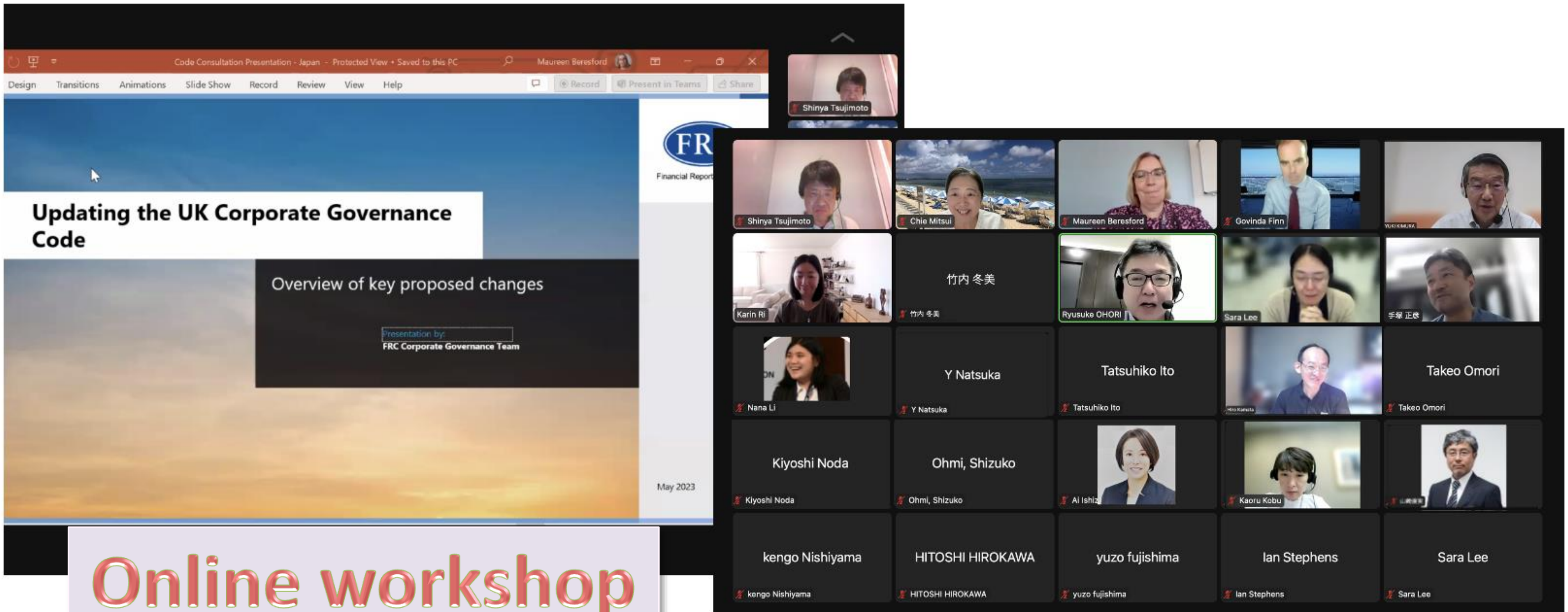
Review of the UK Corporate Governance Code?
--What are the proposed changes?



Online workshop

52st Digital Reporting Workshop

Date and time : 9th Aug 2023, 18:30-20:00 JST

Review of the UK Corporate Governance Code

We have been discussing disclosure related issues since 2014, mostly investors and market participants in Japan and inviting foreign friends. Discussion themes are chosen from IFRS or Corporate Governance issues and responding public consultation of IASB or other organisations. Since we responded EU consultation Fitness Check in 2018, we have recently picked up the Sustainable / environment topics as agenda.


FRC Financial Reporting Council

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Corporate Governance Code Consultation

24 May 2023

Corporate Governance Code Consultation

Following the consultation on Restoring Trust in Audit and Corporate Governance, last year, the government invited the FRC to strengthen the UK Corporate Governance Code in specific areas.

We have now launched a public consultation on our proposed revision to Code. This limited revision aims to enhance the Code's effectiveness in promoting good corporate governance, some of the changes include:

- Setting out a revised framework of prudent and effective controls to provide a stronger basis for reporting on, and evidencing their effectiveness.
- Improving the functioning of comply-or-explain, taking account of recently published FRC research and reports.

The Financial Reporting Council is consulting on proposed changes to the Code Responses are required by 13th September.
Maureen Beresford, Head of Corporate Governance at the FRC explained the proposed changes to the UK Code. This was followed by views from one of our members' presentations to compare UK and Japan. And we had a panel discussion with some investors..

	Who join the discussion?
Attendees (Japan) *attendees have joined this workshop as private,	19 Asset Managers, 5 Investor(Analysts) organisation, 1 pension & insurance & bank, 4 sell-side, Information providers/Researchers, 7 Company side (include Independent non - executive director, support service), 4 Auditor, 1 academic 1 Regulator & Accounting setter & stock exchange, 1 other
Attendees (outside Japan)	4 Asset Managers, 3 Investor(Analysts) organisation, 1 academic, 2 regulators,

Reviewing UK Corporate Governance Code

- FRC is currently discussing the revision of the CG code. In May 2022, the UK government held a public consultation on 'Restoring trust in audit and corporate governance'. As a result the **government asked the FRC to consult on a number of changes relating to intenal controls and remuneration.** In addition the FRC took the opportunity to propose changes where their annual analysis had found weaker reporting. The UK's CG code is compulsory for premium listed companies by the FCA.
- The code has five sections. Section 1 is about Board leadership and company purpose. The change here is "**outcome-based report**". There is a problem for current company reporting as many companies report on their policy or views but not outcomes. It only says "We support diversity," and does not say what they are doing. Also, since the UK code is either complied or explained, it was requested that the quality of this explanation be improved.
- Section 2 is the Division of responsibilities. Especially **Over-boarding** is discussed. The transparency is important, not the numerical target. Explain, such as, how many independent directors, how many committees, and how they actually spend their time. Then, this revision changed "Board evaluation" to "**Board performance review**". More forward-looking reporting is required.
- Section 3 is Composition, succession and evaluation. This section has few proposed changes. On diversity we have suggested that companies should be aware of all aspects of diversity beyond gender and ethnicity and that policies should have targets.
- Section 4, Audit, risk and internal controls. This is where this revision the most changes with the government's requirements. First, FRC is proposing a minimum standards to the new Audit Committee. New regulations 'that are not yet finalised) require that **the company should have an Audit and Assurance Policy.** The Audit Committee must also take responsibility for the ESG data they use in their reports. But the biggest difference is about Internal Control. A system similar to the US SOX was proposed but rejected at consultation. In the CG code, it was decided to ask how the internal control was managed and how to improve transparency. Finally, **this section describes the Resilience Statement.** This is a Regulation requirement, but the code suggests how it should be written. (Consistent explanation of future prospects and Ongoing concerns)
- Section 5, Remuneration, made some changes, including **Malus & clawback**, increased transparency, and the addition of ESG to the evaluation of directors.

Maureen Beresford

FRC

The comments will be accepted until September 23, and a new code will be announced by the end of the year (with audit and internal control guidance).

Compare UK and Japan CG code – different origin

A member of the Japanese investor group

The CG performance metrics may not be perfect for evaluating companies across region, but the current situation where UK companies trade at a discount to global peers relates to financial performance.

■I will make a comparison between the Japanese and UK CG code, specifically in regard to the purpose of the codes, listing requirements, the investor side and finally, enforcement. Japan has experienced the "lost decade", and the gap in ROE with the United States and the rest of the world is large and persistent. **ROE, cost of capital, profitability, and long-term corporate value were issues for Japanese companies.**

■In contrast, the focus of CG codes elsewhere was on restoring trust in the market after the financial crisis. The revised OECD Corporate Governance Principles aim to protect investors and promote resilience. I think that is the starting point for the UK CG Code too. So the **origins of the codes are quite different.**

■That said, there are some important lessons from recent developments. In Japan, the 2021 revision of the Code called for disclosures on corporate sustainability. In Japan, there are many companies supporting TCFD. The number of companies disclosing integrated reports has grown rapidly, exceeding disclosure required by law. More than 70% of the companies in Nikkei 225 disclose and describe materiality. Other revisions for the 2021 edition included a variety of topics, including the disclosure of corporate strategy and risk management. Looking elsewhere, the most important point is the strengthening of the monitoring function of directors. I still feel some frustration, but my analysis suggest **material change** in the boardroom.

■Another trigger for change has been the Tokyo Stock Exchange's new listing rules, with the regulator's concern about companies with a **PBR of less than 1** driving enthusiasm for the 'undervalued Japan' story. Including financial targets in listing requirements is a powerful tool. Next is the big change in terms of investor empowerment. The increase in the number of independent directors is a significant achievement. This will benefit shareholders. The number of investors signing the Stewardship Code is also increasing and engaging effectively with AGM. As a result, **the concentration of AGM has been largely eliminated**.

■In terms of results, the CG code effects on structure and culture are significant and ROE has improved. However, there is still much to do about corporate value. Also, principle-based regulation is not fully fledged as it is in the UK. In Japan, compliance is considered the only acceptable approach, with limited explanation.

Yes, UK starting point was different. The success of each company was not growth. It is an interesting point. As the company's reporting, I sympathies with the issue of compliance. We also require companies to tell their stories. Don't make it a checkbox, to explain why this is good governance... It is not necessary to comply with all provisions... And we encourage investors to engage more with senior management, not just the board. We are also looking to hear about sustainability and investor collaboration. If it works, it would lead to growth.

Panel discussion

I have 4 comments. 1. please tell us about any good examples of outcome-based reports. 2. Overboarding. Why UK code doesn't ask for a numerical target? I think it would be better to set a numerical standard. 3. A board performance review. How should we check the performance of the board? 4. Internal control, you mentioned that it was the government's request. What is the background?

And I believe that stewardship code will inevitably result in a variety of policies for each company, depending on the situation of each company.

ESG Analyst
Japan

As for the **outcome-based report**, we want to know for example how many women and minorities have joined the board, and the diversified experience of management. Not a statement about increasing diversity. Regarding overboarding, the issue of numerical targets differs depending on the company. The number of boards is not important, it's how much they spend undertaking board and committee work. Board performance reviews focus on how to attract people with the right skills. Lastly, the government ask the FRC to propose aan approach that was not UK SOX. The aim is to increase accountability.

My comment is about a Japanese company that introduced CG code. The concern of the Japanese government and investors is profitability, not resilience. We have introduced TCFD and integrated reports, but ROE is still low, and many companies have a PBR of less than 1. This means that future ROE will be below the cost of equity. The only way to solve this is to do something about management. Like the UK code, it's a DIE. The number of independent directors has increased, but they are still in the minority. Most of them are men who joined the company 30 years ago and have been repeatedly promoted internally, all with the same background. This is the reason for the low profitability. I think nomination is the key to overcoming this situation. In Japan, even if there is a **nomination committee**, it hardly functions. The president chooses the next president and the board is just a follower. Japanese companies just like to follow other companies, such as TCFD and integrated reports. Therefore, I believe that the ideal form of the nomination committee is the most demanding.

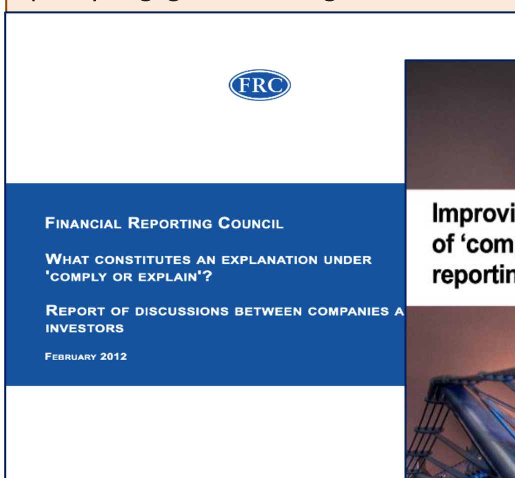
Former CEO
Asset Management
company in Singapore

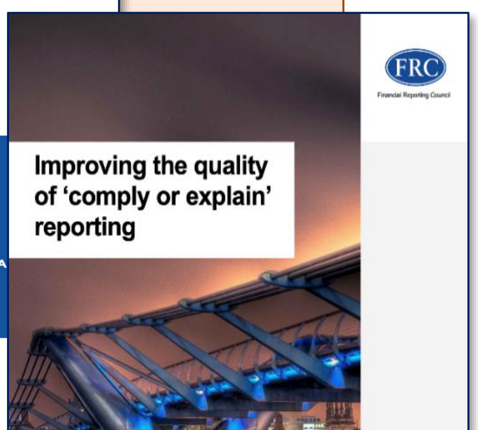
Panel discussion cont.

I would like to share 3 observations. 1. Making “Comply or Explain” mechanism work better is important. The UK CG Code is comprised of **Principles and Provisions**. The **Principles always need to be applied**. “Comply or Explain” is required for Provisions. In other words, if a company is taking an alternative approach to any item under the provisions, **it needs to explain why its alternative approach better fits the company’s unique circumstances, and demonstrate it is still aligning with the Principal (i.e. meeting the spirit of the Principles).** Principle-based CG code offers flexibility but requires a deep understanding of the gist of the principles. The Japanese Code uses the wording of “principle” throughout at different levels, which might have led to some confusion on the distinction between principles and provisions. And the principle-based Code seems to be adopted with a compliance mindset as for the Rule-based approach. So, in Japan, providing a further clarity on the Code implementation and encouraging more meaningful explainations, as a base for quality engagement dialogues with investors, is essential.

Investment Stewardship, London

2. is the **Board Evaluation** has changed to **Board Performance Review**. The expression of “evaluation” gives impression of a backward approach that tends to focus on board composition or structure, the directors’ experience and skills, or what activities the board has done in the past year and etc. The change to “performance review” is to emphasise the **outcome-based reporting** expectations. In Japan this year, TSE and FSA announced action programs and guidance for companies to be conscious of cost of capital and stock price. Continuous efforts are expected, to achieve higher returns that exceed the cost of capital in a sustained manner and to drive a sustainable growth . I think, from the governance perspective, what the CG Code is looking for in a board is **accountability** and its role and performance as a **steward of capital**. Non-executive independenent directors are expected to "hold management accountable" and "perform accountability to shareholders“. These qualitative aspects need to be assessed and covered in the Board Performance Review. More direct dialogues between the shareholders and outside directors in Japan would be helpful and much appreciated.
3. **Diversity.** Not only gender, but also diversity of thought (cognitive diversity) is important. When we set a quantitative measure, problem can sometimes arise when the number itself becomes the purpose or target. I would like to see more explanations of "why" and "how", and what is most material and relevant to the sustainability and resilience of each company that reflects its own circumstances.





I want to add one more word about diversity: it takes time. In the UK, the female board members around around 40%, but we have been working on long, Regarding "comply or explain", in the past, we have published guidance about " good explain".

・What constitutes an explanation under 'comply or explain'? 2012

・Improving the quality of ‘comply or explain’ reporting 2021

Q&A

I agree with some panellists already mentioned that shareholder returns are very low despite Japanese companies' efforts in the TCFD and integrated reports. A lot of people talk about E and S these days, but seem to forget about G. I want to continue to warn companies that G is the most important.

Investor group
Japan

I learned a lot about ”good explain" today. Useful when engaging with Japanese companies. I also think that the nomination committee (system) is the most important. I've been engaging with Chinese companies, and I think Japanese companies are doing much better. But it's true that some industries haven't changed yet, and it will take more time.

Fund manager
Hong Kong

I'm engaging with Japanese companies, voting, and continuing discussions with management. Even when I talk about sustainability, I mostly talk about governance at the first meeting. Because I think this is the core. What I found interesting in today's discussion is about avoiding box-checking and improving quality. I want to hear what the company achieved. I also like outcome-based reports.

Responsible Investment
Hong Kong

I think it is also difficult to connect individual actions and outcomes. My understanding is that if you write an outcome, you have to write an approach to it, and if you write an outcome, you have to write your own assessment.

What we should do for next?

”Comply or explain” is critical for Japanese companies. Many Japanese companies seem to think that as long as they ”explain” the requirement of CG code, they don't necessarily have to comply with it. Also, there was talk that the AGM concentration had resolved a bit, but only within a week. It's not a substantial improvement. I want the FSA to revise the code and specifically suggest companies to issue bulletins before the AGM. If that happens, the AGM dates for listed companies will naturally change as well. The Company Law already allows for changes. i think this is the most important point

Thank you for your time today. The CG code was introduced eight years ago in Japan and has been revised twice. It has been recently heard that the emphasis should be on making it work rather than revising the code, but after hearing today's discussion, there are still many areas to continue to consider. There is a topic. We have to continue the discussion for the next step. Japan has been chasing the UK code for a long time, but it seems that it still has a long way to go. We had a very good discussion today. thank you!

Lots of things that we have to continue to consider…

Comments, impression, opinions, after workshop

- Thank you very much for all speakers and panellists, I have learned a lot.(multiple)

- The discussion about “what is a ‘comply or explain’ ” and “guidance for good explain” were quite helpful.

- The comment about "The importance of submission Yuho (the annual report) before the general shareholders meeting" always make me positive and understandable.

- Regarding the “overboarding issue,” in developed countries other than Japan, it is included it in the voting policies usually. I agree with Ms Maureen that board/audit committee chair usually have to spend a lot of time. In our engagements with Japanese companies, we bring this topic up to improve the quality of boards.

- I think the biggest problem with independent directors in Japanese companies is that they don't think of their role as a "supervisor", they just give advice.