A LEGAL FRAMEWORK FOR IMPACT

JAPAN

INTEGRATING SUSTAINABILITY GOALS ACROSS THE INVESTMENT INDUSTRY

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CONTENTS

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EXECUTIVE SUMMARY

Around the world, investors are recognising that both economic growth and financial returns depend on a healthy environment and a stable society. At the same time, many governments want to help investors put their capital to work addressing crises like climate change and poverty.

In Japan, there has been strong support for sustainable finance from across the private sector as well as from policy makers and regulators. Institutional investors are now widely encouraged to consider environmental, social and governance (ESG) factors – provided they are financially material. However, it is not well understood whether investment institutions in Japan are permitted to *invest for sustainability impact* – that is, to use their powers and resources to intentionally pursue sustainability outcomes.

Drawing on findings from the 2021 report, A Legal Framework for Impact, this Report aims to clarify the extent to which institutional investors in Japan are currently permitted or required to invest for sustainability impact.[1] It then makes recommendations for Japanese policy makers that would empower and support investors to better integrate the consideration of sustainability impacts into their decision-making.

BOX 1: A LEGAL FRAMEWORK FOR IMPACT

The extent to which legal frameworks around the world support investors' efforts to invest for sustainability impact is examined in the 2021 report, *A Legal Framework for Impact*, authored by Freshfields Bruckhaus Deringer and commissioned by the PRI, the United Nations Environment Programme Finance Initiative and the Generation Foundation.

The report found that in the 11 jurisdictions analysed, including Japan:

- Financial return is generally regarded as the primary purpose for investors;
- Investors are likely to have a legal obligation to consider pursuing sustainability impact goals where that can help achieve their financial objectives;
- Some investors can pursue sustainability impact goals for reasons other than achieving a financial return;
- Investors are legally required to pursue sustainability impact goals if the objective of the financial product commits them to do so.

INVESTING FOR SUSTAINABILITY IMPACT

The above report also introduced the concept of *investing for sustainability impact* (IFSI). This used in the report's legal analysis as a concept to catch, broadly, any activities that involve an investor intentionally attempting (through investment decisions, stewardship or policy engagement) to bring about assessable behaviour changes among investee companies, policy makers or other third parties to achieve positive sustainability outcomes. For a more detailed definition, see Box 2 below.

THE CASE FOR INVESTING FOR SUSTAINABILITY IMPACT

Investors recognise that global crises like climate change and poverty pose significant risks to economic growth and financial returns over the long term. Accordingly, leading institutional investors are increasingly seeking to mitigate these risks by setting sustainability impact goals across their portfolios. Investing for sustainability impact requires an element of intentionality not necessarily considered by traditional forms of ESG integration. It entails setting explicit sustainability impact goals, taking action to achieve them, and assessing changes in real-world outcomes.

Such practices are also being driven by market demand and government policy. Institutional investors are facing growing pressure from clients and beneficiaries on these issues. In Japan, awareness of initiatives like the UN Sustainable Development Goals is high; however, consumers are not always sure how to contribute through their investments.

The Japanese government has set out strong support for green growth and responsible investment through a number of high-profile policy initiatives in recent years, and the country's financial regulators are increasingly developing policy to align financial markets with sustainability goals. However, further policy measures are needed to guide and support investors.

1 A Japanese translation of the executive summary and the Japan annex is also available: インパクトをもたらす投資に関する法的枠組み

THE NEED FOR POLICY REFORM IN JAPAN

Japanese authorities have made clear that investors are permitted to consider ESG factors, where relevant to financial returns. But they have not given the same clarity with regard to approaches that align with investing for sustainability impact. The findings of *A Legal Framework for Impact* indicate that investors' understanding of their legal duties regarding sustainability goals is discouraging them from taking such action.

Market infrastructure to support and guide investors continues to improve and the Japanese government has set out strong support for green growth and responsible investment through a number of high-profile policy initiatives. New corporate reporting rules, for example, will improve sustainability disclosures for investors. However, important gaps remain, limiting investors' ability to integrate sustainability impacts into their decision-making.

Guidance on stewardship could be improved to help support investors to address system-level risks and better hold companies accountable for causing externalities that may affect their broader portfolios. Market regulations can be clarified to avoid discouraging collaborative engagement that can help them to do so efficiently.

ESG disclosures by investment managers and investment funds are largely voluntary and not subject to regulation, raising the risk that clients and beneficiaries may struggle to identify appropriate products, or may even be subject to misleading claims.

POLICY RECOMMENDATIONS

- Clarify the extent to which investors' duties permit or require them to consider pursuing sustainability impact goals;
- Ensure better investor access to corporate sustainability-related information by updating existing rules, standards and guidance;
- Clarify when and how investors can use stewardship activities to pursue sustainability impacts, by updating the stewardship code, and through relevant implementation support programmes;
- Enhance transparency and market discipline on responsible investment claims by introducing rules and guidance on disclosures, labelling and classification;
- Ensure better communication between investment managers and their clients and beneficiaries on sustainability objectives and preferences by introducing relevant guidance.

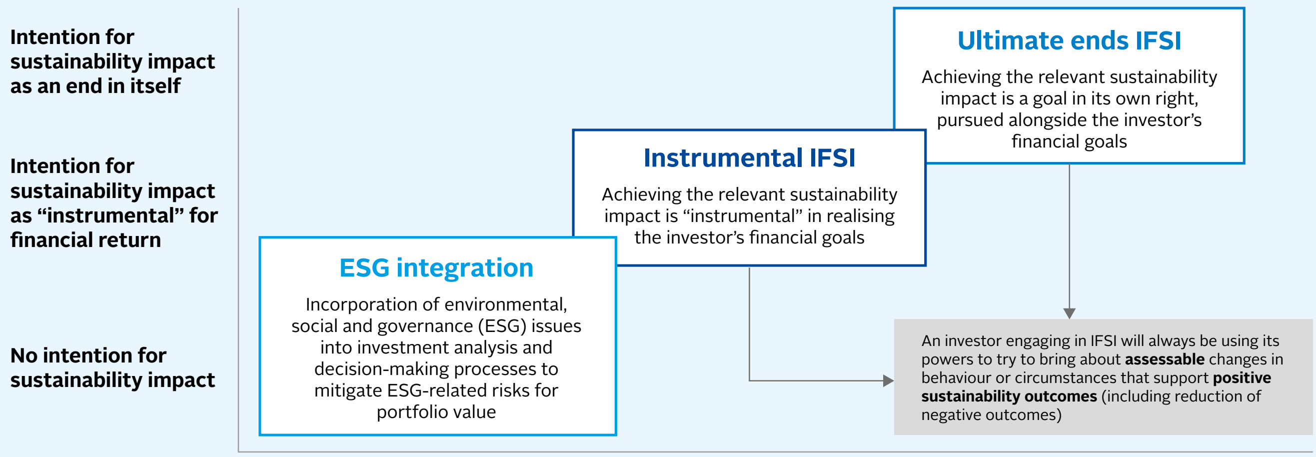
BOX 2: INVESTING FOR SUSTAINABILITY IMPACT

A Legal Framework for Impact (LFI), a report authored by Freshfields Bruckhaus Deringer and commissioned by the PRI, the United Nations Environment Programme Finance Initiative and the Generation Foundation, introduced the concept of *investing for sustainability impact* (IFSI). This is not a legally defined expression. Instead, it is used in the report's legal analysis as a concept to catch, broadly, any activities that involve an investor intentionally attempting (through investment decisions, stewardship or policy engagement) to bring about assessable behaviour changes among investee companies, policy makers or other third parties to achieve positive sustainability outcomes.

The LFI report distinguishes between two types of *investing for sustainability impact* based on the investor's objectives:

- *instrumental IFSI*, where achieving the relevant sustainability impact goal is 'instrumental' in realising the investor's financial return objectives;
- *ultimate ends IFSI*, where achieving the relevant sustainability impact goal, and the associated overarching sustainability outcome, is a distinct goal, pursued alongside the investor's financial return objectives, but not wholly as a means to achieving them.

Figure 1: *Investing for sustainability impact* (IFSI). Source: Adapted from the LFI report



THE DIFFERENCE BETWEEN ESG INTEGRATION AND IFSI

The PRI defines *ESG integration* as "including ESG factors in investment analysis and decisions to better manage risks and improve returns" (PRI Reporting Framework Glossary). In contrast with *investing for sustainability impact*, it does not require an explicit intention to pursue a sustainability impact goal. While there may be overlaps in the practical implementation of each approach, the distinguishing feature of IFSI is this intention to act in pursuit of a real-world sustainability impact goal.

THE DIFFERENCE BETWEEN TRADITIONAL IMPACT INVESTING AND IFSI

Investing for sustainability impact involves a perspective and a set of practices that extend beyond traditional impact investing. Impact investing has tended to mean directing funds towards activities that have a specific sustainability goal and which would not exist without that targeted capital. In contrast, IFSI can include investing in larger, more mature and diversified businesses and pursuing relevant sustainability impacts, with an emphasis not just on capital allocation but on stewardship and policy engagement as well.

Traditionally, impact investing has been conducted through specialist impact investing funds or strategies, whereas *investing for sustainability impact* is increasingly seen as a core investment approach that can be applied to broader portfolios. Still, impact investing is an example of one action institutional investors might take in a broader investment approach to achieve sustainability impact goals.

KEY TERMS

The following key terms are used throughout this report:

- **Asset owners:** for the purposes of this project, we refer to the three largest categories of asset owner by global assets under management, which are public and private pension funds, general and life insurers, and settlors and trustees of mutual funds authorised for public distribution.
- **Beneficiaries:** in this report, beneficiaries are the persons who derive a financial benefit from asset owners' investment activity. The expression should therefore not be understood as referring to a beneficiary relationship in the strict legal sense.
- **Investor duties:** the duties owed by investors to the individuals or legal entities on whose behalf they act in managing portfolios. These include the duties of care and loyalty, which are commonly referred to as the "mandatary's duty" (jutakusha sekinin) in Japan, regardless of the type of investor involved – much like fiduciary duty in common law countries. The expression "investor duties", however, encompasses a wider scope of duties that go beyond how the mandatary's duty is defined in the relevant legal rules, such as duties clarified in legal rules that specifically apply to certain types of investors.
- **Investing for sustainability impact (IFSI):** see Box 2.
- **Stewardship:** the use of influence by institutional investors to maximise overall long-term value, including the value of common economic, social and environmental assets, which affect financial returns and the realisation of clients' and beneficiaries' non-financial interests. For stewardship to be capable of delivering real-world outcomes at the scale needed to achieve our collective goals, the PRI encourages the adoption of its Active Ownership 2.0 approach. This explicitly prioritises the seeking of outcomes over process and activity, and common goals and effort over narrow interests.
- **Sustainability impacts:** the impacts of investors' actions on the environment and society. These impacts manifest themselves as the sustainability impacts of investments and can be positive or negative. Positive sustainability impacts are those aligned with global sustainability goals, such as the goals of the Paris Agreement and the UN Sustainable Development Goals (SDGs), as well as with the UN Guiding Principles on Business and Human Rights, the International Bill of Human Rights and International Labour Organization conventions.
- **System-level risks:** a catch-all term for systematic risk and systemic risk, both of which have implications for investment performance.
- **Systematic risk:** risk, transmitted through financial markets and economies, that affects aggregate outcomes, such as broad market returns. The term is interchangeable with "market risk" or "market-wide risk". Because systematic risk occurs at a scale greater than a single company, sector or geography, it cannot be hedged or mitigated through diversification. One example of a sustainability-related systematic risk is the risk of reduced global economic growth due to sustained physical impacts of climate disruption; another is the opportunity cost associated with failing to meet the SDGs.
- **Systemic risk:** the risk that an event at a particular point in time or a chronic economic condition destabilises the financial system or leads to its collapse. An example of a systemic risk materialising would be a number of "too-big-to-fail" financial institutions defaulting on obligations to their creditors or investors. An example of a sustainability-related systemic risk would be a sudden repricing of assets across the fossil fuel sector, resulting in cascading defaults that destabilise financial markets – this is sometimes referred to as a potential "climate Minsky moment".

THE CASE FOR INVESTING FOR SUSTAINABILITY IMPACT

KEY MESSAGES:

- Global crises like climate change and human rights are becoming more acute. World leaders and governments have agreed on the overarching sustainability outcomes needed to address these crises, which are reflected in agreements such as the UN SDGs and the Paris Agreement. These crises pose significant risks to the world's financial markets, creating a clear incentive for institutional investors to help reduce these risks and improve returns in the long term.
- Institutional investors also face pressure from an increasing number of clients and beneficiaries who show support for initiatives like the UN SDGs. However, many clients and beneficiaries are also unaware that they can contribute to sustainability goals through their investments, or how to do so.
- The Japanese government has set out strong support for green growth and responsible investment through a number of high-profile policy initiatives in recent years. The country's financial regulators are developing policy to align markets with sustainability impact goals.

GLOBAL CONTEXT

The world is facing environmental and social emergencies that pose material risks to the basic quality of life for current and future generations – for example, the crossing of planetary boundaries. Alongside climate change and biodiversity loss, social issues are also gaining prominence – such as human rights, modern slavery, and gender equality. All of these issues present risks to society, the economy, and investors' financial returns.

Governments are increasingly taking action to address these challenges. The UN has adopted the Sustainable Development Goals, and almost all countries in the world have ratified the Paris Agreement.[2] One of its main aims is to put financial capital to work on the climate transition. The Inevitable Policy Response project, commissioned by the PRI, forecasts a further acceleration of government and regulatory action on climate. More broadly, there has also been a wave of sustainable finance regulation in recent years, at both the national and multilateral levels.[3]

Against this backdrop, many investors are concluding that responsible investment practices should have the specific intention of improving outcomes in the real world. Key to this is the attempt to bring about assessable behaviour changes among investee companies or policy makers. This approach can be summarised as *investing for sustainability impact*.

SYSTEM-LEVEL RISKS AND FINANCIAL MARKETS

The World Economic Forum has identified inaction on climate change, human environmental damage, biodiversity loss, erosion of social cohesion and livelihood crises as some of the most severe global risks.[4] The International Corporate Governance Network has warned that such risks are significant threats to the stability of the global financial system.[5]

For Japan, it has been estimated that unmitigated climate change will cause a ¥95 trillion loss in GDP by 2070.[6] Japan's flood risk is also expected to increase, and alongside other risks such as droughts and wildfires, could reduce real GDP by 7% by 2100.[7] Biodiversity loss and environmental degradation also pose severe threats to economic stability,[8] with about 47% of Japan's GDP having a medium or high dependency on nature and its services[9].

Social issues are also pressing concerns. The COVID-19 pandemic increased economic insecurity and exacerbated existing inequalities. In Japan, women suffered significantly worse outcomes across a variety of economic and social metrics, highlighting the persistent gender inequality in society.[10]

2 United Nations, Treaty Collection
3 PRI, Regulation Database
4 World Economic Forum (2023), The Global Risks Report 2023
5 International Corporate Governance Network (June 2019), Investor Framework for Addressing Systemic Risks
6 Deloitte (2020), Japan's turning point: How climate action can drive our economic future
7 Bank of Japan (2022), Physical risks from climate change faced by Japan's financial institutions: Impact of floods on real economy, land prices, and FIs' financial conditions
8 De Nederlandsche Bank (2020), Indebted to nature: Exploring biodiversity risks for the Dutch financial sector
9 World Economic Forum (2020), Nature Risk Rising: Why the Crisis Engulfing Nature Matters for Business and the Economy
10 Gender Equality Bureau Cabinet Office (2021), コロナ下の女性への影響と課題に関する研究会報告書　～誰一人取り残さないポストコロナの社会へ～

Institutional investors, tasked with securing long-term financial returns, have a responsibility to consider whether such system-level risks are relevant to their legal obligations and objectives and, if so, how they can mitigate these risks.[11] Reduced system-level risks have the potential to improve financial outcomes over the long term.[12]

Diversification, a core tenet of modern portfolio theory, does not address such risks to investors' portfolios. Therefore, investors are beginning to make investments more sustainable across the portfolio (i.e., investing for sustainability impact). For example, over 700 investors are members of Climate Action 100+, a stewardship initiative engaging 166 companies on emissions reduction targets.

INVESTOR DUTIES AND BENEFICIARY EXPECTATIONS

Many beneficiaries are becoming increasingly concerned about sustainability issues, and how their investments affect them. Across the globe, they are advocating for investment managers to take actions such as divesting from fossil fuels and deploying capital in line with net zero emissions by 2050.[13] Their concerns and preferences are not limited to climate change. Many pension fund beneficiaries and retail investors want funds to reduce local air and water pollution, advance decent labour conditions, respect human rights, and promote equity, diversity and the inclusion of gender and race.[14]

Studies show Japanese consumers have good awareness of global sustainability frameworks such as the UN SDGs and the Paris Agreement[15,16], but their awareness of how individuals can support these with their investments remains low. The Social Innovation and Investment Foundation (SIIF) reports that consumer awareness of impact investing has remained at about 6-7% in its last three annual surveys.[17] However, a similar study by the Research Institute for Policies on Pension and Aging (RIPPA) found that about 17% of consumers were interested in having public pension funds align their investments with social and environmental outcomes, with a further 30% showing interest if the returns were competitive.[18]

It is also worth noting the ongoing advocacy from the Japanese Trade Union Confederation (RENGO) on workers' capital.[19] RENGO's policy asks were instrumental to reforms that enabled public and private pension funds to consider ESG factors.[20] RENGO's guidelines[21] are especially relevant in the area of labour standards (e.g. violations of the core standards of the International Labour Organization).

POLICY EXPECTATIONS AND REQUIREMENTS

Global policy makers are increasingly encouraging the use of private investment capital to support global sustainability goals.[22] Examples include the European Green Deal, which aims to direct private capital to activities that contribute to the EU's climate and energy goals.

In Japan, too, policy makers have looked to private investors to help achieve sustainable growth. Key policies include:

- **The Action Plan of the Growth Strategy** (Growth Strategy)
  This made a strong commitment to "green growth" through a transition to a carbon neutral economy by 2050, and enhanced labour markets to strengthen human capital investment.[23]
- **The Grand Design and Action Plan for a New Form of Capitalism** (Grand Design)
  This signalled policy makers' commitment to support investors and companies as they contribute to national sustainability outcome goals. The Cabinet Secretariat (CAS) also published the Basic Policy to Achieve GX[24] and the Doubling Asset-based Income Plan[25], which both provide more concrete plans for growing Japan's responsible investment market.

11 Freshfields Bruckhaus Deringer, PRI, United Nations Environment Programme Finance Initiative, Generation Foundation (2021), A Legal Framework for Impact: Sustainability impact in investor decision-making (p.154-p.192)

12 Hawley, J. and Lukomnik, J. (2019), Modernising modern portfolio theory

13 Bauer, R. and Smeets P. (2021), Eliciting pension beneficiaries' sustainability preferences: Why and how? (*Wharton Pension Research Council Working Papers, 710*); Warren, B. (2020, 19 May), RECAI 55: Institutional investors are asking tough questions about corporate ESG performance and expect answers to be embedded in corporate strategy

14 2degrees Investing Initiative (March 2020), A large majority of retail clients want to invest sustainably: Survey of French and German retail investors' sustainability objectives

15 Dentsu (April 2022), Dentsu Conducts Fifth Consumer Survey on Sustainable Development Goals

16 Cabinet Office, Government of Japan (November 2020), 気候変動に関する世論調査

17 The Japan National Advisory Board and the Global Steering Group for Impact Investment (2022), The Current State and Challenges of Impact Investing in Japan FY2021 Survey

18 Research Institute for Policies on Pension and Aging (2022), 年金と投資に関する意識調査結果

19 The Japanese Trade Union Confederation (2022), 政策・制度　要求と提言

20 The Japanese Trade Union Confederation (2009), RENGO's Approach to Financial Policies: Investment fund regulations and improvement of M&A rules

21 The Japanese Trade Union Confederation (2015), 労働組合のためのワーカーズキャピタル責任投資ガイドラインハンドブック（改訂版）

22 G7 (2019), Financing for sustainable development: improving measurement, mobilising resources and realising the vision of the 2030 Agenda and the SDGs

23 Cabinet Secretariat (2021), Action Plan of the Growth Strategy

24 Cabinet Secretariat (2023), GX 実現に向けた基本方針

25 Cabinet Secretariat (2022), Doubling Asset-based Income Plan

Japanese regulators and ministries have supported these policy objectives with a number of specific initiatives:

- **The Financial Services Agency** (FSA) has established the Expert Panel on Sustainable Finance to engage with leading experts in responsible investment. The Panel's first report[26] communicated the FSA's position on the relationship between responsible investing and fiduciary duty; policy-level support for impact investment; and Japan's appropriate approach to a sustainable taxonomy. It is noteworthy that the FSA now recognises a broad definition of "impact investing" that is similar to the concept of investing for sustainability impact. Alongside the Expert Panel, the FSA continues to co-host the Impact Investing Roundtable and also established the Working Group on Impact Investment. The Working Group recently published draft guidelines on impact investing[27], which provide greater clarity on how the principles of traditional impact investing can apply to investments of all sizes and asset classes.
- **The Ministry of Economy, Trade and Industry (METI)** has worked alongside the FSA and the Ministry of Environment (MoE) to lead industry-focused policies pursuant to the Growth Strategy. METI set out its approach in the Green Growth Strategy Through Achieving Carbon Neutrality in 2050. This includes guidelines for climate transition finance[28] and accompanying technology roadmaps for hard-to-abate sectors[29].
- **The Ministry of Environment** published a Basic Approach to Impact Finance in 2020. This promotes environmental considerations across investments, especially in direct financing frameworks. In 2021, the ministry's Positive Impact Finance Task Force published the Impact Assessment Guide Starting with the Green[30].
- **The Ministry of Health, Labour and Welfare** (MHLW), which leads on pensions policy, encourages pension funds to consider ESG factors in their investments and to implement Japan's Stewardship Code. These steps are mandatory for some funds. Notably, MHLW supervises the Government Pension Investment Fund (GPIF), the world's largest institutional investor. As a universal owner, GPIF considers that the sustainable growth of "the capital market as a whole" is "vital" to long-term investment returns.[31] It invests extensively in green, social and sustainability bonds, as well as ESG indices such as the MSCI Japan Empowering Women Index, which tracks gender diversity indicators. GPIF also assesses the alignment of its portfolio with the SDGs.[32] Such an approach is potentially closely aligned with pursuing sustainability impact goals for the purpose of improving overall returns.

26 Financial Services Agency (2021), Report by the Expert Panel on Sustainable Finance - Building A Financial System that Supports a Sustainable Society

27 Financial Services Agency (2023), インパクト投資等に関する検討会報告書（案）

28 Financial Services Agency; Ministry of Economy, Trade and Industry; and Ministry of the Environment (2021), Basic Guidelines on Climate Transition Finance

29 Ministry of Economy, Trade and Industry, Transition Finance

30 Ministry of Environment (2021), 「グリーンから始めるインパクト評価ガイド」について

31 Government Pension Investment Fund (2020), Investment Principles (Principle Four)

32 Government Pension Investment Fund (2022), 2021 ESG Report (p. 79-81)

SUMMARY LEGAL ANALYSIS

A Legal Framework for Impact examines a number of rules applicable to pension funds, mutual funds and insurance companies (the three largest sub-categories of asset owners by global AUM), as well as investment managers. The rules assessed are those relevant to the consideration of sustainability factors and the pursuit of positive sustainability impacts.

Generally speaking, funds operated and managed under the legal frameworks assessed may be set up with the specific purpose of investing or carrying out investment and stewardship efforts for positive sustainability impact. However, the legal analysis in the report, *A Legal Framework for Impact*, focuses on the extent to which the pursuit of sustainability impact objectives is possible, under current laws, where the fund mandate is "silent" on the issue.

Set out below is a brief analysis of Japan's current legal position on investors considering sustainability impact and pursuing positive sustainability outcomes. The analysis includes both findings from *A Legal Framework for Impact* and further analysis of legal and policy developments after the publication of the report in July 2021.

MANDATARY'S DUTY

Though different and specific laws apply to each investor type, as a principle all investors are subject to the Japanese legal concept of "mandatary's duty" (jutakusha sekinin), which is similar to "fiduciary duty" in common law states. Under the mandatary's duty, an asset owner or investment manager owes beneficiaries or clients the duty to consider environmental and social factors in its investment decisions where they are financially material to the performance of the investment, balancing returns against risks. Because the assumed purpose of a mandate is to achieve positive investment returns, investors are not explicitly required to use their investment powers to intentionally invest for sustainability impact and cannot do so in a manner that disregards financial returns.

On the other hand, it may be permissible if the investor reasonably believes that pursuing sustainability impact will lead to achieve higher investment return in the middle to long term by maintaining or enhancing the corporate value of investee companies, even if it potentially compromises investment return in the short term (i.e., *instrumental* investing for sustainability impact). This applies to all investors covered in this legal analysis. For example, where an investor determines that the economic impacts of climate change may harm overall portfolio returns over the long term, they will be permitted and potentially required to consider actions to pursue sustainability impacts that would contribute to reduce these risks – actions can include asset allocation, stewardship activities, and public policy engagement.

PENSION FUNDS

Pension funds are not under an explicit general duty to intentionally invest or engage for sustainability impact in current Japanese law. But in discharging their investment duties they are allowed to engage in instrumental investing for sustainability impact and may have an obligation to do so in some cases. Welfare pension funds subject to the BPR policy[33] are required to incorporate ESG factors in their decision making in the interest of achieving long-term portfolio growth. This does not explicitly require full alignment with the concept of investing for sustainability impact, but implicitly leaves room for interpretation to do so.

Broadly, pension funds may consider the sustainability impact of their investments where consistent with the mandatary's duty, which focuses on financial interests. In other words, pension funds may be permitted to consider pursuing positive sustainability impacts in their investment and engagement activity where that is instrumental to achieving the beneficiaries' financial interest (i.e., instrumental investing for sustainability impact). The position in relation to ultimate ends investing for sustainability impact is more restricted.

33 Full English title: "The Basic Policy to Have the Management and Investment of Reserves be Made Safely and Effectively from the Long-Term Perspective". Ministry of Internal Affairs and Communications, Ministry of Finance, Ministry of Education, Culture, Sports, Science and Technology and the Ministry of Health, Labour and Welfare (2020), 積立金の管理及び運用が長期的な観点から安全かつ効率的に行われるようにするための基本的な指針

INSURANCE UNDERTAKINGS

Insurance undertakings are not under an explicit general duty to intentionally invest or engage for sustainability impact, but directors may need to consider systemic sustainability risk which could materialise in future (and cause a material adverse effect on the company) in order to discharge their duties to shareholders.

With the exception of variable-type life insurance, insurance undertakings are generally free to engage in instrumental investing for sustainability impact – so long as it remains consistent with their mandatary's duty owed to shareholders, and they meet regulatory requirements on retaining sufficient reserves to pay valid claims.

The FSA's Supervisory Guidance on Climate-related Risk Management and Client Engagement[34] may however provide even greater scope for insurance undertakings to engage in instrumental investing for sustainability impact from a system-level risk mitigation perspective. The guidance clarifies the FSA's supervisory view that addressing climate-related risks requires the consideration of various ways these risks can affect financial institutions, including their manifestation as macroeconomic risks affecting economic growth.

MUTUAL FUNDS

Investment trust managers (ITMs) are not under an explicit general duty to intentionally invest or engage for sustainability impact. However, they may consider sustainability impacts in pursuing their financial objectives (i.e., instrumental investing for sustainability impact) – refer to the section on mandatary's duty above. Similarly to pension funds and insurers, any investment or costs incurred (including for engagement) for the purposes of achieving a positive sustainability impact must be justified in line with the financial interest of the end-investors.

INVESTMENT MANAGERS

Investment managers are not under an explicit general duty to intentionally invest or engage for sustainability impact. However, they are generally permitted to consider sustainability impacts where these are instrumental to pursuing their financial objectives (i.e., instrumental investing for sustainability impact) – refer to the section on mandatary's duty above.

As there is no explicit prohibition on an investment manager to use its powers to intentionally invest or engage for sustainability impact, if the investment management agreement with a client expressly requires an investment manager to pursue sustainability impacts, the investment manager can potentially use its powers to pursue both instrumental and ultimate-ends investing for sustainability impact. However, investment managers are not required to ascertain their client's objectives in relation to sustainability impacts and where the investment management agreement is silent on sustainability impact objectives, investment managers are expected to adhere to a financial-return-based objective.

34 Financial Services Agency (2022), Supervisory Guidance on Climate-related Risk Management and Client Engagement

THE NEED FOR POLICY REFORM IN JAPAN

KEY MESSAGES:

- Many Japanese investors remain unaware of the extent to which they are permitted or required to invest for sustainability impact.
- Japanese authorities have made clear that investors are permitted to consider ESG factors where relevant to financial returns, but they have not given the same clarity with regard to investing for sustainability impact.
- New corporate reporting rules will improve sustainability disclosures for investors. However, important gaps remain, limiting investors' ability to integrate sustainability impacts into their decision-making.
- Japan's Stewardship Code could be improved to address system-level risks, and market regulations clarified to avoid discouraging collaborative engagement.
- ESG disclosures by investment managers and investment funds are voluntary and not subject to regulation, raising the risk that clients and beneficiaries may struggle to identify appropriate products, or may even be subject to misleading claims.

A number of leading Japanese asset owners and investment managers are taking action to shape sustainability outcomes on the basis that doing so is in their beneficiaries' interests.[35] However, many others remain unaware about the extent to which they are permitted or required to do so.

There is also a lack of supporting infrastructure. Investors require consistent and high-quality disclosures from companies about their sustainability risks and performance in order to effectively invest for impact. Investors also require regulatory and practical guidance from policy makers as they navigate new territory in pursuing sustainability impacts through stewardship and policy engagement. Market rules and disciplinary frameworks could also be better structured to take sustainability impacts into account.[36]

UNCERTAINTY OVER INVESTORS' POWERS AND DUTIES

In Japan, numerous policies addressing sustainable finance and the climate transition have been introduced recently. The FSA has aligned with the growing global consensus that ESG investment does not run counter to mandatary's duty, and in fact can be regarded as "desirable".[37] The FSA further notes that mandataries are required to aim for market-competitive financial return even in impact investment. Its rules and policies require or encourage investors to consider ESG factors and impact investing, where they are material to enhancing the long-term value of investee companies.

However, regulations and guidance are not sufficiently clear about when intentionally pursuing sustainability impacts can be considered consistent with a mandatary's duty, either to address system-level risks or to achieve other objectives.

Clarifying investor duties on this matter is especially important given the policy backdrop. The government's aim is to "achieve a society in which the private sector plays a public role" in addressing economic externalities.[38]

Current plans under the Grand Design, however, appear to focus on investment funds and direct financing opportunities with explicit impact objectives. They do not address the broader approaches investors can take, such as stewardship activities or policy engagement.

This is especially true for pension funds. Although the FSA is discussing the relationship between impacts and mandatary's duty through forums such as the Expert Panel and the Working Group on Impact Investment[39], the Ministry of Health, Labour and Welfare has not signalled any intention to clarify this relationship through formal guidance or regulation.

Notably, guidance on sustainability impacts is absent from both the BPR and the Government Pension Investment Fund's Mid-term Goals[40]. Given the size and influence of GPIF and other public pension funds, as well as GPIF's leadership in implementing strategies potentially closely aligned with instrumental IFSI, a formal clarification of public funds' ability to pursue sustainability impact goals (in order to address system level risks and improve financial returns) could support Japan's leadership in this area greatly.

35 Examples include the more than 50 investors involved in The Japan Impact-driven Financing Initiative and the Impact Investing Roundtable

36 Freshfields Bruckhaus Deringer, PRI, United Nations Environment Programme Finance Initiative, Generation Foundation (2021), A Legal Framework for Impact: Sustainability impact in investor decision-making (p.129-p.133)

37 Financial Services Agency (2021), Report by the Expert Panel on Sustainable Finance: Building a Financial System that Supports a Sustainable Society

38 Cabinet Office (2022), Grand Design and Action Plan for a New Form of Capitalism (English version). See also: Cabinet Office (2022), Basic Policy on Economic and Fiscal Management and Reform 2022 (English version)

39 Financial Services Agency (2022), Establishment of the "Working Group on Impact Investment"

40 Ministry of Health, Labour and Welfare (2022), 年金積立金管理運用独立行政法人中期目標

LACK OF MARKET INFRASTRUCTURE TO SUPPORT AND GUIDE INVESTORS

Investing for sustainability impact also depends upon knowledge, guidance and market infrastructure. In particular:

- Decision-useful sustainability disclosures from companies
- Guidance from regulators on stewardship and collaborative engagements, which explicitly addresses sustainability impact goals.

CORPORATE DISCLOSURE

The key institutions leading Japan's sustainability reporting policies include the FSA Financial System Council's Working Group on Corporate Disclosure, the Financial Accounting Standards Foundation (FASF) and the Japan Exchange Group (JPX). Their general approach has been to promote voluntary reporting without mandatory requirements. These policies have led to significant uptake in the market, but fragmentation persists among corporate practitioners on crucial topics.[41]

The FSA is proposing a significant change, however, with the introduction of statutory reporting rules[42]. These would take effect in 2023 and would effectively require mandatory corporate reporting on sustainability topics.

However, the proposed framework remains very high level, only requiring reporting for sustainability governance and risk management, alongside a number of gender equality indicators. It will still not require companies to disclose their sustainability *impacts* – i.e. the effects of their business activities on people and planet. It will also not require any commitments to manage sustainability impacts, and does not address important topics, such as third-party verification or mandatory reporting of sustainability targets.

Furthermore, so far Japan has also not adopted a sustainable finance taxonomy of the sort now being developed in a number of other markets.

These limitations in the disclosure regime mean that investors must request this disclosure from companies. The information that is provided is often limited and inconsistent between companies. This increases costs for investors and limits their ability to comply with their existing duties.

STEWARDSHIP

Stewardship is one of the most effective ways for investors to invest for sustainability impact and mitigate system-level risks. The Principles for Responsible Institutional Investors, known as Japan's Stewardship Code, has been instrumental in legitimising stewardship activities in the market. But because the Code is voluntary, signatories are not held accountable to its expectations, and the lack of review and supervisory mechanisms means it is difficult to be certain how far investors are implementing it.

There is also no reference to system-level risks within the Stewardship Code. It notes that engaging with companies to promote sustainable growth is compatible with the mandatary's duty – but appears to assume that material risks apply only at the level of individual issuers. Investors with highly diversified portfolios that are exposed to the entire Japanese economy must consider system-level risks. Compared to other markets, the current code falls short in this regard.

COLLABORATIVE ENGAGEMENT

Considering the urgency and scale of our global sustainability challenges, collaborative engagement is especially important. *A Legal Framework for Impact* identifies it as one of the most cost-effective and powerful ways to invest for sustainability impact. Japan's Stewardship Code supports the use of collaborative methods, stating that "n addition to institutional investors engaging with investee companies independently, it would be beneficial for them to engage with investee companies in collaboration with other institutional investors (collaborative engagement) as necessary."[43]

In practice, however, some aspects of the Japanese legal framework may make investors cautious of collaborative action. For example, they may be deemed to be "acting in concert" under the Financial Instruments and Exchange Act (FIEA), in which case their shareholdings will be aggregated together. If they amount to more than 5% of the company's voting rights, the collaborative group will be required to file a large shareholding report. If they comply with certain requirements, they can exercise the "exceptional reporting right", which provides benefits including reduced reporting burdens. However, if one of them engages in "acts of making an important proposal", they will risk losing this treatment".[44]

41 IFRS Foundation (2022), General Sustainability-related Disclosures and Climate-related Disclosures

42 Financial Services Agency (2023), 「企業内容等の開示に関する内閣府令」等の改正案に対するパブリックコメントの結果等について

43 Financial Services Agency (2020), Principles for Responsible Institutional Investors (Japan's Stewardship Code) (p.16)

44 Freshfields Bruckhaus Deringer, PRI, United Nations Environment Programme Finance Initiative, Generation Foundation (2021), A Legal Framework for Impact: Sustainability impact in investor decision-making (p.361)

The FSA has addressed this issue[45] by clarifying that the 5% rule applies to multiple shareholders only where they agree to exercise voting rights together. It has also explained that the prohibition on proposals relates only to those which aim to significantly influence an issuer's business. Given these clarifications, initiatives such as CA100+ have identified Japan-specific practices to avoid the risk of triggering the 5% rule and the prohibition on proposals.

Nonetheless, the existing mode of practice still poses limitations, especially as investors pursue stronger stewardship actions to meet sustainability impact goals. The FSA has committed to reviewing the relevant rules[46] and has begun this process in its Financial System Council.[47]

LACK OF MECHANISMS TO ENSURE TRANSPARENCY AND MARKET DISCIPLINE

To date, the Japanese government has preferred to encourage responsible investment through voluntary mechanisms. Beyond recently introduced non-binding guidelines and expectations related to the Stewardship Code, investors have limited requirements or guidance on reporting their sustainability practices to their clients or beneficiaries, or to be held accountable to their claims.[48]

As a result, investors who wish to have their money deployed in helping achieve sustainability impact goals may find it difficult to find the right products or investment managers.

This lack of rules on transparency and market discipline applies at two levels:

- **Investment company or entity level:** Fundamental expectations that should apply across all investments
- **Product level:** Expectations that apply to funds and products that intentionally pursue a sustainability impact goal

At the entity level, there is no standardised sustainability reporting requirement that applies to asset owners. Similarly, while the government broadly encourages investors to consider ESG risks where financially relevant, ESG disclosures are not currently mandated in investment management agreements and are, as a result, voluntary and limited.

At the product level, though there is no comprehensive requirement, the FSA has signalled a first step toward such policies through its new supervisory guideline for ESG investment trusts[49]. Nonetheless, its scope is limited to these specific retail investment products, and it could be more detailed and specific on identifying investors' intent to pursue sustainability impacts.

While an investment manager is required to pursue clients' financial objectives to discharge its mandatary's duty, investment managers have not generally sought to confirm their clients' sustainability objectives. Existing Japanese financial rules do not prompt them to do this either. It is therefore likely that investors' sustainability aspirations have not been adequately reflected in the decisions made on their behalf.

Addressing both entity and product level accountability for sustainability claims is also relevant to the Cabinet Secretariat's policy on doubling asset-based incomes. This policy aims to enhance the customer-facing transparency and governance of financial products. Discussions are being led by the FSA's Customer-Oriented Business Conduct Task Force.[50]

45 Financial Services Agency (2014), Clarification of Legal Issues Related to the Development of the Japan's Stewardship Code

46 Financial Services Agency (2022), The JFSA Strategic Priorities

47 Financial Services Agency (2023), 第51回金融審議会総会・第39回金融分科会合同会合 議事次第

48 The Japan National Advisory Board and the Global Steering Group for Impact Investment (2022), The Current State and Challenges of Impact Investing in Japan FY2021 Survey

49 Financial Services Agency (December 2022), Call for Public Comment on Proposed Partial Amendments to the Comprehensive Supervisory Guidelines for Financial Instruments Business Operators, etc. regarding ESG Investment Trusts

50 Financial Services Agency (December 2022), The Customer-Oriented Business Conduct Task Force Interim Report

POLICY RECOMMENDATIONS

KEY MESSAGES:

- Policy makers and regulators can help investors pursue sustainability impact goals by considering the following reforms:
  - Clarify the extent to which investors' duties permit or require them to consider pursuing sustainability impact goals;
  - Ensure better investor access to corporate sustainability-related information by updating existing rules, standards and guidance;
  - Clarify when and how investors can use stewardship activities to pursue sustainability impacts, by updating the stewardship code, and through relevant implementation support programmes;
  - Enhance transparency and market discipline on responsible investment claims by introducing rules and guidance on disclosures, labelling and classification;
  - Ensure better communication between investment managers and their clients and beneficiaries on sustainability objectives and preferences by introducing relevant guidance

As set out in previous sections, Japanese policy makers and regulators have already taken significant steps on sustainable investment. The proposed policies under the Grand Design[51] also suggest commitment to empower investors to help achieve Japan's sustainability impact goals.

These initiatives are predicated upon the existing legal requirement for investors to consider ESG factors where they are financially material. Although not explicitly so, they also support the interpretation that investors have the legal discretion to pursue sustainability impacts, even if it compromises short-term performance, if they reasonably believe it will improve returns in the long term.[52]

Our five recommendations for policy reform aim to make the Japanese legal framework more explicit on this point, and to support investors through practical steps, such as improving corporate disclosures on sustainability.

Where relevant, we have addressed our recommendations to a specific regulatory or policy-making body. Where one is not specified, we address the Japanese government and all relevant regulators (a list is provided in Appendix 2).

We would also encourage the Prime Minister's Council of New Form of Capitalism Realization to consider our five recommendations holistically, maintaining alignment across departments. Alternatively, the Japanese government could consider establishing a separate cross-ministerial platform to do so. We also recognise the pivotal roles played by the FSA's Expert Panel on Sustainable Finance and its Working Group on Impact Investment, and encourage them to consider the following recommendations.

1. CLARIFY THE EXTENT TO WHICH INVESTORS' DUTIES PERMIT OR REQUIRE THEM TO CONSIDER PURSUING SUSTAINABILITY IMPACT GOALS

The policy recommendations in this section focus on the legal duties of pension funds and insurers, though some may also apply to other institutional investors. Their overall objective is to clarify that investors should consider pursuing social and environmental impact goals where they can reasonably be expected to help achieve their legal investment purpose and objectives – for example by serving to address sustainability-related system-level risks.

CLARIFY PENSION SCHEME DUTIES

We recommend that ministries overseeing pension funds (MIC, MoF, MEXT and MHLW[53]) take the following steps:

- MIC, MoF, MEXT and MHLW should consider revising the BPR to clarify that the existing requirement to consider ESG factors should involve the consideration of pursuing sustainability impact goals too – if the pension fund reasonably believes that this will lead to a higher return in the mid- to long-term. MHLW should consider the same revisions for the Guideline on Investment Management Entities' Role and Responsibility in Relation to Defined Benefit Corporate Pensions (the DB Guidelines).

51 A key concept under the Grand Design and Action Plan for a New Form of Capitalism is to enhance the role that the private sector plays in solving social problems traditionally addressed only by the public sector by considering impact as an evaluation indicator alongside risk and return.

52 Freshfields Bruckhaus Deringer, PRI, United Nations Environment Programme Finance Initiative, Generation Foundation (2021), A Legal Framework for Impact: Sustainability impact in investor decision-making (section 1, p.351-p.352)

53 See Appendix 2 for a list of ministries, regulatory agencies and other organisations referred to in this section

- MIC, MoF, MEXT and MHLW should provide supplementary guidance that such a requirement would encompass an obligation to consider taking active steps to pursue the sustainability goals. (E.g. the use of investment powers, stewardship activities, and public policy engagement). Again, this would apply when investors could reasonably expect these steps would help achieve the purpose and objectives of the pension scheme (i.e. instrumental investing for sustainability impact). This would be the case when, for example, the sustainability impacts of a scheme's investments contribute to system-level risks (such as those related to climate change, aging and declining population, or gender inequality).
- MHLW should also consider revising the GPIF's Mid-Term Goals to clarify that the consideration of ESG factors should involve pursuing sustainability impacts if the GPIF (and other relevant welfare pension funds) reasonably believe that it will lead to a higher investment return in the mid- to long-term. Guidance should also clarify that this does not equate to "disregarding the benefit to participants" and therefore is not prohibited by existing regulatory requirements.[54]

CLARIFY DUTIES FOR INSURANCE COMPANIES AND MUTUAL FUNDS

The PRI recommends that the FSA set out guidance in relation to the FIEA to clarify that:

- Insurance companies and mutual funds should take into account sustainability-related system-level risks, as well as the sustainability impacts of their investments, in their investment strategy and decision-making. This includes considering pursuing sustainability impact goals, where doing so will contribute to their legal investment purpose and objectives. This guidance should be consistent with the existing Supervisory Guidance on Climate-related Risk Management and Client Engagement.
- Guidance should explain that active steps to pursue sustainability impact goals may be taken not only through asset allocation investment decisions, but also through stewardship activities such as voting, engaging, or filing resolutions, as well as through policy engagement. Stewardship and policy engagement can be conducted individually or in collaboration with other parties.

REVIEW THE FSA'S POSITION ON RESPONSIBLE INVESTMENT AND THE MANDATARY'S DUTY

The FSA Expert Panel's first report communicated the FSA's positions on ESG integration and on impact investing. Taken together, these seem to suggest a trade-off relationship between sustainability impacts and financial returns. The report states that ESG integration "can be positioned as a desirable measure in fulfilling fiduciary duty, even in Japan." Yet on the consideration of impacts, the position was that investors are "required to aim for market-competitive financial return even in impact investment, unless their beneficiary, for instance, prioritises impact over financial return."[55]

A Legal Framework for Impact analysis shows that in many cases, pursuing sustainability impact goals can be considered a means to achieving long-term financial objectives. The FSA should therefore consider inviting the Expert Panel to provide an updated view on the relationship between sustainability impacts and the mandatary's duty.

PROVIDE IMPLEMENTATION GUIDANCE AND CAPACITY BUILDING SUPPORT FOR ASSET OWNERS

We recommend that government departments and regulators develop further guidance on the application of the relevant duties for asset owners. The guidance should address the ways in which investors consider sustainability impacts and, where appropriate, set and pursue sustainability impact goals.

Specifically, the MHLW/FSA/METI/MoE/CAS (as applicable) should:

- Raise awareness of the long-term financial implications of sustainability-related system-level risks and clarify that pursuing sustainability impact goals is an approach that can address these risks within the boundaries of the mandatary's duty. This should include an examination of such risks; in particular, whether they can continue to be considered so remote or insubstantial as to be irrelevant to the financial goals of asset owners (especially those with long-term time horizons). The market may also benefit from a survey of existing practices, featuring examples of good practice. This is especially relevant for guidance targeting pension plans, for which regulatory encouragement to consider sustainability impacts is not as clearly and strongly stated.

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54 Freshfields Bruckhaus Deringer, PRI, United Nations Environment Programme Finance Initiative, Generation Foundation (2021), A Legal Framework for Impact: Sustainability impact in investor decision-making (section 2.2.6, p.353-p.354). GPIF is required under the GPIF Law to comply with the Mid-Term Goals (most recently revised in 2020), issued by MHLW.

55 Financial Services Agency (2021), Report by the Expert Panel on Sustainable Finance - Building A Financial System that Supports a Sustainable Society

- Clarify that appropriate actions to pursue sustainability impact goals are not limited to buying certain assets or selling others. In particular, regulators should encourage stewardship, including collaborative engagement, by or on behalf of pension funds. The Japanese government should also recognise the importance of stewardship in pursuing positive sustainability impacts and provide guidance on how investors' stewardship activities may help to achieve national sustainability impact goals.
- Publish and continuously update guidance highlighting good practices and case studies. The Japanese government does not have to lead such initiatives itself; it can support and endorse efforts by the investment industry. In Japan, life insurers may be well-placed to provide examples of leading practice in this area. For example, several have proactively supported the UN-convened Net-Zero Asset Owner Alliance, an international group of investors committed to transitioning their portfolios to net-zero greenhouse gas emissions by 2050.
- Provide training opportunities to pension funds (and other professionals such as investment advisers, consultants and lawyers) focused on better equipping them to take sustainability impacts into account in their decision-making. Sustainability impacts should be adequately considered when selecting investment managers, drafting mandates and assessing performance.

2. ENSURE BETTER INVESTOR ACCESS TO CORPORATE SUSTAINABILITY-RELATED INFORMATION BY UPDATING EXISTING RULES, STANDARDS AND GUIDANCE

In order to pursue sustainability impact goals, investors need sustainability information that is robust, relevant and readily available. The disclosures should cover investee companies' sustainability performance (i.e., how an investee's operations and products positively or negatively affect people and the environment), as well as the potential effect of sustainability outcomes on the companies' valuation and value creation over time.

A lack of high-quality sustainability data is not only a barrier for Japanese investors; it could also limit the flow of foreign investments into Japan. International investors increasingly focused on environmental or social outcomes might be deterred from investing in Japanese companies, if those companies do not disclose sustainability information against international baseline standards.

CONTINUE TO EXPAND THE COVERAGE OF STANDARDISED SUSTAINABILITY REPORTING, AND IMPROVE ITS QUALITY

Japan's corporate reporting framework has developed greatly through voluntary initiatives focusing on material ESG risks. Incorporating fresh perspectives on sustainability outcomes and impacts will become increasingly important. In some cases, non-regulatory groups have made progress with practical discussions on impact-focused indicators, which can serve as key resources informing policy makers. For example, Keidanren is leading efforts to identify impact-related indicators through its Working Group on Promoting Corporate and Investor Engagement.[56]

We also anticipate that the following discussions and sustainability reporting initiatives will expand and develop:

- The FSA Financial System Council's Working Group on Corporate Disclosure should continue to cooperate with the Sustainability Standards Board of Japan (SSBJ) to develop a comprehensive framework for the disclosure of sustainability-related risks and opportunities, and for sustainability performance, within statutory reporting requirements. The minimum baseline for this framework should be the final International Financial Reporting Standards (IFRS) Sustainability Disclosure Standards.
- However, the FSA and SSBJ should consider going beyond the IFRS standards to take a "building blocks" approach and complement them with further requirements and guidance for reporting on sustainability performance. This will serve the needs of investors looking for a broader understanding of an entity's sustainability performance and outcomes.
- In doing so, the FSA should continue to monitor sustainability disclosure standards being developed in other jurisdictions. These standards include the Corporate Sustainability Reporting Directive in the EU and the climate disclosure proposal from the US Securities and Exchange Commission. Consistency and interoperability between sustainability reporting requirements in major jurisdictions is of crucial interest to both international investors and global companies.

56 Keidanren (2022), "インパクト指標" を活用し、パーパス起点の対話を促進する

- The FSA and JPX should continue to update the Corporate Governance Code every three years, and consider strengthening its sustainability-related reporting requirements:
    - Sustainability policies: The requirement for boards to develop a basic policy is welcome, but better clarity on what this entails would better support companies to take action. The Code could provide guidance on how companies should report any sustainability impact goals, and the systems and accountability measures in place to deliver on these commitments.
    - Climate reporting: The requirements introduced in 2021 for Prime listed companies to report in line with the Task Force on Climate-Related Financial Disclosures (TCFD) recommendations are welcome, and should be subject to a phased implementation in the Standard and Growth markets as well. In addition, the FSA and JPX should move at pace to align climate reporting requirements with the IFRS Sustainability Disclosure Standards once these are finalised. The regulator and stock exchange should also continue to enhance the quality of reporting, for example by disseminating resources through the JPX ESG Knowledge Hub, and by engaging with and/or endorsing private initiatives such as the TCFD Consortium and the ESG Disclosure Study Group.
    - Diversity and inclusion: The supplementary principle introduced in 2021 that requires reporting on diversity-related policies and goals may benefit from better coherence with existing laws such as the Act on Promotion of Women's Participation and Advancement in the Workplace. Requirements related to diversity should also be accompanied by reporting requirements on human rights in line with Japan's Guidelines on Respecting Human Rights in Responsible Supply Chains issued by METI.
- The FSA should consider encouraging or requiring the attainment of third-party verification, certification or assurance for information provided under "metrics and targets" of the statutory reporting requirements.[57]

STRENGTHEN TRANSITION INITIATIVES BY REQUIRING REPORTING ON TRANSITION PLANS IN LINE WITH NATIONAL GOALS

The Japanese government has promoted transition finance as a key climate policy. Based on the reliance of Japanese companies on financing through loans and bonds, the government has implemented financing frameworks such as the Basic Guidelines on Climate Transition Finance and the accompanying sector-specific Technology Roadmaps. Though these initiatives provide an impetus for companies to devise transition plans, a more holistic approach is necessary.

- The FSA and JPX should consider enhancing the TCFD-aligned reporting requirement in the Corporate Governance Code to explicitly require reporting on transition plans. Transition plans should cover disclosure on strategic alignment with the Paris Agreement objectives, including interim GHG emission reduction targets (Scopes 1, 2 and most relevant scope 3 emissions), capital expenditure plans and accounts aligned with these targets, as well as human capital development plans to support changes in the business portfolio. Reporting on accountability mechanisms such as governance, incentives, and third-party assessments should also be addressed. In addition, the FSA and JPX should consider including requirements on transition plan reporting within the final IFRS Sustainability Disclosure Standards.
- The FSA can also consider a phased approach to promoting standardised reporting on transition plans among asset owners and asset managers, to align their portfolios with the national 2050 net zero target, as per recommendations from the TCFD[58]. This should also align with implementing the IFRS Sustainability Disclosure Standards in statutory reporting.[59] Alignment with the Corporate Governance Code's phased implementation of its climate reporting requirement would also be desirable.

57 Financial Services Agency (2023), 「企業内容等の開示に関する内閣府令」等の改正案に対するパブリックコメントの結果等について

58 Task Force on Climate-related Financial Disclosures (2021), Guidance on Metrics, Targets, and Transition Plans

59 Financial Services Agency (December 2021), 金融審議会ディスクロージャーワーキング・グループ報告（案）

CONSIDER JAPAN'S APPROACH TO A SUSTAINABLE FINANCE TAXONOMY (OR OTHER MEANS OF HELPING INVESTORS UNDERSTAND THE NET-ZERO ALIGNMENT OF THEIR INVESTMENTS)

The FSA should lead a study to consider developing a Japanese sustainable finance taxonomy – an official list of environmentally sustainable economic activities, such as that produced by the European Union.

PRI canvassed the views of investors and other stakeholders in Japan in early 2022. About 60% of respondents supported the development of such a taxonomy. Some market participants and policy makers voiced concerns that it might hinder the allocation of capital to innovative approaches that support the transition of hard-to-abate sectors[60]. However, if it was designed to align with the extended taxonomy proposed by the EU's Platform on Sustainable Finance, or with other markets that are seeking to include transition elements, such a taxonomy can instead help mobilise capital to transition technologies.

Although designed with a narrower focus, existing tools such as the MoE's Green Bond Guidelines and METI's technical roadmaps can potentially be used as a foundation for the development of a sustainable finance taxonomy. As in other markets, a taxonomy can complement entity-level disclosures (e.g. GHG emissions and targets) and provide investors with a view of the alignment of company revenues and expenditures with sustainability outcome goals, at the level of specific assets and activities.

A key consideration for the design of any such tool should be its interoperability with taxonomies being developed in other markets. This, again, could be important for Japanese companies' access to foreign capital.

3. CLARIFY WHEN AND HOW INVESTORS CAN USE STEWARDSHIP ACTIVITIES TO PURSUE SUSTAINABILITY IMPACTS BY UPDATING THE STEWARDSHIP CODE, AND THROUGH RELEVANT IMPLEMENTATION SUPPORT PROGRAMMES

A Legal Framework for Impact found that stewardship – especially in collaboration with other investors – is an essential tool for investors pursuing sustainability impact goals.

The most recent revision of Japan's Stewardship Code, in 2020, explicitly embedded sustainability factors within the scope of stewardship responsibilities for the first time. But the Code still falls short in important areas, including enforcement and accountability of signatories, requirements on processes and reporting, and legal limitations to collaborative engagement.

EMBED SUSTAINABILITY IMPACTS IN THE STEWARDSHIP PRINCIPLES

- The FSA should consider revising the Code to include a detailed explanation of the role it sees for stewardship activity in addressing system-level risks that could affect investment portfolios, especially over the long term.
- The FSA should consider revising the Code to encourage signatories to conduct stewardship that is focused on sustainability outcomes, using all the levers of influence at shareholders' disposal – engagement, voting, filing proposals or even taking roles on company boards.[61] Ambitious and clearly communicated stewardship strategies would support investee companies in responding to investor demands to achieve long-term growth.

60 PRI (March 2023), Does Japan Need a Sustainable Finance Taxonomy: Results From an Investor Survey and Stakeholder Interviews
61 PRI, About Stewardship

- The FSA should consider asking its Expert Panel on Sustainable Finance to discuss outcomes-focused stewardship as one of the "overarching issues" on its agenda. The consensus reached between the FSA and the Expert Panel should be included in a future report, in the same way that their position on the relationship between ESG and fiduciary duty was communicated in the First Report[62]. A possible next step can be to directly revise the Code to reflect the agreed upon position. The same approach can be applied to the Working Group on Impact Investment – the FSA can set outcomes-focused stewardship as a key agenda item for the Working Group and publish a position in future outputs.

CONSIDER INCLUDING ENGAGEMENT WITH POLICY MAKERS IN THE STEWARDSHIP CODE

- The FSA should consider revising the Code to clarify that signatories can also engage with policy makers, regulators and others, and seek to influence them on matters relevant to achieving sustainability impact goals. Where they do this, signatories should be required to publish a policy on how they do it. This can be introduced as a new and independent principle, or as guidance under principle one. Public policy has a substantial effect on the sustainability of financial markets and the economy, so policy engagement is a natural extension of an investor's responsibilities and duties.[63]
- The FSA can also consider a phased approach similarly to the above, which includes detailed consultation with the Expert Panel on Sustainable Finance and messaging a formal FSA position on the topic in a future Expert Panel report.

SET A REGULATORY BASELINE FOR STEWARDSHIP

- The FSA should consider enhancing the effectiveness of the Code through stronger accountability provisions. The regulator is currently undertaking a survey of the Code's signatories and their practices, but a more transparent and comprehensive approach would be beneficial to other stakeholders. The introduction of an accountability provision should consider what is proportionate and fair, based on a comprehensive review of how the market is responding to the Code so far – but it could include standardised reporting on the extent to which the Code's signatories implement its provisions, for example.
- The FSA should also consider ways to identify and share best practice. Examples of the ways in which signatories implement the Code could benefit prospective or new signatories.
- The FSA can also strengthen adherence to the Code among institutional investors by including stewardship guidance in the Law concerning Investment Trusts and Investment Corporations (LITIC). This could be similar to the guidance for pension funds in the BPR and the DB Guidelines. Currently, LITIC requires periodic disclosure of the results of investments to unitholders, but does not address stewardship responsibilities (as pension funds are encouraged to).

CLARIFY LEGAL GUIDANCE ON COLLABORATIVE ENGAGEMENT, ACTING IN CONCERT, AND FILING SHAREHOLDER PROPOSALS

- The FSA should consider updating the 2014 legal guidance on collaborative engagement with the aim of providing greater legal confidence to institutional investors, and removing potential barriers to collaboration. This could include a "safe harbour" provision, or a clear presumption in favour of collaboration in the interest of sustainability impacts aligned with national or global goals. We understand the FSA is already considering how it might best address barriers to collaborative engagement.[64] In doing so, we encourage the regulator to engage with existing collaborative engagement initiatives such as Climate Action 100+ (CA100+) to identify practical issues facing participants.
- The FSA should also consider providing legal guidance to address a particular issue relevant to shareholder proposals. The general practice in Japan is to file shareholder proposals in the form of a special resolution that seeks to amend the articles of incorporation for the relevant joint stock company.[65] This does not allow for shareholder proposals that are non-binding and/or advisory in nature, and may therefore discourage investors from filing resolutions.

62 Financial Services Agency (2021), Report by the Expert Panel on Sustainable Finance - Building A Financial System that Supports a Sustainable Society

63 PRI (2022), The Investor Case for Responsible Political Engagement

64 Financial Services Agency (2022), The JFSA Strategic Priorities

65 PRI (2023), Filing a shareholder proposal in Japan (Factsheet)

4. ENHANCE TRANSPARENCY AND MARKET DISCIPLINE ON RESPONSIBLE INVESTMENT CLAIMS BY INTRODUCING RULES AND GUIDANCE ON DISCLOSURES, LABELLING AND CLASSIFICATION

Policy makers should continue their efforts to address transparency and market discipline in the responsible investment space. Such policies are necessary to minimise the risk of "greenwashing", which erodes trust in the responsible investment market. They will also become increasingly important as the Japanese government aims to strengthen and grow its responsible investment market. Policies that protect such investors, particularly individual investors including pension beneficiaries, from misleading claims, while also enabling them to make informed decisions on pursuing sustainability objectives will become key to its success.

MAINTAIN ALIGNMENT WITH INTERNATIONAL STANDARDS

The FSA would benefit from studying rules on transparency and market discipline that have been developed by other jurisdictions around the world. The EU's regulation on sustainability-related disclosures in the financial services sector (SFDR)[66] and the UK Financial Conduct Authority's proposed Sustainability Disclosure Requirements (SDR)[67] provide leading examples of transparency and disclosure rules on sustainability investment products. Japan's regulator should seek alignment and consistency with these standards where appropriate – which among other benefits, will aid Japanese financial groups seeking to market their sustainability investment products abroad.

It would also be beneficial for the FSA to engage with international efforts to harmonise rules on investor disclosure and financial product labels. The International Organization of Securities Commission's (IOSCO) initiative is especially noteworthy, as they have called upon all voluntary standard-setting bodies and industry associations operating in financial markets to promote good practices among their members to counter the risk of greenwashing.[68]

ENSURE TRANSPARENCY AND MARKET DISCIPLINE ACROSS THE INVESTMENT VALUE CHAIN

The FSA's proposed new rules for ESG investment trusts[69] are a crucial starting point for efforts to ensure market discipline in sustainability products. But their scope is narrow, and the requirements could be more robust. Ideally, these kinds of requirements should apply to all categories of sustainability investment products, and to the companies and other entities offering them.

The FSA can begin by clarifying and defining key concepts that are relevant across the investment value chain – e.g. "greenwashing" and "sustainable" investment products. Such definitions can also serve as the basis for disclosure and product requirements and categories regarding financial products and entities that claim to have a sustainability focus or impact. These requirements should apply to all investors and products, as all investors should be incorporating material ESG factors in their decision making.

For investors and products with sustainability-focused claims, further requirements should be implemented. For example, Japan is yet to introduce minimum requirements regarding negative sustainability impacts, even in the proposed new rules for ESG investment trusts. Additionally, the FSA can consider identifying negative impacts that are not eligible to be categorised as "sustainable", and prohibiting or requiring transparency on relevant investments.

DIFFERENTIATE BETWEEN ENTITY-LEVEL AND PRODUCT-LEVEL REQUIREMENTS

As set out previously, policies to ensure transparency and market discipline should function at two levels – the level of the company or entity undertaking the investment activity; and the level of the investment product.

At the entity level, requirements should build upon the expectation to consider sustainability impacts across all investments. Alongside policies to clarify investor duties and the consideration of sustainability impacts, investors should be required to disclose their fulfilment of these duties. The FSA should ensure new rules do not contribute to confusion or increase the risk of investors believing they are not allowed to pursue positive sustainability impacts. At the same time, new disclosure requirements should not create unreasonable or disproportionate challenges for those investors who are actively investing for sustainability impact.

66 Official Journal of the EU (2019), Regulation on sustainability-related disclosures in the financial services sector

67 Financial Services Agency (October 2022), Sustainability Disclosure Requirements (SDR) and investment labels – Consultation Paper

68 The International Organization of Securities Commissions (November 2022), IOSCO Good Sustainable Finance Practices for Financial Markets Voluntary Standard Setting Bodies and Industry Associations: Call for Action

69 Financial Services Agency (December 2022), Call for Public Comment on Proposed Partial Amendments to the Comprehensive Supervisory Guidelines for Financial Instruments Business Operators, etc. regarding ESG Investment Trusts

At the product level, the FSA should draw a clear distinction between products that incorporate financially material sustainability risks and opportunities; and those that specifically involve pursuing assessable sustainability impact goals, for financial reasons or otherwise.

The LITIC and the FIEA contain several disclosure measures for investment products. In relation to these, the FSA should:

- Ensure that disclosures, labelling and classification for all investment products provide clarity on how the investments are managed so as to take account of sustainability factors; to identify, assess and act upon sustainability-related risks and opportunities; and to pursue any positive sustainability impacts (including reducing negative impacts). The following should be disclosed:
  - the policy and objective for incorporating sustainability factors (including sustainability impacts) – and any goals relating to them[70] – into investment decision making;
  - the strategy for achieving any sustainability impact goals, including actions taken (e.g., investment decisions, stewardship, engagement with policy makers);
  - the approach to the monitoring and assessment of sustainability impacts, as well as the investor's contributions toward achieved impacts;
  - the contribution to wider sustainability goals (e.g. those set by the asset owner or manager, regulators, the national government, or to global goals such as the Paris Agreement or UN SDGs).
- Consider the introduction of a product labelling and classification system. This should help investors understand the different types of sustainable investment products, but avoid giving the impression that managers should only consider sustainability risks, opportunities and impacts in products labelled as sustainable investments. Investors may want to distinguish between the following types of products:
  - funds investing in companies that are already aligned with sustainability outcome goals (or have an effective transition plan);
  - funds that aim to improve investee companies' sustainability impacts, e.g., so they become aligned with sustainability outcome goals;
  - funds that take a highly selective approach to investing in companies that generate specific, targeted positive sustainability impacts (traditionally known as impact funds).
- Continuously review the effectiveness of the Code of Conduct for ESG Evaluation and Data Providers[71] by surveying compliance reports by signatories to this code. If pertinent prior to the three-year review (due in 2025), the FSA should not hesitate to implement changes to the code and the enforcement mechanisms as necessary.

5. ENSURE BETTER COMMUNICATION BETWEEN INVESTORS AND THEIR CLIENTS AND BENEFICIARIES ON SUSTAINABILITY OBJECTIVES AND PREFERENCES BY INTRODUCING RELEVANT GUIDANCE

Research featured in *A Legal Framework for Impact* suggests consumers commit fewer assets to sustainable investments than surveys suggest they will.[72] This issue is compounded in Japan by a relative lack of financial literacy. Studies compiled by the Cabinet Secretariat[73] have shown that Japanese consumers are less inclined to invest their money in financial products, compared to consumers in other countries such as the US and the UK. The government has identified financial literacy as a key factor causing this.

In Japan, therefore, policies should focus on educating the general public on financial literacy; including the role that sustainability impacts can play in their investments and vice versa. Encouraging investors to engage with their clients and beneficiaries on sustainability preferences will also help, but should not be a substitute for this basic education.

CONSIDER FURTHER MEASURES TO IMPROVE CONSUMERS' UNDERSTANDING OF SUSTAINABLE INVESTMENTS

The Japanese government has identified financial literacy as one of the key issues to be addressed in its Doubling Asset-based Income Plan[74]. But its core aim appears to be to shift household financial assets that are largely held in cash and low-yielding deposits toward investments in equity and fixed income products.

70 These goals should be broken down into broad sustainability goals (such as reducing emissions), specific objectives that relate to achieving the goals, and targets that indicate progress towards the goals and objectives.

71 Financial Services Agency (December 2022), Finalization of "the Code of Conduct for ESG Evaluation and Data Providers"

72 Freshfields Bruckhaus Deringer, PRI, United Nations Environment Programme Finance Initiative, Generation Foundation (2021), A Legal Framework for Impact: Sustainability impact in investor decision-making (p.60)

73 Cabinet Secretariat (2022), 資産所得倍増に関する基礎資料集

74 Cabinet Secretariat (2022), Doubling Asset-based Income Plan

Although the plan includes approaches to grow Japan's ESG bond markets, the extent to which responsible investment will be embedded into future programmes under the plan is unclear. The Japanese government should therefore embed responsible investment and the concept of investing for sustainability impact throughout its pursuant education programmes or indicate its plans to do so explicitly. Doing so would provide a vital function in the economic system that the New Form of Capitalism policies aim to achieve.

Meanwhile, decision-makers in the investment industry may not have sufficient information about their clients' or beneficiaries' sustainability preferences. This may hamper their ability to recommend, design or manage products and strategies, and it may also mean they are not sufficiently incentivised to pursue sustainability impacts. Research featured in *A Legal Framework for Impact* suggests that the difference between sustainability aspirations and investment practice could be at least partly explained by structural factors of this sort.[75]

Given these findings, policy makers should explore measures that would encourage investment professionals to assess retail investors' views on sustainability impacts, and take those views into account in product design and distribution. For Japan, there may be an additional need for policies that prompt the investment industry, including investment managers and asset owners, to educate its clients and beneficiaries on these topics. Such policies should ensure that those responsible for managing the underlying investments retain ultimate ownership of, and legal responsibility for, investment decisions and that final investment decisions balance all relevant factors.

CONSIDER CONSUMER-FOCUSED REVISIONS TO THE STEWARDSHIP CODE, AND OTHER RELEVANT REGULATIONS

In its current form, Japan's Stewardship Code requires signatories to "report periodically on how they fulfil their stewardship responsibilities, including their voting responsibilities, to their clients and beneficiaries". This is a one-way explanation from investors, which fails to ensure that beneficiary voices are heard and recognised. The UK Stewardship Code, by contrast, sets out three layers of expectations that address how the investor sought beneficiary views, how these views have been reflected, and how they explained the process and outcomes to beneficiaries.[76]

The FSA could also consider including clients' sustainability preferences within the FIEA's suitability principle. The FIEA currently requires institutions transacting in financial instruments to ascertain the client's knowledge, experience, financial status, and investment objective – but the latter does not explicitly mention the client's sustainability-related objectives. Guidance on how sustainability interests could be considered within the FIEA suitability rule would enable complex investment chains to be better attuned to clients' or beneficiaries' sustainability preferences, including within individual investment agreements.

Finally, the MHLW could consider steps to ensure that private pensions better reflect the sustainability preferences of their beneficiaries. Regarding defined-benefit (DB) plans, MHLW has already revised the DB Guidelines[77] to reflect their expectations for DB plan operators to consider stewardship responsibilities and ESG issues in the selection of investment managers. They can take these provisions further and include sustainability impacts as an evaluation item for investment managers. It is equally important for the DB Guidelines to prompt DB plan operators to explain their approach to stewardship and the consideration of sustainability impacts to beneficiaries and take appropriate steps to understand and reflect beneficiary preferences.

MHLW should also take necessary measures to increase the provision of sustainable-investment funds within defined contribution (DC) pension plans. Japan's Defined Contribution Pension Act requires that DC Plan operators must provide between three and 35 investment options (i.e. financial products) where participants may invest their pension premiums. MHLW and the FSA could consider introducing guidance clarifying that DC Plan operators can and should consider providing sustainable investment options, including approaches that include pursuing sustainability impact goals where doing so can help achieve their investment purpose and objectives. Any such guidance should be in conjunction with introducing product-level transparency standards as discussed above.

75 Freshfields Bruckhaus Deringer, PRI, United Nations Environment Programme Finance Initiative, Generation Foundation (2021), A Legal Framework for Impact: Sustainability impact in investor decision-making (section 4, *Why the difference between positive sustainability attitudes and investment practice?* p.61-62)

76 Financial Reporting Council. December 2019. The UK Stewardship Code 2020 (p.13-14)

77 Financial Services Agency (2017), Guideline on Investment Management Entities' Role and Responsibility in Relation to Defined Benefit Corporate Pensions.

APPENDIX 1: HOW INVESTORS CAN INVEST FOR SUSTAINABILITY IMPACT

Investors can use a variety of tools to influence sustainability impacts. As set out in A Legal Framework for Impact (LFI), the three key levers – best used in combination rather than in isolation – are **investment decisions, stewardship activities and engagement with policy makers**.

By using these levers, investors can bring about assessable changes in the behaviour of investee enterprises, as well as in the systems in which companies and investors operate (e.g., through reforms to government policies and regulatory standards).

In general, investors will need to:

1. decide what global or national sustainability outcomes to focus on (e.g., reducing emissions);
2. set clear objectives for changes in corporate behaviour, and the resulting social and environmental impacts, with the change involving an increase in positive impacts and/or a reduction in negative impacts;
3. assess progress towards these objectives against well-defined timelines.

A key feature of this investment approach is intentionality. Instead of treating sustainability impacts as an unintentional by-product of their activities, **institutional investors can set objectives to intentionally invest for sustainability impact**. Figure 2 sets this out in more detail.

COMMUNICATING WITH STAKEHOLDERS

At both product and portfolio level, investors should:

- disclose their sustainability impact goals to their clients and beneficiaries,
- explain how these goals are reflected in their funds or their entire portfolio,
- what levers they are using to achieve these goals, including any timeframes or deadlines,
- and report on progress towards these goals, based on ongoing assessments.

Figure 2: How investors can invest for sustainability impact

This is an iterative process whereby the assessments of both progress and context feed back into ongoing updates to analysis and strategy.

IDENTIFY REQUIRED OUTCOMES	**IDENTIFY SYSTEM-LEVEL RISKS AND REQUIRED OUTCOMES** Taking into account broader objectives, mandates and strategy, and assessing their potential effects on financial returns. Choose global/national sustainability goals and thresholds, and identify beneficiary preferences.	*E.g. Climate change is a system-level risk to the entire world economy. Mitigating it requires limiting global warming to 1.5C, as per the Paris Agreement.*
SET STRATEGY	**SET SPECIFIC SUSTAINABILITY IMPACT GOALS** Set clear goals and targets for reducing the negative and increasing the positive impacts of investments.	*E.g. Reduce the combined CO2 emissions of companies in the investment portfolio to a level commensurate with the 1.5C goal.*
TAKE ACTION	**USE LEVERS TO INVEST FOR SUSTAINABILITY IMPACT** Use a combination of investment decisions, stewardship and policy engagement to pursue the sustainability impact goals set.	*E.g. participate in collective engagements on emissions reductions, use voting powers accordingly*
ASSESS IMPACT	**MONITOR AND ASSESS IMPACT** Monitor changes in sustainability impacts and the achievement of the specific sustainability impact goals. Assess achievements by reference to these specific goals, global/national sustainability goals and sustainability-related risks.	*E.g. monitor investee company strategy, targets and actions; monitor company and portfolio CO2 emissions; assess alignment with 1.5C goal*

APPENDIX 2: RELEVANT JAPANESE REGULATORS AND GOVERNMENT MINISTRIES

REGULATORS AND GOVERNMENT MINISTRIES

- The Financial Services Agency (FSA) oversees the banking, securities and exchange, and insurance sectors.
- The Ministry of Health, Labour and Welfare (MHLW) oversees the planning and design of public and corporate pension systems. In addition, the Ministry of Internal Affairs and Communications (MIC), Ministry of Finance (MoF) and the Ministry of Education, Culture, Sports, Science and Technology (MEXT) play a role overseeing public pension plans within their policy areas, and are co-authors of the BPR policy.
- The Ministry of Economy, Trade and Industry (METI) oversees company-facing policies that cover broad themes including economic industrial policy, energy, manufacturing, safety and security.
- The Ministry of Environment (MoE) oversees environmental conservation, pollution control and nature conservation, including through the publication and promotion of sustainable financing frameworks.
- Japan Stock Exchange (JPX) operates Japan's equity market and is responsible for the Corporate Governance Code.
- The Cabinet Secretariat (CAS) oversees general affairs related to the Cabinet by coordinating and integrating administrative measures of ministries and agencies.

OTHER KEY STAKEHOLDERS

- The Japan Business Federation (Keidanren) is a comprehensive economic organisation with members worldwide. Keidanren publishes policy proposals and hosts platforms for industry cooperation including those related to responsible investment and business conduct.
- The Sustainability Standards Board of Japan (SSBJ) was established under the Financial Accounting Standards Foundation (FASF) to represent Japan in contributing the development of a global baseline for sustainability reporting and lead the development of a domestic standard.
- The Government Pension Investment Fund (GPIF) is an executing agency under the supervision of the MHLW that manages the pension reserve fund for both the national pension and employees' pensions.

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ABOUT THE PROJECT

A Legal Framework for Impact is a flagship project of the Principles for Responsible Investment, the United Nations Environment Programme Finance Initiative and the Generation Foundation. The project is part of the Investment Leadership Programme, a joint initiative between the Principles for Responsible Investment and the United Nations Environment Programme Finance Initiative, created to accelerate collaboration among leading investors and boost action on achieving key global sustainability objectives. The project aims to identify and overcome the barriers to a financial system that is consistent with achieving the Sustainable Development Goals and limiting global warming to 1.5°C. Freshfields Bruckhaus Deringer were commissioned to produce a report on the extent to which legal frameworks in 11 jurisdictions enable investors to consider the sustainability impacts of their activities. The report provided the first comprehensive analysis of how far the law requires or permits investors to tackle sustainability challenges in discharging their duties – a practice called "investing for sustainability impact" or IFSI. The project is a multi-year work programme and is now focused on five key markets: Australia, Canada, Japan, the European Union and the UK.

ABOUT THE PROJECT PARTNERS

The Principles for Responsible Investment (PRI) works with its international network of signatories to put the six Principles for Responsible Investment into practice. Its goals are to understand the investment implications of environmental, social and governance (ESG) issues and to support signatories in integrating these issues into investment and ownership decisions. The PRI acts in the long-term interests of its signatories, of the financial markets and economies in which they operate and ultimately of the environment and society as a whole. The six Principles for Responsible Investment are a voluntary and aspirational set of investment principles that offer a menu of possible actions for incorporating ESG issues into investment practice. The Principles were developed by investors, for investors. In implementing them, signatories contribute to developing a more sustainable global financial system. More information: www.unpri.org

The Generation Foundation is a UK registered charity and was established alongside Generation Investment Management LLP, the sustainable investment firm founded in 2004. Its vision is an equitable society in which global temperature rises do not exceed 1.5°C. In pursuit of this, the Foundation operates a proactive grant-making and research programme that focuses on four priority areas: investor climate action; carbon pricing; gender inclusion and empowerment; and action on economic inequality. For further information, please visit www.genfound.org

United Nations Environment Programme Finance Initiative (UNEP FI) is a partnership between UNEP and the global financial sector to mobilise private sector finance for sustainable development. UNEP FI works with more than 400 members – banks, insurers and investors – and over 100 supporting institutions – to help create a financial sector that serves people and the planet while delivering positive impacts. UNEP FI aims to inspire, inform and enable financial institutions to improve people's quality of life without compromising that of future generations. By leveraging the UN's role, UNEP FI accelerates sustainable finance. https://www.unepfi.org/about/