Subcommittee on Ending Poverty/Starvation and Protecting the Global Environment

Preliminary Report

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Japan Securities Dealers Association (JSDA)

Council for Promoting the SDGs in the Securities Industry

Subcommittee on Ending Poverty/Starvation

and Protecting the Global Environment

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I. Introduction

The Sustainable Development Goals (SDGs) were listed in the 2030 Agenda for Sustainable Development (the 2030 Agenda), adopted at the UN Sustainable Development Summit held in September 2015, as a set of 17 international development goals from 2016 to 2030 that call for initiatives aimed at eradicating all forms of poverty, fighting inequality, and dealing with climate change.

In Japan, as well, the realization of the SDGs is seen as a central pillar of the national strategy for creating the country's future, and Japan-specific initiatives are being carried out through collaboration across the public and private sectors.

The securities industry, meanwhile, has long been engaged in the promotion of so-called impact investment instruments (green bonds, social bonds, etc.), as well as ESG investment made in consideration of the environment, society, and corporate governance, which seek to solve social issues through the securities business while also maintaining economic profit. To the extent that they aim to realize sustainable development in terms of the environment, economy, and society, these impact investment instruments and ESG investment have much in common with the SDGs. Moreover, since these initiatives are carried out through the capital markets, they have the potential to produce ripple effects extending to all kinds of industries and individuals in Japan and overseas, and are seen as able to contribute toward the realization of a wide range of the SDGs.

As for securities firms, for the sake of raising their own corporate value and achieving sustainable growth, it has become necessary to share the problem awareness and sense of urgency of the United Nations and the Japanese government with respect to the realization of a sustainable society, to position the realization of the SDGs as a key issue for their business management, and to provide products and solutions in their business that address issues faced by global society. It can be thought that the securities industry taking the initiative to fulfil its role in society will likely to contribute to improving the credibility of financial and capital markets, while also helping to realize a sustainable society.

Against the backdrop of such awareness, in September 2017, the Japan Securities Dealers Association (JSDA) established the Council for Promoting the SDGs in the Securities Industry (hereinafter, the "Council") to facilitate active engagement by the securities industry in the social issues underlined by the SDGs, and under the Council formed a Subcommittee on Ending Poverty/Starvation and Protecting the Global Environment (hereinafter, the "Subcommittee") to study possibilities for further contributions through existing initiatives (impact investment instruments, ESG investment, etc.) in light of the SDGs.[1]

Discussions in the Subcommittee have focused on products and solutions that make use of

[1] In addition to this Subcommittee, the JSDA is promoting the realization of the SDGs along multiple fronts through the Subcommittee on Promoting Decent Working Conditions and Women's Participation in Society and the Subcommittee on Supporting Education for the Socially Vulnerable, as it seeks to encourage work style innovation in the securities industry and measures promoting greater roles for women, as well as helping the generation responsible for the future to grow with hope.

capital markets, the main area of activity for securities firms, examining the potential for enhancing and advancing them to make them more effective for the realization of the SDGs.

In September 2018, a Working Group on Financial Instruments that Contribute to the SDGs (hereinafter, the “SDG WG”) was established under the Subcommittee to conduct detailed analysis of Subcommittee proposals from a practical business standpoint.

This Report summarizes the results of discussions over the course of eleven Subcommittee sessions on measures for expanding the markets for financial instruments contributing to the SDGs, taking into consideration studies in the SDG WG and elsewhere.

II. Current Situation Regarding Financial Instruments Contributing to the SDGs

One of the major hurdles for realizing the SDGs that has been pointed to is the severe shortage of funding, most notably in developing economies. It has been estimated that the realization of the SDGs will require a huge sum of about USD 5 to 7 trillion annually worldwide (including USD 3.3 to 4.5 trillion estimated in developing economies alone),[2] for which official funds are deemed insufficient, making fundraising through private sector finance indispensable.

Effective for closing this funding gap and accelerating the inflow of private sector funds toward addressing the issues raised in the SDGs are investment in impact-related financial instruments and ESG investment. Under this framework, investors can contribute to the realization of the SDGs by investing in various financial instruments handled by securities firms. Bonds, in particular, are seen as having advantages over other financial instruments in the ease of managing and tracing the proceeds.

(1) Bonds contributing to the realization of the SDGs

Green bonds and social bonds epitomize such bonds capable of channeling raised funds to specific SDG-related business activities.

In Japan, social contribution-type bonds have been sold since 2008, when the bonds issued by the International Finance Facility for Immunisation (IFFIm; so-called Vaccine Bonds) went on sale to individual investors. After 2008, the bonds adopting the concept of "best-effort" fund management increased, and began spreading to a wide range of themes including microfinance, water, education, and agriculture (by 2017, a total of 16 issuers and 24 themes). Meanwhile, institutional investors such as regional banks and schools increased their investments in social contribution-type bonds through private placement.

Around 2013, against the backdrop of an increase in institutional investors overseas declaring their intention to invest in green bonds, the pace of green bond issuance by private corporations began to pick up. In 2014, the Green Bond Principles (GBP) were formulated by the International Capital Market Association (ICMA), providing guidelines on green bond transparency, information disclosure, and reporting. The Green Bond Principles were followed up by Social Bond Principles (SBP) and Sustainability Bond Guidelines (SBG).[3] In Japan, the Green Bond Guidelines 2017[4] drawn up by the Ministry of the Environment, drew strong interest.

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[2] UNCTAD World Investment Report 2014
https://unctad.org/en/PublicationsLibrary/wir2014_en.pdf

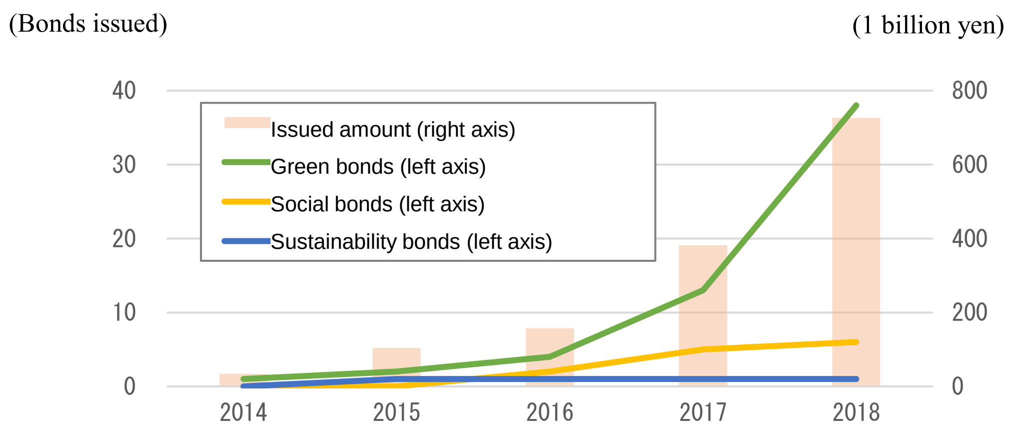
[3] In June 2018, along with revisions to the GBP, SBP, and SBG, the ICMA released "Green and Social Bonds: A High-Level Mapping to the Sustainable Development Goals," enabling public and private issuers and investors to evaluate their issuing of or investment in green, social, or sustainability bonds against the SDGs. At this time as well, Guidelines for Green, Social and Sustainability Bonds External Reviews were issued giving additional guidance on obtaining outside evaluations.
https://www.icmagroup.org/green-social-and-sustainability-bonds/

[4] http://www.env.go.jp/en/policy/economy/gb/en_greenbond_guideline2017.pdf

In the course of these developments, the first green bond issuance by a Japanese issuer on the Euro market took place in October 2014, after which green bonds have continued to be issued, mainly by financial institutions. In 2016, the first GBP-aligned bonds were issued in Japan, and after 2016, the market expanded to include more issuances by the corporate sector and issuances for retail investors.

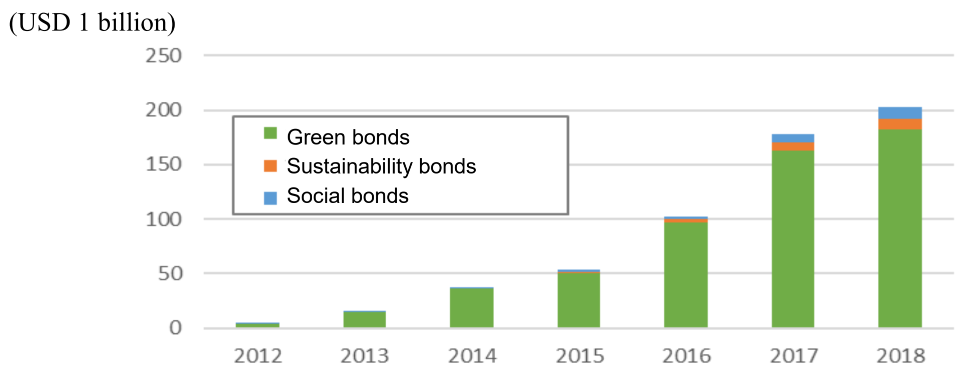
Considering the scale of the Japanese economy and its overall bond markets, however, the market for such bonds is still small compared to the rest of the world (Figure 3), suggesting there is much room for further growth.

Figure 1: Trend in issuing of green, social, and sustainability bonds by Japanese issuers



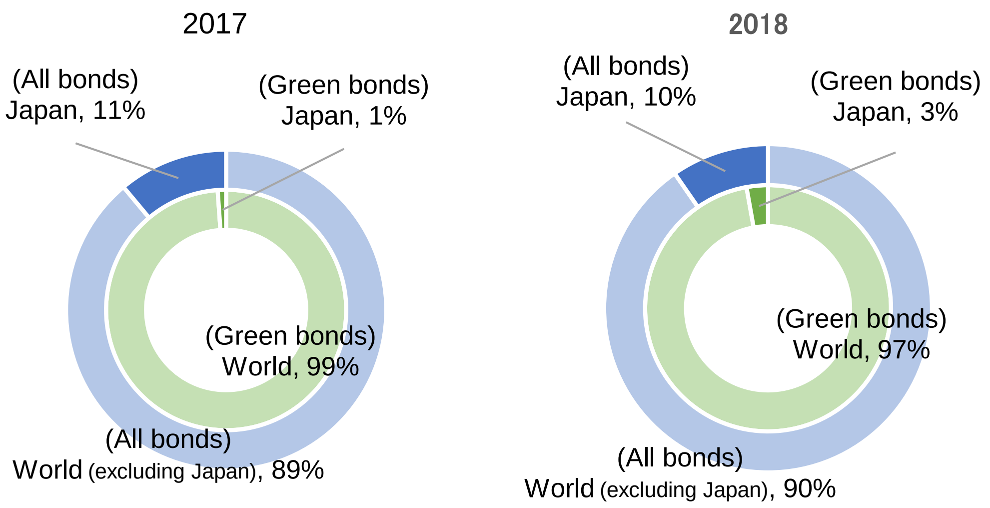
(Source: Prepared by JSDA from data disclosed by issuers on the Green Bond Issuance Promotion Platform of the Ministry of the Environment)

Figure 2: Trend in value of green, social, and sustainability bonds issued worldwide



(Source: Created by JSDA from Bloomberg data)

Figure 3: Value of green bonds issued in Japan and worldwide



(Source: Created by JSDA from Bank for International Settlements statistics and Ministry of the Environment data)

(2) Other investments contributing to the realization of the SDGs

Many other kinds of financial instruments besides bonds can contribute to the SDGs.

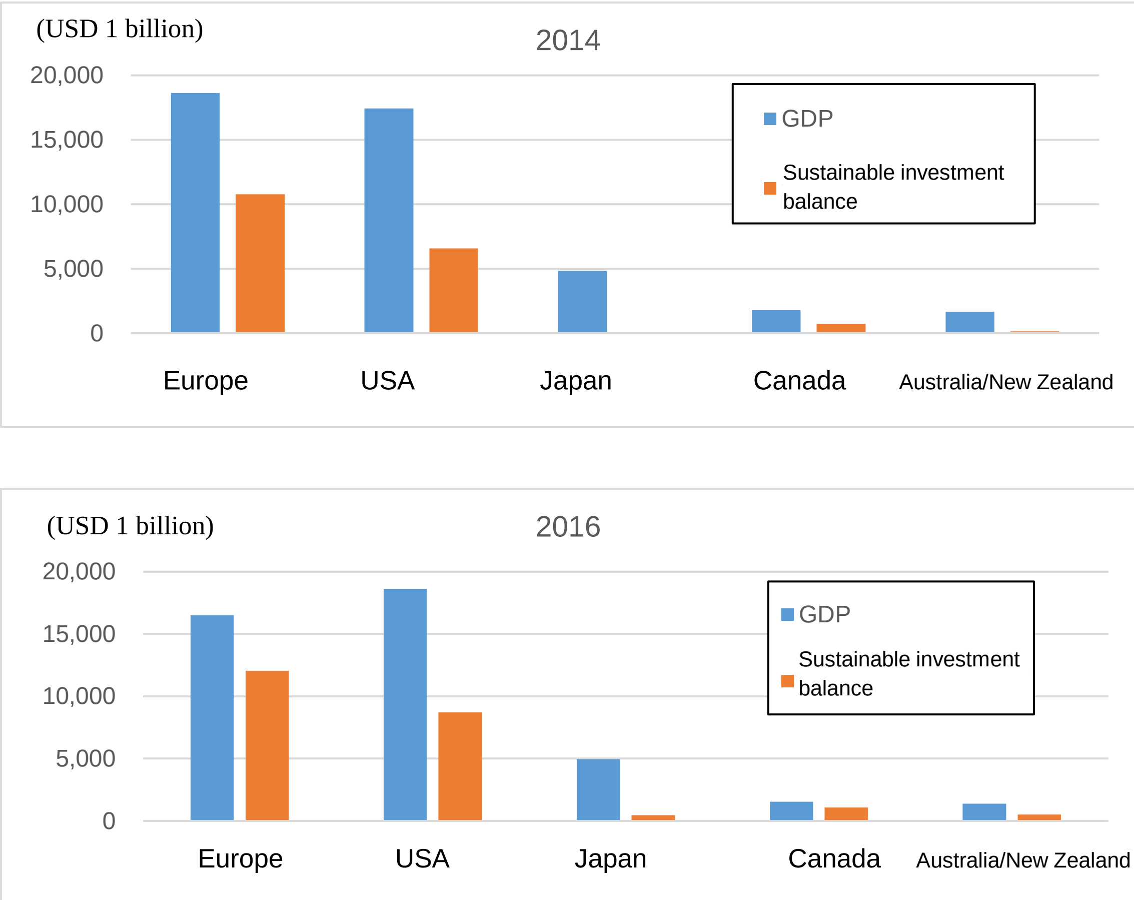
On stock markets, ESG investment is growing, whereby ESG factors are systematically incorporated into investment decisions and investment is made in corporations with an overall high ESG evaluation, or investment is made in sectors or companies with outstanding ESG performance compared to that of other companies in the same industry.

Among investment trusts, there are many trusts emerging that select and evaluate investment targets in relation to specific themes such as the environment or society.[5]

In such ways, the market in Japan for financial instruments aimed at contributing to the SDGs is expanding; but as with bonds above, the market size is still very small relative to that of the rest of the world (Figure 4).

[5]The total net assets (number of funds) of ESG-related funds for public offering and private placement combined as of November 30, 2018 was 38,179.5 billion yen (2,034 funds) (as surveyed by the Japan Investment Trusts Association).
https://www.toushin.or.jp/english/statistics/

Figure 4: Country comparison of GDP and sustainable investment[6] balance



(Source: Created by JSDA from World Bank data and 2016 Global Sustainable Investment Review (GSIA))

[6] "Sustainable investment" in Figure 4 means the investor takes into account ESG factors in portfolio selection and management (e.g., negative screening, positive screening, norms-based screening, ESG integration, sustainability-themed investing, impact investing, community investing, corporate engagement, shareholder action). http://www.gsi-alliance.org/

III. Problems and Specific Measures for Expanding Financial Instruments Contributing to the SDGs

Based on survey results and other referential materials, members of the Subcommittee studied issues and measures toward expanding the market in Japan for financial instruments contributing to the SDGs, in light of the current state of those financial instruments (see II above).

Considering the potential impact on other issues and the appeal to investors of financial instruments contributing to the SDGs, they concluded that priority should be given to studying and addressing the following issues.

- Definition of impact investment instruments, etc., and preparation of consistent guidelines (unifying the names of impact investment instruments and systematizing/clarifying the criteria)
- Provision of economic benefits and incentives (tax breaks on interest income and other gains, exemption from tax, green bond risk weight mitigation)
- Establishment of a system for assessment (ESG assessment that includes a wide range of investment instruments, standardization of items for evaluation by assessment agencies, compilation of ESG indexes)
- Expected investor behavior (promoting the formulation of investment policies such as enforcing ESG-related investment if other conditions are the same or explaining the choice of ESG investment (e.g. Comply or Explain))

In addition to the above, the Subcommittee raised the following issues toward expanding the market for financial instruments contributing to the SDGs.

- Role of sell-side analysts (provision of assessment, analysis, and information taking into account ESG factors, and developing analysts specializing in ESG investment)
- Provision of investment opportunities (diversification of instruments and sales channels)
- Preparation of statistical data
- Provision of improved, more standardized disclosure documents (creating a standard format for disclosure of ESG- and SDG-related initiatives by issuers, improving the format of securities registration statements, prospectuses, etc. (addition of sample entries))
- Awareness-raising activities aimed at officers and employees of securities firms (on-going awareness-raising for management and salespeople)
- Awareness-raising activities aimed at investors (creating readily available and easily understood materials and websites, conducting PR activities with industry and government cooperation, holding seminars)

Addressing these issues, the Subcommittee came up with the following themes 1 to 6 and studied concrete measures to resolve them.

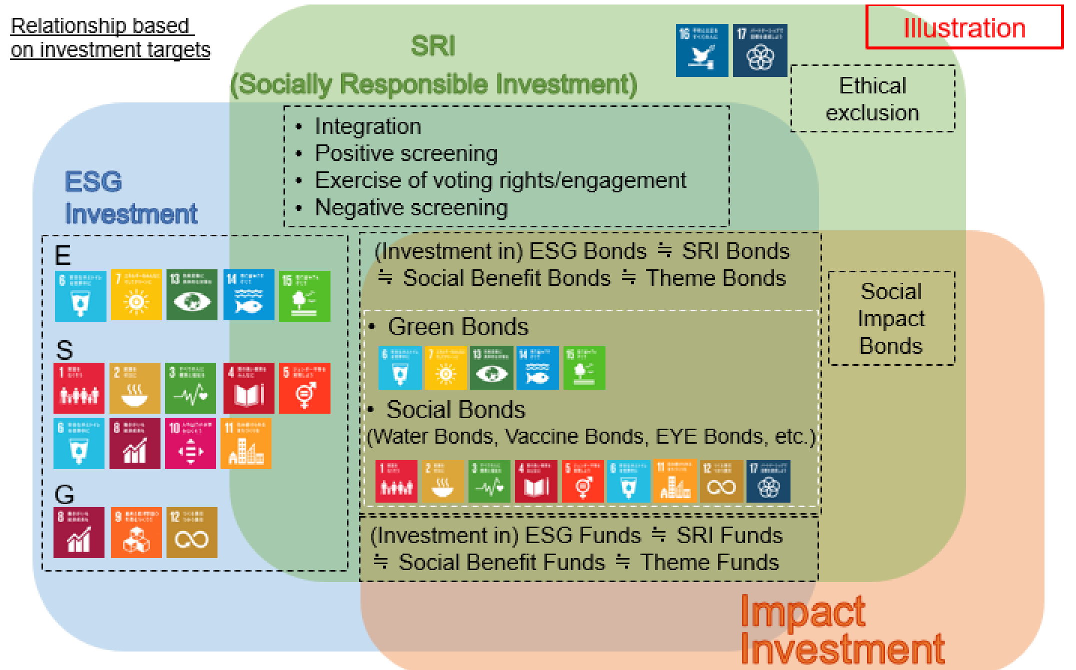
1. Uniform Nomenclature

(1) Background

The general terms given to financial instruments contributing to the SDGs, as well as their definition, vary from one securities firm to another, which may be seen as an obstacle to gaining understanding and greater awareness by the buy-side, i.e. investors (including retail investors), as well as the sell-side, i.e. sales companies (including sales representatives).

The Subcommittee therefore determined that to promote investments that contribute to the SDGs, it would be advisable to adopt standard, easily understood nomenclature; that securities firms should, from the standpoint of increasing customer ease of understanding and awareness, to the extent possible use uniform naming for their financial instruments contributing to the SDGs; and that the JSDA should take measures for making the terminology or nomenclature widely known among the public.

Figure 5: Relationship of SDGs to ESG investment and impact investment



(From material prepared for the 5th meeting of the Subcommittee)

(2) Approach to standardizing nomenclature

The Subcommittee decided to adopt as its basic approach to uniform naming that it was advisable (a) to use "SDGs" in the name, and (b) to limit the object of the name to bonds, and therefore decided that bonds contributing to the SDGs should be uniformly called "SDG bonds." for the reasons below

The specific scope of SDG bonds was considered in the SDG WG, made up of practitioners at securities firms bringing them into contact with issuers and investors.

(a) “SDG” is to be used as the standard name to achieve widespread awareness of financial instruments contributing to the SDGs.

Reasoning

- The SDGs are based on a holistic concept encompassing measures to overcome a wide range of challenges.
- Green bonds, social bonds, etc. are similar in that they contribute to any one of the SDGs.
- The unified name can be applied to future bond issuances for new types of projects.
- The unified name may help raise awareness and deepen understanding of the SDGs themselves among the officers and employees of securities firms.
- The unified name may also help raise awareness of the SDGs themselves among the customers (individuals, corporations, etc.) of securities firms.
- The objective of the Subcommittee is to contribute to the SDGs through the securities business.
- Along with raising awareness of the SDGs among the general public, this unification may encourage investment by those who have interest in the SDGs (including inexperienced investors), thereby expanding the investor and issuer base.

(b) The object of the unified name is to be limited to bonds.

Reasoning

- The use of proceeds can be made clear or limited, making it easy to specify the contribution to the SDGs.
- This can be responded to promptly through deliberations in the securities industry.

(3) The scope of SDG bonds

The SDG WG considered the scope of SDG bonds from a clerical and administrative standpoint, and <u>concluded to include in that scope bonds that, among the SDGs, have a positive impact on the environment and society, and that align with principles generally recognized as standard (hereinafter, “Principles,” for example, GBP, SBP, SBG),[7] or that are issued by institutions whose overall activities themselves are thought to contribute to the SDGs,[8] and for which information disclosure on their impacts (improvement effect) is</u>

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[7] In addition to the principles of the ICMA, there are principles formulated by national governments, regions, international organizations, etc. In Japan, the Green Bond Guidelines were announced by the Ministry of the Environment in 2017. Generally, bonds issued in accordance with these Principles are called green bonds, social bonds, or sustainability bonds, etc., depending on the Principles to which they conform.

[8] Institutions whose overall activities themselves may contribute to the SDGs are likely to be international organizations, for example, the Asian Development Bank, International Bank for Reconstruction and Development (World Bank), European Bank for Reconstruction and Development, Inter-American Development Bank, International Finance Corporation, African Development Bank, European Investment Bank, and Nordic Investment

properly[9] carried out.[10]

2. Preparation of a Guidebook on Financial Instruments Contributing to the SDGs

(1) Background

With respect to the practical response to the increase in investment that contributes to the SDGs, the ICMA has issued the GBP, SBP, and SBG; while in Japan, the Ministry of the Environment has released the Green Bond Guidelines. Provided in the Ministry of the Environment's Guidelines are specific examples of responses aimed to be consistent with the GBP, and interpretations in line with Japan-specific features; but no such guidelines have been prepared in Japan for social bonds or sustainability bonds. When securities firms underwrite these bonds, each firm makes its own underwriting decision taking into account the Principles and other guides, but the necessity of common guidelines is also under consideration.

Given this situation, the Subcommittee, after discussion the various proposals as outlined below, decided first of all to draw up material aimed at raising the awareness of officers and employees of securities firms about the financial instruments contributing to the SDGs and at gaining wider recognition of these instruments among investors (Proposal A-2).

The composition and content of this material was discussed in the SDG WG, after which the Guidebook on Financial Instruments Contributing to the SDGs was created.

Proposal A-1 Create a procedure manual for underwriting and sale by securities firms. (Examples of Content) - Matters to be confirmed with the issuer when underwriting (e.g. issuer policy, approach to conformity with the ICMA principles, obtaining second party opinions) - Matters that should be confirmed with or explained to clients (investors) (e.g. meaning and features of impact investment, intentions of the client)

Bank.

[9] A possible example is reporting that conforms to the impact reporting indicated in the Principles. It must be noted with caution, however, that there are cases where the activities of the issuing institution are considered as contributing to the SDGs, and information disclosure on the impacts is properly carried out, but the bonds are not issued in accordance with Principles.

[10] The term "SDG bonds" is used mainly in Japanese domestic markets and is not necessarily common parlance outside of Japan.

(Views of the Subcommittee members)

While there was consensus with respect to having the JSDA prepare a comprehensive set of best practices, some also suggested the need for more discussions concerning the assessment and decisions required for each securities firm.

<u>Proposal A-2</u>

Prepare educational material (knowledge required for sale, etc.) aimed at the officers and employees of securities firms engaged in underwriting and sale.

(Examples of Content)

- Matters that should be confirmed with or explained to clients (issuers and investors) (e.g. definition and features of impact investment, intentions of the client)

(Views of the Subcommittee members)

To advance matters on a practical level, members agreed that promotion in the securities industry is needed first and foremost. Many members noted that without raising the awareness and understanding of officers and employees of securities firms, it will not be possible to expect them to provide sufficient explanations of the SDGs to their clients.

<u>Proposal B</u>

In addition to the above Proposal A-1 and Proposal A-2, draw up guidelines on social bonds not just for the securities industry but for standard use by a broad range of market players.

(Examples of Content)

- Advantages to society from issuing and investing in social bonds.
- Response to each factor required by the ICMA principles (specific cases)
- Checklist for satisfying the ICMA principles

(Views of the Subcommittee members)

There was some agreement with this proposal, by members who said drawing up guidelines along the lines of the ICMA principles for social bonds, etc., which had yet to be addressed in Japan, would be especially significant, with the prospect of having an impact on issuance. Another view was that Proposal B should be undertaken in the long term, while Proposal A could be carried out in the short term.

(2) Future issues

An issue for drawing up a procedure manual for underwriting and sale (Proposal A-1), or guidelines on social bonds (Proposal B), is the lack of information as a basis for determining the matters necessary to securities firms or comprehensive best practices. At the same time, as to the former, there were views in the Subcommittee that working groups, made up of members who are close to the frontline practices, should come up with a list of issues, which could then be studied in the Subcommittee as needed. On the other hand, regarding the latter, some members noted that, "For our company, this is seen as the most important issue. More discussions are needed about the significance for growth of the market, and whether it will be effective."

In consideration of these views, the Subcommittee decided that the creation of a procedure manual for underwriting and sale, and of social bond guidelines, should be deliberated further, including determination of the problematics for preparing these.

3. Provision of Economic Benefits and Incentives, Revising Laws and Regulations

(1) Background

The lack of clear economic benefits and other incentives to issuers and investors has been raised as one of the obstacles to expanding the market for financial instruments contributing to the SDGs.

In the case of bonds, for example, while it may be possible for the issuer to reduce costs because the needs of investors for green bonds, etc. are high, additional costs are necessary for assessing the eligibility of green projects or social projects for which the proceeds are to be used and for reporting and funds management, such that ultimately there are no economic benefits offered beyond those of ordinary bonds. For investors, as well, the return on investment in green and other such bonds is seemingly unlikely to be superior to that of ordinary bonds, making it difficult to find economic benefits.

(2) Specific measures

(a) Preferential tax treatment

As a measure to help grow the market for financial instruments contributing to the SDGs, the Subcommittee proposed distributing economic benefits through preferential tax treatment for investors who acquire and hold such financial instruments (e.g. adding ESG indices to the list of possible reference indexes subject to the Dollar-Cost Averaging NISA scheme, giving tax breaks or tax exemptions for interest income, etc.).

Preferential tax treatment as a way of promoting SDG-related investment was also proposed in the FY 2019 Requests for Tax Reform, issued in September 2018 by three securities industry-related groups—namely, the JSDA, the Japan Investment Trusts

Association, and the Japanese Stock Exchanges Conference. In the discussions toward finalizing the FY 2020 Requests for Tax Reform, the groups are scheduled to conduct further deliberation into preferential tax treatment for promoting SDG-related investment.

> IV Taxation Measures for Promoting the SDGs (Sustainable Development Goals)
>
> ○ Giving favorable tax treatment for investment in financial instruments contributing to the sustainable development of society (e.g. creating a system enabling individual investors to claim special exemptions on their income tax and residential tax, and corporate investors on their corporate tax, for investments in bonds meeting certain conditions)
>
> (Excerpted from the FY 2019 Requests for Tax Reform)

Subcommittee members commented on these requests by noting that as securities firms, the focus of discussions understandably tends to be on the securities taxation system, but it might be better to consider the taxation system within the context of policies that are effective for expanding SDG-related investment as a whole, including the government's overall finances, as is the case in Denmark, which has preferential treatment for investment (not only in securities).

(b) Risk weight reduction

In Europe, it has been pointed out in recent years that changing the treatment under capital requirements regulations can provide a major incentive to institutions such as banks and insurance companies to increase their holdings in green assets.

Given this trend, the Subcommittee discussed ways of reducing the risk weights of green bonds, etc. held by institutional investors (financial institutions), as a measure for expanding the investor base.

Some Subcommittee members indicated their understanding that the risk weights correspond to the credit risk of the issuer, and pointed out that tying credit risk to the social significance of bonds contributing to the realization of the SDGs would be a rather high bar to overcome. At the same time, among the proposals was a suggestion to issue green bonds as Japanese government bonds as a way of increasing green assets in the banking sector, since other countries issue such green government bonds whereas Japan does not. Another proposal was to promote the issuance of green bonds by issuers already having low risk weights, such as those of fixed-income securities already backed by the government or municipal bonds, in addition to government bonds.[11]

Consequently, the Subcommittee noted that it will <u>carry out long-term studies regarding risk weight reduction, based on the recognition that for the spread of green and other such bonds, various discussions are necessary from an early stage from the perspective of both issuers and investors</u>.

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[11] It was also noted, however, that there are currently legal obstacles to the issuance of green government bonds.

4. Establishment of an Assessment System (ESG Assessment/Indexes)

(1) Background

An environment in which ESG assessments and impact assessments is readily accessible to investors is effective for expanding the market for financial instruments contributing to the SDGs.

In this regard, it was noted in the Subcommittee that the difficulty of understanding the assessment methods and criteria used in each credit rating agency or assessment organization, and the disparity in their assessment results, may hinder this market expansion.

One measure suggested for expanding investment in financial instruments contributing to the SDGs was to create indexes for encouraging entry into the market by passive investors.

(2) Future issues

(a) ESG assessment and rating

Regarding the disparity of ESG assessment and ratings across each agency, experts pointed to the differences among agencies in the items assessed as a factor contributing to the disparity, but also offered the view that this disparity itself leads to investment opportunities for investors, who should look carefully at the differences in assessment among agencies and examine the suitability of their own investment decisions.

Based on these opinions, and with the premise that there exists disparity in ESG assessments and ratings, Subcommittee members offered the following views regarding the establishment of an environment under which ESG assessments can be readily accessed and used by investors.

(Initiatives by securities firms)

- ✓ Securities firms <u>should provide guidance and try to achieve consistency in terminology, in order to promote accurate understanding by investors of the definitions of ESG ratings, ESG assessment, second party opinions (SPO) regarding green bonds, and ratings in general.</u>

(Initiatives in other organizations)

- ✓ It is advisable for ratings and assessment agencies to continue providing consistent explanations regarding the detailed rating symbols, details of each kind of criteria, as well as the decision-making process.
- ✓ Building up a record of ratings and assessments for a wide range of issues and projects is important to enable investors to make cross-comparisons of ratings and assessments.

(Other)

- ✓ An ESG accreditation system for issuers is necessary.

(b) ESG indexes

The Subcommittee offered the following views regarding ESG indexes, considering the methodologies and usage of current indexes, for encouraging entry of passive investors into ESG investment.

(Initiatives by securities firms and the securities industry)

- ✓ To have companies included in ESG stock indexes be highly evaluated by investors in instruments other than stocks (e.g. investors in the bond or loan markets), it would be useful for securities firms to (1) support communication of information about the companies and (2) give explanations to investors when selling.
- ✓ For the securities industry, it would be useful to organize the existing ESG indexes in a way that enables comparison.

(Other)

- ✓ Development of ESG indexes for bonds is useful for appealing to bond investors.
- ✓ If, however, too many different indexes spring up, for investors it becomes a question of which index to use. It can therefore be argued that having just one index as a sole indicator would be more appealing to investors. Which of the many indexes will serve as a benchmark, or which indexes should be used by which investor, are highly important questions that require further discussion.

(c) Information disclosure

Experts pointed out that in conducting ESG assessment and creating ESG indexes, it is necessary to disclose nonfinancial information (ESG information) about companies, but currently the disclosure of such information by issuing companies is inadequate. (See “6. Information Disclosure by Issuing Companies” below.)

5. Ideal Investor Behavior

(1) Background

As noted above, vast amounts of funds are needed to realize the SDGs, and ESG investment by institutional investors is seen as effective for encouraging the initiatives by private sector corporations aimed at solving environmental and social problems.

With this understanding, the Subcommittee expressed the following views on investor behavior.

- ✓ The ideal is for issuers and institutional investors to recognize that social finance contains value that cannot be estimated by cash, and for the acts of issuance, purchase, and brokerage to be seen as a mission of great significance for society.
- ✓ The statements of institutional investors and external directors have a major impact on management. If institutional investors engage and act in accordance with some kind

of standardized rule, their impact will be large because of what issuers must do to gain their favorable appraisal. When it comes to debt, if institutional investors are willing to purchase it, issuers are likely to consider issuing it, making the role of investors an important one.

- ✓ From the investor side as well, it was suggested that there should be a scheme to enforce the choice of ESG-related issues in principle if other conditions are the same, such as by requiring institutional investors to explain their choice in case they do not follow this principle.
- ✓ Since the intentions of the asset owner have a big impact on the behavior of the asset manager, perhaps awareness-raising activities should be aimed at asset owners.

Meanwhile, the following views were expressed regarding the role to be played by securities firms.

- ✓ The strength of securities firms is their connections to retail investors. Since other industries cannot directly appeal to retail investors, securities firms can contribute the most by urging retail investors to contribute to the SDGs through their investments.
- ✓ Retail investors appear to have good understanding of financial instruments that contribute to society, and it would seem that the younger they are, the greater their interest in ESG and the SDGs. Securities firms have strong channels to retail investors as intermediaries.

<u>It is hoped that going forward, securities firms will make even greater efforts at awareness-raising among retail investors to this end.</u>

(2) Submission of the Subcommittee views to the High Level Meeting on ESG Finance

The views of Subcommittee members on investor behavior and on the role to be played by securities firms to promote investment contributing to the SDGs were submitted as reference materials to the High Level Meeting on ESG Finance established in the Ministry of the Environment. The High Level Meeting then released its recommendations in July 2018, "Toward Becoming a Big Power in ESG Finance."[12]

[12] "Recommendation from the High Level Meeting on ESG Finance — Toward Becoming a Big Power in ESG Finance" (July 27, 2018) http://www.env.go.jp/policy/01_Recommendation(full).pdf

(i) Expansion of financial instruments taking into account ESG factors (particularly "E")

— (omitted) —

It is desirable for institutional investors to clarify policies on ESG investments; for example, investing in ESG-related issues if conditions such as yield are nearly the same. This is a natural trend with the prevailing concept of fiducial duty in the 21st century.

It is also pointed out that Millennials, who are said to be oriented toward investments with environmental and social issues in mind, should be developed to be individual, long-term investors. It is also expected that individual investors will be given opportunities for investment in high-quality financial instruments and education with awareness of ESG/SDGs.

(Excerpted from "Recommendation from the High Level Meeting on ESG Finance — Toward Becoming a Big Power in ESG Finance" <Specific Recommendations> 3. Acceleration of ESG investments in the direct finance market (2) To impact the sustainability of the environment and society)

6. Information Disclosure by Issuing Companies

(1) Background

As noted above, ESG investment by institutional investors is seen as effective for encouraging the initiatives by private sector corporations aimed at solving environmental and social problems (See "5. Ideal Investor Behavior" above.). Moreover, the disclosure of nonfinancial information about companies, which is useful for making investment decisions, is considered essential for further expanding ESG investment by investors. An environment making ESG ratings and assessments by ratings agencies and others more accessible and usable is also seen as contributing to investment decisions by investors; but experts invited to the Subcommittee pointed out that information disclosure by companies, used for the ratings and assessments, is currently inadequate. (See "4. Establishment of an Assessment System (ESG Assessment/Indexes)" above.)

Looking at global trends,[13] there are currently movements to promote information disclosure based on the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD), established by the Financial Stability Board (FSB). Companies are asked to go beyond pro forma disclosures, establishing a governance structure for effectively dealing with climate change and voluntarily disclosing the kind of business strategy they have adopted, how they manage risks and opportunities, and what kinds of metrics and

[13]The TCFD recommendations ask for disclosure of four core elements, namely, Governance (the organization's governance around climate-related risks and opportunities), Strategy (the actual and potential impacts of climate-related risks and opportunities on the organization's businesses, strategy, and financial planning), Risk Management (the processes used by the organization to identify, assess, and manage climate-related risks), and Metrics and Targets (the metrics and targets used to assess and manage relevant climate-related risks and opportunities). As of February 2019, 598 companies and organizations worldwide had expressed their acceptance of these elements. In addition to the Carbon Disclosure Project (CDP), a global framework for disclosure of environmental information about companies which asks for disclosures based on the TCFD recommendations, the United Nations Principles for Responsible Investment (UNPRI), with more than 2,000 signatory organizations, has adopted a policy obligating signatories to publish responses to TCFD questions in their annual reports starting in 2020, as there are global moves to encourage TCFD-conformant disclosures.

targets they have set.

Against this backdrop, the Subcommittee offered the following views on corporate information disclosure.

- ✓ Disclosure of nonfinancial information by Japanese companies is said to lag behind that of their Western counterparts. If, however, the rules and formats serving as the basis for ESG-related information disclosure can be prepared, a win-win relationship is likely to be established among corporations, investors, and the securities industry for the further spread of impact investment and ESG investment.
- ✓ Disclosure of companies' ESG-related initiatives using uniform criteria should enable investors and others to readily compare companies.
- ✓ It may be useful for ratings and assessment organizations to clarify to a certain extent the minimum information to be disclosed by issuers.
- ✓ It may be necessary for government agencies to support or authorize stronger ESG information disclosure in line with global trends, such as legal systems in Europe and the movements of the TCFD.

The following views were given on such matters as the role to be played by securities firms toward encouraging disclosure of nonfinancial information about companies.

- ✓ Toward greater disclosure of corporate nonfinancial information, each of the securities firms should, as part of their main business (investment banking business), advise corporate clients as to how they should link ESG to their growth strategy, as ESG for corporates is a management issue that begs redress.
- ✓ The problem today is that securities firms lack personnel with sufficient knowledge to advise corporate clients about ESG, making it necessary to develop human resources capable of substantive ESG assessment.

(2) Support for TCFD recommendations

In February 2019, the JSDA declared its support for the TCFD recommendations, taking into account the global trend toward disclosure of corporate nonfinancial information, and the importance given in Subcommittee discussions to the disclosure of ESG information by companies for encouraging investment in financial instruments contributing to the SDGs.

The JSDA will make efforts to gather information on domestic and world trends relating to the TCFD, and plans to provide information to securities firms as circumstances demand.

IV. Conclusion

This Report has summarized the results of discussions in the Subcommittee on promoting widespread issuance of and investment in financial instruments that contribute to the SDGs, so that more public-sector funds will go toward solving the social problems raised in the SDGs.

As noted earlier, the realization of the SDGs is said to require an annual investment of USD 5 to 7 trillion, including USD 3.3 to 4.5 trillion for developing economies.[14] Capital markets have an extremely large role to play in filling the gap between funding needs and available public funds, enabling the establishment of a sustainable society worldwide, including in developing economies.

The expectation for the securities industry and individual securities companies going forward is that they will exercise their role as market intermediaries, based on the thinking indicated in this Report, to promote the spread of financial instruments that contribute to the SDGs.

Moreover, as indicated also in this Report, for promoting the spread of such financial instruments, in addition to the role of the securities industry, investors and issuers have a highly important role to play. The expectation is that all stakeholders involved in capital markets will work together in promoting initiatives so that a virtuous cycle can be achieved, with companies establishing a win-win relation with investors by incorporating the SDGs in their business models, in turn leading to greater investment in SDG-related initiatives.

At the same time, among the issues for promoting the spread of financial instruments contributing to the SDGs, there are issues that could not be discussed fully in the Subcommittee so far, as well as those determined to be mid- to long-term issues in the course of discussion. In particular, among the various financial instruments contributing to the SDGs, the focus of Subcommittee discussions was predominantly on bonds, which were deemed to have a clearer impact on each of the SDGs. There is a need, however, for discussions of ways to contribute to the SDGs through the handling of financial instruments other than bonds, such as stocks and investment trusts.

Based on international trends regarding the SDGs and the environment for capital markets, the Subcommittee intends to take up the remaining issues as necessary and to study approaches to new measures.

[14]UNCTAD World Investment Report 2014
https://unctad.org/en/PublicationsLibrary/wir2014_en.pdf