expect companies to assess and report on possible future climate change risks, not just those that have already emerged. Therefore, we expect companies to respond positively to the recommendations and to report against them. For companies in sectors where the risks from climate change are most material, this should include identifying potential material issues by testing the performance of their strategies against a range of low-carbon scenarios and demonstrating that these are effectively monitored and managed.

3 Recommendations for additional reporting requirements for Japanese companies

We believe that, following the proposed revisions, the Japanese corporate governance code (the 'Code') and the Guidelines for Investor and Company Engagement (the 'Guidelines'), based on the proposal of the Council, cover many of the elements described in the previous section. Beyond the requirements of the Code and the Guidelines, we encourage companies to consider and disclose on the following:

- Explain the company's performance in the context of its business strategy and long-term plans as well as its business environment. A simple statement of

[4] The guidelines apply to issuers with securities traded on regulated markets, and persons responsible for drawing up a prospectus. Their aim is to improve the transparency and comparability of financial information, reduce information asymmetry among the users of financial statements, and contribute coherent use and presentation of alternative performance measures.

the company's business results is not adequate for investors to judge management's performance and the appropriateness of its risk taking.

- Forward-looking orientation in relation to the economic environment which the company expects to face in terms of risks and opportunities. The company should provide links between information in the reports and this future economic environment.
- Plan for any long-term systematic risks arising from climate change and test performance of strategies against a range of low-carbon scenarios, demonstrating they are effectively monitored and managed. The development of climate actions following the Paris Agreement and the TCFD disclosures should be highlighted.
- Cultivate strong relationships and dialogues with employees world-wide, not only as a stakeholder but also as one of the company's most important assets.
- In the Code, these issues are classified in Section 2, entitled 'Appropriate Cooperation with Stakeholders Other than Shareholders'. We believe shareholders are highly interested in these issues which are closely related to the sustainability of the company.

4 Corporate governance disclosures

In terms of specific corporate governance disclosures (see for further detail the Hermes Corporate Governance Principles of Japan attached separately[5]), we particularly encourage Japanese companies to enhance transparency in the areas of cross-shareholdings, capital management and remuneration.

4.1 Cross-shareholdings

While the current disclosure on strategic holdings in the Annual Securities Report is helpful in identifying companies which have significant holdings of this kind, most companies only provide a boilerplate explanation on the purpose of the holdings. Similarly, companies' explanations on their policies on such holdings in the corporate governance report is often standardised. Companies should be much more specific about their purposes, indicate whether the holdings are part of cross-shareholdings, and give detailed plans for such holdings.
We welcome the proposed amendments of the Principle 1.4 Cross-Shareholdings of the Code, particularly the following:

- Companies should disclose their policies, including policies regarding the reduction of cross-shareholdings.
- The board should annually assess whether or not to hold each individual cross-shareholdings, specifically examining whether the purpose is appropriate and whether the benefits and risks from each holding cover the company's cost of capital.

We believe the current disclosure of the top 10 shareholders in the Annual Securities Reports is not sufficient to check the cross-shareholding relationships, as most of these names are custodian banks. We would encourage companies to disclose at least the top 30 shareholders. We check cross-shareholdings against the company's purpose and in relation to the appointment of independent directors. Hermes EOS recommends voting against when the independent director candidates are current or former director/executives of large shareholders, including financial institutions.

[5] Hermes Corporate Governance Principles – Japan - https://www.hermes-investment.com/wp-content/uploads/2016/08/Japan-CG-Principles-August-2016.pdf

4.2 Efficient capital management

We note that some Japanese companies still have substantial cash balances and/or cross-holdings in securities for considerable periods of time, without providing a solid strategic plan or sufficient explanations for this use of shareholder capital.
We are pleased that this issue is referred to in the newly proposed draft of Guidelines for Investor and Company Engagement, in section I, Management Decisions in Response to Changes in the business Environment.

4.3 Remuneration

We generally do not seek disclosure beyond the current regulatory requirements on details of individual compensation in Japan, given the relatively low level of executive compensation in most cases and cultural sensitivities. However, we expect companies to articulate their remuneration structure and provide clear performance criteria for executives to ensure that remuneration schemes align management incentives with strategic objectives, key drivers of business performance and long-term value creation. This should encourage appropriate risk-taking by senior management.

We are pleased that the Guidelines ask the question in 3.5 under Determination of Management Remuneration: “Are objective and transparent procedures established to design management remuneration systems such that they operate as a healthy incentive to generate sustainable growth and increase corporate value over the mid to long term and to determine actual remuneration amounts appropriately?”

In the Code and the Guidelines, the word ‘management’, or ‘keieijin’ (経営陣), is frequently used. Is this a clearly defined word with the same meaning in English as in Japanese? If not, annotating the word is preferable.

5 Presentation of information: English disclosures

Since Hermes EOS has Japanese engagement professionals covering the Japanese market, for us the English disclosures by Japanese companies add no new information. However, many non-Japanese investors think an English translation of Japanese statutory materials is helpful for companies to broaden a foreign shareholder base, especially mid- and small-sized companies of which brokers’ analyst coverage is limited. Non-Japanese fund managers heavily rely on brokers’ analysts and their reports to make investment decisions. Japanese companies should realise that, if their coverage is limited and the companies’ website disclosure in English is limited, it is difficult for fund managers to convince themselves to make investments in these companies.

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