

WICI Comment to the EC Workshop of ESG Disclosure

Feb.12, 2010

Certainly, ESG information is insufficient in the present business reporting. However, what is insufficient and necessary is not ESG information per se, but explanation which could be a good basis for users to judge the company's sustainable existence and economic performance in the future. Since such an explanation necessarily includes some non-financial aspects, it is highly desirable to have a combined reporting to shed light on this core part of a company, including its non-financial elements

In such a sense, to show the non-financial elements is not enough for a company. Rather it is essential to explain a company's specific way of creating value as its relevant strategy, supported by non-financial elements peculiar to it.

Needless to say, for many companies, such non-financial elements also include ESG ones, and therefore to begin with ESG issues might be a good first step forward.

Also in this case, the European Commission should aim at asking companies to use ESG information as elements to explain their sustainable existence and profit making processes which stakeholders have largest interests. Because ESG elements which have no relation to company's economic performance or value have no substantive meaning, a company's activity can lead to sustainability of the whole society when it uses those as an indispensable element of its own value creation mechanism.

Looking at the state-of-the-art of how ESG information is disclosed in company reports, we can find that most of this disclosure is the response to specific requirement to present a fixed set of indicators selected by a certain group with strong interest in a specific social value. This has resulted in the following situation;

- Poor explanation of the context or the way how the company's value creation mechanism connects with those indicators is making it difficult for users of disclosed ESG information to understand and recognize the real meaning of those indicators in terms of the economic performance of the company.
- Companies are troubled with the increased cost of disclosure to respond to various types of initiatives.
- Most initiatives ask companies to disclose many indicators along the 'one-size-fits-all' approach, rather than requesting management to explain a company's strategy and how the disclosed indicators relates to and fits it.
- These facts have contributed to make reports to be far from company strategy. Rather

companies tend to be more defensive and just 'tick the box' on the pre-fixed indicators.

- As a result, users -including investors- put very little value on ESG disclosed. To overcome these deficiencies, and to encourage more substantial and substantive disclosure of ESG information, we believe it necessary for European Commission to recommend that companies;
- explain their own specific strategy and ways to create value under the form of narrative story shown in a structured context
- incorporate relevant indicators that provide assessments of and support the company strategy
- use standardized structured XBRL taxonomies for reporting of financial and non-financial (including ESG) disclosures so that companies and their stakeholders can more effectively access, reuse, combine, compare, contrast relevant company disclosures;

In addition, to encourage relevant organizations which are leading their own initiatives in favor of ESG disclosure to coordinate with each other would be expected as one of the important roles of the European Commission

When the contents of this recommendation are well implemented, this would

- decrease the cost for and the burden on issuers
- provide users with substantive information that is aligned with company strategy and reflect management assessments of value creation
- protect users from being deceived by disclosed but superficial ESG information which may be provided through a 'tick the box' approach
- encourage companies to invest more in the core non-financial elements, including ESG, relevant to their economic performance
- improve the sustainability of a company and eventually of the whole society

However, disclosure of non-financial information, including ESG, based on each company's own strategy and value creation mechanism might be diversified in its content, inducing a lower degree of comparability. Therefore, in our opinion , European Commission needs to take actions on the following issues to raise the comparability of disclosed non-financial information;

- Setting up a prototype of table of contents of disclosure to be interpreted as a reference context without standardizing the substance of the disclosure content itself.
- Selecting a set of significant indicators frequently used subject to companies choice to explain the strategy, even though it is impossible to standardize a set of indicators relevant to every company
- Fostering the harmonization in the definition of terms and indicators used
- Asking for companies to use XBRL taxonomies for non-financial information in a mandatory

sense, to make it more convenient to access, handle and compare the disclosed diversified information and indicators

Finally, we hope that the European Commission takes a principle-based and flexible approach while leaving room for stepping up to more detailed guideline in the future spreading from the experience in the implementation of the coming proposal as a first step.

Signed by Takayuki SUMITA WICI Chair , on behalf of WICI