ESG Disclosure Study Group Report 2022

- Achieving World-Leading Disclosure and Dialogue Standards -

Executive Summary

August 2022

ESG Disclosure Study Group

Contents

1. About the ESG Disclosure Study Group

Organization name	General Incorporation Association of ESG Disclosure Study Group (EDSG)
Establishment	June 15, 2020
Vision	EDSG contributes to creating a mechanism that realizes the sustainable development of society in keeping with the long-term value creation of companies themselves.
Major activities	(1) Studying effective and efficient ESG disclosure and its framework (2) Accumulating practical knowledge and methodologies to implement ESG disclosure (3) Advancing mutual understanding between companies and stakeholders (4) Publishing white papers to share study outcomes (5) Performing services incidental or related to the above-listed activities as necessary to achieve the objectives of the association
Representative director and study group chair	Tetsuo Kitagawa, Ph.D. Emeritus Professor of Aoyama Gakuin University and Professor at Tokyo Metropolitan University
Number of members (End of June 2022)	Full members: 50 General members: 46 Academic members: 1 Observers: 11 Special members: 7
Website	https://edsg.org/en/

2. Recommendations on the Ideal Form for Non-Financial Information Disclosure

We offer recommendations on the ideal form for ESG disclosure that EDSG has put together based on expertise developed over the past two years of activities. Recommendations are set out individually for companies, investors, and standard-setting bodies, all of which are considered to be stakeholders of particular importance.

(1) Recommendations for Companies

i. Companies are required to explain their own unique long-term value creation (LTVC) story
ii. Companies should express clearly in their own words what kind of value they are focusing on
iii. Materiality should be specified in accordance with the values that each company prioritizes, taking into account the impact on the company and also the impact on key stakeholders
iv. Companies should make clear the impact specified materiality will have on value creation
v. When a company sets its own indicators for delivering on its LTVC story, it is required to provide readily understandable explanations about the concepts underpinning the indicators, and also to describe how to view them
vi. If a company chooses not to use indicators that are commonly recognized by investors to describe its journey to deliver on its LTVC story, then it should also explain the reasons it did not do so
vii. Companies should engage in active dialogue with investors about the ideal form for non-financial information, and work to understand and disclose the non-financial information that investors consider necessary

(2) Recommendations for Investors

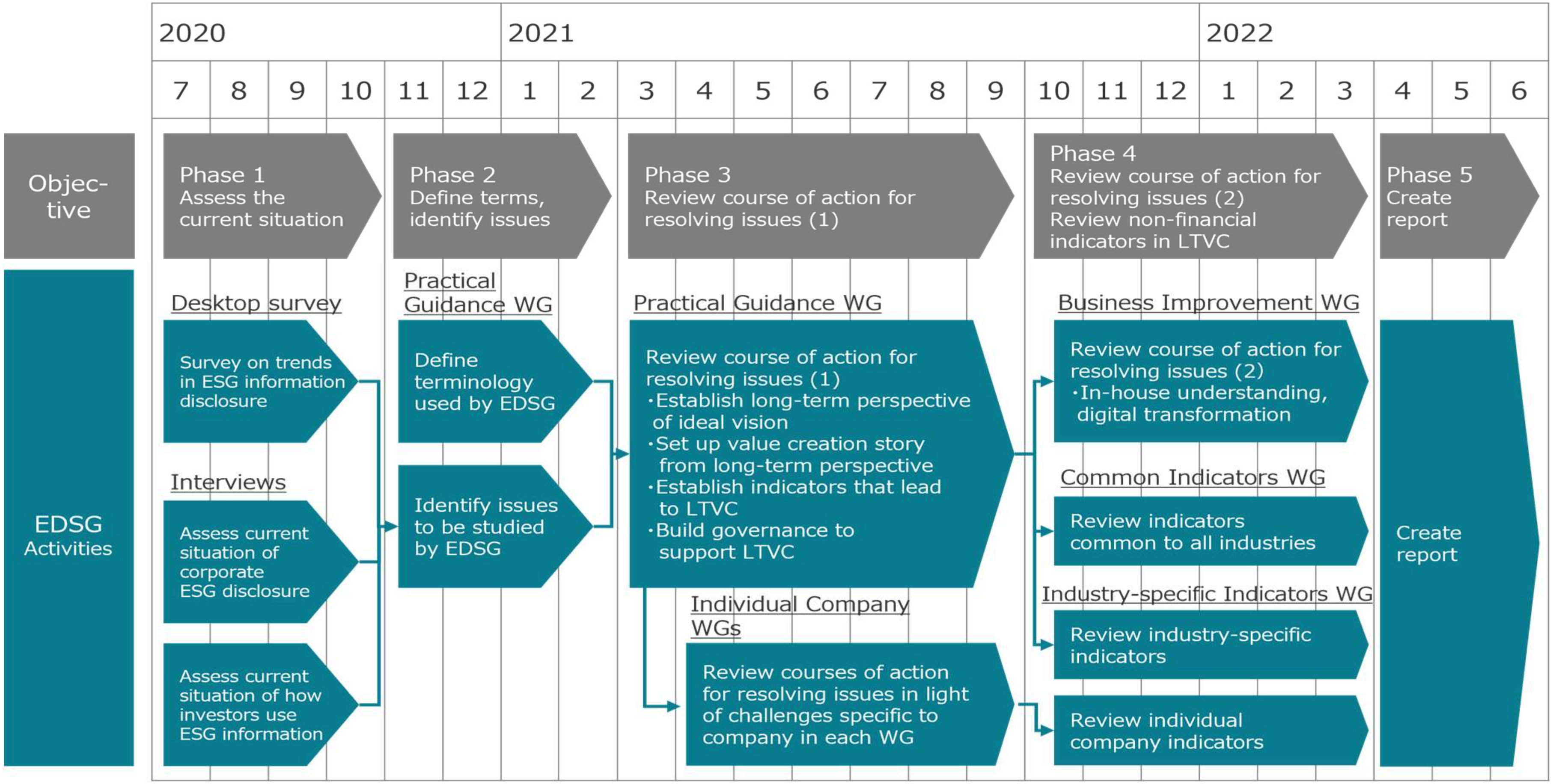
i. Investors are required to understand the unique LTVC stories that each company has formulated
ii. After having first understood the criteria by which a company specifies its materiality, investors should assess whether and how addressing such materiality will contribute to the realization of a company's LTVC story
iii. If using indicators selected and set by companies, it is important for investors not to use the indicators alone in isolation, but rather to use them after first understanding the concepts and thought processes behind their selection and setting as described by the company, as well as the company's description of how to view them
iv. In the case where companies have not chosen any indicators that are commonly recognized by investors, then investors should first seek out the reasons why such indicators have not been selected before evaluating the company
v. Investors should explain how they use companies' non-financial information
vi. Investors should enhance their capacity to study non-financial information

(3) Recommendations for Standard-Setting Bodies

i. The setting of disclosure criteria for a LTVC story based on integrated thinking as a standard for linking financial and non-financial information disclosure standards is necessary for corporate disclosure standards overall
ii. Non-financial information disclosure standards should be set while considering whether there will be any impact on a company's financial value
iii. When setting standards for disclosure of non-financial information, disclosure standards are needed that enable companies to take the initiative in determining the information to be disclosed, while maintaining objectivity in the application of the standards so as not to fall into the trap of formulaic disclosure

3. Overview of Achievements

Since July 2020, EDSG has conducted its activities in phases with separate themes. An activity report summarizing the past two years was published in Japanese at the end of June 2022, and an English version will be published at the end of July. In July 2022, we will begin our third period of activities.



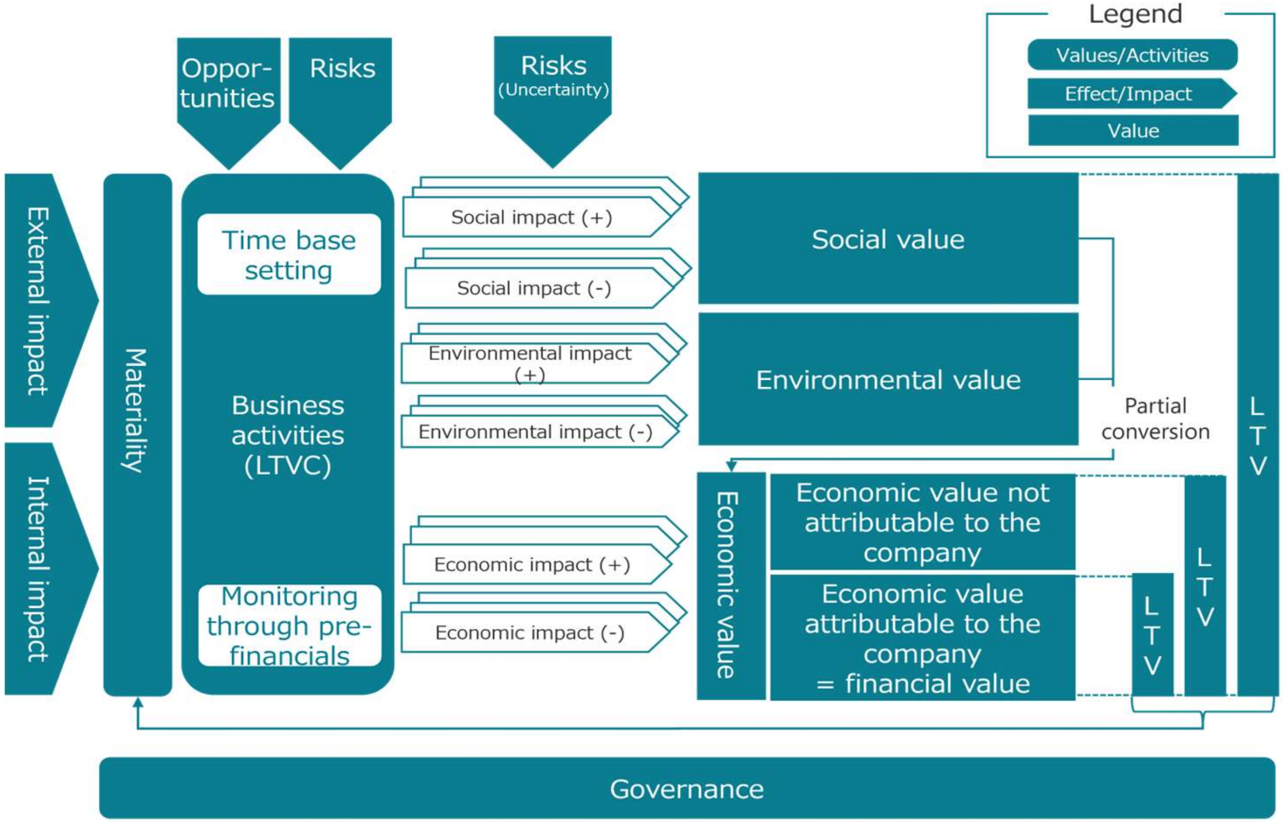
4. Definitions of Terms and Concepts Used by EDSG

EDSG has established definitions for key terms and concepts related to ESG information disclosure and engaged in its activities based on those definitions.

Key Terms and Concepts Defined

- Purpose
- Corporate value
- Social value
- Environmental value
- Economic value
- Financial value
- Non-financial factors and intangible assets
- ESG
- Pre-financials
- Long-term value (LTV)
- Long-term value creation (LTVC)
- Materiality
- Risk
- Who are the users of corporate reporting?
- What is a long-term time base?

Overall Picture and Positioning of Individual Terms



* The scope considered for LTV is determined at the discretion of individual companies.

5. Understanding Current Situations Related to ESG Information Disclosure and Sorting Out Issues (Phases 1 and 2)

EDSG conducted face-to-face interviews with 31 companies and 13 investors in order to understand current situations related to ESG information disclosure and sort out related issues. We more deeply discussed six current situations identified from the interviews and put together a list of ten underlying issues.

Six Current Situations Identified from the Interviews

i. Describing the LTVC story
Inadequate LTVC expression

ii. Polarized initiatives
Polarized ESG initiatives and standards of disclosure at companies

iii. Mismatched perspectives on dialogue
Mismatched perspectives on dialogue between companies and investors

iv. Ineffective systems for collecting information
Ineffective in-house mechanisms for collecting information for disclosure

v. Commitment from top management and in-house involvement
Issues regarding commitment from top management and the involvement of operational departments

vi. Digital transformation (DX)
Expectation for more efficient disclosure through the use of DX

Ten Issues Underlying These Current Situations

i. No coordination between long-term ideal vision and medium-term management plan
ii. Materiality as a differentiating feature not established
iii. ESG perspectives not incorporated in the resource allocation policy
iv. Important management resources for LTVC not specified
v. Non-financial, pre-financial indicators and target values not established
vi. How non-financial information is linked to financial impact not shown
vii. Lack of dialogue with stakeholders directly linked to long-term value of the company
viii. Lack of awareness of ESG perspectives in management ranks and operational departments
ix. Difficult to collect in-house information needed for disclosure
x. No comparable information disclosure for investors

6. Formulating the LTVC Story (Phase 3)

We concluded that formulation of the corporate LTVC story is one of the most important themes in improving the quality of ESG information disclosure from among the current situations related to ESG information disclosure and issues that were identified in the preceding phase. For that reason, we clarified the key points of LTVC story formulation with references to examples among leading companies.

(1) Establishing an Ideal Vision with a Long-Term Perspective

Formulating a LTVC story requires first that an ideal vision with a long-term perspective be established.

i. Establishing a purpose and clarifying its interpretation

A company's purpose is defined as its reason for existence and what it aims to accomplish, and can be considered universal rather than limited to a specific time period. Therefore, a company's purpose must answer the questions of why the company should exist in society, what values the company has, and what it aims to accomplish.

ii. Establishing a time-line with long-term perspective

Establishing an ideal vision with a long-term perspective based on the company's purpose requires a timeline with a long-term perspective of the company's own to be established. Timelines with long-term perspectives vary depending on the business model and other factors, and they also need to take into consideration what sort of timeline important investors and other stakeholders might have in mind. EDSG has set a general standard of about ten years for a timeline with a long-term perspective.

iii. Establishing an ideal vision with a long-term perspective, taking into account purpose and stakeholders' understanding

A company needs to clarify the ideal vision it hopes to achieve in terms of what it will provide to stakeholders a certain number of years in the future, or what sort of outcomes it will provide. A number of ESG information disclosure standard-setting bodies, though using differing phrasing and terminology, advocate for the importance of establishing an ideal vision with a long-term perspective that takes into account the company's purpose and stakeholders' expectations.

(2) Formulating the LTVC Story

After establishing an ideal vision with a long-term perspective, the value creation story is formulated through steps including the identification of materiality and establishment of the value creation process.

i. Identifying materiality

Materiality refers to a company's grounds (criteria) for selecting priority action items from the perspective of achieving its ideal vision, taking into account its mission, values, and strategic perspective. It also indicates the material issues that must be addressed to fill the gap between a company's current situation and its ideal vision (target state with commitment), and takes the entire management strategy related to LTVC as its scope.

ii. Formulating the value creation process and LTVC story

The value creation process and value creation stories are based on sources including the International Integrated Reporting Council (IIRC) framework and the Guidance for Collaborative Value Creation developed by the Ministry of Economy, Trade, and Industry (METI). Their formulation requires three conditions to be satisfied:
(A) Specification of management resources connected to the sources of present and future competitive advantage
(B) Clarification of outcomes created through value creation with a long-term perspective
(C) Organization and visualization of the content elements of the value creation process

(3) Setting Indicators Linked to LTVC

Standards and indicators for disclosure are announced by a number of standard-setting bodies and others. Companies select and set disclosure standards and indicators in accordance with their own LTVC stories as well. The important thing is to explain persuasively to stakeholders, including investors, why standards and indicators for disclosure were selected (or not selected). While the matter of approaches to setting indicators has been discussed separately (Phase 4), an overview can be given as follows in the next item.

(4) Building Governance to Support LTVC

Governance should support LTVC rather than simply satisfying the Corporate Governance Code's demands in a formulaic manner. As such, it requires three conditions to be satisfied.

i. Capabilities (responsibilities) and composition of the board of directors

Companies must evade or minimize potential risks and maximize ESG opportunities on the market. Therefore, the board of directors should have a diverse membership, including members with ESG-related knowledge. Opportunities for training should be made available as needed. It is also necessary to clarify the jurisdiction and scope of involvement by the board of directors, specific committees, and responsible departments, and to establish the roles and responsibilities of board members and committees.

ii. Clarify supervisory, reporting, implementation processes

The board of directors is obliged to supervise ESG performance for the company as a whole, and needs to confirm whether appropriate solutions have been found for the most important ESG issues. Therefore, the board of directors must work closely with management to decide what kind of information (non-financial indicators, progress with ESG initiatives etc.) should be reported to the board.

iii. Evaluating effectiveness and validity of the board of directors

Each year the board should analyze and evaluate its effectiveness as a whole, taking into consideration self-evaluations of each director. A summary of the results should be disclosed.

7. Individual Companies' Initiatives for LTVC (Phase 3)

Issues in aiming for LTVC and ESG information disclosure vary among individual companies. For that reason, we invited member companies to participate in working groups on a per-company basis to resolve issues through dialogues with institutional investors, experts, and so on. Companies that implemented working groups and key themes of their initiatives are shown below.

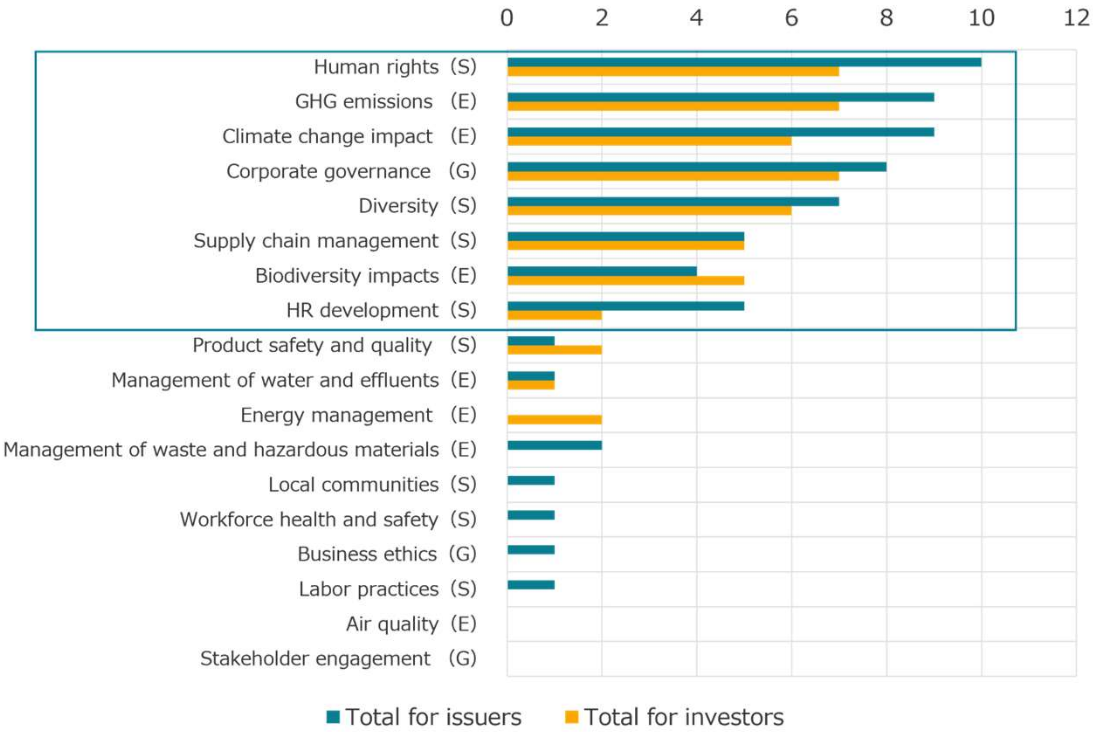
Company name	Key themes
Asahi Group Holdings, Ltd.	• Improving the value creation process diagram • Identifying and improving components identified as inadequate from the perspective of integrating sustainability and management • Identifying and improving areas of inadequacy among sustainability management components, including materiality and KPIs
Tokyo Electric Power Company Holdings, Inc.	• Further evolving integrated reporting by linking elements unique to the company such as involvement with disaster preparedness to the corporate value creation story with regard to the social aspect of ESG, which tended to be mere data disclosure and CSR reporting in past years
KDDI Corporation	• Considering the value creation story (KDDI's business strategy and social value creation) • Re-considering non-financial KPIs • In-house assimilation from the management team to operational departments
Ajinomoto Co., Inc.	• Using integrated reports to realize more effective communication with stakeholders
Idemitsu Kosan Co., Ltd.	• Expressing the company's various initiatives' linkage to LTVC and sustainability in an easily understandable way (for investors in particular) • Identifying weaknesses in the contents of the company's disclosure and analyzing it to make improvements

Company name	Key themes
Sompo Holdings, Inc.	• Identifying points in need of improvement in describing the business model and capital (outcomes) • Reviewing evaluations from investors regarding the positioning of materiality and these KPIs • Reviewing points in need of improvement with regard to the production concept of integrated reports themselves and their contents' level of execution
Hitachi, Ltd.	• Receiving evaluations from external stakeholders of the importance of issues Hitachi should address in aiming for its ideal vision for fiscal 2030, having it pointed out whether any social issues the company should consider are missing, and reflecting this in the materiality map (Also, using this in the formulation of its next mid-term management plan)
Kao Corporation	• Establishing an axis that runs through the whole in order to express the company's unique nature, and story creation based on it • Recognizing that the past reports tended to simply put together drafts from the divisions in charge, and that it was difficult to see the storyline from the company's ideal vision to the individual initiatives.
Sekisui House, Ltd.	• Validating the message inherent in the company's value creation process (i.e. whether the corporate story is being represented) • Recognizing again issues in the establishment of materiality and KPIs • Sorting out financial impacts of non-financial information
AGC Inc.	• Identifying issues with the fiscal 2021 integrated report through interviews with investment institutions and issuers, and linking them to improvements for the next fiscal year's integrated report
Olympus Corporation	• Formulating a value creation story consistent with the company's management philosophy and externally announced materiality

8. Non-financial Indicators in LTVC (Phase 4)

We considered what the ideal form for setting non-financial indicators aimed at LTVC should be, based on indicators announced by various global standard-setting bodies, classifying them into indicators common to all industries, and industry-specific indicators. This activity investigated the ideal form for higher-quality use of non-financial indicators and did not aim to formulate new non-financial indicators.

(1) Considering the Ideal Form for Indicators Common to All Industries



In considering indicators common to all industries, we analyzed indicators announced by various global standard-setting bodies and identified 18 common indicators. (See graph at left)
Next, we surveyed both companies and investors about themes common to all companies that they will pay particular attention to over the next three years, and the necessary indicators common to all industries among companies. As a result, we decided to discuss the top eight indicators shown in the graph to the left.

Key contents of discussions for the indicators we focused on are as follows.

Indicator	Key contents of discussions (Key opinions of investors and issuers)
GHG emissions and climate change impact	**Investors**: "It is preferable to disclose milestones for GHG reductions, setting dates such as 2030 or 2050." "The first thing that we want to know in any scenario is the financial impact, or in other words the impact on sales and profitability." **Issuers:** "We are considering the compilation of a roadmap to the formulation and achievement of long-term goals based on the GHG Protocol." "Financial impact is difficult to quantify and therefore quantitative disclosures are not currently provided."
Biodiversity impacts	**Investors**: "It is important for companies to consider what impact their business is having on biodiversity, how management is involved in addressing that impact, and what decisions are being made, as well as to consider the wider value chain." **Issuers**: "Given that an important indicator for biodiversity is 'no net loss,' we recognized that one option we have is to aim for neutrality with respect to natural capital."
Human rights (including supply chain management)	**Investors**: "In addition to disclosures on human rights policies and human rights due diligence processes, companies should go as far as including post-monitoring results." **Issuers**: "Although we could set a goal of having every employee take human rights-related training, we are concerned whether such a superficial KPI would be sufficient. " "Although we want to make links to LTVC, as yet only modest results are being reported."
Diversity	**Investors**: "It is not enough to describe diversity in quantitative information alone. Rather, it is important to provide qualitative information to underpin the quantitative data, including addressing why diversity is important, what goals are and their current status (actions and issues)." **Issuers**: "Information on the purpose of diversity and diversity-related goals is more important than quantitative information." "Our efforts to tackle diversity have provided great opportunities for securing outstanding human resources."

Indicator	Key contents of discussions (Key opinions of investors and issuers)
Human resources development	**Investors**: “It is important to report not only quantitative information, but also to explain the company’s ideal vision, the image of human resources required to realize that vision, and policies for developing those human resources, as part of the company’s story, while incorporating qualitative information as well.” **Issuers**: “We have established and disclose HR effectiveness indicators that measure the penetration of the company’s purpose and the improvement of employee engagement and performance.”
Governance	**Investors**: “The key point is how the board is monitoring value creation processes. What should be shown is their basic approach to governance.” **Issuers**: “In ESG discussions the items considered and approved by the business execution team are being monitored. In addition, the content of discussions is being reported, in combination with ESG and financial information.”

(2) Considering the Ideal Form for Industry-Specific Indicators

We discussed the ideal form for indicators with companies in relevant industries and institutional investors based on accounting metrics and activity metrics in each of the sustainability disclosure topics announced by SASB for five industries: construction materials, chemicals, commercial banks, pharmaceuticals, and automobiles. Key contents of our discussions are as follows.

Industry	Key discussions contents
Construction materials	**i. Ideal form and methods of presentation for non-financial indicators** • Results should be presented not only for the reporting year but also for changes over time. • Disclosure by site is more useful for some of the accounting metrics, including those for "Air quality," "Water management," and "Workforce health & safety" • There are different definitions and standards depending on the country and the region for some of the accounting metrics, and these should be clearly stated. • With regard to "Workforce health & safety" at manufacturing sites, consideration should be given to expanding the boundary to include partner companies operating at the same manufacturing site. **ii. Perspective of LTVC** Among the disclosure topics in construction materials, only "Product innovation" took the perspective of LTVC. In addition to this, the working group suggested that it would be useful to be able to provide additional explanation of the opportunity aspect, since the following disclosure topics are also important from the perspective of LTVC: • Water management and waste management • Biodiversity impacts **iii. Risk perspective** From the perspective of avoiding risk, it would be useful to disclose additional information on the following: • Financial impacts and related costs • Risk management targets and plans, and their progress • Factor analysis of changes over time (both positive and negative) • Disclosure on an intensity basis

Industry	Key discussions contents
Chemicals	**i. Ideal form and methods of presentation for non-financial indicators** In addition to the discussions regarding construction materials above, it would be useful to provide explanations that link each metric with activity metrics (production volume by major product segment); e.g., the percentage of eco-friendly products accounted for by major product segments, due to the diverse range of product lines in the chemicals industry. **ii. Perspective of LTVC** Topics with LTVC perspectives were “Product design for use-phase efficiency” and “Genetically modified organisms.” Being able to explain more about opportunity aspects would also be useful, since the following disclosure topics are important from the perspective of LTVC as well: • Water management and waste management **iii. Risk perspective** Same as the “Construction materials” discussion above
Commercial Banks	**i. Ideal form and methods of presentation for non-financial indicators** The following methods of presentation would be useful: • Disclose using percentages • Clearly specify the criteria and thresholds for accounting metrics • Disclose information in accordance with the disclosure requirements for each initiative, such as TCFD, etc. **ii. Perspective of LTVC** Topics with LTVC perspectives were “Financial inclusion & capacity building” and “Incorporating environmental, social, and governance factors into credit analysis.” As many accounting metrics for “Financial inclusion & capacity building” are made for the U.S., however, explanations concerning recognition of new revenue opportunities in line with the actual situation in Japan are needed. Being able to explain more about opportunity aspects would also be useful, since the following disclosure topics are important from the perspective of LTVC as well: • Incorporation of environmental, social, and governance factors in credit analysis • Data security **iii. Risk perspective** From the perspective of avoiding risk, it would be useful to disclose additional information on the following: • Initiatives to promote awareness among employees

Industry	Key discussions contents
Pharmaceuticals	**i. Ideal form and methods of presentation for non-financial indicators** A company's operating regions and focus regions should be included in the scope of disclosure; not only Japan and the U.S. Improved response to disclosure requests should be pursued, such as by including regulatory authorities from major markets besides just the U.S., depending on the company's operating country or region. **ii. Perspective of LTVC** The only topic with a LTVC perspective was "Counterfeit drugs." Being able to explain more about opportunity aspects would also be useful, since the following disclosure topics are important from the perspective of LTVC as well: • Affordability & pricing • Employee recruitment, development & retention **iii. Risk perspective** It would be useful to disclose additional information on the following: • Disclose the status of development and improvement of risk management and governance structures, including points of differentiation from other companies
Automobiles	**i. Ideal form and methods of presentation for non-financial indicators** The following presentation methods also would be useful: • Presentation with trends over time (discussion of whether there is improvement) • Presentation of information as a percentage or number of cases per 10,000 units to improve comparability • Presentation by vehicle segment **ii. Perspective of LTVC** Topics that took LTVC perspectives were "Fuel economy & use-phase emissions (but only short-term evaluation)," "Materials sourcing," and "Materials efficiency & recycling." Being able to explain more about opportunity aspects would also be useful, since the following disclosure topics are important from the perspective of LTVC as well: • Product safety • Materials efficiency & recycling **iii. Risk perspective** It would be useful to disclose additional information on the following: • Financial impacts and related costs • Targets, plans, progress, and monitoring indicators

EDSG