ESG AND IMPACT INVESTING

Japan

LEXOLOGY
Getting The Deal Through

Consulting editor
Legance

ESG and Impact Investing

Consulting editors

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Legance

Quick reference guide enabling side-by-side comparison of local insights into the local legal and policy framework; duties, liabilities and best practices; ratings; incentives; formation and operation of purpose-driven companies; state supervision; public procurement; governmental, NGO and supranational support; sources of finance; and recent trends.

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LEGAL AND POLICY FRAMEWORK

Legislation

Has your jurisdiction enacted any laws or regulations addressing environmental, social and governance (ESG) factors in banking, finance and corporate law, or legislation addressing the pursuit of other non-financial objectives by companies and investors?

Generally, the existing legislation, including the Companies Act and the Financial Instruments and Exchange Act (FIEA), addresses these issues to a certain extent. The Companies Act prescribes the corporate governance systems that Japanese joint-stock companies and other companies must put in place. It also requires joint-stock companies to disclose certain corporate governance matters to their shareholders in their business reports. The FIEA requires reporting companies subject to its regime (typically, listed companies) to disclose certain corporate governance matters to investors in their annual securities reports. In January 2023, the Financial Services Agency (FSA) announced certain amendments to its disclosure regulation under the FIEA that require the disclosure of certain kinds of sustainability information. More specifically, the reporting companies are required to disclose their governance around sustainability-related risks and opportunities, and how they identify, assess and manage such risks. They are also encouraged to disclose their efforts to cope with sustainability-related risks and opportunities that may affect their short-term, mid-term and long-term business plans and strategies, and the metrics and targets used to assess, manage and monitor their results on sustainability-related risks and opportunities in the long run, where they believe such information is material. The new disclosure regulation is in line with the recommendations of the Task Force on Climate-related Financial Disclosures. The new disclosure regulation also requires a more detailed disclosure regarding human capital, diversity and corporate governance. It will apply to the reporting companies for their disclosure for their fiscal year ended on or after 31 March 2023.

As a roadmap toward a decarbonised society, the Cabinet approved its Basic Policy for the Realisation of Green Transformation (GX) in February 2023. In accordance with this Basic Policy, the Diet enacted the Act on the Promotion of a Smooth Transition to a Decarbonised Growth-Oriented Economic Structure in May 2023. This Act, among others, requires the Japanese government to develop and implement a GX promotion strategy, allows the Japanese government to issue GX economy transition bonds every fiscal year from 2023 to 2032 to finance the costs of a smooth transition to a decarbonised growth-oriented economic structure, imposes levies on certain fossil fuel miners and importers depending on their CO2 emission amounts (commencing from the fiscal year 2028) and allocates CO2 emission quotas to certain electricity utilities, collecting contributions from them in proportion to their quotas commencing from the fiscal year 2033.

Law stated - 12 June 2023

Policy guidance

How would you describe the general level of policy guidance regarding ESG and sustainability issues in your jurisdiction?

The concept of ESG became current in Japan around the time the Prime Minister's Cabinet put in place a 'Japan Revitalization Strategy' in June 2013. This strategy included efforts to strengthen the corporate governance of companies and was followed by the establishment of the Principles for Responsible Institutional Investors (Stewardship Code), put in place in February 2014 by the FSA, and by the Corporate Governance Code (CG Code) of March 2015, adopted jointly by the FSA and the Tokyo Stock Exchange (TSE). The Government Pension Investment Fund, the world's largest pension fund, signed up for the Stewardship Code in May 2014 and for the United Nations Principles for Responsible Investment (PRI) in September 2015. Since then, Japanese signatories to the PRI have been increasing steadily in number.

Additionally, after the adoption of the United Nations' Sustainable Development Goals (SDGs) in September 2015, the Japanese government established an SDG Promotion Headquarters headed by the presiding Prime Minister at the time in May 2016, to effectively promote and achieve the goals of SDGs nationwide. Japan also ratified the Paris Agreement under the United Nations Framework Convention on Climate Change in November 2016. Japan's nationally determined goal for post-2020 global greenhouse gas emission reductions has been set at a reduction of 26 per cent by 2030 compared with 2013 levels. Further, then Prime Minister Yoshihide Suga pledged before the Diet in October 2020 that Japan would endeavour to reduce greenhouse gas emissions to net zero and thereby realise carbon neutrality (a decarbonised society) by 2050.

Against this background, the Japanese government is currently active in promoting ESG financing and impact investing. The Basic Policy on Economic and Fiscal Management and Reform, formulated annually by the Cabinet, has placed importance on ESG investments since 2016. Current Prime Minister Fumio Kishida's Cabinet formulated the Grand Design for the New Form of Capitalism and Action Plans in June 2022, inheriting the former Cabinet's attitude promoting ESG financing and impact investing. Various specific measures have been implemented by various governmental bodies such as the Ministry of Economy, Trade and Industry, the Ministry of Environment and the FSA. His Cabinet also set up the GX Implementation Council whose work began in July 2022. This Council drafted the Basic Policy for the Realisation of Green Transformation (GX) in February 2023 as a map towards a decarbonised society.

The Japanese government is also active in human rights protection. The Japanese government developed and announced a 'National Action Plan on Business and Human Rights (2020 - 2025)', based on the United Nations 'Guiding Principles on Business and Human Rights: Implementing the United Nations "Protect, Respect and Remedy" Framework' in 2020. As a follow-up to this Action Plan, the Japanese government developed and announced its 'Guidelines on Respecting Human Rights in Responsible Supply Chain' in September 2022.

While there is no legal system for purpose-driven companies or benefit corporations to date, the 'Grand Design for the New Form of Capitalism' provides that the government will consider the necessity of a new legal system for benefit corporations as a new form of public-private cooperation.

Law stated - 12 June 2023

INVESTMENT AND FINANCIAL SERVICES

Regulatory and fiduciary duties

Are institutional investors and financial intermediaries legally required to consider ESG factors when making investment decisions? Must any additional non-financial principles and objectives be considered?

There is no legal requirement for institutional investors or financial intermediaries to consider ESG factors when making investment decisions.

Institutional investors such as investment managers, advisers, insurance companies and pension funds owe fiduciary duties to their respective beneficiaries. While the specific fiduciary duties of such institutional investors may vary depending on applicable laws and contracts, the fiduciary duties generally require fiduciaries to pursue and protect the economic interests of their beneficiaries. It is generally understood that said fiduciary duties do not legally require fiduciaries to consider ESG factors, but ESG factors may be considered within the scope of the beneficiaries' instructions and the fiduciaries' discretion so long as such consideration would benefit mid-term to long-term investment returns, or at least so long as such consideration would not ignore or adversely affect the economic interests of beneficiaries. In practice, especially when a fiduciary adopts ESG considerations in its investment decisions, a fiduciary duty would require the investment decisions to be made with due process and competence, which may require the fiduciary to show that it has identified and assessed ESG risks and adopted specific approaches taking into account these risks.

Law stated - 12 June 2023

Voluntary standards and best practices

What voluntary standards and best practices are commonly followed in your jurisdiction with regard to integrating ESG factors and other non-financial principles into investment decisions and financial services?

The United Nations Principles for Responsible Investment (PRI) and the Stewardship Code are widely followed in Japan with regard to integrating ESG factors and other non-financial principles into investment decisions.

The number of signatories to the PRI has been steadily increasing in Japan since the Government Pension Investment Fund (GPIF) became a signatory in September 2015.

The Stewardship Code was established in 2014 by the Financial Services Agency (FSA) and revised in 2017 and again in 2020. The Stewardship Code provides principles for institutional investors in fulfilling their stewardship responsibilities as responsible institutional investors, with due regard both to their clients and beneficiaries as well as to investee companies. The Stewardship Code is not legally binding but requires institutional investors accepting it to either comply with its principles or explain why they do not (the 'comply or explain' approach). The 2020 revised version explicitly requires institutional investors, as part of their stewardship responsibilities, to consider sustainability, including ESG factors consistent with their investment management strategies. More specifically, the 2020 revised version requires institutional investors to aim to enhance the mid-term to long-term returns on investments for their clients and beneficiaries, by improving and fostering investee companies' corporate value and sustainable growth through constructive engagement, or purposeful dialogue, as based on in-depth knowledge of the companies, their business environment and on consideration of sustainability (mid-term to long-term sustainability including ESG factors) consistent with their investment management strategies. The 2020 revised version also requires institutional investors to clearly specify how they take issues of sustainability into consideration in their policy, consistent with their investment management strategies. According to the FSA, 324 institutional investors have signed up to the Stewardship Code as of 30 April 2023.

Law stated - 12 June 2023

Measurement, reporting and disclosure

What voluntary and statutory measurement, reporting and disclosure frameworks are followed in your jurisdiction with regard to ESG and other non-financial factors?

The statutory disclosure frameworks in Japan were not designed to disclose ESG and other non-financial factors. Therefore, many Japanese companies are utilising voluntary disclosure media to disclose such factors.

The Companies Act requires joint-stock companies to disclose business reports and financials to their shareholders. Certain corporate governance matters are required to be disclosed in such business reports; however, environmental or social matters are not required explicitly.

Under the Financial Instruments and Exchange Act (FIEA), reporting companies (typically, listed companies) are subject to the statutory disclosure framework. The FIEA requires reporting companies to make financial and non-financial disclosures in their annual securities reports, with more emphasis on financial disclosures. Corporate governance matters are required to be disclosed in such reports to a certain extent; however, environmental or social matters have not been included in these requirements, unless such matters would materially affect the financial status of the disclosing companies. The FSA published its ‘Principles Regarding the Disclosure of Narrative Information’ in March 2019 to enhance disclosure of non-financial factors under the current statutory disclosure framework. Since then, the FSA has from time to time updated and published its ‘Examples of Good Practices of Disclosure of Narrative Information’. In January 2023, the FSA amended the disclosure regulation under the FIEA to require the disclosure of certain sustainability information. More specifically, the reporting companies are required to disclose their governance around sustainability-related risks and opportunities, and how they identify, assess and manage such risks. They are also encouraged to disclose their efforts to cope with sustainability-related risks and opportunities that may affect their short-term, mid-term and long-term business plans and strategies, and the metrics and targets used to assess, manage and monitor their results on sustainability-related risks and opportunities in the long run, where they believe such information is material. The new disclosure regulation is in line with the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD). The new disclosure regulation also requires a more detailed disclosure regarding human capital, diversity and corporate governance. It will apply to the reporting companies for their disclosure for their fiscal year ending on or after 31 March 2023.

Stock exchange rules also require listed companies to file and disclose their ‘corporate governance reports’.

The Corporate Governance Code (CG Code) was published jointly by the FSA and the Tokyo Stock Exchange (TSE) in 2015 and revised in 2018 and again in June 2021. The CG Code provides principles for effective corporate governance at listed companies in Japan. The CG Code and the Stewardship Code are designed to work as ‘the two wheels of a cart’ to achieve effective corporate governance in Japan. As with the Stewardship Code, the CG Code is not legally binding but adopts a ‘comply or explain’ approach that requires listed companies to either comply with its principles or explain reasons why they do not do so. The 2021 revised version requires listed companies to appropriately disclose their initiatives on sustainability (mid-term to long-term sustainability including ESG factors) in the context of their disclosure of management strategies, and to disclose information on investments in human capital, which falls under the social rubric of ESG. The 2021 revised version further requires companies listed on the Prime Market to collect and analyse data on the impact of climate change-related risks and of earning opportunities on their business activities and profits, and enhance the quality and quantity of disclosures based on the TCFD recommendations or equivalent standards. The CG Code does not specify the media for the above disclosures.

Many Japanese companies disclose ESG and other non-financial factors via voluntary reports such as integrated reports and sustainability reports. They follow overseas disclosure frameworks such as the Global Reporting Initiative Standards, the International Integrated Reporting Council framework, the Sustainability Accounting Standards Board Standards and the Recommendations of the TCFD along with domestic disclosure frameworks such as the ‘Guidance for Collaborative Value Creation’ published by the Ministry of Economy, Trade and Industry (METI) and the TCFD Guidance formulated by the METI and revised by the TCFD Consortium. The Japan Exchange Group (JPX) and the TSE published a Practical Handbook for ESG Disclosure in March 2020 to support listed companies in improving ESG disclosure and to encourage dialogue with investors and other stakeholders.

While the International Financial Reporting Standards Foundation (IFRS Foundation) established a new standard-setting body, the International Sustainability Standards Board, in 2021 for the creation and development of sustainability-related financial reporting standards, the Financial Accounting Standards Foundation (a counterpart of IFRS Foundation in Japan) established in July 2022 the Sustainability Standards Board of Japan for the development of domestic sustainability information disclosure standards and the contribution to the development of international sustainability information disclosure standards.

Law stated - 12 June 2023

Ratings, indices and guidelines

What ratings, indices and guidelines are used to benchmark adherence to ESG principles and other non-financial factors in your jurisdiction?

There are no official, uniform or standard ratings, indices or guidelines used to benchmark adherence to ESG principles in Japan.

The ESG rating agencies and data providers such as Arabesque Group, Bloomberg LP, CDP, FTSE Russell, MSCI, Nikkei Inc (Nikkei NEEDS), S&P Global, Sustainalytics and Truvalue Labs, and also the ESG finance rating agencies such as DNV Business Assurance, Japan KK, Japan Credit Rating Agency, Ltd, Rating and Investment Information, Inc and, again, Sustainalytics, appear to be well-known in Japan. ESG valuation methods differ from agency to agency.

The ESG-related indices for Japanese equities selected and employed by the GPIF are as follows: FTSE Blossom Japan Index, FTSE Blossom Japan Sector Relative Index, MSCI Japan ESG Select Leaders Index, MSCI Japan Empowering Women Index (WINJ) and S&P/JPX Carbon Efficient Index. The ESG-related indices calculated and published by JPX Market Innovation & Research are: S&P/JPX 500 ESG Score Tilted Index Series, S&P/JPX Carbon Efficient Index, S&P/TOPIX 150 Fossil Fuel Free Index, FTSE JPX Net Zero Japan 500 Index, FTSE JPX Net Zero Japan 200 Index, Tokyo Stock Exchange Infrastructure Fund Index, JPX/S&P CAPEX&HUMAN CAPITAL INDEX, JPX-Nikkei Index 400 and JPX-Nikkei Mid and Small Cap Index.

In December 2022, the FSA published a Code of Conduct for ESG evaluation and data providers. The Code of Conduct provides principles for ESG evaluation and the provision of data. The Code of Conduct is not legally binding but requires ESG evaluation and data providers that accept the Code of Conduct to either comply with its principles or explain why they do not (the ‘comply or explain’ approach). The FSA is calling for ESG evaluation and data providers to endorse the Code of Conduct. The FSA will publish the status of endorsement of the Code in or around June 2023.

Law stated - 12 June 2023

Incentives, benefits and financial support

Are any fiscal incentives or other benefits available in your jurisdiction to encourage institutional investors and financial intermediaries to integrate ESG and other non-financial factors into their investment decision-making and financial services?

There are none.

Law stated - 12 June 2023

Impact investing

In addition to ESG factors, what considerations and practices are commonly integrated into impact investment strategies?

As there is no legal definition of ‘impact investment strategy’, considerations and practices integrated into impact investment strategies may slightly differ from one investor to another depending on their definition of this term.

The Japan National Advisory Board, the Global Steering Group for Impact Investment (GSG-NAB Japan), defines ‘impact investing’ as investing that meets both of the following two conditions:

- impact investments are investments made with the intention to generate positive, measurable social and

environmental impact alongside a financial return; and
- impact measurement is conducted before and after making investments (who does the post-investment measurement does not matter).

While ESG investment aims to reduce long-term risk and maximise returns (two-dimensional) considering its social and environmental effects, impact investing has the clear intention of solving a specific social issue (three-dimensional). Impact investing is expected to play a large role in helping achieve the United Nations' SDGs, which will not be possible with ESG investment alone.

The Positive Impact Finance Task Force, the ESG Finance High-Level Panel established by the Ministry of Environment, published its Concept Paper on Impact Finance in July 2020 and defined 'impact finance' as finance that satisfies all of the following four elements:

- an intention to have a positive impact in at least one aspect, on the assumption that a material negative impact is appropriately mitigated in all environmental, social and economic aspects;
- the conducting of impact assessment and monitoring;
- disclosure of information on the results of impact assessment and monitoring; and
- efforts have been made to ensure an appropriate risk-return profile for individual financial institutions and investors from a mid-term to long-term perspective.

As compared to conventional ESG investment and financing, impact finance is characterised by clearly intending and measuring a given impact. This fourth element aims to promote and expand impact finance in Japan, targeting areas that financial institutions and investors can engage in as their core businesses. From this impact-oriented perspective, impact finance can be considered to be a developed form of ESG investment and financing that seeks to deepen the practice of ESG integration, engagement and sustainability-themed investment.

Law stated - 12 June 2023

CORPORATE GOVERNANCE AND PURPOSE-DRIVEN COMPANIES

Legal recognition and certification

What legal forms or statuses are used in your jurisdiction to incorporate purpose-driven companies?

Currently, there are no specific legal forms or statutes governing purpose-driven companies in Japan. There is neither a public nor a private certification system for companies that pursue social or environmental purposes in Japan.

Companies established under the Companies Act (typically, joint-stock companies) are for-profit entities. The articles of incorporation of a company must state its purposes and the company has its rights and obligations within the scope of such purposes stated in its articles of incorporation. Such purposes stated in the articles of incorporation must be for-profit business purposes and may not be non-profit purposes. That being said, the Supreme Court ruled in 1970 that a political donation by a company may be within the scope of the company's business purposes to the extent of its being a reasonable amount in light of its social role, and directors of the company making the political donation are not in breach of their fiduciary duties to the extent that such political donation is reasonable. Against this backdrop, the business purposes of Japanese companies are widely and flexibly interpreted generally. There are many companies undertaking various corporate social responsibility activities and pursuing non-profit purposes to a reasonable extent that would not impair their economic interests. However, there are no clear guidelines as to what extent Japanese companies may pursue non-profit purposes.

NPO corporations are non-profit organisations incorporated under the Act on Promotion of Specified Non-profit Activities (NPO Act). The NPO Act lists 20 specified non-profit activities (eg, enhancing healthcare and welfare, preserving environment and protecting human rights) and requires NPO corporations to have one or more of such specified non-profit activities as their main purpose or purposes. NPO corporations are non-profit entities and may not distribute their profits or residual assets, if any, to their members. NPO corporations may engage in for-profit businesses to the extent such businesses do not harm their non-profit activities and on the condition that they appropriate the profits gained from such businesses for their non-profit activities. NPO corporations may obtain approval from the competent authorities to enjoy certain tax benefits if they have broad public support bases and meet certain requirements.

General incorporated associations (GIAs) and general incorporated foundations (GIFs) established under the Act on General Incorporated Associations and General Incorporated Foundations (GIA/GIF Act) may have for-profit purposes or non-profit purposes, or both; provided that they do not distribute their profits or residual assets, if any, to their members or founders. GIAs may be approved as ‘public interest incorporated associations’ and GIFs may be approved as ‘public interest incorporated foundations’ by the national or local governments to enjoy certain tax benefits pursuant to the Act on Authorization of Public Interest Incorporated Associations and Public Interest Incorporated Foundations if they mainly engage in non-profit activities as specified in said Act (eg, enhancing public health, preventing and eliminating unreasonable discrimination and protecting and maintaining the natural environment) and meet certain requirements.

If American benefit corporations, French mission companies or Italian benefit corporations (for-profit corporate entities pursuing social or environmental missions in addition to profit) are taken as the template for a prototypical ‘purpose-driven company’, none of the aforementioned Japanese vehicles (NPO corporations, GIAs or GIFs) seem suitable to be referred to as purpose-driven companies, as they are prohibited from distributing their profits or residual assets to their members or founders. Under the existing legislation in Japan, companies established under the Companies Act may nonetheless be used as purpose-driven companies even in the absence of a special law, regulation, certification procedure or applicable tax benefit. There are, however, a few Japanese companies that have obtained ‘Certified B Corp’ certifications from the US non-profit organisation B Lab.

While there is no legal system for purpose-driven companies or benefit corporations to date, the ‘Grand Design for the New Form of Capitalism and Action Plans’ recently formulated by the Cabinet provides that the government will consider the necessity of a new legal system for benefit corporations as a new form of public-private cooperation.

Law stated - 12 June 2023

Purpose and mission

What rules and standard practices govern the establishment of companies’ social or environmental purposes and mission?

Companies are required under the Companies Act to state their purposes in their articles of incorporation. Such purposes must be for-profit business purposes and non-profit social or environmental purposes may not be stated in the articles.

Apart from such business purposes, many Japanese companies voluntarily publish their mission statements in practice. Such mission statements often include non-profit, social and environmental elements. These mission statements are usually established and amended by the companies’ founders, representative directors or boards of directors. It seems rare that such mission statements are established or amended by the shareholders.

Law stated - 12 June 2023

Profit distribution, winding up and remuneration

What rules and restrictions govern profit distributions for purpose-driven companies in your jurisdiction?

There are no special rules or restrictions governing profit distributions for purpose-driven companies in Japan.

Generally, Japanese companies may declare and pay dividends to their shareholders within the amount of profits as calculated in accordance with the Companies Act. As Japanese companies are for-profit companies, the Companies Act prohibits them from rescinding all of their shareholders' rights to receive dividends and residual assets.

Law stated - 12 June 2023

What rules and restrictions govern the winding up of purpose-driven companies?

There are no special rules or restrictions governing the winding up of purpose-driven companies in Japan.

Generally, when Japanese companies are wound up, their liquidators distribute the residual assets, if any, to the shareholders after the repayment of the companies' debts.

Law stated - 12 June 2023

What rules and restrictions govern the remuneration of directors, officers, employees and third parties?

There are no special rules or restrictions governing the remuneration of directors, officers, employees and third parties of purpose-driven companies in Japan.

Generally, the remuneration of directors must be approved by the shareholders or, in the case of a company adopting a three-committee system (ie, establishing a nominating committee, an audit committee and a remuneration committee), the remuneration of directors and executive officers must be determined by the remuneration committee. There are no rules or restrictions on salaries or other payments to employees or third parties under the Companies Act.

Law stated - 12 June 2023

Measurement, benchmarking and reporting

Are purpose-driven companies legally required to measure, benchmark and report the social and environmental impact of their business?

There are no legal requirements aimed specifically at purpose-driven companies to measure, benchmark or report the social and environmental impact of their business.

Law stated - 12 June 2023

What statutory and voluntary standards, guidelines and best practices are followed by purpose-driven companies in your jurisdiction with regard to the measurement and reporting of ESG and other non-financial factors?

There are no statutory or voluntary standards, guidelines or best practices aimed specifically at purpose-driven companies with regard to the measurement and reporting of ESG and other non-financial factors.

Law stated - 12 June 2023

Director liability and private enforcement

What rules govern the liability of directors of purpose-driven companies for compliance with social and environmental standards and principles? In addition to shareholders, are stakeholders entitled to hold directors accountable through private enforcement action?

There are no special rules governing the liability of directors of purpose-driven companies for compliance with social and environmental standards and principles in Japan.

Generally, directors of Japanese companies owe fiduciary duties to their companies, and these fiduciary duties require the directors to manage their company's business in line with their business purposes to earn a profit, since companies are for-profit entities. However, directors may pursue other social and environmental missions to the reasonable extent that it would not impair the economic interests of the company. There is no clear rule or guidance as to whether or not directors are legally bound by such non-profit voluntary mission statements. It is unclear whether or not directors are found to be in breach of their fiduciary duties and liable for damages to the company if their compliance or non-compliance with the company's voluntary social and environmental missions gives rise to damages for the company; however, Japanese courts generally tend to interpret broadly the exercise of discretion by directors acting according to their business judgement. Shareholders may bring derivative actions against directors for damages suffered by the company arising out of the breach of their fiduciary duties. A third party may also claim damages against directors for wilful misconduct or gross negligence.

Law stated - 12 June 2023

State supervision

Is there any form of state supervision of purpose-driven companies in relation to their social and environmental purposes?

No.

Law stated - 12 June 2023

Incentives and benefits

Are any fiscal incentives or other benefits available for purpose-driven companies in your jurisdiction? What is the scope of these benefits and what requirements apply?

There are no fiscal incentives or other benefits available for Japanese companies pursuing non-profit purposes.

Law stated - 12 June 2023

Public procurement

Do the public procurement rules and policies in your jurisdiction confer any advantages on companies for pursuing social or environmental purposes? If so, what conditions apply?

No.

Law stated - 12 June 2023

Economic sustainability and market competition

How would you describe the level of economic sustainability and market competition of purpose-driven companies?

Currently, there are no specific legal forms or statutes for purpose-driven companies in Japan. There is neither a public nor a private certification system for companies that pursue social or environmental purposes in Japan. That being said, there are a steadily increasing number of Japanese companies that voluntarily establish their own mid-term to long-term sustainable goals and that disclose their progress in their voluntary reports.

Law stated - 12 June 2023

GOVERNMENT, NGO AND SUPRANATIONAL SUPPORT

Government support

Are there any governmental actors in your jurisdiction that are specifically dedicated to promoting and supporting socially and environmentally responsible investment practices, as well as purpose-driven companies? What purposes do they pursue and how do they do so?

There is no single governmental body specifically dedicated to promoting and supporting ESG investments, but multiple governmental bodies promote and support ESG investments in accordance with their responsibilities.

The Financial Services Agency (FSA) is responsible for the supervision of financial sectors such as banking, securities, investment management and advisory and insurance. The FSA holds jurisdiction over the Financial Instruments and Exchange Act (FIEA), the Stewardship Code, the Corporate Governance Code (together with the Tokyo Stock Exchange), the Social Bond Guidelines and the 'Basic Guidelines on Climate Transition Finance' (together with the Ministry of Economy, Trade and Industry (METI) and the Ministry of Environment (MoE)). The FSA endorses the Task Force on Climate-related Financial Disclosures (TCFD). The FSA is a member of the Network of Central Banks and Supervisors for Greening the Financial System.

The METI is responsible for developing Japan's economy and industry. The METI published the 'Guidance for Collaborative Value Creation' in May 2017 and the 'TCFD Guidance' in December 2018 (updated by the TCFD Consortium in July 2020). The METI endorses the TCFD and has hosted the TCFD Summit every year since 2019. The METI, together with the Japan Business Federation (Keidanren) and the New Energy and Industrial Technology Development Organization, initiated the 'Zero Emissions Challenge' in October 2020.

The MoE is responsible for environmental matters. The MoE has published the 'Practical Guide for Scenario Analysis in Line with TCFD Recommendations', the 'ESG Regional Finance Practical Guide', the 'Green Bond Guidelines', the 'Green Loan and Sustainability-Linked Loan Guidelines', the 'Basic Concept of Impact Finance' and the 'Green Impact Assessment Guide'. The MoE provides the Green Bond Issuance Promotion Platform and the Green Finance Portal.

Law stated - 12 June 2023

NGO support

Are there any non-governmental organisations (NGOs) operating in your jurisdiction that are specifically dedicated to promoting and supporting socially and environmentally responsible investment practices, as well as purpose-driven companies? What purposes do they pursue and how do they do so?

The TCFD Consortium is a private sector-led initiative established in May 2019 that promotes effective and efficient corporate disclosure based on the TCFD recommendations. The Consortium, as a successor of the METI, revised the TCFD Guidance in July 2020. The Consortium also published the 'Green Investment Guidance' in October 2019.

Keidanren is a comprehensive economic organisation with a membership comprised of 1,512 Japanese companies, 107 industrial associations and 47 regional economic organisations as of 1 April 2023. Keidanren establishes consensus in the business community and publishes policy proposals. Keidanren promotes the SDGs and ESG investments and endorses the TCFD. Keidanren sets the Charter of Corporate Behaviour for its member organisations aiming to achieve the SDGs, considering ESG factors.

Recently some environmental NGOs have acquired small equity stakes in companies and have made shareholder proposals to the companies in connection with environmental issues.

Law stated - 12 June 2023

Supranational support

Are there any supranational actors operating in your jurisdiction that are specifically dedicated to promoting and supporting socially and environmentally responsible investment practices, as well as purpose-driven companies? What purposes do they pursue and how do they do so?

The United Nations Principles for Responsible Investment (PRI), the United Nations Environment Programme Finance Initiative and the United Nations Global Compact play important roles in promoting and supporting ESG investment in Japan. The SDGs promoted by the Global Compact are well-accepted in Japan by both public and private sectors. The Global Compact Network Japan, the Global Compact's local network in Japan, has been operating since 2003.

The Global Steering Group for Impact Investment and its Japan National Advisory Board (GSG-NAB Japan) also play an important role in promoting and supporting impact investment in Japan. Since June 2020, the GSG-NAB Japan has jointly with the FSA co-hosted the Impact Investing Study Group.

Law stated - 12 June 2023

FINANCIAL TOOLS

Equity funds and loans

Does your jurisdiction regulate equity funds or other financial tools such as loans designed to scale up companies with social or environmental objectives? Even if not expressly regulated, are there venture funds specifically focused on investing in purpose-driven companies?

There is no specific regulation for equity funds or loans designed to scale up companies with social or environmental objectives. Venture funds focused on ESG investment are quite new in Japan, and as yet there appear to be only a few of them.

Law stated - 12 June 2023

Outcomes funds

Does your jurisdiction regulate 'pay for success' investing models such as outcomes funds? Apart from specific regulation, are any of these mechanisms in force or in progress in your jurisdiction?

The Cabinet Office is promoting pay for success (PFS) projects and there are an increasing number of PFS projects such as social impact bonds (SIBs) in Japan. In March 2020, the Liaison Conference among Relevant Ministries and Agencies on the Promotion of Pay for Success formulated an Action Plan on the Promotion of Pay for Success. Under the Action Plan, the Cabinet Office and related Ministries are now in the course of reviews and discussions to establish structures to support PFS projects by reference to outcomes funds in the UK and the USA.

Law stated - 12 June 2023

Social and development impact bonds

Does your jurisdiction regulate 'pay for success' investing models such as social impact bonds and development impact bonds? Apart from specific regulation, are any of these mechanisms in force or in progress in your jurisdiction?

The Cabinet Office is promoting PFS projects and there are an increasing number of PFS projects including SIBs in Japan. In February 2021, the Cabinet Office published its 'Guidelines of Pay for Success' as a practical guideline for local governments and other participants for conducting PFS projects such as SIBs. Since the public service system providing welfare is well developed in Japan, PFS is used to achieve cost-effectiveness of the existing government services.

Law stated - 12 June 2023

Crowdfunding

Does your jurisdiction regulate crowdfunding initiatives aimed at scaling up companies with social or environmental objectives?

Crowdfunding initiatives aimed at scaling up companies with social or environmental objectives would fall within broader regulations of crowdfunding generally. There are three types of crowdfunding in Japan, namely, an investment type, a donation type and a purchase type. Investment type crowdfunding is regulated by the Financial Instruments and Exchange Act (FIEA), while the other two types are not. Various additional laws and regulations including consumer protection laws and business regulations would also apply, depending on the type, structure, business, transactions, flow of funds and other factors.

Law stated - 12 June 2023

LITIGATION AND ENFORCEMENT ACTIVITY

Recent activity

Has your jurisdiction seen any ESG-related litigation or enforcement activity?

It seems that so far ESG-related litigation in Japan has been sparse. We have seen only a few cases, such as unsuccessful injunction cases against coal-fired power plants. There had been a view that ESG-related litigation against alleged misstatements of sustainability information in disclosure documents might increase upon the introduction of the new sustainability information disclosure regulation under the Financial Instruments and Exchange Act, however, the Financial Services Agency (FSA) also revised related guidelines to clarify that a reporting company will not be liable for forward-looking information so long as it is stated together with a detailed explanation containing, for example, the factual grounds, assumptions and reasoning, inasmuch as these can be regarded as generally reasonable. This clarification was made in order to avoid the situation where reporting companies end up becoming overcautious of the risk of litigation and subsequently hesitate to disclose sustainability information.

In response to the growing concern over the 'greenwashing' of rapidly increasing ESG funds, the FSA amended its Comprehensive Supervisory Guidelines for Financial Instruments Business Operators in March 2023 in order to define specific points that the regulator will use to check the disclosure of information related to publicly offered investment trusts, and information related to the organisational resources and due diligence practices of asset managers regarding ESG. We do not know at the moment whether the regulator intends to strictly enforce these guidelines.

Law stated - 12 June 2023

UPDATE AND TRENDS

Update and trends

What are the key recent developments, hot topics and future trends in your jurisdiction relating to social finance, purpose-driven companies and the impact economy in general? Are there any recent studies and initiatives to identify or quantify these market sectors? Are there any new or proposed regulations or taxonomies in this regard?

Concerning ESG disclosure, the Financial Services Agency (FSA) amended its disclosure regulation under the Financial Instruments and Exchange Act in January 2023 to require reporting companies subject to its regime (typically, listed companies) to disclose certain sustainability information. More specifically, reporting companies are required to disclose their governance around sustainability-related risks and opportunities, and how they identify, assess and manage such risks. They are also encouraged to disclose their efforts to cope with sustainability-related risks and opportunities that may affect their short-term, mid-term and long-term business plans and strategies, and the metrics and targets used to assess, manage and monitor their results on sustainability-related risks and opportunities in the long run, where they believe such information is material. The new disclosure regulation is in line with the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD). The new disclosure regulation requires a more detailed disclosure regarding human capital, diversity and corporate governance. It will apply to reporting companies for their disclosure for their fiscal year ending on or after 31 March 2023. The Financial Accounting Standards Foundation established in July 2022 the Sustainability Standards Boards of Japan (SSBJ) as a counterpart of the International Sustainability Standards Boards (ISSB), established by the International Financial Reporting Standards Foundation, for the development of domestic sustainability information disclosure standards and in order to contribute to the development of international sustainability information disclosure standards. It is expected that the SSBJ will develop a sustainability information disclosure standard by reference to the discussion document on sustainability information disclosure standards, published in March 2022, to be finalised at the end of the second quarter of 2023 by the ISSB.

From the perspective of market functions, the Japan Exchange Group launched an information platform in July 2022, into which the information and data relating to ESG investment products, such as green bonds, transition bonds, social bonds, sustainability bonds and sustainability-linked bonds, are aggregated. The FSA published a set of indicators to measure the social benefits of social bonds in July 2022, which is an annex to the Social Bond Guidelines. The FSA also published a Code of Conduct for ESG evaluation and data providers in December 2022. The FSA further amended the Comprehensive Supervisory Guidelines for Financial Instruments Business Operators to introduce certain guidelines on ESG investment funds in response to greenwashing concerns on rapidly increasing ESG funds, which became effective in March 2023. The Ministry of Environment (MoE) updated the Green Bond and Sustainability-Linked Bond Guidelines and the Green Loan and Sustainability-Linked Loan Guidelines in July 2022.

Concerning the transition finance, the Ministry of Economy, Trade and Industry (METI) is preparing sector-by-sector roadmaps. The METI announced in February 2022 the launch of the 'GX League' to promote transition finance and achieve carbon neutrality in 2050. The FSA published a discussion paper on guidance for financial institutions to address climate-related opportunities and risks in July 2022, aiming to understand the climate-related strategies of financial institutions and their implementation challenges through dialogue.

Concerning impact investing, the FSA holds a quarterly study group on impact investing together with the Japan National Advisory Board and the Global Steering Group for Impact Investment.

In terms of purpose-driven companies, the 'Grand Design for the New Form of Capitalism and Action Plans' formulated by the Cabinet provides that the government will consider the necessity of a new legal system for benefit corporations as a new form of public-private cooperation.

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Recommendations

Do you have any recommendations for legal models, fiscal treatment and public procurement in your jurisdiction in relation to social finance and purpose-driven companies? Do you see a need for regulatory intervention or is the market capable of self-regulation in these sectors?

We see that the new disclosure regulation on sustainability information has made good progress since it is in line with the TCFD recommendations widely accepted around the world. From the perspective of the comparability of sustainability information disclosure, while there are currently a variety of ESG disclosure standards followed by Japanese companies when they disclose ESG information in their voluntary integrated reports or sustainability reports, it is preferable to have a single uniform standard for ESG disclosure. In this regard, the SBBJ is developing domestic sustainability information disclosure standards in line with the international sustainability information disclosure standards to be developed by the ISSB. We see that the domestic sustainability information disclosure standards to be developed by the SBBJ also represent a positive step as they are expected to improve the comparability of sustainability information disclosure.

Currently, multiple governmental bodies have committed to promoting sustainable finance and ESG disclosure. It appears that the FSA focuses on sustainability information disclosure, the MoE focuses on sustainable finance and the METI focuses on transition finance and green transformation, all with a view to the realisation of a decarbonised society. These governmental bodies should act more in concert to promote sustainable finance and ESG disclosure.

The current level of regulations concerning sustainable finance, adopting as they do a soft law approach, seem moderate and sufficient, and a further tightening of the regulations does not seem necessary. However, the government might consider creating more incentives such as tax benefits and subsidies to promote sustainable finance.

Although there is no legal concept of a 'purpose-driven company' in Japan, many Japanese companies publish their mission statements voluntarily and pursue, in practice, social, environmental and other non-profit missions to a certain extent. We note that the government will commence discussions to introduce a new legal form for benefit corporations. Giving incentives such as tax benefits and subsidies to companies pursuing non-profit social and environmental missions might be also considered in order to promote social and environmental values in the private sector.

Law stated - 12 June 2023

Jurisdictions

Egypt	Shahid Law Firm
Italy	Legance
Japan	Anderson Mōri & Tomotsune
Luxembourg	CMS Luxembourg
Poland	WKB Wiercinski Kwiecinski Baehr
Portugal	PLMJ
Singapore	Mayer Brown
South Korea	JIPYONG LLC
Switzerland	Homburger
Taiwan	Lee and Li Attorneys at Law
USA	Sidley Austin LLP