
Part 7: Regulatory Perspectives: Rights, Responsibilities & Reporting

Monday 28 September 2020 at 1300 hours, BST

The protection and maintenance of stakeholders’ rights is paramount as the world seeks to build back better to a more sustainable economy where long-term value creation and the social purpose of companies is at its core. These rights, and the responsibilities they confer to stakeholders and to companies, play a crucial role in the recovery towards a fairer and more prosperous world. In addition, reporting mechanisms are critical in rebuilding and sustaining companies and the reputational capital of business.

ICGN is grateful to our Speakers as follows:

- Mark Babington, Acting Executive Director of Regulatory Standards, Financial Reporting Council
- Toshitake Inoue, Deputy Director-General of Corporate Disclosure, Accounting, Auditing and Governance, Financial Services Agency of Japan
- Kerrie Waring, Chief Executive Officer, International Corporate Governance Network

Annex 1: slides from Toshitake Inoue

Introduction

The S in ESG has been elevated in company engagements as a priority, with a focus of how to mitigate inequalities, social welfare and justice, not only at a company level but within the supply chain and in communities.

Companies are demonstrating their social license to operate in a more meaningful way, driven by the idea of stakeholder capitalism, demanding accountability and shared prosperity for all those who have an interest in the long-term success of companies.

COVID has exposed high levels of public mistrust in capitalism fueled by economic equality in environmental devastation. The question is how to strike the right balance between optimizing the world’s finite resources while at the same time driving economic growth for shared prosperity; should we have more regulation to speed dial our efforts?

Types of emergency legislation and what might we expect over the coming months?

The pandemic hit during Japan’s audit period and end of fiscal year and the government declared a state of emergency from the beginning of April to end of May, which was a peak season for accounting and audits and there was concern that the labour intensive accounting work would be disrupted. A networking group was set up by Financial Services Agency (FSA) of related organisations and ministries in Japan to identify the situation and share initiatives with related parties about year-end closing and audit for March year-end.

Key initiatives implemented by the networking group focused on year-end accounting; publication of consideration in making accounting estimates with difficulty to predict when Covid-19 will end (ASBJ); In disclosure as the FSA gave an extension to the deadline for
submission of annual securities reports and to encouraged corporate disclosure regarding
the impact of the COVID-19; and in auditing with the release of “Audit consideration related
to COVID-19” by JICPA and a request to listed companies for re-examination of schedule for
earnings release by TSE.

AGMs became a concern as they are concentrated in a narrow window at the end of June,
so companies were encouraged to defer AGMs to July and after. Japanese AGMs are
usually very full of individual Japanese shareholders, so shareholders were advised not to
go to AGMs in person but to vote in advance via a electronic platform and encouraged
companies to broadcast AGMs online or to hold a hybrid virtual AGM. Thanks to these
measures Japan could go through the AGM season, but they will continue to consider how
to navigate through mid to long term issues such as digitalisation of accounts and auditing
works or how to introduce a virtual only AGM in preparation for next year’s AGM season.

In the UK, with a situation of unprecedented levels of uncertainty, there was the priority to
continue to uphold the flow of high-quality information of financial markets, critical for the
decision making of investors. The FRC worked closely with the Financial Conduct Authority
(FCA) and the Prudential Regulation Authority (PRS) to put in place a package of measures
and issued a joint statement, which recognised they were in unprecedented times of
uncertainty to allow people time to think how to respond.

Over time this has been supplemented with flexibility from the FCA on reporting deadlines
and the government did the same for smaller companies with flexibility from Companies
House. Auditors would be facing 2 main areas of challenge, one caused by the physical
restrictions of movement, meaning the work had to be done in a different way, and then also
to put in place some guidance over how the auditor might want to approach these increased
areas of uncertainty. FRC put out information over growing concerns for implications of how
the audit is delivered and how they responded proactively to the needs of the markets. The
FRC worked with the government to put in place guidance on AGM arrangements,
recognising that it was no longer feasible to have in-person meetings for large numbers of
people.

Since then, there has been guidance for companies on how they can really focus on
enhancing the quality of the disclosures. Due to such unprecedented uncertainty, it was
important to communicate to shareholders and other stakeholders what the company was
doing to manage that uncertainty and what it was doing to address its prospects going
forward.

There would be a risk of significantly higher levels of modified audit opinions, so FRC put out
schematic guidance for investors explaining the different types and their Financial Reporting
Lab issued a report ‘Reporting on times of uncertainty’ which focused on December and
March year ends. The FRC continues to engage with stakeholders and regulators because
in the UK, December year ends are prevalent; for most Dec 2019 year ends, COVID was a
post-balance date sheet event; as we go into Dec 2020 year ends we see far more
businesses deal with the consequence of covid on their businesses. In responding to this
challenge, the government set up a range of business support in ensuing there is clear and
transparent disclosure over the schemes that companies can assess, how they’ve been able
to use them and the assessment they make about the impact they make on business. Within
challenging times it has seen positive close cooperation between regulatory authorities seeking to ensure information is flowing to markets remains high quality.

The European Commission is consulting on “sustainable corporate governance” with a focus on balancing shareholder and stakeholder interests and requiring boards to integrate sustainability into strategy using targets aligned with the SDGs. Meanwhile, New Zealand have just made the Taskforce for Climate Related Financial Disclosures which requires companies to describe how climate is reflected in governance, strategy and risk management – mandatory. Will Japan or the UK follow suit? Will there be mandatory ESG reporting on an international scale, for example could TCFD be integrated within the IFRS accounting framework?

Sustainability is a hot topic in Japan and the importance of sustainability issues after the covid-19 pandemic, although beforehand many investors and companies were considering how to integrate the climate change or the environmental issues in their strategy but now people are also considering the S factor as well. The employment and labour stabilities are a big issue here in Japan too. GPIF is actively engaging in ESG issues and the notion has been widely split to asset managers and companies. There is still a debate that we have to go through before we make it a mandatory disclosure; for example, there is a debate in EU whether we should stick to single materiality, only to consider the social or environmental impact of companies or we should consider dual materiality, to incur the impact by society and environment on companies considering the framework of sustainability reporting. We need to strike a balance between the needs of shareholders and other stakeholders. In the short term there may be a wide gap between the consequences of the two approaches, but the gap will be minimised if we take a long-term viewpoint so we encourage investors and companies to take a longer termism.

There are a couple of movements to integrate standards, the IRF foundation trust committee is looking to integrate a number of private reporting standards. If successful, Japan would like to support their efforts to set up a high-quality global sustainable reporting standards, which is a prerequisite for a reliable future statutory standards disclosure for sustainability issues.

There are huge areas of common interest between the UK and Japan. FRC stakeholders are passionate about sustainability reporting and how we build that into corporate reporting and how we make it of value to users of those financial statements. The one real challenge is that a lot of companies feeling their way forward, looking to improve the quality of what they disclose but we don’t have a single consistent framework. One of the things people want is comparability in the way they can assess how effective one company is being compared to another. So I agree very strongly about the importance of having a single global framework for reporting against. However, I do think there is a two-stage consideration, for those of us who have been around long enough for us to see the establishment of the IASB and FRS Foundation, international progress on standard setting is not a swift exercise; there will be challenging things to overcome, for instance if the remit of the foundation was to increase, how would that be funded? We are going to have to work with international regulators and with other national regulators to say ‘how do we close that gap in the meantime’ and ‘how do we point to some of the existing framework like TCFD and SASB and say is there scope to be able to make better use of these to improve the quality and consistency of reporting until we can present a global solution to the challenge’. In the UK we have a senior steering
board looking at TCFD, that brings together government departments and regulatory authorities including the FRC about how we respond to that need, particularly because towards the COP26 meeting and it’s important we can show we can make definitive steps forwards, that will enhance the value of this reporting and maintain the focus on this important area.

**Would you be favourable of seeing COP26 mandatory in the UK?**

Having a mandatory framework does address the concern about bringing together consistent practice, which is a decision for ministers if something goes into law but there is clear support for that and trying to work out how we best meet the needs of those stakeholders. In the next couple of weeks, the FRC is going to be offering a piece of thought leadership on the future of corporate reporting, which contains several proposals that we have worked out to improve the quality of the product and the responsiveness of the product and the FRC need to engage not only with the UK but with global stakeholders to see how those proposals are received, covering both financial and non-financial reporting. Having that consistency and comparability is really important. Something to consider in any regime that has mandatory requirements, is just who are you making those mandatory requirements cover? Because there will be sectors of the market where it is more important to have arrangements in place. The direction of travel is very clear, its making sure we can reach an attractive consensus globally.

**Is TCFD going to be mandatory in Japan?**

Japan has a great number of TCFD supporters, 300 organisations have signed up in support of the TCFD; but there is a degree of variety in their disclosures and so we are still in a stage to encourage their continued adoption of TCFD. First of all, we have to widen our base of the TCFD supporters and then as TCFD gains contraction as one of the leading global standards in climate change reporting standards then that will help to making it mandatory.

**There are now 220 US companies signed up to the Business Roundtable statement asking them to define corporate purpose. How do companies disclose their obligations to stakeholders in your markets? Are companies explicitly required to disclose on the subject and if so how?**

Recently FRC did a call for participants for a new project that our financial reporting lab has set up to look at best practices in that section 172 ‘how is the company meeting the needs of that wider stakeholder group?’, to see how we can support and encourage what is being done in that area by identifying the components of high-quality disclosure.

FRC revised their Stewardship Code, with part of it saying effective stewardship responds to the needs of wider stakeholders in the company. FRC lab is reviewing this significant expansion of auditing a company and wants to make it better focused, more meaningful and useful.

An outcome of the covid pandemic is that people are asking more questions about the companies they invest in or give their business to and the pandemic has made our community more discriminating, where they want their money to go to the companies that
they perceive are doing the right thing and that is driving a lot of practice in the marketplace and this is being investigated in the lab over the autumn.

The Japanese Corporate Governance (CG) Code states companies are encouraged to disclose their mission purpose in their CG reporting. For stakeholder capitalism, Japan has a long history and upholds a three-way satisfaction, saying business needs to be appreciated by three parties; sellers, buyers and society as a whole. This concept has existed for a long time in Japan’s CG Code, which was established in 2015 and devotes one chapter to the conservation of stakeholders and states that listed companies should strive for appropriate relationship with stakeholders other than shareholders. However, it has been noted that the interests of stakeholders did not lead to the corporate value in the mid-to-long term economic growth as a whole, so in light of that observation the CG Code in Japan calls for improving corporate value in the mid-to-long term with appropriate cooperation with stakeholders, ensuring the rights of stakeholder. The interests of stakeholders and shareholders may be in conflict with each other in the short-term but they should all have significant extent in the mid-long term. So, it is important to maintain a longer-term perspective. Due to those backgrounds it is important for Japanese companies to protect interests of shareholders and other stakeholders while in the culture to consider shareholders and more. The covid-19 pandemic reminded many Japanese companies of the importance of considering their diversity stakeholders, so the government of Japan needs to consider balanced corporate management to ensure those benefits are passes onto a wider range of stakeholders, including shareholders. So that should be one of the measured topics that we have to tackle when we consider the next version of the CG Code.

ICGN Members approved changes to the ICGN Global Stewardship principles which build on our first statement on investor responsibilities in 2003. New elements include references to systemic risk, capital allocation, fiduciary duty, and values. What is next for your own respective stewardship codes, and what about your corporate governance codes?

The FRC has started a programme of monitoring and the CG team are going to issue a report on how people are reporting their obligations under the CG code, analysing the quality of the reporting and evidence that underpins that reporting. Although the new stewardship code kicks in for the next reporting season, they are seeing early adopters and will be doing monitoring of stewardship reporting as well as people come forwards and asked to be recognised as signatories to the code. There is a mechanism to pick up on good practice and also to encourage entities to change their behaviour where it’s not good enough, which is something they haven’t had before and is a significant step forward.

Having an increased focus on outcomes and purpose, not just about process and procedure but actually ‘what does this translate into’ and FRC stakeholders consider this very important. Next steps are to build our evidence base from the monitoring work being done and use that to report publicly on periodically as a way of driving improvement in the marketplace.

To further promote the effectiveness of corporate governance reform, based on discussion in the Council of Experts on Stewardship Code (held three times between October 2019 and
December 2019), Japan’s Stewardship Code was revised on March 24, 2020 (second revision).

General discussion points include consciousness towards the medium- to long-term increase of corporate value in stewardship activities; Consideration of sustainability (medium- to long-term sustainability including ESG factors); and Applying to other asset classes, e.g. bonds, as far as it contributes to carrying out stewardship responsibilities.

Asset managers should disclose the reasons of votes on the agendas of investee companies, either “for” or “against”, which are considered important from the standpoint of constructive dialogue with investee companies, including those suspected to have conflicts of interest or those which need explanation in light of their voting policy. Also asset owners should conduct stewardship activities corresponding to their size and capacity, etc.

In order to assure accuracy and transparency of proxy recommendations, proxy advisors should: develop appropriate and sufficient human and operational resources (including setting up a business establishment in Japan); assure transparency of proxy recommendation process; exchange views actively with companies; and regarding self-evaluations and stewardship activities including dialogue with companies, it is important to disclose them with consciousness of the sustainable growth of companies and the medium- to long-term increase of corporate value.

In regard to the CG Code, Japan is restarting discussions at the Council of Experts regarding Japan’s CG Code. One of the big topics to consider for this new revision is the reaction of companies to the covid-19 pandemic; where we have seen changes in the consumers and in corporate behaviours so we would like to discuss how the covid-19 pandemic affect the social and economic structures and how companies can respond, for example to digital transformation, supply chain and work style reforms and how we can connect these responses to the established sustainable business models.

We also have to consider the existing topics for our CG reform, such as further performance of management and cost of capital. Implementation of business portfolio strategies or strengths of group CG including handling of double listed subsidiaries, ensuring confidents in audits, short- & long-term sustainability issues, improve quality of external directors. TSE is reorganising their markets, into primary & standard markets, considering applying higher governance standards for primary market listed companies – which will be a big topic. The Council of Experts discussion will start in October, with a first draft by spring 2021, before AGM season.
Annex 1: slides from Toshitake Inoue

Networking Group on the corporate disclosure, financial reporting and audit of listed companies in Consideration of the Impact of the COVID-19 (Novel Coronavirus) Infection (1)

Objectives
- Many listed companies are facing drastic decrease of the sales and uncertainty of future fiscal outlook due to the effect of COVID-19
- For year-end closing and audit, companies and auditors should consider and judge not only the effect of the COVID-19 but also government emergency economic measures for appropriate disclosure of corporate information
- Based on the above, Financial Services Agency (FSA) established the networking group to identify current situation and share initiatives with related parties about year-end closing and audit for March year-end

Members
- Tokyo Stock Exchange
- Accounting Standards Board in Japan (ASBJ)
- Japan Business Federation (Keidanren)
- Japanese Institute of Certified Public Accountants (JICPA)
- Securities Analysts Association of Japan

Observers
- Ministry of Justice
- Ministry of Economy, Trade and Industry
- Japan Bankers Association

Secretariat
- FSA

Networking Group on the corporate disclosure, financial reporting and audit of listed companies in Consideration of the Impact of the COVID-19 (Novel Coronavirus) Infection (2)

Key initiatives implemented by the Networking Group

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<th>Event</th>
<th>Description</th>
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<tr>
<td>Year-end Accounting</td>
<td>Publication of consideration in making accounting estimates with difficulty to predict when Covid-19 will end (ASBJ)</td>
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<tr>
<td>Disclosure</td>
<td>Extension of deadline for submission of annual securities reports (FSA)</td>
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<tr>
<td>Auditing</td>
<td>Encouragement of corporate disclosure regarding the impact of the COVID-19 (FSA)</td>
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<td>Auditing</td>
<td>Release of &quot;Audit consideration related to COVID-19&quot; (JICPA)</td>
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<td>Auditing</td>
<td>Request to listed companies for re-examination of schedule for earnings release (TSE)</td>
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<td>Annual general meeting of shareholders (AGM)</td>
<td>Publication of the Statement to encourage consideration on deferring the timing of an AGM or holding the “following meeting” after AGM (Networking Group)</td>
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<tr>
<td>Annual general meeting of shareholders (AGM)</td>
<td>Publication of extraordinary convocation notice model of AGM considering the spread of COVID-19 (Keidanren)</td>
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Implication
- It is highly appreciated that year-end accounting and auditing work was completed without major disruption such as the occurrence of Covid-19 clusters.
- We will continuously discuss with stakeholders how to respond to mid-to-long term issues, such as how AGM is conducted, digitalization of accounts and auditing, etc.
- Networking Group closed on July 2nd, but likely to be held again when situation changes.

Key Points to the Second Revision to Japan’s Stewardship Code

- To further promote the effectiveness of corporate governance reform, based on discussion in the Council of Experts on Stewardship Code (held three times between October 2019 and December 2019), Japan’s Stewardship Code was revised on March 24, 2020 (second revision).

< Key Points >

1. **General Discussions:**
   - (1) Consciousness of "medium- to long-term increase of corporate value"
   - (2) Consideration of "sustainability" (medium- to long-term sustainability)
   - (3) Applying to other asset classes

2. **Asset Managers:** Improvement of disclosure to promote constructive dialogue

3. **Asset Owners:** Support for the stewardship activities of corporate pension funds

4. **Proxy Advisors**

5. **Investment Consultants for pensions:** Improvement of quality of services for institutional investors

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### Key Points

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| ① General Discussions | (1) Consciousness towards the medium- to long-term increase of corporate value in stewardship activities  
(2) Consideration of sustainability (medium- to long-term sustainability including ESG factors)  
(3) Applying to other asset classes, e.g., bonds, as far as it contributes to carrying out stewardship responsibilities |
| ② Asset Managers | - Asset managers should disclose the reasons of votes on the agendas of investee companies, either “for” or “against”, which are considered important from the standpoint of constructive dialogue with investee companies, including those suspected to have conflicts of interest or those which need explanation in light of their voting policy.  
- Regarding self-evaluations and stewardship activities including dialogue with companies, it is important to disclose them with consciousness of the sustainable growth of companies and the medium- to long-term increase of corporate value. |
| ③ Asset Owners | - Conduct stewardship activities corresponding to their size and capacity, etc. |
| ④ Proxy Advisors | - In order to assure accuracy and transparency of proxy recommendations, proxy advisors should:  
  - develop appropriate and sufficient human and operational resources (including setting up a business establishment in Japan)  
  - assure transparency of proxy recommendation process  
  - exchange views actively with companies |
| ⑤ Investment Consultants for pensions | - Develop structures of conflicts of interest management. |