The Future Corporate Reporting

-- Let's discuss Climate & Remuneration disclosure! --

Digital Reporting Workshop for CG & other issues extra session

Date and time : 16th July 2019, 19:00-20:30

Climate & Remuneration disclosure, why we chose these topics?

After our numerous discussions on corporate disclosure for good corporate governance, we picked up some topics that we would like to discuss more, which were Climate & Remuneration.
We shared the current situation of Japanese companies and what investors want to know, discuss what is important for good corporate governance.

In July 2019, ICGN conference was held in Tokyo, so we had the opportunity to discuss with FRC and foreign investors. We heard about the progress of UK corporate reporting, shared some Japanese companies' cases and discussed the role of reporting/disclosure in improving governance.
In Japan, the regulation was just revised for remuneration disclosure. The discussion about climate change disclosure has just begun. In the UK, the CG code was revised last year, and the remuneration disclosure was enhanced. The discussion about climate change disclosure has begun.
After discussing them, we talked a little about the discussion of future corporate reporting, which is currently discussed in the EU as well as in the UK.

What was good about this workshop for Japanese investors, since we were asked about situation in Japan and were able to have deep thoughts. What the report has to do? What will happen in the future reports?
Let's see our discussion.

	Workshop on 4th February
Guest from oversea	2 from UK FRC, 1 UK investor, 
Attendees	22 Investors, 4 Investor(Analysts) organization, 2 pension & insurance, 6 Information providers/Researchers, 4 Company side (include Independent non - executive director), 2 Auditor, 1 Academic, 5 Regulator/Accounting setter/etc

CG code and Remuneration

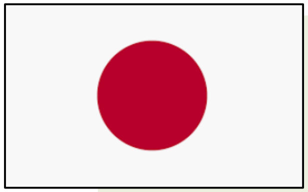
Why Remuneration becomes one of the key?

- In the UK, the CG code was revised last year.
  Company Act 172 requires management to have stakeholders engagement, such as employees, customers, etc.
  Enhance the function of the nomination committee and the remuneration committee, disclose succession plan, diversity, pay ratio, etc.
  Strengthening independence for the board

- Importance of disclosure of executive compensation
  Investors spend a lot of time in engagement on the evaluation of executive compensation. The remuneration discussions are growing year by year.

- Differences from the past discussions
  Previously, it was said that CEO remuneration should reflect shareholder value, but recently a wide range of topics such as gender pay gaps and how to link business strategies and risks with remuneration are being discussed.

- New issues
  It has been pointed out that the pages of remuneration disclosure is too much and difficult to understand. The companies are asked to explain what is incentives.



Revision of Japanese remuneration disclosure

・Detailed disclosure of remuneration governance was added. Specifically, the role of Remuneration Committee, the members of the committee, how many times a year the meetings were held, and what matters were discussed are required to disclose. (It should be applied from next year)

・Even for companies with good disclosure, there is a lack of description of remuneration governance. But it is important to explain why the remuneration is appropriate.

Case of Japanese companies

Overview of Compensation Structure for Directors

(1) Compensation composition ratio

Compensation consists of a "base salary" (fixed compensation) and compensation according to Company performance, namely "short-term performance-linked compensation (bonuses)" and "medium-to-long-term, performance-linked compensation (Performance-linked and Share-based Incentive Plan)." The ratio of compensation consisting of performance-linked compensation compared to base salary has been determined for each role:

Base salary : Short-term performance-linked compensation (bonuses) : Medium-to-long-term, performance-linked compensation (Performance-linked and Share-based Incentive Plan) = 1 : 1 : 1.5*

*Referring to Representative Director, President and CEO
*The ratio is based on the assumption that the performance targets are set as 100% for each performance-linked compensation

(2) Base salary

A base salary is paid to Directors as fixed compensation. Base salaries are determined for each role by taking into account the salary levels of officers at other companies (benchmarked companies of the same industry and scope selected by the Compensation Advisory Committee), as surveyed by a specialized outside organization.

(3) Short-term performance-linked compensation (bonuses)

Bonuses are paid to Directors excluding Directors (Independent) as short-term performance-linked compensation, which is linked to yearly performance indicators and the degree of achievement of performance targets. Director bonuses vary between 0% and 200% according to the achievement of operating income, net income, and ROIC targets defined in the annual operating plan.

Base amount for each position × Performance score (Operating income 50%, net income 50%) × ROIC score = Short-term performance-linked compensation (bonuses)

(4) Medium-to-long-term, performance-linked compensation (Performance-linked and Share-based Incentive Plan)

Stock compensation is paid as medium-to-long-term, performance-linked compensation to Directors excluding Directors (Independent). Stock compensation comprises the performance-linked component (60%), which is linked to the degree of achievement of the medium-term management plan, and the non-performance-linked component (40%), which aims for retention and motivation to improve share prices over the medium- to long-term, and is paid under the condition of a certain term of service. Stock compensation for performance-linked component varies between 0% and 200%, according to achievement of net sales, EPS, and ROE targets based on the medium-term management plan, as well as sustainability evaluation* based on a third-party organization.

Base amount for each position × Performance score (Net sales 30%, EPS 70%) × ROE score × Sustainability evaluation = Stock compensation (performance-linked)

As a rule, stock paid in stock-based compensation must be held by the individual during their term of service. In the event that an individual Director in question engages in serious misconduct during their term of service, and such misconduct harms the Company, the Compensation Advisory Committee will deliberate and make a recommendation. Based on this discussion and recommendation, the Board of Directors shall resolve to limit the payment of stock-based compensation.

* Sustainability evaluation
An evaluation based on the Dow Jones Sustainability Indices (DJSI). The DJSI are a series of ESG Indices which include companies evaluated and selected based on long-term shareholder value perspective, reflecting economic, environmental, and social factors comprehensively.

The details of compensation are written very well so that they can be understood. However, the role of the remuneration committee and what kind of discussions have been made regarding remuneration governance are not disclosed.

Disclosure in English is based on the Companies Act only (not individually disclosed even if it exceeds 100 million yen)

However, we want description of the process of determining compensation rather than too much detailed numbers.

I check how much compensation is appropriate against net income. So detail numbers are also important.

(2) Compensation of Directors and Audit & Supervisory Board Members

1) Policy on Determining Amount of Compensation, etc., and Methods Used for Calculation

The Company has a Compensation Advisory Committee to increase objectivity and transparency with respect to the compensation of Directors. The Compensation Advisory Committee is composed of members the majority of whom are Directors (Independent), and is chaired by a Director (Independent). The Company determines the Compensation Policy for Directors by resolution of the Board of Directors based on discussions by and recommendations from the Compensation Advisory Committee.

The amount of compensation for each Director is determined by resolution of the Board of Directors, within the scope of the aggregate amount of compensation, etc. for Directors set by resolution of the General Meeting of Shareholders, in light of discussions by and recommendations from the Compensation Advisory Committee based on the above policy.

In addition, the amount of compensation for each Audit & Supervisory Board Member is determined by discussions among Audit & Supervisory Board Members, based on the Compensation Policy for Audit & Supervisory Board Members, which has been set forth through discussions among Audit & Supervisory Board Members, within the scope of the aggregate amount of compensation, etc. for Audit & Supervisory Board Members set by resolution of the General Meeting of Shareholders.

The Company's Compensation Policy for Directors, Overview of Compensation Structure for Directors and Compensation Policy for Audit & Supervisory Board Members are as described in the following pages.

2) Amount of Compensation of Directors and Audit & Supervisory Board Members

(JPY millions)

Title	Number (Persons)	Base Salary	Short-term Performance-Linked Compensation (Bonuses)	Medium-to-long-term, Performance-Linked Compensation (Performance-linked and Share-based Incentive Plan)	Aggregate Compensation
Directors [Directors (Independent)]:	8 [3]	323 [41]	104 [—]	317 [—]	744 [41]
Audit & Supervisory Board Members [Audit & Supervisory Board Members (Independent)]:	4 [2]	86 [23]	— [—]	— [—]	86 [23]
Total [Outside Officers (Independent) included in total]:	12 [5]	409 [64]	104 [—]	317 [—]	830 [64]

Notes: 1. The maximum limit of the aggregate compensation of Directors was set at JPY 35 million per month at the 63rd Ordinary General Meeting of Shareholders held on June 27, 2000. In addition, the maximum limit of the aggregate compensation of Audit & Supervisory Board Members was set at JPY 11 million per month by resolution of the 81st Ordinary General Meeting of Shareholders held on June 19, 2018.
2. The maximum limit of Directors' bonuses was set at JPY 600 million per year at the 81st Ordinary General Meeting of Shareholders held on June 19, 2018.
3. The 80th Ordinary General Meeting of Shareholders held on June 22, 2017 made a resolution to introduce a Performance-linked and Share-based Incentive Plan. Under the Plan, the maximum limit of money to be contributed by the Company is JPY 2.4 billion, and the maximum limit of the number of the Company's shares to be granted and delivered as sales proceeds ("grant(ing), etc.") is 600,000 shares during the four fiscal years of the medium-term management plan. Under the Performance-linked and Share-based Incentive Plan, the Company shall award points to Directors calculated according to a prescribed formula, and the trust shall grant, etc. the Company's shares corresponding to the points awarded during a certain period to the Directors. Expenses of the Performance-linked and Share-based Incentive Plan, as indicated above, are associated with the points granted during the fiscal year under review.
4. No Directors of the Company received any employee wages other than their compensation as Directors.

From AGM agenda of Omron

General Opinions to Japanese companies from oversea

Incentive rewards do not work

Looking at this year's disclosure, about 9% of board members of companies included in TOPIX500 received over 100 million yen. I don't know how many of them are foreigners, but they generally are paid more than Japanese managements. Of these, 30% are outside directors, and their average remuneration is very low. This is the background in Japan. The major issue overseas is that the remuneration is too high. But I think the problem is that the managements are not receiving enough remuneration in Japan. Moreover, mostly they are fixed amount. Therefore, it is not tied to performance. That is not working as incentive. In Japan, the total values for outside directors and positions are disclosed. So you can see that in average 85% of remuneration is fixed. But the companies are not mandatorily required to disclose more details. It would be helpful if they disclosed more.

Foreign investor in Japan

I believe what is important is not the amount of money but how to determine it. The governance system of how directors are evaluated is important.

Transparency is important. First, we need to know the fact. If not, we cannot find the issue.

Climate change Disclosure

We still don't know what is the best climate change disclosure. However, it turns out that many UK investors are welcoming TCFD because they want to make evaluation from the viewpoint of valuation of corporate activities and stewardship code.
Business models, strategies, risks, and performance metrics are already required as general disclosure frameworks. The new disclosure required by TCFD is scenario analysis. How the company plans about the future, how the board think the business model will be affected by scenarios such as 2 degrees or 1.5 degrees, what about risks, and opportunities...How the board monitors risk, how it thinks about physical risks of assets, and how performance metrics are managed. I understand that such disclosure are required.

Regarding Bank A, it was written that the impact was estimated to be around 1 billion yen in 2050, but this is only an estimate of the impact only in Japan. It is not so valuable number because the company operates its business globally, moreover, the impact of climate change is big issues globally. Next, Bank B has declared that it will supply 20 trillion yen as sustainable finance by 2030. However, the breakdown and assumptions were not explained why it was 20 trillion yen.

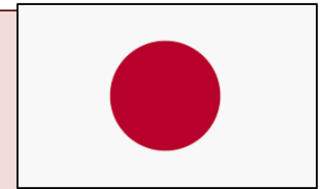
However, TCFD disclosure is very difficult for a small company. There is a lot of disclosure requirements even for small companies today. How about in the UK?

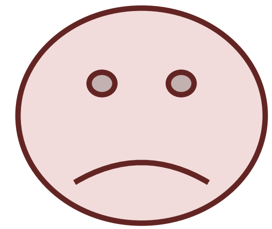
Isn't it too difficult?

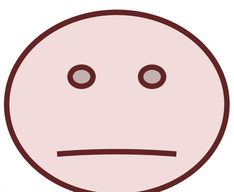
Aside from disclosure requirement, climate change measures are not important for all companies

How different from ordinary Disclosure?

Today, 163 companies have declared to accept TCFD disclosure in Japan (July 2019). In addition, 227 companies disclose climate change opportunities, risks, and countermeasures, in the 383 companies which issued integrated report. Company C discloses TCFD. It is an active company, and became one of the best practice of TCFD disclosure in Japan. Governance, and important points from their key business (strategy, risk management, and KPIs) are set in the overall framework. In particular, in terms of strategy and scenario analysis, power generation business, natural gas, and coal are described. Similar businesses are listed for risk management are written, Includes metrics and targets, and goals for 2030. Although the elements of TCFD have been organized, physical risks are not mentioned much with focus on transition risks. In 2018, Japan's non-life insurance claims were the largest ever. In Japan, physical risks (disaster risks) are increasing. The actualized such risks are thought to be directly linked to business risks through disruption of the supply chain. I would like the company to disclose them.

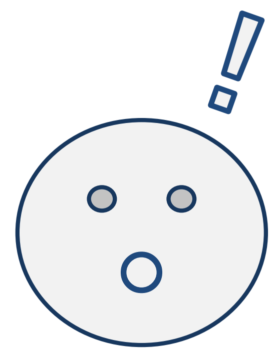






Since company C's business is wide, I think that there is no choice. (not explained well)

Isn't that a basic disclosure requirement? Not a TCFD special....



Where & How Climate-related should be disclosed?

Questions To Japanese investors

- Do you have any requests for mandatory disclosure of TCFD disclosure in Japan?
- Do you have any opinions or requests that the format or description be specified in the annual report (regulatory disclosure)?
- What do you think if company disclose summary on the annual report and refers to the details in separate data book?

I want company to write it on the securities report (Yuho)

I agree with the way to separate summary and the data book. TCFD alone is a huge number of pages and it is hard to read, if it would be disclosed on the annual report together.

The reason why you want to write in the annual report is, because easy to find ? Or because that you can link with other information?
What about the idea of summaries and data books?

No..., in that case, we need really material summary.

Does they need Audit or assurance?

Questions To Japanese people

• Do you have any requests for auditor audits or assurances for that information?

Assurance is interesting for auditors or Audit committee. It is also a necessary element for audit. External reviews will be increasingly required as users want such things, especially information about the environment, etc., but these reviews are responsible.

So, is that what the auditor provides? For example, it is better for other experts to provide assurance for the details of the environment ...

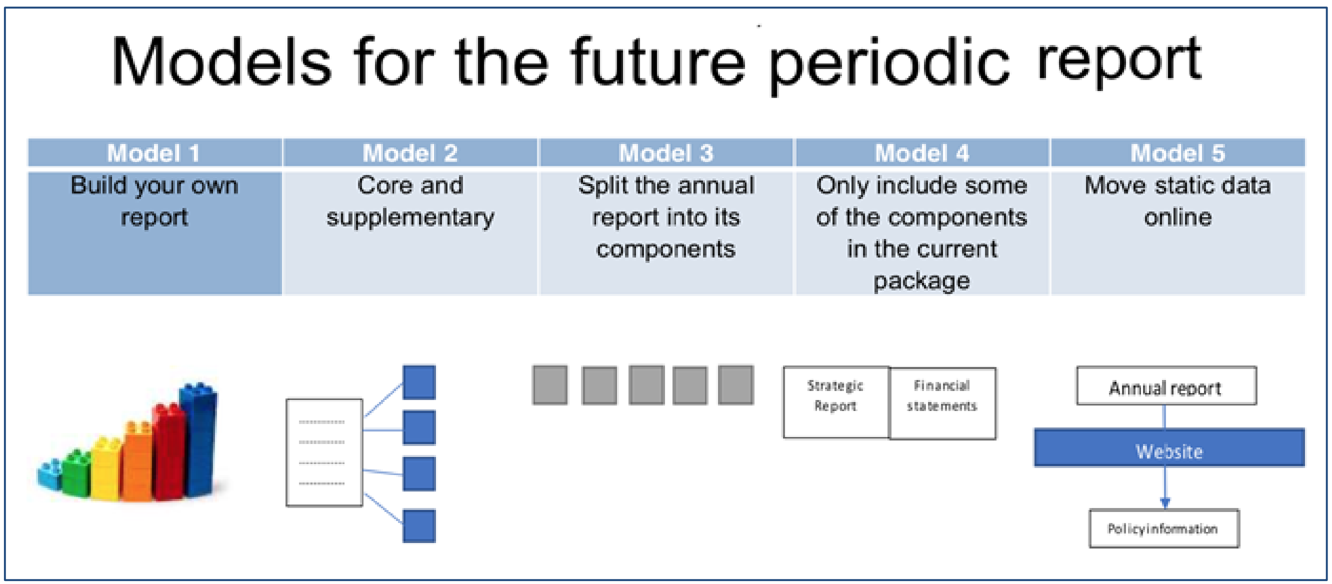
Auditor

This would be challenging if the auditor would be responsible for a wide range of information that would be spread supplementally. However, the audit firm has already concluded in the assurance work for some non-financial information. In terms of the ability of auditors, audit firms have specialists in various fields such as finance, governance, and climate change. For this reason, when discussing these models, I think it can be said that major audit firms have such capacity and ability.

The future corporate reporting

We are discussing what the annual report should be, what information investors need, and what information is needed to exercise voting rights. How is each piece of information handled best for communication, what format and how it should be handled, and how the new technology will change the way it is communicated. In order to clarify the principles and purpose of the report, we discuss who is the audience, the role of regulation for them, and the issues on the user side. Going forward, for example, shareholders will require information on stewardship and information on impacts of climate change... we will organized those things. The proportion of needs for financial statements might become relatively small.

The FRC has also discussed various stakeholders on how future reports should be. A model that separates very core information from supplemental information in a report, and a model that separates information in an annual report into its components. A company spends about 10 pages every year on information that does not normally change, such as accounting standards. There is a discussion that it may be easier to understand if it is removed from the report and placed on the website. These are not the stories that will happen tomorrow. It is a search for what will work in the future.



From Document of FRC

Attendees consensus

Among various issues such as remuneration disclosure and climate change-related disclosure ...

- **What reporting should be going forward?**

From our discussion today..

- Both compensation and climate change, each company's processes should be different. So it should be an opportunity to show **their strategies and processes**.

- Investors should also actively have **their own opinions** on remuneration and climate change telling what is important, for encouraging good disclosure.

- With all kinds of information increasing, **more efficient and unified disclosure** means are more desirable, should be discussed.

- Even if it is classified as "non-financial" information, it will be able to be used effectively by making investment decisions if it is **digitized and converted into data that can be compared with other companies.**