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The Growth of Japanese Green Bonds and Challenges Ahead

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In the spring of this year, a committee organized by the Japanese Ministry of Environment ("MOE") issued a report referring to the promise of Japanese green bonds and expressing the MOE's expectation that Japanese green bonds would increase private investment into green projects and eventually contribute to a long-term reduction of greenhouse gasses. This was followed in April by Japan's signing of the Paris Climate Change Agreement of the COP21, which is scheduled to take effect on November 4, 2016 and is expected to be ratified by the Japanese government during an extraordinary session of the Diet this autumn. A significant investment will be required to achieve the goals of the agreement; however, this challenge has further stimulated interest in green bonds by the Japanese government as well as the private sector.

1. Rising Crop of Japanese Green Bonds

The MOE's spring announcement follows a growth in Japanese green bond related transactions over the last few years on both the issuer and investor sides. Data on some recent high profile transactions are provided as follows:

DBJ Green Bonds (Issuer side)

Issuer:	Development Bank of Japan
Issue amount:	EUR 2,500,000
Use of proceeds:	Investment in real estate properties in respect of which DBJ Green Building Certificates are issued.
Other features:	DNV GL issued a second opinion in respect of compliance with Green Bond Principles.[1]

[1] http://www.dbj.jp/pdf/ir/credit/greenbond/001_opinion.pdf (Japanese)

MUFG Green Bonds (Issuer side)

Issuer:	Mitsubishi UFJ Financial Group
Issue amount:	USD 500,000,000
Use of proceeds:	Lending to certain renewable energy projects which satisfy certain eligibility criteria.
Other features:	Sustainalytics issued a second opinion in respect of compliance with Green Bond Principles[2].

SMBC Green Bonds (Issuer side)

Issuer:	Sumitomo Mitsui Banking Corporation
Issue amount:	USD 500,000,000
Use of proceeds:	Lending to certain renewable energy projects and/or energy efficiency projects meeting certain project criteria.

Goldman Sachs – JAG mega solar green bonds (Issuer side)

Issuer/Trustee:	Shinsei Trust Bank
Issue amount:	JPY 4,770,000,000 (trust beneficial interests)/ JPY 2,000,000,000 (asset backed lending)
Use of proceeds:	Lending/equity investment to solar power projects.

NRI Green Bonds (Issuer side)

Issuer:	Nomura Research Institute, Ltd.
Issue amount:	JPY 10,000,000,000
Use of proceeds:	Investment in trust beneficial interests which are issued in respect of certain buildings for which multiple environmental certificates are issued.
Other:	Vigeo Eiris issues a second opinion in respect of compliance with Green Bond Principles.[3]

World Bank Green Bonds (Investor side)

Issuer:	World Bank (International Bank for Reconstruction and Development, "IBRD")
Investor:	Japan Post Insurance Co., Ltd.
Investment amount:	USD 100,000,000 (private placement, Shogun Bonds)
Use of proceeds:	Various green projects selected by IBRD

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2 http://www.mufg.jp/csr/juten/sustainability/greenbond/pdf/Sustainalytics'_opinion_jp.pdf

3 https://www.nri.com/~/media/PDF/jp/csr/greenstyle/greenbond/greenbond_01_02.pdf

2. Current Conditions

(a) Japan's INDC Submission

The Japanese government's Intended Nationally Determined Contribution (INDC) submission of July 2015 targets a reduction of 26.0% by FY 2030 compared to FY 2013 (a 25.4% reduction compared to FY 2005).[4] It is expected that Japan's INDC target will be achieved through various domestic/international policies, such as expansion of Japan's carbon credit mechanism, the Joint Crediting Mechanism ("JCM").[5] The JCM's initiatives are funded by the Japan Fund for the Joint Crediting Mechanism (the "Fund"). It is hoped that green bonds will play a role in bringing investment from the private sector to JCM's initiatives.

(b) Recent Practices in the Japanese Market

As the International Capital Market Association ("ICMA") continues to update its recommended Green Bond Principles[6] with the aim of improving the integrity and transparency of the green bond market internationally, developments in Japan also continue to move toward this goal. One of the developments that has been seen is a growing practice among some issuers to arrange for second opinions on the compliance of the product with the ICMA's Green Bond Principles. This goes toward one of the key areas of importance with respect to green bonds – the credibility of the bond as a "green product" in terms of the use of its proceeds.

(c) Investor Awareness in Japan

Awareness of and interest in environmentally responsible investment among Japanese investors continues to grow. As a reflection of this growing trend, Japan's Government Pension Investment Fund (GPIF) announced on 28 September 2015 that GPIF has become a signatory to the UN-PRI (Principles of Responsible Investment) by which GPIF has incorporated Environmental, Social and Governance (ESG) issues in GPIF's investment activities[7]

3. Challenges Ahead

A key area of concern for investors interested in green bonds will be a level of certainty as to the "greenness" of the bonds, which can be addressed, among others, by obtaining a second opinion in respect of compliance with Green Bond Principles. Moving towards a credible definition of "green bonds" with some level of certainty for the Japanese market will require constant monitoring of international trends as well as a consideration of practical factors. In particular, the tradeoff for the certainty gained by

[4] http://www4.unfccc.int/Submissions/INDC/Published%20Documents/Japan/1/20150717_Japan's%20INDC.pdf
[5] http://gec.jp/jcm/about/index.html
[6] The four main components of these guiding principles are: (i) use of proceeds; (ii) process for project evaluation and selection; (iii) management of proceeds; and (iv) reporting.
[7] http://www.gpif.go.jp/en/topics/pdf/20150928_signatory_UN_PRI.pdf

narrowly defined scope would be the costs required for the necessary due diligence at the time of issuance as well as a strict monitoring/reporting thereafter. A narrow definition could also possibly prevent the market from responding to technological advances in the field of alternative energy and evolving mechanisms for investment.

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