

SHAPING A SUSTAINABLE FINANCIAL SYSTEM

Future-proofing global finance for a net-zero, nature-positive world

JAPAN



INTRODUCTION

Japan is the world's **3rd largest economy** and **5th largest emitter of CO₂**.



More than **95%** of Japan's **primary energy supply mix**, are imported from abroad.



Japan is the **3rd largest importer of wood products** **US\$8.8 billion** in 2019², after China and the United States.



Japan is the world's third largest economy and the fifth largest emitter of CO₂. The energy self-sufficiency is as low as 12% which is the second lowest among OECD member countries¹. While fossil fuels account for more than 85% of Japan's primary energy supply mix, over 95% of them are imported from abroad. Promotion of renewable energy usage is a key issue in terms of both sustainability and energy security.

Japan currently has the largest number of TCFD supporters (401 institutions, as of May 28, 2021) in the world and the second largest number of companies with approved science-based targets (SBTs) (following the US, 108 as of 16 June 2021).

The Japan Climate Initiative (JCI), a group of non-state actors committed to taking climate actions, was launched in 2018. JCI had 105 members when it was launched in 2018, and currently has 658 members (as of June 27, 2021). In the first few years following the Paris Agreement, climate actions were led by the private sector rather than the government.

Japan is the third largest importer of wood products (US\$8.8 billion in 2019²), after China and the United States. Although two thirds of Japan's land area is forest and the amount of forest stock is increasing year by year, the timber self-sufficiency rate remains at 37.8% in 2019, resulting in Japanese companies and investors involved in funding and importing forest risk commodities (FRC) from abroad.

Domestic forest use is one of the key issues to be prioritized from the perspective of sustainable procurement and CO₂ absorption. The landscape changed when in October 2020 Prime Minister Suga announced Japan's commitment to become carbon neutral by 2050. This created a great momentum to accelerate climate actions by stakeholders including policymakers, corporates, investors and others.

To show a pathway toward 2050, Japan then raised its Nationally Determined Contribution

(NDC) under the Paris Agreement to 46% by 2030 from its previous NDC of 26% (both compared to 2013 levels) in April 2021. With the current government's intention to put green economy as one of the top priorities, it approved the Green Growth Strategy in June 2021 to realize carbon neutrality by 2050.

This strategy focuses on 14 areas, not limited to climate change and the energy sector, but also focusing on forestry, agriculture, and biodiversity. The policy also aims to promote various finance measures, such as investment in transition and innovative technology. In this way, with the policy on climate change as a trigger, sustainable finance is expected to expand in the areas of water and forest.

Not only are these actions necessary to sustain economic competitiveness, but environmental issues, including climate change, are something that everyone is keen on. Japan is already experiencing impacts of climate change, and is vulnerable to natural disasters such as typhoons, floods, and torrential rains, which are closely related to changes in climate patterns.

In October 2019, in addition to a typhoon in September, Japan was hit by the most powerful typhoon in more than 60 years; and the economic damage³, Japan is also experiencing other types of extreme weather, including heatwaves, which put people's lives in danger.

This is a serious issue for insurance companies; insurance payment due to natural disasters has been over 1 trillion yen every year for the past decade.

1. <http://energyatlas.iea.org/>

2. Chatham House Resource Trade Database, <https://resourcetrade.earth/>

3. https://germanwatch.org/sites/default/files/Global%20Climate%20Risk%20Index%202021_1.pdf

KEY SUSTAINABLE FINANCE POLICY ACTORS

Actor	Responsibilities and actions taken
REGULATORS	
MINISTRY OF THE ENVIRONMENT (MOE)	The main regulator of environmental issues. It operates the mandatory greenhouse gas (GHG) reporting system. Entities with a total energy consumption of 1,500 kl / year or more at all business sites should report their Scope 1 and 2 emissions and cargo owners should report their Scope 3 on their transportation and distribution. MOE is now leading the introduction of the carbon pricing mechanism in Japan.
MINISTRY OF ECONOMY, TRADE AND INDUSTRY (METI)	METI is aiming to develop Japan's economy and industry by focusing on promoting economic vitality in private companies and smoothly advancing external economic relationships; and to secure a stable and efficient supply of energy and mineral resources. The Agency for Natural Resources and Energy, which is a part of METI is responsible for the energy policy. METI regulates sustainable finance issues incorporation with the Financial Services Agency (FSA) and MOE.
MINISTRY OF LAND, INFRASTRUCTURE, TRANSPORT AND TOURISM (MLIT)	MLIT is responsible for the comprehensive and systematic use, development and conservation of land, and the consistent development of social capital for that purpose. MLIT regulates water issues as well as natural disaster countermeasures.
MINISTRY OF AGRICULTURE, FOREST AND FISHERIES (MAFF) AND THE FOREST AGENCY	MAFF is developing a Strategy for Sustainable Food Systems, for agricultural, forestry, and fishery supply chains, with a 2050 timeline for implementation. Through the initiative, MAFF aims to achieve net-zero carbon emissions, a reduction in pesticide and fertilizer use, the conversion of 25% of arable land to organic production; and a number of other sustainability targets.
FINANCIAL SERVICES AGENCY (FSA)	FSA publishes the Corporate Governance Code and Stewardship Code with JPX and regulates financial disclosures. It will start discussions about mandatory disclosure of climate change information in the corporate annual mainstream financial report from this summer (2021).
JAPAN EXCHANGE GROUP (JPX)	Japan Exchange Group (JPX) operates the Tokyo Stock Exchange, the Osaka Exchange, the Tokyo Commodity Exchange, etc. From April 2022, the Tokyo Stock Exchange will introduce tighter listing criteria for the top category which will be encouraged to disclose climate change information in line with TCFD recommendations.
GOVERNMENT PENSION INVESTMENT FUND (GPIF)	GPIF is the world's largest pension fund with assets of 177.7 trillion yen (as of December 2020). GPIF became the signatory of PRI in 2015.
MINISTRY OF HEALTH, LABOUR AND WELFARE (MHLW)	MHLW regulates the pension system.
BANK OF JAPAN	The Bank of Japan is the central bank of Japan. In July 2021, the Bank of Japan published a comprehensive strategy on climate change and decided to introduce a new fund-provisioning measure which supports financial institutions.

KEY SUSTAINABLE FINANCE POLICIES AND REGULATIONS

	Policy/Regulation	Supervisory/ Enforcement	Implementing Agency	Positioning on Sustainable Finance	Year of Implementation	Addresses Climate Change?	Addresses the Safeguarding of Water Resources?	Addresses the Protection of Forests?
1	Green Growth Strategy	METI	METI in collaboration with other Ministries	<p>This is an industrial policy that outlines measures for Japan to become carbon neutral by 2050. The five policy tools are:</p> <ul style="list-style-type: none"> ▼ grant funding of 2 trillion yen from the 'Green Innovation Fund- over ten years, which is expected to stimulate 15 trillion yen of private R&D and investment; ▼ a tax incentive that is expected to stimulate 1.7 trillion yen of private investment over ten years; ▼ a guidance policy on finance with a scheme of long-term funds to attract global ESG investment; ▼ regulatory reform in areas of hydrogen, offshore wind power and mobility/batteries; and ▼ international collaboration on innovation. <p>The three growth sectors are:</p> <ul style="list-style-type: none"> ▼ energy; ▼ transport/manufacturing; and ▼ housing. 	June 2021	x	x	x
2	6th Strategic Energy Plan	METI	METI	<p>The government will terminate new international direct support for coal-fired power generation for which no emission reduction measures have been taken, by the end of 2021.</p> <p>In order to achieve carbon neutrality in 2050, the government will work to maximize the introduction of renewable energy under the highest priority as the main power source, and promote the implementation of hydrogen and CCUS. (2030 power source composition: renewable energy = 36–38%, Coal = 19% hydrogen / ammonia = 1%.)</p>	First draft was published in July 2021 and will be approved in October 2021	x	-	-
3	Climate Innovation Finance Strategy 2020	METI	METI	<p>This is a fundamental strategy for Japan to simultaneously promote 'Green', 'Transition' and 'Innovation' finance to achieve the Sustainable Development Goals (SDGs) and the goals set in the Paris Agreement.</p>	September 2020	x	-	-
4	Green Innovation Fund	METI	METI	<p>METI decided to develop a Green Innovation Fund at the level of 2 trillion yen (US\$19.2 billion) toward the goal of achieving carbon neutrality by 2050. They are determined to fund a project with an ambitious target towards 2030 in terms of CO₂ reduction effectiveness and cost effectiveness.</p> <p>The first public offering included the projects of hydrogen technology development (US\$3.4 billion).</p>	April 2021	x	R&D project of CO ₂ reduction / absorption technology for food, agriculture, forestry and fisheries is subject to this fund.	

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5	Basic Guidelines on Climate Transition Finance	METI	METI, FSA, MOE	<p>The 'Climate Transition Finance' covers the Green/Social bond, Sustainability bond and Sustainability-linked Bond/Loan which will finance entities that will ensure more ambitious initiatives with strategies to achieve long-term goals that align with the Paris Agreement.</p> <p>This guideline shows expected elements disclosed by the fundraiser in transition finance, and is not aiming to introduce taxonomy.</p>	May 2021	x	It is recommended that the fundraiser also takes into consideration the impact of business innovations to society and environment other than climate change where their transition strategy affects society and environment.	
6	Green Bond Guideline	MOE	MOE	The guideline was initially published in 2017 and revised in 2020 reflecting the development of the Green bond market in Japan. It also added the guidelines for the Green Loan and Sustainability-Linked Loan.	Revised in March 2020	x	x	x
7	Social Bond Guideline	FSA	FSA	In Japan, while the issuance of social bonds has increased significantly, most of them are the issuance by the public sector. (The total amount of the corporate bonds is 115 billion JPY (US\$1 billion) which is only 6% of the social bonds.) To facilitate the issuance by the private sector, this guideline has been developed as a practical guideline for social bonds so that practitioners can refer to it when considering specific measures regarding social bonds.	Draft was published in July 2021	x	x	x
8	Green Investment Promotion Fund	Ministry of Finance	Development Bank of Japan (DBJ)	DBJ established an 80 billion JPY (US\$730 million) fund for financing projects related to renewable energy, fuel efficient energy, battery etc., which will contribute to carbon neutrality towards 2050.	February 2021	x	-	-
9	The Bank of Japan's Strategy on Climate Change	Bank of Japan	Bank of Japan	The Bank decided to introduce a new fund-provisioning measure so that financial institutions that disclose a certain level of information on their efforts to address climate change can receive funds from the Bank against their investment or loans made as part of such efforts. It will launch the measure likely within 2021.	Published in July 2021	x	-	-
10	Strategy for Sustainable Food Systems	MAFF	MAFF	This mid-long term strategy is aiming for enhancing engagement of stakeholders at each stage of food supply chains and promoting innovation to reduce environmental load. The financial support based on this strategy will be introduced to achieve zero CO ₂ emission from fossil fuel combustion in agriculture, forestry and fisheries, sustainable sourcing for import materials, etc.	May 2021	x	x	x

Nb: This is not an exhaustive list of actors but key regulatory and policy initiatives in Japan

ANALYSIS (INCLUDING GOVERNANCE CHALLENGES) AND WAY FORWARD

GHG reduction and energy target towards achieving the Paris agreement

CDP welcomes that Japan raised its ambition to become carbon neutral by 2050 and raised its NDC to achieve this to 46% reduction by 2030. Although this was significantly improved compared to the previous climate targets, it is necessary to further raise ambition to meet its responsibility and play a role as a developed country. Being the GHG reduction target closely tied with the energy policy, the draft 6th Strategic Energy Plan would leave much to be desired.

As Japan is scarce in its own energy resources and relies on fossil fuels from other countries, there is a great potential for Japan to become a country with more renewable energy. Not having a carbon-intensive domestic mining market is an advantage. A greater portion of renewable energy in the new energy mix toward carbon

neutrality is necessary. The introduction of the carbon pricing is under discussion in MOE. It is expected that fossil fuels will be priced appropriately and that an economically rational energy supply and demand will be established.

The draft 6th Strategic Energy Plan sets a target of 36–38% from renewable energy sources by 2030. Though this target is higher than the previous target (~22–24%), it is still low compared to targets of the European countries and proactive US states. In order to contribute to achieving the Paris agreement, it is recommended to set a target of ~40–50%. In addition, it should clearly outline the plan for phasing out coal while it still promotes the so-called 'efficient' coal power plant technology such as integrated coal gasification combined cycle.

Sustainability disclosure

Though Japan has a mandatory GHG reporting system, it was implemented for the purpose of energy savings. Under the current regulation, companies should only report their domestic Scope 1 and 2 emissions but not overseas emissions, which are calculated based on the domestic methodology, and are not required to have the data verified. The system should be updated or a new platform implemented so that GHG emissions data, calculated under the global standard (GHG protocol) and assured and reported in the same boundary as financial data, can be utilized by financial institutions for their investment decision making.

CDP welcomes the revised Corporate Governance Code that mentions TCFD-aligned climate disclosure for listed companies in

the Prime Market. To be competitive at the global level and draw attention from global investors, it is necessary to meet global trends and standards. However, it is necessary to have a clear pathway toward mandatory climate disclosure as soon as possible. CDP suggests a mandatory requirement for listed companies to disclose Scope 1+2 GHG emissions to begin with.

While the requirements on corporate disclosure are enhancing, there is no regulation for financial institutions to disclose their sustainable investment-related information. All market participants, including asset owners, need to disclose their policies regarding sustainability risk and the impact of their investment on sustainability, including information on their GHG emissions in their portfolio.

Sustainable value chain

It is sometimes argued that Japanese companies and financial institutions are involved in operation or finance in the deforestation area in South-East Asia or Latin America. The Clean Wood Act went into force in 2017. As the objective of this law is not to ban the illegal timber but to promote the use and distribution of wood and wood

products made from trees harvested in compliance with the laws and regulation, it lacks the perspective of due diligence to eliminate illegal timber. Though Japan depends on much supply chains outside of the country, not only because of the deforestation issue, Japanese entities tend to be less aware of the water risks abroad.

Governance challenges

In order for Japan to take the initiative on recent rapid changes in climate issues around the world, policy implementation is necessary in a more effective way and with an internationally aligned view.

CDP suggests establishing an independent advisory body on climate change policy to provide comprehensive recommendations to

policy makers and monitor progress, with a clear mandate for the advisory body to issue recommendations and for the government to respond to any recommendations. (Research shows an independent advisory body is most effective when it has a legal mandate to make recommendations and for the government to respond to those recommendations⁴)

4. London School of Economics (2018). The role and influence of the UK's Committee on Climate Change.

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About CDP

CDP is a global non-profit that drives companies and governments to reduce their greenhouse gas emissions, safeguard water resources and protect forests. Voted number one climate research provider by investors and working with institutional investors with assets of over US\$106 trillion, we leverage investor and buyer power to motivate companies to disclose and manage their environmental impacts. Over 9,600 companies with over 50% of global market capitalization disclosed environmental data through CDP in 2020. This is in addition to the hundreds of cities, states and regions who disclosed, making CDP's platform one of the richest sources of information globally on how companies and governments are driving environmental change. CDP is a founding member of the We Mean Business Coalition.

Visit <https://cdp.net/en> or follow us @CDP to find out more.
