

POLICY BRIEFING

JAPAN'S FINANCIAL INSTRUMENTS AND EXCHANGE ACT: INTEGRATING ESG INTO THE REGULATORY FRAMEWORK

November 2024

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ABOUT THE PRI

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

ABOUT THIS BRIEFING

This briefing summarises [the amendments](#) made to the Financial Instruments and Exchange Act (FIEA) by the Japan Financial Services Agency (FSA) in January 2023, which introduced mandatory sustainability disclosure in statutory annual reports. The amendments were made effective from reports regarding fiscal year ending on or after 31 March 2023. Reporting entities are required to disclose their governance and risk management approach to sustainability-related issues, and where material, also report on strategy and metrics and targets – these four pillars are aligned with the TCFD recommendations.

The FSA is also considering amendments to these provisions to embed the sustainability reporting standards being developed by the Sustainability Standards Board of Japan (SSBJ), which are being developed based on those by the International Sustainability Standards Board (ISSB). [Proceedings](#) in the FSA indicate that these amendments are likely to take effect in 2027.

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INTRODUCTION

The [Financial Services Agency \(FSA\)](#) introduced proposals for significant amendments to the [Financial Instruments and Exchange Act \(FIEA\)](#), a cornerstone of Japan's financial regulatory framework [in late 2022](#), with a particular focus on enhancing sustainability disclosures and practices among public companies.

KEY ELEMENTS

The amendments introduce a new section to the statutory reporting requirement titled "Sustainability Perspective and Measures", which is designed to provide stakeholders with a comprehensive view of a company's approach to sustainability. The amendments also introduced mandatory indicators relating to gender equality, as well as a recommendation to disclose scope 1 and 2 greenhouse gas (GHG) emissions.

SCOPE

The amendments apply to all listed companies in Japan. They aim to:

- **Improve stakeholder understanding:** Provide stakeholders with a more comprehensive understanding of how companies manage sustainability-related risks and opportunities.
- **Promote informed decision-making:** Enable investors, customers, and the public to make more informed decisions based on a company's sustainability disclosures.
- **Encourage sustainable practices:** Drive companies to adopt more sustainable practices by requiring them to disclose their approach to managing sustainability issues.
- **Align with global trends:** Ensure that Japanese companies are aligned with global trends in sustainability reporting.

REQUIREMENTS

Under the new "Sustainability Perspective and Measures" section, companies are required to disclose their general and organizational approach to sustainability issues in their statutory annual reports. Companies are provided with four sub-sections in line with the TCFD categories.

- **Governance and Risk Management:** Companies must disclose their governance structures and risk management processes related to sustainability, encompassing the governance processes, controls, and procedures designed to monitor and manage risks and opportunities regarding sustainability. These items are mandatory for all reporting entities.
- **Strategy and Metrics and Targets:** Companies are encouraged to disclose their strategy to address sustainability-related risks and opportunities and relevant metrics and targets where it is material. This includes information on how sustainability-related issues influences the company's management policies in the mid to long term.

Although the amendments are generally agnostic on specific sustainability-related issues, the exception is human capital and diversity. Reporting entities are mandated to disclose the company's policies on human resource training, improvement of the work environment, and related issues. Such disclosures should be included in the Strategy section, regardless of the provision to consider this only where it is material. Building on this requirement, reporting entities are required to report metrics and indicators where they have established them in relation to their Strategy for human capital and diversity.

The amendments also identified three indicators under the Act on Promotion of Women's Participation and Advancement in the Workplace that should be reported in statutory annual reports as well. More specifically, reporting entities that disclose any of the following indicators in compliance to the Act are required to report this information under the "Situation of Employees" section in their statutory annual reports: the ratio of women in managerial positions, ratio of male employees taking childcare leave, and gender pay gap. Additional diversity disclosures are encouraged but not required.

The FSA furthermore issued supplementary [principles](#) to serve as a guidance for reporting entities. In it, they iterate that climate-related reporting is still dependent on a reporting entity's assessment of its own materiality, but also acknowledge that GHG emissions is an increasingly referenced indicator by investors in their corporate engagement. They go on to note that therefore there is an expectation for entities to report Scope 1 and Scope 2 GHG emissions where this information is material.

The FIEA amendments address the issue of liability for forward-looking statements within ESG disclosures. Companies providing management's understanding of forward-looking statements, along with the underlying facts and assumptions, will not be held liable solely if there is a later discrepancy between the forward-looking statements and actual outcomes. This provision aims to encourage companies to share their sustainability goals and projections without the fear of legal repercussions for discrepancies that may arise due to unforeseen circumstances.

PENALTIES

Non-compliance with the FIEA amendments on ESG disclosures can result in various penalties, including:

Administrative Actions: The FSA can impose administrative fines and penalties on entities that violate the FIEA's provisions on ESG disclosures.

Criminal Penalties: In cases of severe non-compliance, criminal penalties, including fines and imprisonment, can be imposed by the courts.

Other Consequences: Entities may face additional consequences such as reputational damage.

NEXT STEPS

The revised regulations apply to statutory annual reports for fiscal years ending on or after 31 March 2023.

The FSA has provided guidance on the content and presentation of ESG-related information, which is expected to be updated periodically to reflect global and national trends in sustainability information disclosure regulations and practices. They have also continued to issue annual best practice compendiums for statutory reporting, which includes best practices regarding the newly introduced sustainability section – the latest version was issued [November 2024](#).

The FSA has also proceeded to consider adoption of the disclosure standards issued by International Sustainability Standards Board (ISSB). The FSA is monitoring the proceedings by the Sustainability Standards Board of Japan (SSBJ) to develop a Japanese version of the ISSB Standards. The SSBJ has conducted a three month [consultation](#) on their exposure drafts – PRI provided a [submission](#) welcoming the large degree of functional alignment with the ISSB Standards. In parallel, the FSA's Working Group on Disclosure and Assurance of Sustainability-related Financial Information (of the

Financial System Council) is deliberating how to embed the SSBJ Standards into legal rules once they are finalized. The [latest meeting](#) took place in October 2024 and indicated plans to introduce these requirements in 2027.

FURTHER RESOURCES AND REFERENCES

FSA (2024). Sustainable Finance: <https://www.fsa.go.jp/en/policy/sustainable-finance/sustainable-finance.html>