Japan's new era of sustainable finance

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The Japanese government's commitment to reduce greenhouse gas (**GHG**) emissions to net zero by 2050 has ushered in a new era of alignment with international frameworks and practices in the field of sustainability.

Since the introduction of Japan's de-carbonisation policy in 2020, the country's finance industry has launched several significant actions related to environmentally sustainable practices.

Sustainability reporting standards

At the start of this year, the Japan Financial Services Agency (**FSA**) has finalised the "Basic Guidelines on Impact Investment (Impact Finance)" which aims to promote a common understanding of impact investment concepts and encourage dialogue amongst market participants.

Japan's Financial Accounting Standards Foundation has also made steps toward integration of the disclosure recommendations developed by the International Financial Reporting Standards Foundation (**IFRS**) in June 2023. The first set of published Exposure Drafts, which are open for market consultations until 31 July, align companies' practices with the two standards developed by the IFRS, namely: S1 *General Requirements for Disclosure of Sustainability-related Financial Information* and S2 *Climate-related Disclosures (*more commonly known as ISSB Standards S1 and S2*).*

Both standards were already fully adopted by the Sustainability Standard Board of Japan (**SSBJ**), while jurisdiction specific rules have been applied on a voluntarily basis. Japan is one of the first countries to start the process of adoption of the ISSB Standards into national regulation. The Exposure Drafts were developed under the assumption that the ISSB standards would eventually be required, under the Japanese securities laws and regulations, to be applied by companies listed on the Prime Market of the Tokyo Stock Exchange.

As of June 2024, sustainability information such as climate change measures and human capital has been put in a new section of the Annual Securities Reports (applicable for reports for a financial year end of March 2023 and thereafter). The intention of the FSA is to align disclosures with the international standards such as those developed by the ISSB by the end of March 2025.[1] This is part of a wider sustainability-enhancement plan that the FSA has embarked on, which centres around three pillars:

- the enhancement of corporate disclosure
- development of new function for capital markets
- assistance with risk management of financial institutions

Another important initiative is within the development of functioning of the capital markets. In May 2023, the FSA revised the Comprehensive Supervisory Guidelines for Financial Instruments Business Operators, etc. regarding ESG Investment Trusts[2], in order to define specific points for the disclosure on publicly offered investment trusts that incorporate environmental, social and governance (**ESG**) matters**.** The intention of the regulator is to avoid risk of greenwashing and to harmonise market's understanding of what constitute an ESG investment strategy. The new guidelines defined the scope of ESG investment trust as "a publicly offered investment trust which considers ESG as a key factor in the selection of investment assets." The guidelines also outlined how key E, S and G factors should be taken into account in ESG funds. In particular, the "Objective and Characteristics of the Fund" section urged to check the following items:

- details of key ESG factors used/referred to (e.g. how comprehensive are ESG ratings or specific environmental or social issues that the fund is trying to address) in the selection of investment assets
- how and when ESG factors are considered in the investment process (e.g. pre-investment screening, post investment monitoring, explanation of relevant criteria and indicators, evaluation methods, etc.)
- what are the risks and limitations of ESG factors considerations
- what are the details of the impact measurement methods and targets for those ESG investment trusts that aim to create environmental or/and social impact in order to build a sustainable society?

Green transformation

Looking wider away from asset management, a new Green Transformation policy was approved in February 2023, outlining a 10-year roadmap to transition to clean energy via the usage of nuclear power, renewables, and carbon-pricing mechanisms. This is aimed at helping Japan meet its net-zero goal by 2050 and to channel more capital into key sectors of the economy that require transition away from fossils. One of the key outputs was a publication of the Japan

Climate Transition Bond Framework [3] which aims to mobilise ¥150 trillion (USD 970 million) [4] over the next decade in support of advanced sustainable technologies necessary to move Japan away from fossil fuel and toward carbon neutrality. The first climate transition bond was issued in February this year, with a successful three-times oversubscribed issuance. It secured bids in excess of ¥2.3 billion.

There are number of other important initiatives in the sustainable finance area which the FSA is currently working on. The details and progress of these initiatives can be tracked on the Financial Services Agency website.

Funds, pensions and sustainability

Funds and pensions funds have also been moving towards responsible investment practices on a voluntary basis. Japan has witnessed a spike in signatories to the Principles of Responsible Investment (**PRI**) in recent years, with numbers in Q1 2024 indicating that there were 91 investment managers and 31 asset owners in Japan that have signed up to the PRI, exceeding a significant ¥90 trillion (USD 600 billion) of funds under management.[5] The six Principles of Responsible Investment offer a guiding framework for asset managers for incorporating ESG into their investment strategies, stewardship policies and ownership practices. The PRI signatories are able to publicly demonstrate their commitment to responsible investment and support transparency on ESG issues within the investment industry.

How can Ogier help?

Ogier's Sustainable Investment Consulting works with financial institutions and asset managers across Asia, Europe and the US, to help navigate ESG regulations and compliance. We assist clients with ESG policy drafting and review, ESG metrics implementation and due diligence preparation.

For asset owners and investment managers considering becoming a PRI signatory, Ogier can provide pre-sign up services, including health checks to identify eligibility and readiness against the PRI Minimum Requirements; implementation of the PRI Minimum Requirements and internal readiness check against core indicators for PRI assessment. We also have strong expertise in impact measurement and management. We advise clients on impact measurement frameworks, carry out assessment of impact strategies and chosen metrics, and help align desired outcomes with impact targets.

Please contact Sustainable Investment Consulting and Ogier Legal's Kate Hodson, who is client relationship partner for the firm's global offering on ESG services, for more information.

[1] Japan Releases Proposed IFRS-Based Sustainability Reporting Standards - ESG Today

[2] Response to the FSA's Consulation on the Proposed Amendment of the Comprehensive Supervisory Guidelines for Financial Instruments Business Operators, etc. regarding ESG Investment Trusts

[3] climate_transition_bond_framework_eng.pdf (meti.go.jp)

[4] japan-transition-bond-briefing-note-14022024.pdf (climatebonds.net)

[5] Japan Prime Minister Kishida Says Japan Pensions With $600 Billion to Sign ESG Pact - ESG News

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