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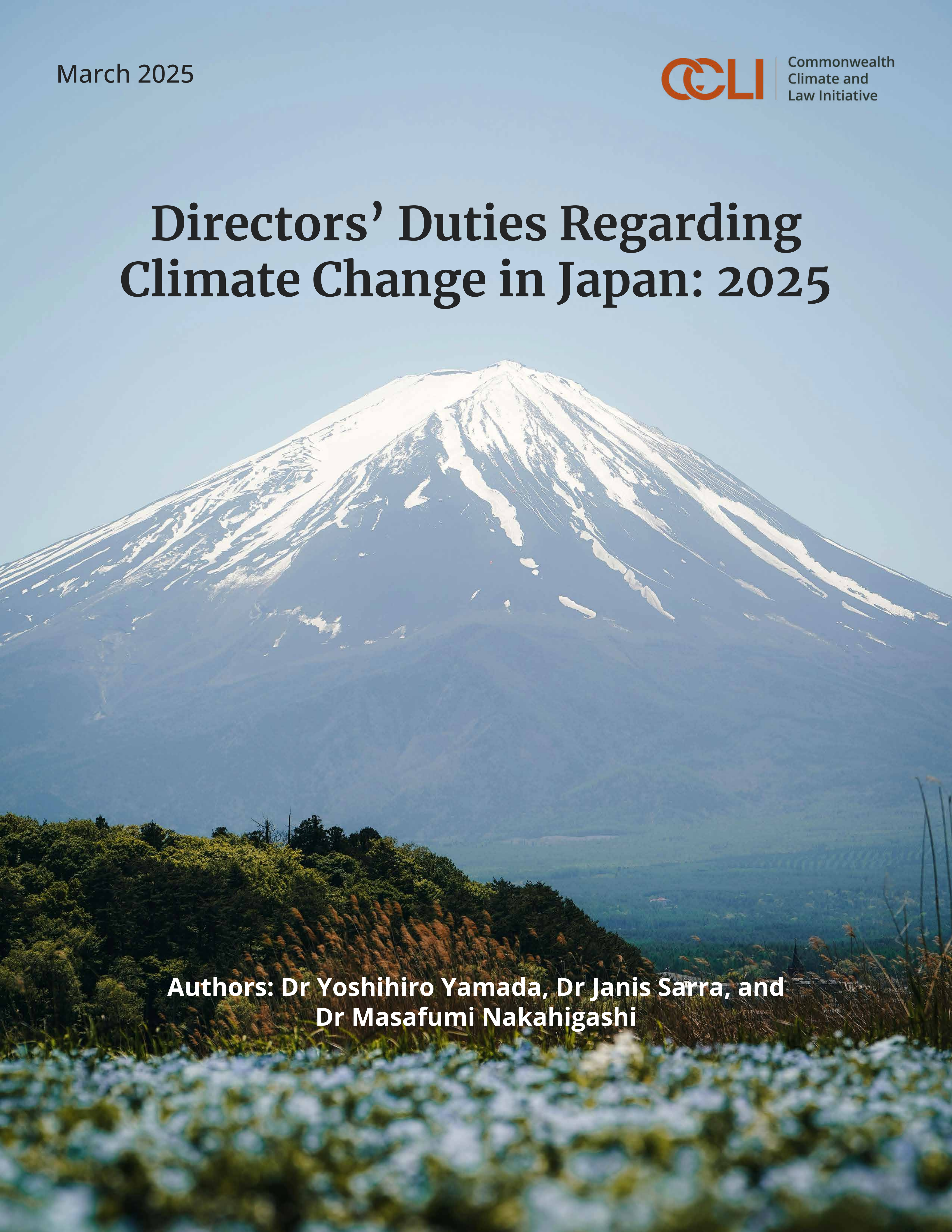
Commonwealth Climate and Law Initiative

# Directors' Duties Regarding Climate Change in Japan: 2025



**Authors: Dr Yoshihiro Yamada, Dr Janis Sarra, and Dr Masafumi Nakahigashi**

# *Directors' Duties Regarding Climate Change in Japan: 2025*

By Dr Yoshihiro Yamada, Dr Janis Sarra, and Dr Masafumi Nakahigashi
March 2025

## EXECUTIVE SUMMARY

### *Introduction*

In February 2021, the Commonwealth Climate and Law Initiative (CCLI) released *Directors' Duties Regarding Climate Change in Japan.*[1] Four years later, the urgency of the climate crisis is increasingly evident, with Japan suffering direct impacts of acute climate events, including sea-level rise, inundation into fresh water sources that are affecting food production, increased frequency and severity of typhoons, and sustained heat waves causing increasing climate-related morbidity and mortality rates. The most affected areas include Tokyo, Nagoya, Osaka, and Okayama, with more than 100 million people concentrated in coastal urban areas exposed to its worst impacts. Japan faces economic transition risks as global investors increasingly signal that they will shift capital to decarbonized sustainable investments. The Bank of Japan has reported that climate change poses a systemic risk to the Japanese financial system because asset prices could fall substantially as climate-related risks materialize, and misevaluation of climate risks can lead to the misallocation of resources with interrelated impacts on the real economy and financial system.

The Government of Japan has recognized climate change as a material financial risk affecting the sustainability of almost all Japanese companies. Corporate directors need to recognize their obligations to identify and manage climate-related risks. *Directors' Duties Regarding Climate Change in Japan: 2025* (the Report) provides up-to-date guidance regarding directors' fiduciary duties in respect of climate-related risks and opportunities. It summarizes recent scientific and financial research regarding the negative impacts of climate change on Japanese companies. It examines the most recent changes to Japanese Government policy and regulation that directors should be aware of as they fulfill their obligations to act in the best interests of the company, and offers best practice insights for directors to mitigate the risks associated with their legal duties.

### *Directors' Duties in Japan and Relevance to Climate Risk*

Directors' duties are set out in the *Companies Act of Japan*, the articles of incorporation, and the *Civil Code of Japan*. Directors in Japan have three primary duties: a duty of loyalty; a duty to be in compliance with all laws, regulations, and ordinances, and the company articles; and a duty of care. The duty of care informs both the duty of loyalty and duty to comply with laws. Directors must act as a mandatary in the best interest of the company. Since climate change is affecting almost all businesses, failure by corporate directors to meet their obligation to identify and manage climate-related risks and opportunities could result in personal liability for failure to act with due care and in the best interests of the company. In their oversight of management of climate risks, directors must meet the objective standard of what a reasonably prudent person would do in comparable circumstances.

The statutory requirement that directors of a large stock company establish a proper internal control and risk management system means that climate governance should be embedded in the board's risk management strategy. The climate risk management system adopted needs to be capable of performing the required proper controls in light of the likelihood and magnitude of climate risks to the company.

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[1] Dr Yoshihiro Yamada Dr Janis Sarra, and Dr Masafumi Nakahigashi, *Directors' Duties Regarding Climate Change in Japan* (February 2021, CCLI), Directors-Duties-Regarding-Climate-Change-in-Japan.pdf (ubc.ca).

Important to emphasize is that the board of directors as a whole retains legal responsibility for oversight of the company efforts to identify and manage climate-related financial risks and opportunities, notwithstanding any allocation of risk management or disclosure of climate-related risks to a specific board committee.

The business judgment rule, as recognized by the Supreme Court of Japan, may offer a defence to specific actions with respect to the management of climate-related risks and opportunities. However, this safe harbour is limited as Japanese courts have been clear that they will undertake a review of directors' decisions from an objective standpoint, to assess whether a director acted unreasonably at the time of the decision. If directors neglect to undertake reasonable analysis of the relevant facts, fail to get expert advice on climate-related risk management, and/or fail to exercise due care in respect of climate risks, the courts are unlikely to defer to their business judgment and could find that they have breached their duty of care.

### *Disclosure Requirements*

Japan is moving rapidly to require that companies identify, manage, and disclose climate-related risks. The Japanese Government has signalled to companies that climate change is a foreseeable material financial risk that they must address in the short, medium, and long term.

For both privately-held and publicly-held stock companies in Japan, directors have an obligation to shareholders to report material financial information in their financial statements. While the *Companies Act of Japan* is silent on climate-related risks, if information is material, arguably failure to disclose it could give rise to a complaint that directors have failed in their fiduciary duty. The directors of publicly-held stock companies in Japan have a further duty to give both periodic and continuous disclosure of material risks pursuant to securities law, filed with the local Finance Bureau pursuant to the *Financial Instruments and Exchange Act.* Moreover, Japan's *Climate Change Adaptation Act* and its *Act on Promotion of Global Warming Countermeasures*, read together, create regulatory expectations that all sectors of Japanese society make efforts to control climate change through mitigation and adaptation, although these two statutes currently impose no legal liabilities on directors for non-compliance.

New rules designed by the Financial Services Agency (FSA) in 2023 mandate the creation of a new section in the annual securities report (statutory report) – サステナビリティに関する考え方及び取組 ('sustainability policy and initiatives'). The section must describe the company's sustainability policy, measures, and initiatives using the Financial Stability Board's Taskforce on Climate-related Financial Disclosures (TCFD) four disclosure pillars. The disclosure of information about governance and risk management is required, whereas the disclosure of information about strategy and metrics and targets is required only if the information is material. Required sustainability disclosure includes matters related to the environment, society, employees, respect for human rights, anticorruption, governance, cybersecurity, and data security. The Rules became effective on 31 January 2023 and apply to securities registration statements and annual securities reports for fiscal years ending on and after 31 March 2023. Even if a company decides not to include strategy, metrics and targets after determining their importance, it is expected to disclose that decision and the reasons for it ('comply or explain'). The Rules apply to approximately 4,000 listed companies.

The *Financial Instruments and Exchange Act* and securities listing regulations published by the securities exchanges require disclosure of material risks and strategies to address them. The Ministry of Environment has advised companies to engage in TCFD-aligned scenario analysis to assess the resilience of their business in the face of global warming.

In 2024, the FSA indicated its intention to require Tokyo Stock Exchange (TSE) Prime-listed companies with a market capitalization of 3 trillion yen or more to disclose their Scope 1 and 2 greenhouse gas (GHG) emissions as early as the fiscal year ending March 2027. With the adoption of new sustainability accounting standards in March 2025, the FSA is considering how its requirements for TSE Prime-listed companies can align.

### *Sustainable Accounting Standards*

The TCFD's framework has now been absorbed into the International Financial Reporting Standards (IFRS) International Sustainability Standards Board's (ISSB) accounting standards for climate-related and sustainability-related disclosure; and Japan's long-term approach to disclosure is aligning towards IFRS S1 General Requirements for Disclosure of Sustainability-related Financial Information (IFRS S1) and IFRS S2 Climate-related Disclosures (IFRS S2). In March 2024, the Sustainability Standards Board of Japan (SSBJ) issued its Exposure Drafts of Sustainability Disclosure Standards aligned with IFRS S1 and IFRS S2. A revised proposal was made based on the opinions received on the public draft in November, and the standard was finalized in March 2025. Companies may choose to voluntarily apply the standards from that date. Based on discussions of the relevant working group of the FSA, it is expected that the standards would gradually become mandatory for all Prime-listed companies, starting from March 2027 for companies with the largest market capitalization.

The Exposure Drafts were developed under the assumption that the Sustainability Disclosure Standards issued by the SSBJ will eventually be required under Japanese securities law and regulations for companies listed on the TSE Prime Market, and could be applied to financial reporting under Japanese GAAP, US GAAP and/or IFRS. Given that the draft SSBJ standards require disclosure of Scope 1, 2, and 3 emissions, Japan's sustainability accounting standards include transitional provisions that exempt companies from applying Scope 3 emissions disclosure (disclosure along the supply chain) for the first fiscal year reporting period after the standards are adopted, with the earliest implementation date being the fiscal year ending March 2028.

### *Resources to Support Directors and Best Practice Tips*

The Report discusses a growing number of government and private sector resources that can support directors in their oversight of climate-related risks and opportunities, including guidance on scenario analysis, environmental, social and governance (ESG) disclosure, and ESG evaluation. It also offers best practice suggestions that will help directors meet regulatory requirements and market expectations. Well-counselled boards of directors will:

- Ensure climate-related risks and opportunities are integrated into board governance, strategy, and oversight responsibilities and are receiving timely consideration and focus, as well as giving climate-related issues sufficient time on the board agenda.
- Ensure climate-related issues are fully integrated into strategic planning and oversight of risk management, including financial and operational risk management, and that the board understands the relevant risks and opportunities for the company in the short, medium and long term.
- Ensure that responsibility for climate risk identification, management, and evaluation is assigned to a clearly-identified management team that reports directly to the CEO and the board, and ensure that the board has effective oversight of that management.
- Ensure that a process is on the board agenda, to develop and continue to enhance a climate transition roadmap, plan, or strategy to 2050, in accordance with best practice, with transparent net-zero or reduction targets and clear interim targets to 2030 and 2040 and

within the current rolling multi-year strategic plan; and that there is a process for annually reporting to the board on progress in meeting the targets. For corporations that already have a transition plan, the board should ensure that strategies and risk management systems are effective in meeting interim and long-term goals.

- Delegate to the appropriate committee(s) of the board the task of translating the company's long-term strategy into a structured decision-making process for each aspect that is relevant to each committee's terms of reference.
- Ensure that material climate-related issues are being disclosed in accordance with legislative and regulatory requirements, and where necessary, consult with expert advisors.
- Ensure that the board is receiving information/education to stay current on regulatory and policy developments regarding climate-related, sustainability, biodiversity, and other evolving risks and opportunities.

The Corporate Governance Code, while non-binding, offers strong normative guidance for directors to effectively manage material climate-related financial risks and opportunities in compliance with their legal duties. The Code states that publicly-listed companies should take appropriate proactive measures to address sustainability issues, including ESG matters. A stock company listed on the TSE may choose to comply with each principle of the Corporate Governance Code or explain the reasons why it is not complying. However, once the company, through its legitimate decision-making process, has chosen to comply with specified principles of the Corporate Governance Code, directors, officers, and employees must adhere to the company's decision and have no freedom to choose whether to comply or not.

### *Looking Forward*

Directors need to be highly attentive to changing regulatory requirements and market expectations regarding their duties to oversee and manage climate-related risks and opportunities. Many resources are available to support the design and implementation of transition plans.

The Report ends with a number of key issues that directors should be aware of. For example, in 2023, Japan adopted the Green Transformation (GX) Basic Policy, which lays out Japan's national decarbonization strategy to 2040. The GX will be finalized by the end of the 2024-2025 fiscal year. The GX is aimed at achieving the three goals of emissions reduction, stable energy supply, and economic growth, thereby contributing to global decarbonization. In December 2024, the Japanese Government released a draft of a new global warming countermeasure plan, containing updated interim targets of 60% reduction in GHG emissions from fiscal 2013 levels by fiscal 2035 and 73% by fiscal 2040. The Plan commits Japan to making renewable energy as the main source of power, tripling renewable energy capacity and doubling the global average annual rate of energy efficiency improvements.

Also to note is that Japan has embraced the move to a circular economy, in which there are net-zero emissions or climate positive emissions (going beyond net-zero). The Government's 'Circular Economy Vision' urges a shift to new business models with higher circularity that will support establishment of a resilient resource circulation system.

Finally, the global Taskforce on Nature-related Financial Disclosures (TNFD) has developed a set of disclosure recommendations and guidance that encourage companies to assess, report, and act on their nature-related dependencies, impacts, risks and opportunities. The ISSB has also announced that it will commence work on disclosure requirements relating to risks and opportunities associated with biodiversity, ecosystems, and ecosystem services, which in turn may be adopted by the SSBJ. These developments are relevant to directors' oversight of climate-related risks because many Japanese companies have high direct dependency on nature (estimated to be about 18% (938 billion USD) of the local stock market's capitalization), and thus management of nature-related risks are highly intertwined with climate-related risks. As of January 2025, 44 Japanese companies/organizations have adopted the TNFD recommendations.

## About the Authors

Dr Yoshihiro Yamada is Vice Dean of Law and Professor of Law, College of Law, Ritsumeikan University, Japan.

Dr Janis Sarra is Professor of Law Emerita, University of British Columbia Peter A Allard School of Law, Canada, and Principal Co-Investigator of the Canada Climate Law Initiative, and a former Director of the Commonwealth Climate and Law Initiative, Oxford UK.

Dr Masafumi Nakahigashi is Dean of Law and Professor of Law at the School of Law, Nagoya University, Japan.

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## About the Commonwealth Climate and Law Initiative

The Commonwealth Climate and Law Initiative (CCLI) is a legal research and stakeholder engagement initiative founded by Oxford University Smith School of Enterprise and the Environment, ClientEarth, and Accounting for Sustainability (A4S). The CCLI examines the legal basis for directors and trustees to manage and report on climate change and nature-related risks. Its research is at the forefront of the intersection of climate and biodiversity under existing companies and securities laws. Founded to focus on four Commonwealth countries: Australia, Canada, South Africa, and the United Kingdom, the CCLI has expanded its remit to the United States, Hong Kong, India, Singapore, Japan, the Philippines and Malaysia. The CCLI leverages the inter-disciplinary and cross-jurisdictional perspectives provided by its global experts from academia and the legal, accountancy, business, and scientific, communities.

The Canada Climate Law Initiative, the CCLI's sister organization and co-producer of this report, is a collaboration of the University of British Columbia and York University. It provides directors, trustees, and regulators with climate governance research and guidance so they can make informed decisions in the transition to a net-zero emissions economy. The Canada Climate Law Initiative is situated on the ancestral, unceded territory of the xʷməθkʷəy̓əm (Musqueam) and is committed to working in partnership with Indigenous communities.



*Cover photo of Mount Fuji, an active volcano that stands at 3,776 meters high and is visible on a clear day from Tokyo. In 2024, Mount Fuji's first snowcap did not appear until November 6, the latest ever recorded according to the Japan Meteorological Agency. The city of Fuji at its foot has lost over one month of winter days per year in the past decade due to human-caused global warming, with increasing risk of water shortages from reduced mountain snowpack.*

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## FOREWORD

I've been fortunate to call several places home, Japan among them. Being half-Japanese and having spent many years living there, I have a deep appreciation for how Japanese culture is intertwined with the natural world. This connection is reflected in traditions like *mottainai* - the philosophy of minimising waste and treasuring resources; *chisan-chisho* - the practice of local production for local consumption; and *kintsugi* - the art of repairing broken objects with gold, transforming flaws into beauty. These philosophies embody renewal, resilience and harmony with nature - values that have profoundly shaped my commitment to a career in sustainability.

Resilience is something Japan has long understood. From earthquakes to economic shocks, the country has navigated change with precision and foresight. When disasters strike, Japan doesn't just recover - it builds for the future. The climate crisis calls for the same bold, forward-looking approach.

This report on *Directors' Duties on Climate-related Risks in Japan* is not about hypothetical risks. It is about real business risks - market volatility, regulatory shifts, investor scrutiny - that are already reshaping corporate strategy. Boards that recognise and respond to these pressures will gain a competitive edge. Those that delay risk financial and reputational consequences.

Corporate governance is at the heart of this transition. Directors have a responsibility - not just to shareholders, but to employees, communities, and the long-term viability of their businesses - to integrate climate risks into strategy. This goes beyond compliance. It is about securing long-term value and ensuring that Japan's industries remain competitive in a decarbonising world. At the same time, the legal and regulatory landscape is evolving. New disclosure requirements, investor expectations, and litigation risks are emerging faster than ever. This report brings together expert analysis and the latest developments, helping directors, legal practitioners and other stakeholders navigate this shifting landscape with confidence.

According to the Asia Investor Group on Climate Change, under current policies, Japan's economy could face climate-related income losses of approximately JPY 952 trillion (USD 9.2 trillion) between now and 2050. Meanwhile, a survey found that 85% of institutional investors in Japan now use the sustainability information disclosed in annual securities report, including as an indicator to make investment decisions. As investors shift their priorities, businesses are under increasing pressure to adapt. Some of Japan's leading companies are already responding - developing innovative circular economy models, redesigning manufacturing processes to reduce resource dependency, and investing in nature-based solutions to strengthen supply chain resilience. Others risk falling behind, risking stranded assets and weakening their market position. We can take inspiration from *monozukuri* - the pursuit of excellence not only in artisanry but in innovation and adaptation. Just as Japan's industries have set new global standards in quality and innovation, today's corporate leaders have an opportunity to redefine success in a rapidly changing world.

This report is designed to help them do exactly that - by distilling the latest regulatory, legal, and market developments into practical insights that support sound decision-making and long-term business resilience. The decisions made today will determine Japan's economic resilience for the decades to come.

Natalie Shippen
*Executive Director*
*Commonwealth Climate and Law Initiative*

## Abbreviations

| | |
|---|---|
| °C | degrees Celsius |
| AZEC | Asia Zero Emissions Community |
| CBAM | Carbon Border Adjustment Mechanism, European Union |
| CCH | Climate Coordination Hub |
| CEO | chief executive officer |
| EDINET | Electronic Disclosure for Investors' Network, Japan |
| ESG | environmental, social and governance |
| EU | European Union |
| *FIEA* | *Financial Instruments and Exchange Act,* Japan |
| FMM | Financial Macro-econometric Model, Bank of Japan |
| FSA | Financial Services Agency, Japan |
| *FSAEA* | *Financial Services Agency Establishment Act,* Japan |
| FY | financial year |
| GHG | greenhouse gas |
| GPIC | Government Pension Investment Fund, Japan |
| GX | Green transformation (GX) Basic Policy, Japan |
| IAS | International Accounting Standard |
| IASB | International Accounting Standards Board |
| IFRS | International Financial Reporting Standards Board |
| IFRS S1 | IFRS S1 General Requirements for Disclosure of Sustainability-related Financial Information |
| IFRS S2 | IFRS S2 Climate-related Disclosures |
| IPCC | Intergovernmental Panel on Climate Change |
| ISSB | International Sustainability Standards Board |
| J4CE | Japan Partnership for Circular Economy |
| JPX | Japan Exchange Group |
| KPI | key performance indicators |
| METI | Ministry of Economy, Trade, and Industry, Japan |
| MOE | Ministry of Environment, Japan |
| NDC | Nationally Determined Contribution |
| NGFS | Network for Greening the Financial System |
| SASB | Sustainability Accounting Standards Board |
| SSBJ | Sustainability Standards Board of Japan |
| SX | Sustainability Transformation, Japan |
| TCFD | Taskforce on Climate-related Financial Disclosures |
| TSE | Tokyo Stock Exchange |
| UK | United Kingdom |
| UN | United Nations |
| UN PRI | United Nations Principles for Responsible Investing |
| US | United States |
| USD | United States dollars |

## 1. INTRODUCTION

Globally, climate change has been recognized as an existential threat to humanity and a serious threat to economic activity.[2] The Intergovernmental Panel on Climate Change (IPCC), comprised of more than 800 scientists representing 195 governments, has concluded that at 1°C (Celsius) above pre-industrial temperatures, which Earth is experiencing currently, we are beginning to see irreparable damage to ecosystems and business assets and operations.[3] The World Meteorological Organization reports that from January to September 2024, the global average temperature was 1.54°C above pre-industrial levels, with Japan and the world experiencing the warmest year on record.[4] At 2°C warming, there will be irreversible serious consequences for human and ecological systems.[5] There is now broad scientific consensus that global emissions must drop by 50% over the next decade for the world to have any chance of returning to below 1.5°C.[6] Thus, the goal must be net-zero emissions as soon as reasonably possible. Investors, companies, and governments are grappling with strategies to effectively address the risks of climate change and decarbonize economic activity in order to save the planet.

Japan is particularly susceptible to the physical risks of climate change, particularly sea-level rise, inundation into fresh water sources, sustained heat waves, and increased typhoon frequency and intensity.[7] It also faces economic transition risks as global investors increasingly signal that they will shift capital to decarbonized sustainable investments. Japan has started to respond to these impacts. In his first general policy speech to both Houses of the Diet in October 2020, then-Prime Minister Yoshihide Suga committed Japan to working to meet the goal of net-zero greenhouse gas (GHG) emissions by 2050.[8] He stated:

> My administration will devote itself to the greatest possible extent to bring about a green society, while focusing on a virtuous cycle of the economy and the environment as a pillar of our growth strategy. We hereby declare that by 2050 Japan will aim to reduce greenhouse gas emissions to net-zero, that is, to realize a carbon-neutral, decarbonized society. Addressing climate change is no longer a constraint on economic growth. We need to adjust our mindset to a paradigm shift that proactive climate change measures bring transformation of industrial structures as well as our economy and society, leading to dynamic economic growth.[9]

As the world's third largest economy, this announcement aligned Japan with major economies committed to building a sustainable, carbon-neutral, and resilient world.[10]

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[2] Intergovernmental Panel on Climate Change (IPCC), *Global warming of 1.5°C – An IPCC Special Report on the impacts of global warming of 1.5°C above pre-industrial levels and related global greenhouse gas emission pathways, in the context of strengthening the global response to the threat of climate change, sustainable development, and efforts to eradicate poverty,* (October 2018) IPCC <https://www.ipcc.ch/sr15/>. (hereafter IPCC, 2018).
[3] *Ibid.*
[4] World Meteorological Organization, *State of the Climate 2024 Update for COP29* (11 November 2024).
[5] IPCC, 2018, *supra* note 2.
[6] *Ibid,* European Union Technical Expert Group, 2020.
[7] Japan Government, *Synthesis Report on Observations, Projections and Impact Assessments of Climate Change, 2018 Climate Change in Japan and Its Impacts,* Ministry of the Environment Ministry of Education, Culture, Sports, Science and Technology Ministry of Agriculture, Forestry and Fisheries Ministry of Land, Infrastructure, Transport and Tourism Japan Meteorological Agency at 3, https://www.env.go.jp/earth/tekiou/pamph2018_full_Eng.pdf (hereafter Japan Government Synthesis Report).
[8] The speech in provisional English version is available at Prime Minister of Japan, 'Policy Speech by the Prime Minister to the 203rd Session of the Diet', (28 October 2020), https://japan.kantei.go.jp/99_suga/statement/202010/_00006.html.
[9] *Ibid.* See also Nikkei, 'Suga vows to meet Japan's zero-emissions goal by 2050', Nikkei Asia (26 October 2020), https://asia.nikkei.com/Politics/Suga-vows-to-meet-Japan-s-zero-emission-goal-by-2050 .
[10] United Nations Secretary General, 'Statement attributable to the Spokesperson for the Secretary-General – on Japanese Prime Minister Suga's net-zero announcement', (26 October 2020), https://www.un.org/sg/en/content/sg/statement/2020-10-26/statement-attributable-the-spokesperson-for-the-secretary-general-%E2%80%93-japanese-prime-minister-suga%E2%80%99s-net-zero-announcement.

In December 2023, former Prime Minister Fumio Kishida stated that 'the world is not yet on the pathway to 1.5 degrees. In order to make a course correction, our action until 2030 is critical. Achieving the global goal of net-zero by 2050, setting the economy-wide absolute reduction target covering all greenhouse gases and peaking global greenhouse gas emissions by 2025 are all required.'[11]

Our report, titled *Directors' Duties Regarding Climate Change in Japan: 2025* (the Report) explains in detail the responsibilities of corporate directors and officers to identify, oversee, and manage climate-related risks and opportunities. It highlights the most recent changes to Government policy and regulation, and offers guidance to directors and officers as they fulfill their obligations to act in the best interests of the company.

Part 1 sets out the context in which directors should be concerned about climate impacts, including key observations regarding the physical, financial, and transition risks that climate change poses for companies. Part 2 gives a brief overview of corporate board structure in Japan. Part 3 examines in depth directors' duties under corporate law, including the duty of loyalty, the duty to comply with statutes, regulations, and corporate articles, and the duty of care. Part 4 sets out in detail the changing regulatory framework for directors and officers in respect of disclosure of their oversight and management of climate-related risks and opportunities. Part 5 highlights a number of government and private sector resources available to support directors and some best practice tips for directors of Japanese companies. Part 6 examines the growing number of climate-related shareholder proposals as part of director engagement strategies in Japan. Part 7 concludes with some observations looking ahead.

### 1.1 Context - Climate Change as a Material Financial and Health Risk

Climate change is a systemic risk. The Bank of Japan, as Japan's primary prudential regulator, has acknowledged that climate change poses a systemic risk to the Japanese financial system.[12] It reports that asset prices could fall substantially as climate-related risks materialize, and misevaluation of climate risks can lead to the misallocation of resources.[13] The Bank states that when physical risks and transition risks materialize, the financial system is affected through both direct and indirect channels, with interrelated impacts on the real economy and financial system.[14] In 2021, the Bank launched its comprehensive Strategy on Climate Change, consistent with its mandate of achieving price stability and ensuring the stability of the financial system.[15]

In 2024, Ueda Kazuo, Governor of the Bank of Japan, observed that financial institutions must address climate-related financial risks through proper assessment and management of physical and transition risks through scenario analysis to understand both climate-related risks and opportunities and to conduct their business and risk management on that basis. He also emphasized that new investment and finance for the transition are essential in pushing ahead with decarbonization without compromising social welfare. To meet the demand for capital needed by the corporate sector, financial

[11] Prime Minister's Office of Japan, 'Statement by Prime Minister KISHDA Fumio at COP28 World Climate Action Summit' (1 December 2023), Statement by Prime Minister Kishida Fumio at COP28 World Climate Action Summit.
[12] Bank of Japan, 'Bank of Japan joins the Network for Greening the Financial System (NGFS)' (28 November 2019), https://www.boj.or.jp/en/announcements/release_2019/rel191128a.htm/. See also Kakuho Furukawa, Hibiki Ichiue and Noriyuki Shiraki, 'How Does Climate Change Interact with the Financial System?', Bank of Japan Working Paper (24 December 2020), https://www.boj.or.jp/en/research/wps_rev/wps_2020/wp20e08.htm/ (hereafter Bank of Japan working paper).
[13] Bank of Japan working paper*, ibid* at 5.
[14] *Ibid* at 9.
[15] Bank of Japan, 'The Bank of Japan's Strategy on Climate Change' (16 July 2021), https://www.boj.or.jp/en/about/release_2021/rel210716b.pdf.

institutions and investors should be able to appropriately assess the risks and returns of their investments, taking account of the effects of measures to address climate change.[16]

Globally, almost ten years ago, the Financial Stability Board's Taskforce on Climate-related Financial Disclosures (TCFD) was commissioned by the G20 Finance Ministers and Central Bank Governors out of concern for the disruptive changes due to climate change across economic sectors in the near to medium term, with implications for the global financial system in terms of avoiding financial dislocations and sudden losses in asset values.[17] The TCFD reported that the two principal types of climate-related risk, physical risks and transition risks, are inextricably linked.

### 1.2 Physical Risks

Physical risks resulting from climate change can be event driven (acute) or longer-term shifts (chronic). Acute physical risks refer to increased severity of extreme weather events, such as cyclones or hurricanes; and chronic physical risks refer to longer-term shifts in climate patterns, such as sustained higher temperatures and sea level rise.[18]

#### *i. Acute Physical Risks*

The acute physical risks are integrally related to the chronic changes to ecosystems due to global warming. An example of an acute impact was a devastating downpour in western Japan in July 2018 that forced two million people to evacuate their homes due to flooding, claiming over 200 lives.[19] In the aftermath of the event, experts agreed that the intensity of the storm was exacerbated by climate change.[20]

Increasing coastal flooding, heavy rainfall events, and storm surges are putting millions of people and valuable assets in cities at risk.[21] One study documents Japan's high exposure to asset damage due to more frequent, higher winds.[22] The World Meteorological Organization reports increases in tropical cyclones in 2024, with heavy rainfall causing inundation damage to rivers and increasing landslides.[23]

Japan is also being hit by a growing number of extreme heatwaves.[24] In 2018, Japan's temperature record was broken by a heatwave that peaked at a 41°C (106° Fahrenheit), a heat wave that the Japan

[16] UEDA Kazuo, Governor of the Bank of Japan, 'Progress and Challenges in the Asia-Pacific Financial System', Keynote Address at the 18th Asia-Pacific High-Level Meeting on Banking Supervision, (6 March 2024), Speech by Governor UEDA at the 18th Asia-Pacific High-Level Meeting on Banking Supervision (Progress and Challenges in the Asia-Pacific Financial System) : 日本銀行 Bank of Japan.
[17] TCFD, 'Final Report: Recommendations of the Task Force on Climate-related Financial Disclosures' (June 2017), at iii, https://www.fsb-tcfd.org/publications/final-recommendations-report/; Japanese translation at: https://www.fsb-tcfd.org/wp-content/uploads/2017/06/TCFD_Final_Report_Japanese.pdf (hereafter TCFD).
[18] *Ibid* at 6.
[19] The Climate Reality Project, 'How the Climate Crisis Impacts Japan', (2020), https://www.climaterealityproject.org/blog/how-climate-crisis-impacts-japan.
[20] *Ibid.*
[21] Japan Government Synthesis Report, *supra* note 7.
[22] R J Nicholls, S Hanson, C Herweijer, N Patmore, S Hallegatte, J Corfee-Morlot, J Château, and R Muir-Wood, 'Ranking port cities with high exposure and vulnerability to climate extremes. Environment working paper no 1', (2008) Paris: Organisation for Economic Co-operation and Development, http://www.oecd.org/officialdocuments/displaydocumentpdf?cote=ENV/WKP%282007%291&doclanguage=en (hereafter Nicholls *et al*) at 37.
[23] World Meteorological Organization, *State of the Climate in Asia 2023* (23 April 2024) at 8, 20.
[24] Japan Government Synthesis Report, *supra* note 7.

Meteorological Agency declared a natural disaster, hospitalizing over 30,000 people and claiming at least 80 lives.[25]

### *ii. Chronic Physical Risks*

With respect to chronic physical risks, scientists attribute a recent acceleration in global sea-level rise to global warming, resulting in more severe storms in Japan.[26] The Union of Concerned Scientists has reported that a sea-level rise of 1 metre could place 4.1 million people in Japan at risk of flooding and inundate more than 2,339 square kilometers of land in major cities.[27] The most affected areas include Tokyo, Nagoya, Osaka, and Okayama, and the highly populated south coast of Japan; with more than 100 million people concentrated in coastal urban areas, coastal population exposure is widespread.[28] The city of Osaka alone, with a population 2.5 million people, has over 200 billion USD (United States dollars) worth of assets threatened by sea-level rise.[29]

Japan's temperature is rising at a faster rate than the global average. The number of days with a maximum temperature of 30°C to 35°C or above is increasing.[30] Japan is experiencing an increasing trend in fatalities due to heat illness, and a G20 report states that under a high emissions scenario, heatwave-related excess deaths will increase by 174%, and even under a moderate warming scenario of medium emissions, the increases in heatwave-related excess mortality will be 104%.[31] The Japan Government's report on *Climate Change in Japan and its Impacts* published in 2018 (the Synthesis Report), observed that the number of cases where heat illness patients will be carried by ambulances will increase nationwide, projected to at least double in eastern and northern Japan between 2031 and 2050.[32]

Inundation of seawater into freshwater along with sustained heat may also place agricultural production of rice, a key staple of the Japanese diet, at risk.[33] The Japanese Government reported the impacts of climate change on rice yield and quality:

> Cases of white immature grain (high temperature or other damaging condition causes insufficient starch production in the grain, making it look milky white), cracked grain (high temperature causes cracks in the grain) and other degraded quality rice have already been reported throughout Japan. Some cases of reduction in yield have also been reported in specific areas or in extremely warm years.[34]

Another impact of climate change on agriculture in Japan is that high temperatures, solar radiation, and decreased precipitation in the summer are negatively affecting fruit production, including causing sunburn damage.[35] Temperature rise during the summer is also negatively affecting Shiitake mushroom

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[25] Jason Samenow, 'Japan soars to its highest temperature ever recorded: 106 degrees', *The Washington Post,* (23 July 2018), https://www.washingtonpost.com/news/capital-weather-gang/wp/2018/07/23/japan-soars-to-its-highest-temperature-ever-recorded-106-degrees/?noredirect=on.

[26] Union of Concerned Scientists, 'Climate Hot Map', https://www.climatehotmap.org/global-warming-locations/osaka-japan.html#end9#end9#end9#end9#end9#end9.

[27] *Ibid.*

[28] G20, *Climate Risk Atlas* (2022), *G20 Climate Risk Atlas* at 7.

[29] Nicholls *et al, supra* note 22.

[30] Japan Government Synthesis Report, *supra* note 7 at 3.

[31] G20, *Climate Risk Atlas, supra* note 28 at 16.

[32] Japan Government Synthesis Report, *supra* note 7 at 6.

[33] Kenji Washio, 'The Prediction of Climate Change and Rice Production in Japan' (2013) *Rice Research,* https://www.omicsonline.org/open-access/the-prediction-of-climate-change-and-rice-production-in-japan-jrr.1000e103.php?aid=23457, finding that the reproductive phase of rice is highly sensitive to high temperature, and hotter conditions lead to increasing sterility.

[34] Japan Government Synthesis Report, *supra* note 7 at 3.

[35] *Ibid* at 3.

production due to the increased generation of pathogens and decreased generation of the edible parts, requiring further research.[36] The problem of abandoned bamboo forests, primarily in western Japan, means intrusion into mixed-use forests, which will possibly cause adverse effects on local ecosystems and biodiversity.[37]

With the increase in ocean temperature caused by climate change, spawning and feeding grounds of marine organisms in offshore and coastal areas of Japan, as well as migration routes, are likely to change, causing a direct impact on their distribution.[38] In shallow waters, areas for seaweed cultivation and tidal flats may be reduced or species diversity may decline or disappear due to global warming.[39] Changing weather patterns also have indirect impacts, such as changes in natural ecosystems and impacts on fisheries, which can cause a wide variety of secondary effects on industrial and economic activities.[40]

### *iii. Impacts on Companies*

Physical risks and impacts due to climate change have financial implications for companies, such as direct damage to assets and indirect impacts from supply chain disruption.[41] Direct damage to assets leads to reduction of the value of collateral and write-downs on balance sheets, which can negatively affect annual revenues. It can increase the costs of raising capital, particularly where the company is located in areas such as coastal shorelines where the physical risks are higher. When physical risks materialize, fixed assets such as factories and equipment are damaged, leading to economic loses from irreparable assets or loss of production time, deterioration in the company's creditworthiness and ability to borrow, all of which, in turn, affect both companies' and banks' balance sheets.[42] The G20 *Climate Risk Atlas* reports that the combination of sea level rise, coastal erosion, and fiercer weather is likely to cause chaos for Japan's economy, which stands to lose around 3.72% of GDP by 2050, with €404 billion in coastal infrastructure damage by 2050 alone absent action to limit global warming.[43]

The Bank of Japan observed in 2024:

> In terms of the specific impact on economic activity, there has been an increase in constraints on it, such as supply chain disruptions caused by natural disasters in recent years. In the medium to long run, energy price fluctuations and a decrease in investment and employment in industries with significant greenhouse gas emissions may also exert downward pressure on economic activity. On the other hand, new opportunities may arise, such as an increase in investment related to renewable energy. The future impact on economic activity is thus highly uncertain. Prices and wages could be affected by both natural disasters and the various measures introduced for the transition to a carbon-neutral society.
>
> Climate change, through the channels of "physical risk" and "transition risk", can also impact the financial system. Physical risk refers to the risk that physical phenomena triggered by climate change, such as large-scale disasters and rising sea levels, will have a negative impact on firms and households. Transition risk refers to the risk of an economic impact on firms and households due to changes in policies, technologies, or consumer preferences associated with the transition to a carbon-neutral society. Depending on the response, both risks could adversely affect the

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[36] *Ibid*.
[37] *Ibid* at 4.
[38] *Ibid*.
[39] *Ibid*.
[40] *Ibid.*
[41] TCFD, *supra* note 17 at 6.
[42] Bank of Japan working paper, *supra* note 12 at 10.
[43] G20, *Climate Risk Atlas, supra* note 28 at 10.

financial system by changing the investment or lending behavior of financial institutions, both qualitatively and quantitatively.[44]

Both acute and chronic physical effects can also negatively affect the cost and availability of insurance.[45] One report in January 2025 found that Japan's bill for climate change-related damages in the decade through 2023 was 90.8 billion USD.[46] Companies' financial performance may also be affected by changes in the availability, sourcing, and quality of certain inputs, such as water. Extreme temperature changes can negatively affect organizations' premises, operations, transport needs, and employee safety. When companies have inadequate information about the physical risks that climate change poses, there is risk that they have mispriced assets and misallocated capital.[47]

In summary, unabated climate change will continue to have a negative impact on short-, medium-, and long-term economic performance.

### 1.3 Transition Risks

Japan is also vulnerable to transition risks. In its trade relationships with foreign nations and investments in other countries, businesses in Japan are dealing with different legal regimes and standards for reporting on climate change or meeting Scope 1, 2, and 3 emissions reductions targets. Policy uncertainty in some jurisdictions and liability risk for investee companies in countries like the United States (US) are also becoming evident. The time horizons for climate-related risk are not only manifested over the long term; climate change is disrupting businesses today. Thus, oversight and management of climate-related risks must become embedded in governance processes for risk management, strategic planning, and financial reporting in the short, medium, and long term. Within transition risks are numerous types of financial risks, including market risks, legal and policy risks, technology risks, and reputational risks.

#### *i. Market Risks*

Market risks include direct impacts on supply and demand for different products, services, and commodities, with investors and consumers increasingly taking account of climate-related risks and opportunities in their investment and purchase decisions.[48] For example, institutional investors have signalled concerns about the financial materiality of climate risks and are shifting their investment priorities; hence, there is risk of investors moving away from Japan as a market unless investee companies demonstrate that they are effectively managing climate risk.

Companies' failures to act to address market pressure to engage in climate mitigation and adaptation strategies are likely to reduce their access to capital and increase its cost. The chief executive officer (CEO) of the world's biggest institutional asset manager BlackRock, Larry Fink, sent a letter in 2020 addressed to all its investee companies, including a number of Japanese companies, warning that climate change is a financial risk that could shake the stability of economic growth and the financial system, and asking companies for disclosure based on the Sustainability Accounting Standards Board (SASB) standards and the TCFD recommendations, stressing that companies need effective disclosure so that investors can ascertain whether they are properly managing sustainability risks and

[44] Bank of Japan, 'Bank of Japan Climate Change Initiatives: Disclosure Based on TCFD Recommendations' (29 May 2024), at 3-4, "Bank of Japan Climate Change Initiatives: Disclosure Based on TCFD Recommendations".
[45] Anton Delgado, 'Disaster-hardened Japan faces enormous costs from climate change' *Japan Times* (12 January 2025), Disaster-hardened Japan faces enormous costs from climate change - The Japan Times.
[46] *Ibid.*
[47] TCFD, *supra* note 17 at 1.
[48] *Ibid* at 6.

opportunities.[49] This message was reflected again in Larry Fink's 2021 and 2022 CEO letters, which asked companies to set short-, medium- and long-term targets for GHG emission reductions.[50] A study by Choi, Gao, and Jiang found that financial institutions around the world have reduced their exposure to stocks of high-emission industries since 2015, and firms in such sectors have experienced lower price-to-earnings and price-to-book ratios, which make financing costlier.[51]

Also in 2020, Hiromichi Mizuno, then Executive Managing Director and Chief Investment Officer of Japan's 151 trillion yen (1.4 trillion USD) assets Government Pension Investment Fund (GPIF) issued a letter, signed also by two other global asset managers, pointing out that climate change alone has the potential to destroy 69 trillion USD in global economic wealth by 2100 and calling on companies to develop sustainable long-term strategies to address climate-related risks.[52] GPIF has stated that it is:

> committed to fulfilling our fiduciary duty to secure adequate retirement funds for both current and future beneficiaries. We believe that improving the governance of the companies that we invest in while minimizing negative environmental and social externalities – that is, ESG (environment, social and governance) integration – is vital in ensuring the profitability of the portfolio over the long term.[53]

In 2023, in analyzing its portfolio exposures, GPIF observed that investee 'companies that set Scope 3 targets may demonstrate a broader climate risk awareness and strategy than peers that do not, potentially indicating greater preparedness to manage transitional risks tied to their products and supply chains.'[54]

### *ii. Policy and Legal Risks*

Policy risks can include government policy measures aimed at constraining company actions that contribute to the adverse effects of climate change and policy aimed at promoting mitigation and adaptation. Examples include implementing carbon-pricing mechanisms to reduce GHG emissions, shifting energy use toward lower-emission sources, adopting energy-efficiency measures, and encouraging greater water efficiency and sustainable land-use practices.[55] For example, a carbon tax introduced to reduce GHG emissions may result in the market value of fossil fuels such as oil and coal dropping substantially, leaving companies with stranded assets that are no longer able to earn an economic return, in turn, negatively affecting the balance sheet.[56]

There are increasing expectations by Japanese regulators that companies will address climate-related financial risks. Japan's Ministry of the Environment (MOE) Climate Change Policy Division has reported that climate-related risks can result from reassessment of the value of a large range of GHG intensive

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[49] Larry Fink, BlackRock, 'A Fundamental Reshaping of Finance', Letter to CEOs, (January 2020), https://www.blackrock.com/corporate/investor-relations/larry-fink-ceo-letter.
[50] Larry Fink, BlackRock, 'Larry Fink's 2021 letter to CEOs' (2021), https://www.blackrock.com/corporate/investor-relations/2021-larry-fink-ceo-letter; Larry Fink, BlackRock, 'The Power of Capitalism', Letter to CEOs, (2022), https://www.blackrock.com/corporate/investor-relations/larry-fink-ceo-letter.
[51] Darwin Choi, Zhenyu Gao, Wenxi Jiang, 'Global Carbon Divestment and Firms' Actions' (29 May 2020), SSRN 358995, at 9, 13, 14, https://papers.ssrn.com/sol3/papers.cfm?abstract_id=3589952.
[52] Hiro Mizuno *et al,* 'Our Partnership for Sustainable Capital Markets' (March 2020), https://www.gpif.go.jp/en/investment/Our_Partnership_for_Sustainable_Capital_Markets.pdf (hereafter Mizuno *et al*). See also the discussion of GPIF in Appendix I.
[53] Government Pension Investment Fund, 'For All Generations, ESG Report 2019', at 2, https://www.gpif.go.jp/en/investment/GPIF_ESGREPORT_FY2019.pdf.
[54] GPIF and MSCI ESG Research LLC, '2023 Analysis of Climate Change Related Risks in the GPIF's Portfolios', (July 2023) at 11, 2023 Analysis of Climate Change-Related Risks in the GPIF's Portfolios.
[55] TCFD, *supra* note 17 at 5.
[56] Bank of Japan working paper, *supra* note 12 at 10.

assets during the process of adjustment towards a lower carbon economy.[57] Its recent guidance on scenario analysis is discussed in Part 5.1.

Japan's Financial Services Agency (FSA) reports a major shift in the way Japan is addressing 'the challenge of the climate emergency'.[58] These policy shifts have encouraged a substantial increase in the number of Japanese firms committed to reporting their approach to climate change using the TCFD recommendations.[59] The Japan TCFD Consortium reports that as of November 2023, 1488 companies and financial institutions had embraced the TCFD disclosure framework,[60] and that as of August 2024, 1,230 Japanese companies have established or committed to establishing GHG emission reduction targets under the science-based targets initiative.[61] After the TCFD wound up its activities in 2023 in support of the work of the International Sustainability Standards Board (ISSB), ISSB's IFRS S1 General Requirements for Disclosure of Sustainability-related Financial Information (IFRS S1) and IFRS S2 Climate-related Disclosures (IFRS S2) standards, in effect in 2024, meet and enhance the TCFD recommendations, and companies are beginning to use the ISSB Standards.[62] The changing disclosure requirements for Japanese companies are discussed in Part 4.

Another example of regulatory policy relevant to Japanese companies is Japan's *Climate Change Adaptation Act,* enacted in 2018.[63] It is aimed at promoting climate change adaptation through establishing necessary measures such as formulating plans for adaptation to global warming and providing information on climate change impacts in order to contribute to the health and cultural life of the Japanese people, both now and in the future. Article 3 requires the national Government to promote the enhancement of scientific knowledge on climate change, its impacts and adaptation, and to use this knowledge to comprehensively establish and promote policies for climate change adaptation.[64] The *Climate Change Adaptation Act* specifies that businesses must endeavor to adapt to climate change in accordance with the content of their business activities, and in cooperation with national and local Governmental programs for climate change adaptation.[65]

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[57] The Ministry of the Environment, Government of Japan Climate Change Policy Division, *Practical Guide for Scenario Analysis in line with the TCFD recommendations,* 2nd edition (March 2020), at 1-5, http://www.env.go.jp/policy/policy/tcfd/TCFDguide_2nd_EN.pdf; Japanese version: TCFD を活用した経営戦略立案のススメ ～気候関連リスク・機会を織り込むシナリオ分析実践ガイド～, 気候関連リスク・機会を織り込むシナリオ分析実践ガイド_0318v2 (env.go.jp) (hereafter *Practical Guide for Scenario Analysis*). See also "Report by the Working Group on Financial Institutions' Efforts towards Decarbonization of the Economy Recommendation (Guide) on financial institutions' works toward Net-zero" (27 June 2023).

[58] The Japan Financial Services Agency is the financial regulation oversight agency, 'responsible for ensuring stability of Japan's financial system, protection of depositors, insurance policyholders and securities investors, and smooth finance through such measures as planning and policymaking concerning the financial system, inspection and supervision of private sector financial institutions, and surveillance'; Japan Financial Services Agency, 'The Role of the FSA' (2020), https://www.fsa.go.jp/en/about/pamphlet_e.pdf (hereafter FSA). Satoshi Ikeda, Chief Sustainability Officer, Financial Services Agency, Japan, 'Why Japan is leading the TCFD wave', Commentary, London School of Economics Grantham Research Institute, (March 2020), https://www.lse.ac.uk/granthaminstitute/news/why-japan-is-leading-the-tcfd-wave/.

[59] FSA *ibid*.

[60] TCFD Consortium, 'About TCFD', (25 November 2024) https://tcfd-consortium.jp/en/about.

[61] TCFD Consortium, 'Transition Plan Guidebook' (September 2024), Transition_Plan_Guidebook_e.pdf. See also IMF, Japan: Financial Sector Assessment Program-Technical Note on Financial Supervision and Regulation of Climate Related Issues (13 May 2024), https://www.imf.org/en/Publications/CR/Issues/2024/05/10/Japan-Financial-Sector-Assessment-Program-Technical-Note-on-Financial-Supervision-and-548825.

[62] IFRS Foundation, 'ISSB and TCFD', https://www.ifrs.org/sustainability/tcfd/.

[63] *Climate Change Adaptation Act,* Act No 50 of June 13, 2018, 気候変動適応法 平成 30 年 6 月 13 日法律第 50 号, at article 1, English translation, https://www.japaneselawtranslation.go.jp/ja/laws/view/3212. Please note, for translation of Japanese laws generally, see the website of Japanese Law Translation - http://www.japaneselawtranslation.go.jp/?re=01>. See also Bank of Japan, 'Climate Change Initiatives: Disclosure Based on TCFD Recommendations' (29 May 2024), tcfd24.pdf (boj.or.jp).

[64] *Climate Change Adaptation Act, ibid,* articles 3(1), (2). Article 4 directs local governments to endeavour take measures for climate change adaptation in accordance with natural, economic, and social factors in their region.

[65] *Climate Change Adaptation Act, ibid*, Article 5.

‘Climate change impact’, as defined in the *Climate Change Adaptation Act,* means impact by climate change that negatively affects human health and the living environment, causes a decline in biodiversity, and impacts daily life, society, economy, and the natural environment.[66] ‘Climate change adaptation’ means ‘reacting to the climate change impact so as to prevent or reduce damage, and to contribute to a stable living environment, sound development of a society and economy, and to preserve the natural environment.’[67]

While the term ‘mitigation’ and references to GHG are not mentioned in the *Climate Change Adaptation Act,* article 1 makes reference to article 2(1) of the 1998 *Act on Promotion of Global Warming Countermeasures* (*Countermeasures Act).*[68] That article expressly refers to global warming affecting the planet as a whole, and the increasing concentration of GHG in the atmosphere as a result of human activity. Article 2(2) of the *Countermeasures Act* discusses ‘global warming countermeasures’ to control GHG emissions and to maintain and improve the absorption of GHG, as well as other measures to take in international cooperation for the prevention of global warming. The two statutes read together clearly indicate that adaptation measures include measures to reduce emissions, referred to as ‘mitigation’ internationally.

One challenge in respect of enforcing the goals of the *Climate Change Adaptation Act* is that the direction to businesses is not expressly enforceable; the *Act* does not, by itself, provide a legal basis for directors’ duties in respect of climate change. However, the *Climate Change Adaptation Act* and *Countermeasures Act,* read together, create regulatory expectations that all sectors of Japanese society must make efforts to control climate change through mitigation and adaptation.

The purpose of the *Countermeasures Act* is to promote global warming countermeasures by formulating a plan to achieve targets under the Kyoto Protocol and taking measures to promote the control of GHG emissions due to social, economic, and other activities.[69] It requires the national Government to implement comprehensive and systematic global warming countermeasures to reduce GHG emissions; and to provide technical advice and promote activities by businesses, local governments, and citizens.[70] The Government was required to establish a National Government Action Plan to set targets for reduction of GHG emissions and to report annually on progress.[71] In 2016, the Japanese Government established its ‘Plan for Global Warming Countermeasures’ by Cabinet Decision,[72] with review every five years. A fully revised version was created in 2021.[73] The National Action Plan commits to Japan reducing its GHG emissions by 46% by 2030, continuing strenuous efforts in its challenge to cut its emissions by 50%.[74]

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[66] *Climate Change Adaptation Act, ibid,* Article 2(1).
[67] *Climate Change Adaptation Act, ibid,* Article 2(2).
[68] *Act on Promotion of Global Warming Countermeasures*, Act No 117 of October 9, 1998 ,as amended, **地球温暖化対策の推進に関する法律平成 10 年法律第 117 号**, Article 2(1); English translation can be found at https://www.japaneselawtranslation.go.jp/ja/laws/view/4479. Article 1 states: In recognition of the serious impact of global warming on the environment of the entire planet, and the importance of efforts on the part of all humankind to actively and voluntarily address the universal issue of stabilizing greenhouse gas concentrations in the atmosphere at levels where human interference does not pose a danger to climate systems, the purpose of this Law is to promote global warming countermeasures by formulating a plan for attaining targets under the Kyoto Protocol and taking measures to promote the control of greenhouse gas emissions due to social, economic, and other activities, thereby contributing to the health and cultural life of the Japanese people, both now and in the future, as well as contributing to the wellbeing of all humankind.
[69] *Act on Promotion of Global Warming Countermeasures, ibid,* Article 1.
[70] *Act on Promotion of Global Warming Countermeasures, ibid,* Article 3.
[71] *Act on Promotion of Global Warming Countermeasures, ibid,* Articles 20-21.
[72] 平成 28 年 5 月 13 日閣議決定「地球温暖化対策計画」[the Cabinet Decision (13 May 2016), ‘Plan for Global Warming Countermeasures ’, https://www.env.go.jp/content/900447150.pdf (text in Japanese).
[73] 令和 3 年 10 月 22 日閣議決定「地球温暖化対策計画」[the Cabinet Decision (22 of December 2021), ‘Plan for Global Warming Countermeasures ’ ]. Provisional English Translation can be viewed at https://www.env.go.jp/content/000249336.pdf.
[74] Together for Action: Japan’s Initiatives for Achieving the Common Goal of Net Zero by 2050 (1 December 2023), https://www.japan.go.jp/kizuna/_userdata/pdf/2024/spring2024/together_for_action_japan_initiatives.pdf.

On 24 December 2024, the Japanese Government released a draft of a new global warming countermeasure plan.[75] The proposed new targets for reducing GHG emissions are set at 60% reduction from fiscal 2013 levels by fiscal 2035, and 73% by fiscal 2040. The plan commits Japan to making renewable energy the main source of power, tripling renewable energy capacity and doubling the global average annual rate of energy efficiency improvements. The Government aims to achieve net-zero emissions by 2050 under its Nationally Determined Contribution (NDC).[76]

In 2023, Japan enacted the *GX Promotion Act*[77] and adopted the Green Transformation (GX) Basic Policy, which lays out Japan's decarbonization strategy.[78] In May 2024, then-Prime Minister Fumio Kishida announced the development of a new national strategy that includes a path for decarbonization and industrial policy toward 2040, the 'GX 2040 Vision'. The GX will be finalized by the end of the 2024-2025 fiscal year.[79] The GX is aimed at achieving the three goals of emissions reduction, stable energy supply, and economic growth, thereby contributing to global decarbonization.[80] Japan is working with countries under the framework of the Asia Zero Emissions Community (AZEC). The Government expects that the GX will require 150 trillion yen (1 trillion USD) of public-private investment. Japan will issue 20 trillion yen (137.5 billion USD) of GX Economy Transition Bonds to finance these investments.[81] The first 1.6 trillion yen (11 billion USD) of GX Economy Transition Bonds were issued in February 2024, aimed at the three goals of emission reduction, stable energy supply, and economic growth.[82]

With respect to carbon pricing, Japan introduced a carbon pricing mechanism, the Tax for Climate Change Mitigation on fossil fuels, in 2012. The current rate is 289 yen per ton of $CO_2$.[83] In April 2023, Japan launched a carbon pricing scheme consisting of emissions trading and a carbon levy. The emissions trading system operates currently on a voluntary basis, and will start full-scale operation from

[75] 環境省地球環境局総務課脱炭素社会移行推進室「「地球温暖化対策計画（案）」に対する意見募集について」（E-GOV パブリックコメント）[Carbon-Free Society Transition Promotion Office at General Affairs Division in Global Environment Bureau of the Ministry of the Environment, "Request for opinions on the 'Global Warming Countermeasures Plan (draft)'" (E-GOV public comment)], https://public-comment.e-gov.go.jp/pcm/detail?CLASSNAME=PCMMSTDETAIL&id=195240104&Mode=0. 2024/12/25 Nihon Keizai Shimbun Morning Edition article, at 5: 「温暖化ガス、４０年度７３％減　新目標、家庭８割／産業６割減　省エネや行動変容必須」 'Greenhouse gas emissions to be reduced by 73% in FY2040; new target: 80% reduction in households and 60% reduction in industry; energy conservation and behavioral change essential.' [text in Japanese]. The Cabinet previously approved (in 2021) the Climate Change Adaptation Plan, based on the *Climate Change Adaptation Act*, which describes measures to be taken for climate change adaptation, including science-based goals, target periods, strategy, and the management and evaluation of the progress, including specific sector-based guidance.
[76] Statement by Prime Minister KISHDA Fumio at COP28, *supra* note 11.
[77] Japan *GX Promotion Act.* Full title in English is *Act on Promotion of Smooth Transition to a Decarbonized Growth-Oriented Economic Structure* (Act No. 114 of 2023, as amended), 脱炭素成長型経済構造への円滑な移行の推進に関する法律 Act No 32 May 19, 2023（令和 5 年 5 月 19 日法律第 32 号.
[78] Japan *GX Promotion Act, ibid.* See, Kenji Miyagawa, Takashi Fujiki and Mai Kurano, 'Enactment of GX Promotion Act and its Impact on Corporate Decarbonization' (July 2023) https://www.amt-law.com/asset/pdf/bulletins12_pdf/230703.pdf. Ministry of Economy, Trade, and Industry, 'Cabinet Decision on the Basic Policy for the Realization of GX', (10 February 2023), https://www.meti.go.jp/english/press/2023/0210_003.html. Related Material: Outline of the Basic Policy for the Realization of GX (Green Transformation), https://www.meti.go.jp/english/press/2023/pdf/0210_003b.pdf.
[79] Reuters, 'Japan to craft 2040 strategy of decarbonisation and industrial policy', (14 May 2024), https://www.reuters.com/sustainability/climate-energy/japan-craft-2040-strategy-decarbonisation-industrial-policy-2024-05-13/.
[80] Statement by Prime Minister KISHDA Fumio at COP28, *supra* note 11. Ministry of Finance, 'Japan Climate Transition Bond Framework' (November 2023), https://www.mof.go.jp/english/policy/jgbs/topics/JapanClimateTransitionBonds/climate_transition_bond_framework_eng.pdf. See, *Act on Special Accounts*, Article 85 paragraph 3,特別会計に関する法律（平成 19 年法律第 23 号）Act No 23 of 2007. The budget related to GX, including the management of the funds raised through these bonds, are categorized Energy Supply and Demand Account in the Special Account for Energy Measures, separate from other accounts of Japan's National Budget.
[81] Ministry of Finance, 'Japan Climate Transition Bond Framework' (November 2023), https://www.mof.go.jp/english/policy/jgbs/topics/JapanClimateTransitionBonds/climate_transition_bond_framework_eng.pdf.
[82] *Ibid.*
[83] J Schmittmann, 'The Financial Impact of Carbon Taxation on Corporates - Japan' (International Monetary Fund, SIP/2023/034, May 2023).

the 2026/2027 fiscal year. Participants in the scheme must pledge and disclose their GHG reduction targets. Where the target is not met, participants will trade emissions through the market. Auctions for emission allowances in the power generation sector are expected to begin around 2033/34. A carbon levy will be introduced from 2028/2029 based on the amount of emissions generated by each fossil fuel and its importance in terms of carbon emissions.[84] The TSE started trading carbon credits in October 2023.[85]

There are also extensive policies adopted under securities law and financial services law, and the requirements for directors and officers are discussed in Parts 3 and 4 of this Report. In brief, under securities law, in January 2023 the FSA announced new rules that require all listed companies to disclose sustainability information—including climate-related information—in four categories generally aligned with the TCFD recommendations. The Bank of Japan is requiring financial institutions to make disclosures on results and targets on green loans and investments, which in turn affects the ability of companies in all sectors of the Japanese economy to access capital. The FSA also revised Japan's Stewardship Code regarding the responsibilities of institutional investors, discussed in Appendix 1.[86] All of these Government policies reveal that there are risks to Japanese directors that fail to read regulatory signals in respect of the need to manage climate-related financial risks and fail to disclose the effectiveness of measures taken.

Another important legal risk is litigation risk. Globally, there has been a huge increase in the number of climate-related lawsuits, which include claims by investors in respect of alleged breaches of directors' duties, securities law claims regarding the failure of companies to disclose material climate-related risks and financial impacts, and lawsuits commenced by regional and local governments and public interest organizations against companies that are major GHG emitters.[87] A study published in November 2024 evidenced that following a climate-related filing or unfavourable court decision, firms on average experienced a 0.41% fall in stock returns, with cases against carbon majors suffering reductions by 0.57% and 1.5% following filings and unfavourable decisions respectively.[88] As companies and financial institutions experience more financial losses due to climate change, the risk of litigation regarding directors' failure to act is likely to increase.

### *iii. Technology Risks*

Technologies are rapidly developing to respond to the risks created by climate change, aimed at shifting businesses and economies to more sustainable and climate-friendly economic activities. Disruptive technologies can pose either risks or opportunities for Japanese companies. As the TCFD observed, to the extent that new technology displaces old systems and disrupts some parts of the existing economic system, winners and losers will emerge from this 'creative destruction' that is inevitable, even though the exact timing is still uncertain.[89]

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[84] J Ishikawa, 'Equilibrium carbon price for future carbon pricing in Japan' (Nomura Research Institute, Iakyara vol38 5, 15 May 2024); Y Obayashi, K Golubkova, 'Explainer: Japan's carbon pricing scheme being launched in April', *Reuters*, (31 March 2023), https://www.reuters.com/markets/carbon/japans-carbon-pricing-scheme-being-launched-april-2023-03-30/.

[85] Japan Exchange Group, 'Outline of Specifications for the Carbon Credit Market' (9 June 2023), https://www.jpx.co.jp/english/equities/carbon-credit/overview/uorii5000000103s-att/Specifications_Eng.pdf.

[86] Financial Services Agency, 'Finalization of Japan's Stewardship Code (Second revised version)' (24 March 2020), https://www.fsa.go.jp/en/refer/councils/stewardship/20200324.html.

[87] Janis Sarra, *From Ideas to Action, Governance Paths to Net Zero* (2020, Oxford University Press), chapter 7 (hereafter Sarra, *Governance Paths to Net Zero)*.

[88] Misato Sata *et al,* 'Impacts of climate litigation on firm value', *Nature* (November 2024), https://www.nature.com/articles/s41893-024-01455-y . See also Grantham Research Institute, 'Global trends in climate change litigation: 2024 snapshot', (27 June 2024), https://www.lse.ac.uk/granthaminstitute/publication/global-trends-in-climate-change-litigation-2024-snapshot/.

[89] TCFD, *supra* note 17 at 6.

Climate-related risks and opportunities may change the profile of a company's debt and equity structure because of the need for new capital expenditures to meet technological changes needed for mitigation, such as reduction of waste and conversion to renewable energy sources, and research and operational capital to adopt production processes and net-zero emissions technologies.[90]

#### *iv. Reputational Risks*

The TCFD also identified climate change as a source of reputational risk tied to changing customer or community perceptions of an organization's contribution to or detraction from the transition to a low-carbon economy.[91] Consumer trends and civil society pressure to develop a serious path to decarbonization can affect the company reputationally, and thus financially, if the directors fail to recognize and act on climate-related risks and opportunities. Also, with a growing number of institutional investors endorsing the United Nations (UN) Sustainable Development Goals and engaging with investee companies through Climate Action 100+, there is a growing social risk to companies in terms of their reputation and 'social licence' to operate.[92]

### 1.4 New Opportunities

The Japan Government's Synthesis Report also discusses the opportunities that climate change presents. It uses, as examples, businesses developing information technologies, such as agriculture support services and services to project and assess risks from disasters; technologies to improve the heat-tolerance environment and the comfort of buildings and houses; as well as financial instruments that provide insurance or a hedge against possible damage due to abnormal weather events.[93] There are financial opportunities relating to adoption of effective climate governance, including reduced operating costs through efficiency gains and other cost reductions; increased production capacity, resulting in increased revenues; increased value of fixed assets such as highly rated energy-efficient buildings; increased revenue through demand for lower emissions products and services; and increased reliability of the supply chain and the ability to operate under various conditions.

There is growing interest in investing in new technologies that are energy efficient, use renewable energy sources, and reduce GHG emissions. Innovations in battery storage, energy efficiency, and carbon capture and storage will affect the competitiveness of many companies, their production and distribution costs, and demand for their products and services from end users.[94]

Having briefly canvassed the context in Japan regarding climate change and its attendant risks, the next part of this Report gives an overview of the various options that companies have in terms of type of company and governance structure, and Part 4 discuses corporate directors' duties in Japan.

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[90] Sarra, *Governance Paths to Net Zero, supra* note 87 at 45.
[91] TCFD, *supra* note 17 at 6.
[92] Sarra, *Governance Paths to Net Zero, supra* note 87. See also United Nations Sustainable Development Goals, https://www.un.org/sustainabledevelopment/sustainable-development-goals/.
[93] Japan Government Synthesis Report, *supra* note 7 at 7.
[94] TCFD, *supra* note 17 at 6.

## 2. OVERVIEW OF CORPORATE BOARDS IN JAPAN

Directors' duties in Japan are set out in the *Companies Act of Japan* (*Companies Act*) and in the companies' articles.[95] Publicly-listed stock companies are also regulated by the *Financial Instruments and Exchange Act*,[96] and securities listing regulations published by the securities exchanges, as well as the Corporate Governance Code, the latter of which is non-binding guidance.[97] The governance structures of Japanese companies arise from a deep history of cross-shareholdings and cultural norms regarding the relationship between directors and the myriad interests implicated in the corporation's activities.[98] The evolution of corporate law in Japan, particularly in the past decade, has resulted in a focus on directors' duties, particular in respect of ensuring that proper governance and internal control systems are in place.[99]

A 'stock company' (*kabushiki kaisha*) pursuant to the *Companies Act* includes all privately-held and publicly-listed companies that are incorporated and have issued shares.[100] A 'public company' is defined as any stock company, the articles of incorporation of which do not require, as a feature of all or part of its shares, the approval of the stock company for the acquisition of such shares by transfer.[101] Stock companies, whether privately-held or public companies, have options, pursuant to Japanese corporate law, to organize their governance structures in a number of ways. Of note, is that 'company' is defined in the *Companies Act* more broadly than stock companies and includes a general partnership company, limited partnership company, or limited liability company.[102] A 'limited liability company' does not issue stock. Approximately 94% of Japanese corporate entities are *kabushiki kaisha* (stock companies).[103]

### 2.1 Options for Corporate Governance Structures

The structure of corporate boards in Japan differs from many countries in that most of Japan's largest public companies have been overwhelmingly dominated by corporate insiders, with very few outside or independent directors.[104] Nakahigashi and Puchniak observe that even when the *Companies Act* was amended to allow companies the option of more US-style corporate boards and the Tokyo Stock Exchange (TSE) Listing Rules were amended in 2010 to require all listed companies to have at least one

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[95] *Companies Act of Japan,* Act No 86 of 26 July 26 2005 (会社法 平成 17 年 7 月 26 日法律第 86 号), English translation at http://www.japaneselawtranslation.go.jp/law/detail/?id=2035&vm=04&re=02 (hereafter *Companies Act of Japan*). *Companies Act of Japan* (Act No 2005, as amended, **会社法平成 17 年法律第 86 号**). For an English translation see Japanese Law Translation run by the Ministry of Justice, Japan at Companies Act - Japanese/English - Japanese Law Translation.

[96] *Financial Instruments and Exchange Act* (*FIEA*), https://www.fsa.go.jp/en/policy/fiel/, *The Act for the Amendment of the Securities and Exchange Act, etc (Act No 65 of 2006) and the Act for the Development, etc of Relevant Acts for Enforcement of the Act for the Amendment of the Securities and Exchange Act, etc* (2006 Act No 66), promulgated on 14 June 2006. Translation of the *Act* is available at http://www.japaneselawtranslation.go.jp/law/detail/?id=3538&vm=04&re=01&new=1 (hereafter *Financial Instruments and Exchange Act* or *FIEA*).

[97] Tokyo Stock Exchange, 'Japan's Corporate Governance Code Seeking Sustainable Corporate Growth and Increased Corporate Value over the Mid- to Long-Term' (as revised 1 June 2018) at 16, https://www.jpx.co.jp/english/news/1020/b5b4pj000000jvxr-att/20180602_en.pdf (hereafter Corporate Governance Code). For a discussion of early corporate law, prior to the modernization of company law, see Janis Sarra and Masafumi Nakahigashi, 'Balancing Social and Corporate Culture in the Global Economy: The Evolution of Japanese Corporate Culture and Norms' (2002) 24 *Law & Policy* 4 at 299-354.

[98] Sarra and Nakahigashi, *ibid.*

[99] See for example, Article 348(4), *Companies Act of Japan*, *supra* note 95.

[100] *Companies Act of Japan, supra* note 95, Article 25.

[101] *Companies Act of Japan, supra* note 95, Article 2(v).

[102] *Companies Act of Japan, supra* note 95, Article 2(i).

[103] Katsuyuki Yamaguchi, Kaoru Tatsumi, and Mamiko Komura, 'Corporate governance and directors' duties in Japan: overview' (1 May 2020), *Thompson Reuters Practical Law,* https://uk.practicallaw.thomsonreuters.com/1-502-0177?transitionType=Default&contextData=(sc.Default)&firstPage=true (hereafter Yamaguchi *et al*). *Kabushiki kaisha* are generally classified according to the transfer restrictions imposed on their shares.

[104] Dan W Puchniak and Masafumi Nakahigashi, 'Case No. 21: Corporate Law – Business Judgment Rule – Derivative Action – Supreme Court, 15 July 2010', in Moritz Bälz et al eds, *Business Law in Japan -- Cases and Comments*（Kluwer Law International; 2012) at 215-226 (hereafter Puchniak and Nakahigashi).

independent director or statutory auditor (*kansayaku*),[105] the vast majority of corporate boards in publicly-listed Japanese companies remain insider dominated.[106] That situation has started to change with publication of the Corporate Governance Code, as discussed in Part 3.4 below, although the majority of directors continue to be inside directors.

Effective May 2015, companies in Japan may choose one of three main forms of organizational structure under the *Companies Act*: (1) a 'Company with *Kansayaku* Board' (audit and supervisory board); (2) a 'Company with Three Committees' – a nomination, audit, and remuneration committee; or (3) a 'Company with Supervisory Committee'.[107] The latter two forms of organizational structure under the *Companies Act* are similar to companies in other countries where committees are established under the board and assigned certain responsibilities with the aim of strengthening oversight and monitoring functions.[108] All three forms of company governance structures have a board of directors.

Under the governance model of <u>Company with a *Kansayaku* Board</u>, there are two boards, the *Companies Act* allocates specific governance functions to the board of directors and the *kansayaku* board, the latter of which must have three or more auditors, as well as specifying the function of the *kansayaku* (auditors). The *kansayaku* audit the performance of duties by directors and the management and have investigation powers by law. The *kansayaku* board decides audit policy and the execution of each *kansayaku*'s authority. However, the *kansayaku* board's decision may not preclude *kansayaku* from exercising their authority.[109] The *kansayaku* serve an oversight function over the directors and the board of directors in the exercise of their audit powers, and the *kansayaku* can bring a lawsuit against directors seeking an injunction or damages for director misconduct.[110] No one can be elected as director and *kansayaku* at the same time. In order to ensure independence, not less than half of *kansayaku,* as appointed at the general shareholder meeting, must be outside *kansayaku*, and at least one full-time *kansayaku* must be appointed.

A <u>Company with Three Committees</u> must appoint one or more *shikkoyaku* (executive officers) from directors or non-directors, by a resolution of the board, and delegate business administration and substantial business decision-making authority to the *shikkoyaku*.[111] The board must appoint one or more 'representative executive officers' from among the executive officers, who have responsibility for carrying out decisions made by the board or the executive officers, and have authority to represent the company. As of May 2020, only 76 of the approximately 3,700 publicly-listed companies on the TSE had the three-committee structure. A <u>Company with Supervisory Committee</u> has only one board, and it is represented by the representative director. If independent directors do not comprise a majority of the board, the Corporate Governance Code recommends, as best practice, establishing an independent advisory committee under the board, in which independent directors approve remuneration and some executive hiring decisions.[112]

All three forms of companies can create a position with the title of *shikkoyaku* or *shikkoyakuin* for persons who are delegated by the board to exercise a specified range of decisions regarding business administration.[113]

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[105] Tokyo Stock Exchange, Securities Listing Regulations Rule 436-2; Tokyo Stock Exchange, Enforcement Rules for Securities Listing Regulations Rule 436-2. English translation at <http://www.tse.or.jp/english/rules/regulations/>.
[106] Puchniak and Nakahigashi, *supra* note 104 at 10.
[107] Corporate Governance Code, *supra* note 97.
[108] *Ibid.*
[109] *Companies Act of Japan, supra* note 95, Article 390(2).
[110] *Companies Act of Japan, supra* note 95, Articles 385, 386.
[111] *Ibid.*
[112] Corporate Governance Code, *supra* note 97*,* Supplementary Principle 4.10.1.
[113] *Ibid* at 16.

The 2019 amendments to the *Companies Act* now require public companies to have at least one 'outside director'.[114] Publicly-listed companies that are not large companies defined by *Companies Act* are not required to have at least one outside director, but the Tokyo Stock Exchange's securities listing regulations require them to appoint one or more outside directors.[115] Article 2(15) of *Companies Act* defines the standard of 'outside' director, but makes no reference to independence. The TSE adds a requirement of 'independent director', but does not make the criteria of independence clear in the Securities Listing Regulations. Publicly-listed companies set their own criteria regarding the independence of directors and must disclose that criteria. However, the TSE may publicly announce a listing agreement violation penalty if a company's criteria does not satisfy TSE requirements of independence in accordance with the TSE 'Guidelines Concerning Listed Company Compliance'.[116] Rule 436-2(1) states that directors are independent if they are unlikely to have conflicts of interest with general investors, giving the TSE authority to impose a listing violation penalty on them for failure to comply.[117]

No matter which corporate board structure, all Japanese companies have directors with duties pursuant to corporate law and, where they are publicly-listed, pursuant also to financial services law.

[114] *Companies Act of Japan, supra* note 95, Article 327-2.

[115] *Companies Act of Japan, supra* note 95*,* Article 2(vi). Rule 437-2, Tokyo Stock Exchange, Inc., Securities Listing Regulations (April 1,2024), 有価証券上場規程 437 条の 2 < https://www.jpx.co.jp/english/rules-participants/rules/regulations/tvdivq0000001vyt-att/listing_regs_20240401.pdf>. Rule 437-2 of the Tokyo Stock Exchange's Securities Listing Regulations requires a listed domestic company to secure at least one outside director (meaning an outside director prescribed in Article 2, Item (15) of the Companies Act).

[116] TSE, 'Guidelines Concerning Listed Company Compliance', Part III.

[117] Securities Listing Regulations Rule 436-2; https://www.jpx.co.jp/english/rules-participants/rules/regulations/tvdivq0000001vyt-att/securities_listing_regs1-826_20190716.pdf.

## 3. DIRECTORS' DUTIES UNDER CORPORATE LAW

As a civil law jurisdiction, the legal basis for the scope of directors' and officers' duties in Japan is set out in statute under the *Companies Act* and the *Civil Code of Japan*.[118] Directors in Japan have three primary duties:

- A duty of loyalty,[119] including a requirement to act in the company's best interests.
- A duty to comply with all laws, regulations, ordinances, resolutions of shareholders' meeting and the company articles of association. Directors of large companies are additionally required to develop internal controls and systems for managing the risk of loss.[120]
- A duty of care, which requires directors' conduct to be of the standard of a prudent manager.[121] This duty informs the duty of loyalty and the duty to comply with all applicable laws and regulations. If a director has met the standard of a prudent manager, it may be a defence to personal liability for an alleged breach of the duty of care.[122]

### 3.1 Directors' Duty of Loyalty and Duty to Comply with Specific Laws, Regulations, and Ordinances, the Corporate Articles, and Shareholder Resolutions

The first two duties are contained in Article 355 of the *Companies Act,* which sets out the duty of loyalty that directors owe to the company, including the duty to act in in compliance with laws, the corporate articles, and resolutions of shareholders meetings. It specifies:

> Article 355 (Duty of Loyalty)
> Directors shall perform their duties for the Stock Company in a loyal manner in compliance with laws and regulations, the articles of incorporation, and resolutions of shareholders meetings.[123]

In general, the duty of loyalty includes a duty on directors to avoid conflicts of interest and self-dealing transactions. However, article 355 requires directors to perform their duties for the company in a 'loyal manner', so the duty of loyalty is also viewed as a duty of care in directors' oversight and management of the company. Therefore, the duties of loyalty and care are closely interwoven in Japan,[124] and most directors' duties in respect of oversight and management of climate change are likely to arise under article 355, as well as the duty of care under article 330 of the *Companies Act* and article 644 of the *Civil Code*, as discussed in Part 3.2. A growing number of lawyers and regulators believe that the directors' duty to act in the best interests of the company includes a duty to oversee its long-term sustainability.[125]

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[118] *Civil Code of Japan*, Act No 89 of 27 April 1896, as amended, article 644, 民法 明治 29 年 4 月 27 日法律第 89 号); *Companies Act of Japan, supra* note 95*,* Article 355. Japan is a civil law country, and thus the statutes set out the legal basis for the scope of directors' and officers' duties.

[119] *Companies Act of Japan, supra* note 95*.*

[120] *Companies Act of Japan, supra* note 95*,* Articles 348,362,399-13 and 416.

[121] *Civil Code of Japan, supra* note 118, Article 644; *Companies Act of Japan, supra* note 95, Articles 330, 355. As has been suggested by the Supreme Court of Japan, the duty of care is judged to be the objective standard of what a reasonably prudent person would do in comparable circumstances (see Puchniak and Nakahigashi, *supra* note 104 at 223.

[122] *Companies Act of Japan, supra,* note 95, examples of where having taken due care is a defence include article 52 (2)(ii), article 120 (4), and article 213 (2)(ii).

[123] *Ibid*.

[124] 24-6 Saikosaibannsyo Minjihanreisyu 625, Japanese Supreme Court's decision June 2 of 1970.

[125] Koichi Kusano, 株主の利益に反する経営の適法性と持続可能性 [translated title is "The Justifiability and Sustainability of the Corporate Management Inconsistent with the Interests of the Shareholders"] (Yuhikaku, 2018) 347-348. Koichi Kusano insists that a director has an obligation based on the principle of maximizing social welfare to continue management policies that contribute to sustainability that do not benefit shareholders directly, although a breach of such obligation will not result in liability to pay corporate damage in relation to Japanese business judgement rule. He is a Justice of Japan's Supreme Court and one of the leading Japanese attorneys specialized in company law.

Directors of companies in a corporate group are required to act in the best interests of their specific company. Where transactions enhance the interests of the whole corporate group, they are permissible; however, directors should not make such decisions if they are not in the interests of the specific entity of which they are directors.

Encompassed within the duty of loyalty, directors have a duty to report any information that is likely to harm the company. Article 357(1) of the *Companies Act* specifies that if directors detect any fact likely to cause substantial detriment to the stock company, they shall immediately report such fact to the shareholders, or, for a company with auditors, to the company auditors. Article 357(2) states that for the purpose of application of article 357(1) to a company with a *kansayaku* board, the report is to be made to that board.[126]

In relation to directors' duty to comply with laws, the *Companies Act* specifies that the directors of large companies must develop the systems necessary to ensure that directors execute their legal duties and comply with the laws and regulations and the articles of incorporation, and other systems prescribed by ordinance necessary to ensure the proper operation of the company.[127] This statutory obligation is reinforced by article 100 of the Regulation for Enforcement of the Companies Act, which requires directors of large companies to develop systems related to management of the risk of loss to the stock company and any of its subsidiaries[128] and to establish an internal control system to ensure that the execution of their duties complies with the relevant laws, regulations, and the company's articles of association.[129] In such companies, a director's duty of care will not be effectively performed without a proper internal control system.[130]

The duty to comply with laws is straightforward. Statutes set out the standards, and if a director violates specific provisions that require a corporation to act, it is a breach of the director's duties, as well as a breach of statutory obligation by the company. Various Japanese laws impose civil, criminal, and administrative penalties or other liabilities both on the corporation and on the directors as the decision-makers. A number of environmental laws, such as the *Soil Contamination Countermeasures Act*[131] and the *Water Pollution Prevention Act*,[132] regulate the actions of the company; and directors who violate environmental and health and safety laws can be subject to both civil and criminal liabilities as specified in each legislation.[133]

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[126] *Companies Act of Japan, supra* note 95, Article 357(2).

[127] *Companies Act of Japan, supra* note 95, Article 348(4), referencing also 348(3)(iv), which specifies that directors of a company without a board of directors must develop a system of internal controls if it is a large company, a decision that cannot be delegated to a single director. The obligation is reinforced by Article 98 of the *Regulation for Enforcement of the Companies Act.* Article 362(5), referencing (4)(vi) of the *Companies Act of Japan* specifies that board of directors of a company with *Kansayaku* Board must develop the system if it is a large company. The obligation is reinforced by Article 100 of the *Regulation for Enforcement of the Companies Act.* Article 399-13(2), referencing (1)(i)(c) of the *Companies Act of Japan* specifies that board of directors of a company with supervisory board must develop the system. The obligation is reinforced by Article 110-4 of the Regulation for Enforcement of the *Companies Act.* Article 416(2), referencing (1)(i)(e) of the *Companies Act of Japan* specifies that board of directors of a company with three committees must develop the system. The obligation is reinforced by Article 112 of the Regulation for Enforcement of the *Companies Act*, Japanese Law Translation 会社法施行規則平成 18 年 2 月 7 日法務省令第 12 号 Ministry of Justice Order No 12 of 7 February 2006, http://www.japaneselawtranslation.go.jp/law/detail/?ft=1&dn=1&x=52&y=13&co=01&ia=03&ja=04&ky=companies+act+enforcement+regulation&page=9.

[128] Regulation for Enforcement of the *Companies Act*, *ibid,* article 100(ii).

[129] *Companies Act of Japan, supra* note 95, Articles 348,362,399-13 and 416.

[130] Regulation for Enforcement of the Companies Act, *supra* note 127, Articles 98, 100(ii), 110-4 and 112.

[131] *Soil Contamination Countermeasures Act,* Act No 53 of 29 May 2002, as amended.

[132] *Water Pollution Prevention Act*, Law No 138 of 1970, as amended by Law No 75 of 1995, 水質汚濁防止法 昭和 45 年 12 月 25 日法律第 138 号.

[133] Yamaguchi *et al, supra* note 103.

### 3.2 Directors' Duty of Care

Directors' duties of care are set out in articles 330 and 355 of the *Companies Act of Japan* and article 644 of the *Civil Code of Japan* and the duty of care informs the duty of loyalty and the duty to comply with laws. Japanese directors have a duty of care in their oversight and management of the company. This obligation is both a positive obligation of exercising due care in the performance of their duties and a defence to personal liability where directors have acted with due care.[134] These duties apply to all stock companies, regardless of whether they are publicly- or privately-held. Article 330 of the *Companies Act* specifies that the relationship between a stock company and its officers or accounting auditors shall be governed by the provisions on mandate, including article 644 of the *Civil Code*. The *Civil Code* specifies:

> Article 644 (Duty of Care of Mandatary)
> A mandatary shall assume a duty to administer the mandated business with the care of a good manager in compliance with the main purport of the mandate.

A 'mandatary' in the corporate context is one that has been given a mandate to oversee or manage the affairs of the company. Article 644 thus requires directors to exercise the care that a good manager would exercise. Directors who neglect their duty of care are jointly and severally liable to the company for any resulting damages; and where directors are grossly negligent or knowingly fail to perform their duties, such directors are also liable to third parties or shareholders for the resulting damages.[135] However, if directors can demonstrate that they did not fail to exercise their duty of care in the performance of their duties, they will not be held liable.[136] Article 423 sets out directors' liability to the company:

> Article 423(1) (Liability of Officers to Stock Company for Damages)
> If a director, accounting advisor, company auditor, executive officer or financial auditor (hereinafter in this Section referred to as "Officers, Etc.") neglects their duties, they are liable to such Stock Company for damages arising as a result thereof.[137]

Under corporate law, for example, directors can be found personally liable for breach of their duty of care if they did not respond to changes in law in a timely and effective manner.[138] One example would be a failure to comply with articles 348, 362(5), 399-13(2), and 416(2) of the *Companies Act*; If directors of a large stock company fail to establish a proper internal control system that appropriately addresses risk, they could be found personally liable for breach of their duty of care.

### 3.3 Application of Directors' Duties to Climate-related Risks and Opportunities

Directors' duty of loyalty and duty of care to the company means that they are required to act in its best interests. Arguably, best interests includes the long-term sustainability of the company. As noted above, the *Climate Change Adaptation Act* requires that businesses endeavour to adapt to climate change in accordance with the content of their business activities, and to cooperate with governments at all levels.

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[134] *Companies Act of Japan, supra* note 95*,* examples of where due care are a defence include Article 52.2(2)(ii), Article 120.4(4), and Article 213.2(2)(ii).

[135] Yamaguchi *et al*, *supra* note 103. *Companies Act of Japan, supra* note 95, Article 52(2)(i), including for actions in the incorporation of a company, liabilities of directors in case of shortfall in value of property contributed, and liability where shares are acquired in response to demand for purchase.

[136] *Ibid,* see the discussion on the business judgment rule in Part 3.7.

[137] *Companies Act of Japan, supra* note 95*,* Articles 423 (2), (3), (4), relate to interested transactions and potential director conflicts of interest and are not relevant for this paper.

[138] Janis Sarra and Masafumi Nakahigashi, 'Kigyo No Shakai-Teki Sekinin: Challenges for Corporate Social Responsibility in Japan' (2012) 45:3 *UBC Law Review* 779 at 828.

The statutory requirement that directors of a large stock company establish a proper internal control and risk management system means that climate governance should be embedded in the board's risk management strategy. Directors have a broad discretion to design internal control and risk management systems. Where they determine that a separate risk management or sustainability committee is necessary, they can embed oversight of climate risk in that committee. Any committee authorized with this responsibility must have directors that have sufficient capability to scrutinize climate risks to the company and then to interact with management and the board to oversee and manage these risks. More specifically, such risk management committee needs to be able to assess and analyze both the physical risks and transition risks of climate change discussed in Part 1.

It is important to emphasize that the board of directors as a whole retains legal responsibility for the company identifying and managing climate-related financial risks, notwithstanding any allocation of risk management or disclosure of climate-related risks to a specific board committee. Where directors lack the expertise and that expertise is not available among the executives of the company, directors should hire outside professional expertise that can support their climate-related risk management decisions in the best interests of the company.

The MOE has advised companies to engage in scenario analysis to assess the resilience of their business in the face of global warming.[139] The World Economic Forum has observed that as stewards for long-term performance and resilience, the board of directors should determine the most effective way to integrate climate considerations into its structure and committees.[140] Regardless of board structure, 'the approach to embedding climate considerations should enable sufficient attention and scrutiny to climate as a financial risk and opportunity.'[141]

In relation to the duty to comply with laws, even though directors have a broad business discretion to design board committees, arguably directors could be held liable under articles 423(1), 348(4), 362(5), 399-13(2), and 416(2) of the *Companies Act* and articles 98, 100, 110-2, and 114 of the Regulation for Enforcement of the *Companies Act* for failure to establish a risk management system with sufficient capabilities to perform their responsibilities to oversee and manage climate-related financial risks and opportunities, including both physical and transition risks. Depending on the size and kinds of business lines, the risk management system adopted needs to be sufficiently capable of performing the above-mentioned responsibilities in light of the likelihood and magnitude of climate risks to the company.

Since climate change is affecting almost all businesses and has been recognized by the Japanese government, regulators,[142] and investors as a material issue affecting the sustainability of the company, corporate directors need to recognize their obligation to address climate-related risks and opportunities.[143] Directors could be found in breach of their duties and found personally liable for failing to act in accordance with their duty to act in the best interests of the company by failing to

[139] See Part 5.1 for a discussion.
[140] World Economic Forum, *How to Set Up Effective Climate Governance on Corporate Boards: Guiding principles and questions,* (19 January 2019), principle 3, https://www.weforum.org/whitepapers/how-to-set-up-effective-climate-governance-on-corporate-boards-guiding-principles-and-questions.
[141] *Ibid* at 13.
[142] *Climate Change Adaptation Act*, *supra* note 63, Article 1, 気候変動適応法平成 30 年 6 月 13 日法律第 50 号 Act No 50 of 13 June 2018. Bank of Japan, 'Climate Change Initiatives: Disclosure Based on TCFD Recommendations' (29 May 2024), tcfd24.pdf (boj.or.jp).
[143] Dr Yoshihiro Yamada, Dr Janis Sarra, and Dr Masafumi Nakahigashi, *Directors' Duties Regarding Climate Change in Japan* (February 2021, CCLI), Directors-Duties-Regarding-Climate-Change-in-Japan.pdf (ubc.ca) (hereafter Yamada, Sarra, and Nakahigashi).

address climate-related risks and opportunities.[144] This liability for breach of their duties is in addition to their potential personal liability for failure to meet the requirements of any statutes or ordinances.

Legal opinions in Australia, New Zealand, Singapore, India, Canada and other countries have all concluded that the duty of care of corporate directors in each respective jurisdiction includes a duty of oversight and effective management of climate-related risks and opportunities.[145] In the Canadian legal opinion, Carol Hansell opines:

> Directors must put climate change on the board agenda. They must require reports and recommendations from management and external sources as necessary, and be satisfied that the corporation is addressing climate change risk appropriately… Since there can be little doubt that directors are aware of climate change risk, they must inform themselves of the risk that climate change poses to the corporation and how that risk is being managed. If this information is not already included in management reports to the board, the board should direct management to deliver the necessary information to them…
>
> As is the case for any disclosure, misrepresentations about climate change risk can expose the corporation, its officers and its directors to both regulatory and civil liability. In respect of potential civil liability, an important factor for directors is that investors need not be aware of a misrepresentation about climate change to seek damages based on it; securities law deems them to have relied on the misrepresentations. Directors should also be aware that their decisions about disclosure are not protected by the business judgment rule.[146]

Given some of the similarities between Canada's and Japan's corporate governance systems, directors' duties to oversee and manage climate-related risks and opportunities are likely to be approached in a similar way.

Examples of breach of the duty of care would include:

- failure to engage in oversight of the management of climate-related financial risks;
- failure to set up an appropriate risk management system pursuant to article 348 of the *Companies Act;*
- failure to make relevant enquiries to management regarding physical and transition risks to the business due to climate change;

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144 J Mark Ramseyer and Masayuki Tamaruya, 'Fiduciary Principles in Japanese Law' (2017) Discussion Paper No. 935 09/2017 Harvard Law School, at 8, 10, citing [No names given], 2063 Hanrei jiho 138 (Sup Ct 27 November 2009). The Supreme Court similarly used an *ex post* analysis of the outcome to declare loans by the Hokkaido Development Bank to a troubled real estate firm to constitute a duty of care violation in [No names given], 1997 Hanrei jiho 143 (Sup Ct 28 January 2008); http://www.law.harvard.edu/programs/olin_center/papers/pdf/Ramseyer_935.pdf.

145 Noel Hutley SC and Sebastian Hartford Davis, 'Climate Change and Directors' Duties, Supplementary memorandum of Opinion' (26 March 2019), Australia Centre for Policy Development; Noel Hutley SC and Sebastian Hartford Davis, 'Climate Change and Directors Duties, Memorandum of Opinion' (7 October 2016), commissioned by the Future Business Council and the Centre for Policy Development, Legal-Opinion-on-Climate-Change-and-Directors-Duties.pdf; Chapman Tripp, 'Climate Change Risk— Implications for New Zealand Company Directors and Managed Investment Scheme Providers' (October 2019) climate-change-risk-legal-opinion-2019.pdf; Canada Legal Opinion; Carol Hansell, 'Putting Climate Change Risk on the Boardroom Table' (2020), https://law-ccli-2019.sites.olt.ubc.ca/files/2020/06/Hansell-Climate-Change-Opinion.pdf; Jeffrey W T Chan SC et al., Legal Opinion on Directors' Responsibilities and Climate Change under Singapore Law (April 2021), https://law-ccli-2019.sites.olt.ubc.ca/files/2021/04/Legal-Opinion-on-Directors-Responsibilities-and-Climate-Change-under-Singapore-Law.pdf. See also https://ccli.ubc.ca/wp-content/uploads/2021/09/CCLI_Legal_Opinion_India_Directors_Duties.pdf; Hong Kong https://ccli.ubc.ca/wp-content/uploads/2021/10/Hong-Kong-Directors-obligations-and-climate-change.pdf; Malaysia https://commonwealthclimatelaw.org/wp-content/uploads/2022/07/CCLI-Legal-Opinion-on-Directors-Duties-and-Disclosure-Obligations-under-Malaysian-Law-in-the-context-of-Climate-Risks-22-July-2022-w-signatures.pdf; the Philippines, https://commonwealthclimatelaw.org/directors-duties-responsibilities-and-disclosure-obligations-under-philippine-law-on-climate-change-risks/; and South Africa, https://cer.org.za/wp-content/uploads/2024/10/Final-Director-Duties-and-Liability-for-Climate-Risk-under-SA-Law.pdf.

146 Hansell, *ibid* at 21.

- failure to seek outside expertise where the directors and managers do not possess the knowledge or expertise to devise a strategy to address climate risk;
- failure to robustly assess the assumptions underlying revenue/cost projections for climate-related disruption; or
- failure to ensure assets and supply chains are resilient to foreseeable physical climate risks.

In Canada and the United Kingdom (UK), directors' duty of care is assessed by an objective standard, as has also been suggested by the Supreme Court of Japan, discussed in Part 3.7 below. The obligation of directors to consider the implications of climate change risk is grounded in the duties each director owes to the corporation he or she serves. In their oversight of management of climate risks, directors must meet the objective standard of what a reasonably prudent person would do in comparable circumstances.[147]

As discussed in Part 1.3, the *Climate Change Adaptation Act* requires businesses to endeavour to adapt to climate change in accordance with the content of their business activities,[148] and the *Countermeasures Act* requires businesses to prepare and publicize measures they are taking to control their GHG emissions, and to cooperate with the measures implemented by the national and local Governments to control GHG emissions.[149] These statutes inform any assessment of whether directors have met their duties to the corporation.

### 3.4 The Duty of Care of Directors of Public Companies is Reinforced by Japan's Corporate Governance Code

#### *i. Scope of the Corporate Governance Code*

Japan's Corporate Governance Code, while non-binding, establishes fundamental principles for effective corporate governance at listed companies in Japan. The 2021 revision of the Corporate Governance Code marked a significant milestone, fostering board independence, diversity, and oversight.[150] The Code now requires 'Prime' listed companies to ensure that at least one-third of their directors are independent and that the company provides transparent disclosure about the appointment process of external directors. It advocates the appointment of a lead independent director and the adoption of sustainable, long-term business strategies. The Code recommends that boards develop a basic policy for the company's sustainability initiatives to increase corporate value over the medium to long term.[151] The Corporate Governance Code offers strong normative guidance for directors to effectively manage material climate-related financial risks and opportunities in compliance with their legal duties

A stock company listed on the TSE may choose to comply with each principle of the Corporate Governance Code or explain the reasons why it is not complying. However, once the company, through its legitimate decision-making process, has chosen to comply with specified principles of the Corporate Governance Code, directors, officers, and employees must adhere to the company's decision and have

[147] See for example, the Supreme Court of Canada judgments in *Peoples Department Stores Inc (Trustee of) v Wise*, 2004 SCC 68 at para 63 and *BCE Inc v 1976 Debentureholders*, 2008 SCC 69 at para 44.
[148] *Climate Change Adaptation Act, supra* note 63, Article 5. It also requires prefectures and municipalities, either independently or in coordination with each other, to formulate a local climate change adaptation plan and create a centre to implement it, Articles 12-14.
[149] *Act on Promotion of Global Warming Countermeasures, supra* note 68, Article 5.
[150] JPX, 'Publication of Revised Japan's Corporate Governance Code', (June 2021), https://www.jpx.co.jp/english/news/1020/20210611-01.html.
[151] Tokyo Stock Exchange, 'Japan's Corporate Governance Code Seeking Sustainable Corporate Growth and Increased Corporate Value over the Mid- to Long-Term', (as revised 11 June 2021) at 9, 19, https://www.jpx.co.jp/english/news/1020/b5b4pj0000046kxj-att/b5b4pj0000046l07.pdf. For a discussion of early corporate law, prior to the modernization of company law, see Sarra and Nakahigashi, *supra* note 97 at 299-354.

no freedom to choose whether to comply or not. Arguably, the principles of the Corporate Governance Code that are adopted by a company should be treated as 'fundamentally important internal rules' of the company such that directors have a duty of care not to ignore these principles.

The Corporate Governance Code specifies that 'companies should take appropriate measures to address sustainability issues, including social and environmental matters' and that 'given the increasing demand and interest with respect to sustainability issues in recent years, the board should consider addressing these matters positively and proactively'.[152] The board should actively commit to ensuring that disclosed information, including non-financial information, is as valuable and useful as possible.[153]

Since climate-related financial risks and opportunities are part of ESG, the Corporate Governance Code supports directors' efforts to effectively manage climate-related issues. The Code has the potential to be instrumental for certain companies. The TSE reports:

> Supplementary Principle 3.1.3 requires that: The Prime Market-listed companies, in particular, should collect and analyze necessary data about the impact of climate change-related risks and profit opportunities on a company's business activities and earnings to enhance the disclosure based on TCFD, an established global disclosure framework, or an equivalent framework, qualitatively and quantitatively. An equivalence framework in this Supplementary Principle is expected to be the standards published by the ISSB under the IFRS Foundation…[154]

In 2023, the TSE reported that 95.8% of the Prime Market-listed companies and 94% of the Standard Market-listed companies complied with Supplementary Principle 2.3.1 of the Corporate Governance Code that specifies that the 'board should recognize that dealing with sustainability issues are important management issues that can lead to earning opportunities as well as risk mitigation'.[155] The TSE has incorporated the fundamental principles for effective corporate governance established in the Corporate Governance Code into its listing rules. Thus, a Prime or Standard Market-listed company is required to provide explanation for non-compliance with any principle of the Code, while a Growth Market-listed company is required to provide explanation for non-compliance with any General Principle of the Code.[156]

### *ii. Adoption of the Corporate Governance Code and Application to Duty of Care*

Adoption of the Corporate Governance Code is communicated to the TSE in a statement. While it does not create a new contractual obligation, the Corporate Governance Code principles chosen by corporate boards determine the fundamental governance structure of the company together with the company articles; and directors owe a duty of care not to simply ignore the principles chosen by the company. Failure to comply with the principles adopted could jeopardize the company's listing. Thus, any failure to meet the commitments the company has made to the listing exchange would be assessed

[152] Corporate Governance Code, *supra* note 97, Principle 2.3, at 10.
[153] *Ibid.*
[154] TSE, 'TSE-Listed Companies White Paper on Corporate Governance White Paper on Corporate Governance', at 171, https://www.jpx.co.jp/english/equities/listing/cg/tvdivq0000008jb0-att/uorii50000003gfb.pdf.
[155] *Ibid* at 162, Chart 114 'Comply or Explain' Status Relating to Sustainability Principles. However, The results of analysis of key words related to sustainability in the Corporate Governance reports that 1,837 companies listed on the TSE Prime Market disclosed in 2022 shows that as a keyword related to sustainability elements, S (Social)-related rather than E (Environment)-related keywords in terms of ESG elements tend to be used by many companies: 'diversity' (91.0%), 'women' (75.4%), 'employees' (83.2%), 'business partners' (53.9%), and 'human capital' (55.5%) are used more frequently than the word 'climate change'(49.2%). TSE thought it is caused by two reasons. One is that disclosures on climate change have already been established to some degree in other media such as integrated reports. Another is that the recent trend of the theme of 'investment and distribution to people', which is positioned as one of the most important issues under the 'new capitalism' advocated by the Kishida administration, has sparked directors' and executives' interest in the S (Social)-related fields.
[156] Japan Exchange Group, 'Enhancing Corporate Governance' (29 September 2023), Enhancing Corporate Governance | Japan Exchange Group (Enhancing Corporate Governance).

as part of the directors meeting their statutory duty of care to act in the best interests of the company. The obligations owed to the company are to comply with all the adopted principles, unless the board subsequently decides to officially change its decision from compliance to non-compliance by explaining the reasons for the change.

Principle 2.1 of the Corporate Governance Code states that '[g]uided by their position concerning social responsibility, companies should undertake their businesses in order to create value for all stakeholders while increasing corporate value over the mid- to long-term. To this end, companies should draft and maintain business principles that will become the basis for such activities.'[157] Principle 4.5 of the Corporate Governance Code specifies that the fiduciary responsibilities of directors and *kansayaku* require that they 'secure the appropriate cooperation with stakeholders and act in the interest of the company and the common interests of its shareholders.'[158] In order to promote sustainable corporate growth, the board is required to set corporate strategy, and carry out effective oversight of management from an independent and objective standpoint, regardless of the form of corporate structure.[159]

In the application of these principles to climate governance, of note is that the TSE reports that almost all of the principles have been adopted by companies listed on its exchange.[160] Therefore, practically, it would be near-impossible for a non-compliant director to convince the board to switch from compliance to non-compliance of the Corporate Governance Code. As a result, it would be possible to argue that failure to consider climate risks and opportunities over the mid-to-long-term in determining strategies for the company's sustainable growth constitutes a breach of duty of care.[161] For instance, directors of a company with very large fossil fuel positions in their business or investment portfolio are arguably obligated to create a mid-to-long-term strategy to reallocate business resources from fossil fuels to new opportunities to achieve sustainable growth, embedding that strategy in their mid-term business plan.[162]

In addition to their articles of association, publicly-listed Japanese companies normally have a number of internal rules such as board meeting rules, risk management rules, and rules regarding operation of board committees, all of which directors must comply with. Internal approval processes tend to be formal based on such internal rules.[163] A company can change any internal rule if directors find it is unreasonable or impractical. Equally, a director can be held personally liable for a breach of duty of care when violating an important internal rule.[164]

Similarly, the Corporate Governance Code principles adopted should be treated as important internal rules of the company. While there are not yet any Japanese court precedents in which any principles have been applied to a director's duty, since the Corporate Governance Code's early introduction, it has

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[157] *Ibid* at 10.
[158] *Ibid*, Principle 4.5.
[159] *Ibid* Principle 4.
[160] *Ibid.*
[161] Similar analysis has been undertaken in the UK, Canada and Australia, see Sarah Barker and Ellie Mulholland, *Directors' Liability and Climate Risk: Comparative Paper – Australia, Canada, South Africa, and the United Kingdom* (CCLI 2019), https://ccli.ouce.ox.ac.uk/wp-content/uploads/2019/10/CCLI-Directors%E2%80%99-Liability-and-Climate-Risk-Comparative-Paper-October-2019-vFINAL.pdf (hereafter Barker and Mulholland).
[162] Mid-term business plans (*chuuki keiei keikaku*) for Japanese companies are typically 3-year plans. Corporate Governance Code, *supra* note 97.
[163] The terms Kessai and Ringi refer to a Japan-specific internal procedures to decide some issues in a company, and they are not relevant in the climate context as they do not relate to issues of the binding power of directors' decisions.
[164] In a Tokyo High Court judgment dated May 21 in the 20th year of Heisei, a director who executed a derivative transaction in contravention of the internal risk management rule was held liable for damages in breach of duty of care, *Yakult Honsha co, Ltd. Case,* 1281 Hanrei jiho 274 (Tokyo High Ct, 21 May 2008).

been aimed at making directors' duty of care and duty of loyalty effective in practice by providing an important framework.[165] For example, the Code states:

> the reasonableness of the decision-making process at the time of the decision is generally considered an important factor in determining whether or not the management and directors should owe personal liability for damages. The Code includes principles and practices that are expected to contribute to such a reasonable decision-making process, and promote transparency, fairness, timeliness and decisiveness as well. [166]

The Corporate Governance Code will likely be relied on in any lawsuit seeking a director's personal liability for damages.

As noted above, the Corporate Governance Code is non-binding, but creates some normative pressure on corporate directors to identify and oversee material ESG risks and opportunities, including climate related-financial risk. If ESG factors are part of the key performance indicators (KPI) of the company's mid- and long-term business plan and are indicators of medium-to-long-term performance-linked compensation, directors have the obligation to effectively manage climate-related risks and opportunities. Several companies make ESG factors indicators of directors' and executives' performance-linked compensation, and management of climate-related risks and opportunities is therefore part of their mandate.

### 3.5 Duty of Care to Stakeholders

There is currently no express duty of care to stakeholders set out in Japan's corporate legislation. However, Japan's corporate governance structure has a long history of concern for stakeholders beyond shareholder interests, situating the activities of companies within an elaborate framework of intercompany crossholdings and an understanding of the company as embedded in the community, with strong relationships with employees, customers, and stakeholders that are part of the company's supply chain.[167] Given this extensive history, normatively, directors should be thinking about the social and consumer risks of climate change and the reputational effects of their decisions.

Directors have a responsibility to consider mid- and long-term interests of the company. Directors are allowed to consider stakeholders' interests, but in Japan, this consideration should contribute to long-term success of the company, and thus, ultimately to shareholders' benefit. In most cases, directors who consider stakeholders' interests will be protected by the business judgment rule, discussed below in Part 3.7.

When shareholders' interests come into conflict with the other stakeholders' interests, directors must make decisions in the best interests of the company because they legally owe duties to the company and shareholders. Their climate governance decisions must either arise out of their legal obligations to manage risks to the company or out of shareholder decisions amending the company articles to expressly adopt policies such as targets to move to net-zero emissions. As in many countries, leadership by the corporate board will be essential to managing climate-related risks and opportunities and to embedding consideration of stakeholder interests into climate governance.

The Corporate Governance Code, while stating that companies should 'take appropriate measures to fully secure shareholder rights and develop an environment in which shareholders can exercise their rights appropriately and effectively', also states:

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[165] Corporate Governance Code, *supra* note 97, preamble.
[166] *Ibid* at 18.
[167] For a discussion, see Sarra and Nakahigashi, *supra* note 138.

> Companies should fully recognize that their sustainable growth and the creation of mid- to long-term corporate value are brought as a result of the provision of resources and contributions made by a range of stakeholders, including employees, customers, business partners, creditors and local communities. As such, companies should endeavor to appropriately cooperate with these stakeholders. The board and the management should exercise their leadership in establishing a corporate culture where the rights and positions of stakeholders are respected and sound business ethics are ensured.[168]

The Corporate Governance Code also states that the 'appropriate actions of companies based on the recognition of their stakeholder responsibilities will benefit the entire economy and society, which will in turn contribute to producing further benefits to companies, thereby creating a virtuous cycle.'[169] The Code creates best practice norms that support management of climate-related financial risks and opportunities, and, as noted above, may ground an action in respect of the duty of care where the principles have been adopted by the company and a director has failed to comply.

### 3.6 Institutional Investors' Fiduciary Obligations Have an Impact on Corporate Directors' Duties

Institutional investors also have fiduciary obligations to address climate-related risk, as discussed in Appendix I. The FSA has specified that fiduciary duties of institutional investors include the duties of prudence and loyalty, requiring directors, trustees, and administrators to avoid conflicts of interest and provide services in the best interests of their beneficiaries.[170] Institutional investors such as pension funds need to consider the intergenerational impact of their investment decisions.[171] In 2022, the FSA's Expert Panel on Sustainable Finance Second Report emphasized that institutional investors must deepen their knowledge of the sustainability practices of their investee companies in order to increase the growth and sustainability of assets under management and expand the benefits for the ultimate beneficiaries over the long-term. [172]

The FSA's Stewardship Code, while non-binding, refers to the responsibilities of institutional investors, including pension funds, to enhance the medium- to long-term investment return for their clients and beneficiaries by fostering investee companies' sustainable growth through constructive engagement based on in-depth knowledge of the companies and consideration of medium- to long-term sustainability including ESG factors consistent with their investment management strategies. [173]

The fact that institutional investors are increasingly acknowledging that their fiduciary obligations include investing in companies that are reducing their carbon footprints and are developing innovative technologies for climate mitigation and adaptation means that investee companies are directly affected by these decisions shifting investment portfolios towards climate-mitigating activities. If company directors fail to recognize these strong shifts in capital markets activity, they may be in breach of their duty of care.

The United Nations Principles for Responsible Investing organization (UN PRI) has observed that Japan's Corporate Governance Code should result in improved disclosure of key ESG issues and enhance

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[168] Corporate Governance Code, *supra* note 97*,* Principle 2.
[169] *Ibid* at 9.
[170] UN PRI and Baker Mackenzie, 'Recommendations of Task Force on Climate-related Financial Disclosures, review of local relevance JAPAN' at 7, https://www.unpri.org/download?ac=1406.
[171] Mizuno *et al, supra* note 52 at 1.
[172] FSA, *The Second Report by the Expert Panel on Sustainable Finance* (13 July 2022), "The Second Report by the Expert Panel on Sustainable Finance" Announced.
[173] Financial Services Agency, 'Finalization of Japan's Stewardship Code (Second revised version)', *supra* note 86.

corporate governance.[174] In 2024, the Japanese Government published the 'Asset Owner Principles'.[175] Asset owners are a broad range of organizations, including public pension schemes, mutual aid associations, corporate pension schemes, insurance companies, the funds of JST, and educational corporations. The Supplementary Principle 5-2 states that 'asset owners may make sustainability investments that contribute to the sustainable growth of the investee companies, if necessary, in light of their stakeholders' views and their own investment purposes. For example, asset owners may require entrusted financial institutions to incorporate sustainability considerations into their investments. Asset owners may also formulate a sustainability investment policy and sign the PRI.'

### 3.7 Liability Risk and Deference to the Business Judgment of Corporate Directors

#### *i. Potential Liability*

Directors have overall responsibility for oversight of management of the company and for ensuring that a company's financial disclosures are accurate. Thus, directors of public companies may be liable for any misleading disclosures made to the market.[176] Directors who neglect their duties are jointly and severally liable to the company for any resulting damages; and where directors are grossly negligent or knowingly fail to perform their duties, they are also liable to third parties or shareholders for the resulting damages.[177] Thus, directors should proactively identify and manage climate-related risks and ensure their companies take robust action, although, to date, there has not yet been litigation to test the scope of directors' potential liability in respect of their climate-related duties.[178]

A failure to monitor climate change risks and compliance with climate-related regulations could give rise to a breach of the directors' duty of care in their oversight and management of the company.[179] Directors need to ensure that a risk management system is proper and sufficiently capable of fulfilling the responsibilities to monitor and manage the company's business, given the likelihood and magnitude of climate risks to the company.

Directors could also potentially breach their general duty to act with due care in the best interests of the company by failing to address climate-related risks and opportunities.[180] Both companies and directors may be subject to sanctions under financial services legislation for failure to comply with

[174] United Nations PRI, *Fiduciary duty in the 21st century: Japan roadmap* (25 April 2017), https://www.unepfi.org/wordpress/wp-content/uploads/2017/04/Fiduciary-duty-in-the-21st-century-Japan-roadmap.pdf https://www.unepfi.org/regions/asia-pacific/fiduciary-duty-in-the-21st-century-japan-roadmap-publication/. The UN PRI's *Fiduciary Duty in the 21st Century* was updated in 2021 with a Legal Framework for Impact.

[175] Government of Japan, Secretariat of New Form of Capitalism Realization Headquarters Cabinet Secretariat (28 August 2024), https://www.cas.go.jp/jp/seisaku/atarashii_sihonsyugi/pdf/assetownerprinciplesen.pdf.

[176] Janis Sarra, Audit Committees and Effective Climate Governance, A Guide for Boards of Directors (CCLI, December 2020) https://law-ccli-2019.sites.olt.ubc.ca/files/2020/12/CCLI-Guide-for-Audit-Committees-on-Effective-Climate-Governance.pdf.

[177] Katsuyuki Yamaguchi, Kaoru Tatsumi, and Mamiko Komura, 'Corporate governance and directors' duties in Japan: overview' (1 November 2016), https://www.nishimura.com/sites/default/files/articles/file/478.pdf.

[178] There have been cases against the government in respect of corporate activities. In *Citizens' Committee on the Kobe Coal-Fired Power Plant (CCKCPP) v Japan* (2023), in which the Osaka District Court rejected a request for an injunction to prevent the construction and operation of two new units at a coal-fired plant in Japan with the CCKCPP arguing that the project was inconsistent with Japan's 2030 and 2050 climate targets. On 9 March 2023, the Supreme Court rejected the request for a final appeal and the Supreme Court upheld the judgment of the Osaka High Court; the Supreme Court stated that it did not find grounds for a final appeal under Article 312 of the Code of Civil Procedure but no specific reasons were given. Subsequently, on 14 September 2018, thirty-one families filed a lawsuit seeking an injunction to prevent the construction and operation of two units at a coal-fired plant in Kobe, Japan (*Citizens' Committee on the Kobe Coal-Fired Power Plant v Kobe Steel Ltd, et al,* 2023); the Court did not recognize the existence of a concrete danger to the plaintiffs' life, bodily integrity, and health while it stated that there could be an abstract danger by the emission of $CO_2$ that could aggravate global warming. This judgment is under appeal; Sabin Centre for Climate Change, Global Climate Change Litigation, Citizens' Committee on the Kobe Coal-Fired Power Plant v. Kobe Steel Ltd., et al. - Climate Change Litigation (climatecasechart.com).

[179] For example, under Articles 423(1), 348(4), 362(5), 399-13(2), and 416(2) of the *Companies Act of Japan, supra* note 95 and Articles 98, 100, 110-2, and 114 of the Regulation for Enforcement of the *Companies Act*, *supra* note 128.

[180] See Yamada, Sarra, and Nakahigashi, *supra* note 143.

disclosure requirements. For example, a person that submits an annual securities report that contains a false statement about a material particular or that lacks a statement of a material particular that is required to be stated is subject to punishment by imprisonment for not more than 10 years, a fine of not more than ten million yen, or both.[181] Unlike general directors' duties, disclosure pursuant to financial services law is not subject to the business judgment rule; therefore, a court will not consider whether a decision to make or omit a disclosure was 'significantly unreasonable', but will focus on whether the disclosure was required by law.

Litigation is a less-used strategy for holding Japanese corporate directors accountable for breaches of their duty of loyalty, duty of care, and duty to comply with laws. However, Japanese corporate law does allow for derivative actions by shareholders, which may offer an avenue for future litigation in respect of directors' failure to manage climate-related risks.[182] Shareholders who have continuously held shares for more than six months may demand that the company sue its directors, and if the company does not file the lawsuit within 60 days of the demand, the shareholders may bring a derivative action on behalf of the company.[183] Under Japanese law, a plaintiff is not allowed to seek in advance reimbursement of litigation costs from the company, but a derivative action can overcome financial barriers to holding directors accountable as a plaintiff is allowed to seek compensation from the company for the equivalent amount of expenses incurred, such as attorney's fees, if a shareholder derivative lawsuit wins, including a partial win (Article 852 of *Companies Act of Japan*).

### *ii. Business Judgment Rule*

It is now well established that directors' business decisions will be assessed based on their due diligence with consideration of the business judgment rule. In the case of *Apamanshop Holdings*,[184] the Supreme Court of Japan overturned a High Court judgment that had held that directors breached their duty of care in agreeing to a share purchase deal carried out for the purpose of making a partially-owned subsidiary a wholly-owned subsidiary of Apamanshop Holdings Co Ltd (Apamanshop) as a part of the corporate group's restructuring plan.[185] At the time, Apamanshop had obtained an appraisal stating that the valuation of its partially-owned company's shares calculated for the restructuring was between 6,561 yen and 19,090 yen per share, but decided to set the valuation at 50,000 yen per share based on the amount paid for the shares at the time of its establishment. In response, Apamanshop's shareholder filed a derivative lawsuit against the director who made the decision, claiming that the purchase price above the valuation price was a breach of the duty of care, and seeking damages from the company.

The Supreme Court of Japan held that the formulation of such a business restructuring plan is deemed to be left to professional management judgment covering future forecasts, including the evaluation of the benefits of making the company a wholly-owned subsidiary. The method and price of the share acquisition in this case can be determined by the directors by comprehensively taking into consideration not only the valuation of the shares, but also the necessity of the acquisition, the financial burden, and the need to smoothly proceed with the acquisition of shares, etc. The Supreme Court of Japan held that 'so long as there are *no significantly unreasonable aspects* involved in the process and content of such decisions, it should be understood that the directors will not violate their duty of care

[181] *Financial Instruments and Exchange Act, supra* note 96, Article 197,1-(1). If the representative of a corporation commits a violation in submitting a annual securities report that contains false statement, or if the agent, employee, or any other worker of a corporation commits that violation, the corporation is sentenced to the fine of not more than 700 million yen. See, *Financial Instruments and Exchange Act* Article 207,1-(1).

[182] *Companies Act of Japan, supra* note 95, Article 847.

[183] *Ibid.* Shareholders of a parent company may also file a derivative suit against directors of wholly owned subsidiaries if such subsidiary does not file the lawsuit within 60 days of the demand against the subsidiary by the parent company's shareholders.

[184] The case of the derivative action of *Apamanshop Holdings,* 2091 Hanrei Jiho 90 (Sup Ct, July 15 2010).

[185] *Ibid* at 220.

as directors'.[186] In arriving at its decision, the Supreme Court placed considerable weight on the directors' reasonable deliberations of the relevant facts at the board meeting and on the directors' decision to seek and follow a lawyer's opinion.[187] The Supreme Court cited several specific factors, such as the short time period since the partially-owned subsidiary's public offering, the range in the value of its unlisted shares, the essential nature of the affiliated shops, the relationship between the entities, and the corporate group's future business, concluding that the content of the decision was not 'significantly unreasonable'.[188]

The decision was the first time that the business judgment rule was explicitly applied by the Supreme Court of Japan, and was particularly significant because of several judgments in the period prior that expressly did not defer to business judgment.[189] The framework used by the Supreme Court suggests that directors' managerial decisions should be protected from liability by the business judgment rule when: (1) the decision was based on reasonable research and analysis of the relevant facts; and (2) the decision was not irrational or inappropriate in comparison to what a reasonable manager in the specific business environment would have decided.[190]

Thus, deference to the directors' business judgment depends on the directors actually turning their minds to an issue. Courts are unlikely to defer to directors where there has been a failure to exercise oversight of management of climate-related financial risks.[191] Puchniak and Nakahigashi observe that

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[186] Supreme Court of Japan Decision, Supreme Court 15 July 2010 – Case No 2009 ju 183, Apamanshop Case, 1332 Hanrei Taimuzu 501,.Part 4, para 2 (emphasis added).

[187] *Ibid,* Part 4, para 3.

[188] Puchniak and Nakahigashi, *supra* note 104 at 8.

[189] *Ibid* at 222, citing M Kitamura, 'Hi-jôjô-kaisha no kabushiki no kaitori to keiei-handan-no-gensoku' [Purchase of Shares in Unlisted Corporations and the Business Judgment Rule], in *Juristo* 1420 (2011) 139; and R Kobayashi, 'Hi-jô-jôkaisha no kaitori kakaku no kettei to torishimariyaku no zenkan-chui-gimu-ihan no umu' [Decision of Purchase Price of Unlisted Companies and the Existence of Directors' Breach of the Duty of Care], in *Hanrei Select* 2010 [II] (2010) 18. For the Kitamura article in Japanese, 非上場会社の株式の買取りと経営判断の原則. For the Kobayashi article in Japanese, 非上場会社の買取価格の決定と取締役の善管注意義務違反の有無.

[190] Puchniak and Nakahigashi, *supra* note 104 at 223.

[191] Unrelated to climate change, on 13 July 2022, the Tokyo District Court held, in a shareholder derivative lawsuit, that former executive directors of Tokyo Electric Power Company (TEPCO) failed in their duty of care of a prudent manager to order appropriate tsunami countermeasures, the Court ordering the directors to pay 13.32 trillion yen (97 billion USD) to the company for damages caused by reactor meltdowns at Fukushima No 1 nuclear power plant following the March 2011 earthquake and tsunami. A key issue was whether the directors had a duty to take measures to prevent nuclear power plants from being submerged in the event of an earthquake. Based on the facts recognized by the court, employees in the nuclear power division proposed implementing measures to prevent being submerged in accordance with the opinion of a public expert committee, but TEPCO's directors ignored the proposal and prioritized seeking the opinion of experts that were convenient for TEPCO and in the meantime did not take any measures against tsunamis. The question was whether the response of TEPCO's directors was appropriate. The Tokyo District Court said following:

> 'Evaluations and judgments regarding the safety and soundness of nuclear power plants often involve highly specialized and technical matters, including those regarding the natural phenomena on which they are based. Therefore, it is permissible for directors of a company that establishes and operates a nuclear power plant to rely on the evaluations and judgments of internal and external experts and specialized institutions, unless such evaluations and judgments are deemed to be significantly unreasonable. Conversely, if directors make evaluations and judgments that differ from those of internal and external experts and specialized institutions without any special circumstances, the process and content of such judgments will be deemed to be significantly unreasonable.'

The Tokyo District Court held that while the directors' decision to delay starting a large-scale construction of seawalls to prevent a huge tsunami from reaching the vital area of the plant was understandable due to its enormous cost, they should have at least taken temporary stopgap measures, which would cost less and take shorter time; The case of the derivative action of TEPCO, 2580/81 Hanreijiho 5 (Tokyo District Ct.., July 13th 2022). The judgment has drawn attention to the question of whether it will change the business judgment rule in the future in respect of factors regarding climate-related or other ESG risks, although this issue was not part of this judgment. See Gen Goto, 'ESG, Externalities, and the Limits of the Business Judgment Rule: TEPCO Derivative Suit on Fukushima Nuclear Accident and the Expansion of Caremark', The Chinese Journal of Comparative Law (December 2024, Volume 12). This court decision also can be seen as providing a new approach that focuses on the risk management situation to evaluate directors' breach of duty of care regarding 'things the directors did not do.' The determining factor in the evaluation is the breach of duty of care in risk management, which was the failure to place emphasis on risks the willingness of courts in Japan to engage in a detailed examination of the reasonableness of the content of directors' decisions distinguishes the Japanese business judgment rule from the business judgment rule in the US.[192] Unlike the US rule, directors in Japan are unlikely to be released from the duty of care or duty of loyalty under the Japanese business judgment rule solely by their state of mind, *eg,* acting in good faith or in their belief regarding the best interest of the company. The Supreme Court of Japan's reasoning appears closer to the business judgment rule as defined by Canadian courts.

The Supreme Court of Canada has held that many decisions made in the course of business, although ultimately unsuccessful, are reasonable and defensible at the time they are made; and that provided the decision taken is within a range of reasonableness, courts are unlikely to substitute their opinion for that of the board, even though subsequent events may have cast doubt on the board's determination.[193] However, the Supreme Court of Canada has also held that the courts 'are capable, on the facts of any case, of determining whether an appropriate degree of prudence and diligence was brought to bear in reaching what is claimed to be a reasonable business decision at the time it was made'.[194] The specificities of the elements necessary to find a breach of the duty of care in Japan may facilitate a finding by a court that directors breached their duty of care.

Given the scientifically predictable nature and magnitude of climate change risks, arguably directors are required by their duty of care under the *Companies Act of Japan* to be educated by appropriate experts, to have the skills and information to appropriately assess material risks and opportunities to the company and maintain command of climate-related risks and opportunities. If they do not have climate expertise on the board, directors need to ensure that they have that expertise within the company's management or they need to hire external expertise.[195]

For duly diligent directors, the Court's recognition of a business judgment rule may offer a defence to specific actions to address climate mitigation and adaptation, when hindsight information suggests that the directors should have made a different decision. However, the business judgment rule does not offer a safe haven to directors that fail to act on climate-related risk. Japanese courts have been clear that they will examine not only the process used to reach the business decision but also undertake an objective review of the duty of care to assess whether a director acted significantly unreasonably from an objective standpoint at the time of the decision-making. This objective assessment by the courts is also reflected in case law in Canada, the UK, and Australia,[196] and if anything, is likely to be an even more stringent test applied by Japanese Courts.

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specified by administrative guidance. See, Yoshihiro Yamada, 振り上げた「拳」の大きさ：東京電力ホールディングス株主代表訴訟〈判例時評〉［Text in Japanese. Translated title is 'The size of the raised "fist": Case Law Commentary of TEPCO's shareholder derivative suit'], 94:11 Horitsu-Jiho (2022) 4. The ruling has been controversial, and is under appeal at the Tokyo High Court, decision expected in June 2025. On the other hand, in 2023, the Tokyo High Court upheld a not guilty criminal verdict by a lower court that cleared former TEPCO executives of negligence over the 2011 Fukushima nuclear power station disaster; T Bateman and S Murakami , 'Tokyo court upholds not guilty verdict for ex-Tepco execs over Fukushima disaster' Reuters (18 January 2023).

[192]Puchniak and Nakahigashi, *supra* note 104 at 9, 11.

[193] *BCE Inc v 1976 Debentureholders*, (2008) 3 SCR 560 at para 64.

[194] *Ibid.*

[195] See international authorities such as the World Economic Forum, *The Global Risks Report 2020,* (2020), https://www.weforum.org/reports/the-global-risks-report-2020 and TCFD, *supra* note 17.

[196] See for example, Janis Sarra, *Fiduciary Obligations in Business and Investment: Implications of Climate Change* (CCLI, 2018) janis-cover.pdf (ubc.ca); Sarah Barker, *Directors' Liability and Climate Risk: Australia - Country Paper* (CCLI 2018), https://ccli.ouce.ox.ac.uk/wp-content/uploads/2018/04/CCLI-Australia-Paper-Final.pdf; and Alexia Staker and Alice Garton, *Directors' Liability and Climate Risk: United Kingdom - Country Paper* (CCLI April 2018), https://ccli.ouce.ox.ac.uk/wp-content/uploads/2018/04/CCLI-UK-Paper-Final.pdf; (CCLI/CGI), *UK: Directors' Duties Navigator: Climate Risk and Sustainability Disclosures* (September 2024), https://hub.climate-governance.org/Resource/directors-duties/directors-duties-in-united-kingdom/pdf; CCLI/CGI, *Australia: Directors' Duties Navigator: Climate Risk and Sustainability Disclosures* (September 2024), https://hub.climate-governance.org/Resource/directors-duties/directors-duties-in-australia/pdf; CCLI/CGI, *Canada: Directors' Duties Navigator: Climate Risk and Sustainability Disclosures* (September 2024), https://hub.climate-governance.org/Resource/directors-duties/directors-duties-in-canada/pdf.

## 4. DIRECTORS' DUTY OF DISCLOSURE

### 4.1 Directors' Duty to Disclose Material Information

The *Financial Instruments and Exchange Act* (*FIEA*) contains the duty for all publicly-listed companies to disclose, on a continuous and periodic basis, material business risks.[197] The *FIEA* was enacted to enhance fairness and transparency, and to restore confidence in Japanese capital markets.[198]

Articles 27-36 of the *FIEA*, generally referred to as the 'fair disclosure rule', were introduced to ensure listed companies fairly disclose information to investors.[199] The fair disclosure rule is applicable to information of a precise nature that, if disclosed, is likely to have a material influence on the value of securities.[200] Where the relevant information falls under the category of material information, the listed company must promptly disclose it.[201] Introduction of the fair disclosure rule was aimed at promoting early disclosure of information by issuers and enhancing dialogue between issuers and investors.[202] The 'Fair Disclosure Rule Guidelines' specify that 'material information' refers to the 'undisclosed material information about the operations, business, or assets of the listed company, etc, which has a material influence on investors' investment decisions'.[203]

In terms of future-oriented information, the 'Fair Disclosure Rule Guidelines' specify that:

> when specific details of the plan concerning operating profits or net profits that are planned to be disclosed as the contents of the medium-term management plan are pieces of information which, in themselves, can be used for making investment decisions and are likely to have a material influence on the value of securities if they were disclosed and when such details of the plan are to be provided to the investors immediately prior to the disclosure of the medium-term management plan, the provision of such pieces of information may constitute provision of material information.[204]

### 4.2 Directors' Duties Relating to Disclosure of Material Climate-related Risks

Climate change presents a foreseeable financial risk in the short, medium, and long term. Financial disclosure is critically important for companies, investors, and regulators, and for effective functioning of capital markets; and directors and their corporate boards have a responsibility to disclose material risks.

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[197] Cabinet Office Ordinance Partially Amending the Cabinet Office Ordinance on Financial Instruments and Exchange Business, etc. and the Cabinet Office Ordinance on Disclosure of Corporate Affairs, etc. Cabinet Office Order No 53 of 2023 金融商品取引業等に関する内閣府令及び企業内容等の開示に関する内閣府令の一部を改正する内閣府令（令和 6 年内閣府令第 53 号） Article 24 (1), *Financial Instruments and Exchange Act, supra* note 96. In 2006, the *Financial Instruments and Exchange Act* replaced the former *Securities and Exchange Act*, the *Law Concerning Foreign Securities Firms*, and the *Law Concerning the Regulation of Investment Advisory Services Relating to Securities.*

[198] Financial Services Agency, 'New Legislative Framework for Investor Protection - Financial Instruments and Exchange Law', https://www.fsa.go.jp/en/policy/fiel/20061010.pdf.

[199] *Ibid* at 5.

[200] *Ibid* at 5.

[201] *Ibid* at 6.

[202] *Ibid* at 3.

[203] As provided in Article 27-36, paragraph (1) of the *Financial Instruments and Exchange Act, supra* note 96. Planning and Coordination Bureau, Financial Services Agency, 'Points to Note Regarding Article 27-36 of the *Financial Instruments and Exchange Act* (Fair Disclosure Rule Guidelines)', (April 2018), translation at https://www.fsa.go.jp/en/laws_regulations/disclosure/20180206-2.pdf. It specifies: 'These guidelines are not binding on determinations made by investigative authorities and judicial decisions including the application of penal provisions. In addition, these guidelines do not guarantee that the Financial Services Agency (FSA) will make the same interpretations as those shown in these guidelines in the future.'

[204] *Ibid* at 5.

For both privately-held and publicly-held stock companies in Japan, directors have an obligation to shareholders to report material financial information in their financial statements. While the *Companies Act of Japan* is silent on climate-related risks, if information is material, arguably failure to disclose it could give rise to a complaint that directors have failed in their fiduciary duty. Both privately-held and publicly-held companies must submit or provide the financial statements and business reports to annual shareholders meetings, required by Article 438 of *Companies Act*.

The directors of publicly-held stock companies in Japan have a further duty to give both periodic and continuous disclosure of material risks pursuant to securities law, filed with the local Finance Bureau pursuant to the *Financial Instruments and Exchange Act.* Japan's *Climate Change Adaptation Act* and its *Act on Promotion of Global Warming Countermeasures*, read together, create regulatory expectations that all sectors of Japanese society make efforts to control climate change through mitigation and adaptation, although these two statutes currently impose no legal liabilities on directors for non-compliance. Since it is the directors that have the overall responsibility for ensuring the company's financial disclosures are accurate, they may be primarily liable for misleading disclosures made to the market.[205] Both companies and directors may be subject to sanctions under securities legislation for failure to comply with disclosure requirements. Unlike general director duties under company law, disclosure pursuant to securities or financial services law is not subject to the business judgment rule, as the requirements are clearly set out in law.

It is in the area of disclosure that Japanese regulators are moving rapidly to have companies disclose how they identify and manage climate-related risks, generally as part of ESG factors that companies and investors are increasingly identifying as important. There have been a number of recent regulatory and guidance developments aimed at enhancing the disclosure of ESG risks and opportunities, including climate-related risks and opportunities. This part of the Report outlines current requirements for companies to disclose climate-related information and directors' associated duties.

### 4.3 Disclosure and Reporting Requirements under the *Financial Instruments and Exchange Act*

Publicly-held companies must submit securities reports, including financial statements, to the *KANTO-Zaimukyoku* (Kanto Regional Finance Bureau). Article 24 of *FIEA* requires publicly-held companies to submit annual securities reports to the Prime Minister and the *Financial Services Agency Establishment Act (FSAEA)* establishes the FSA as an external bureau of the Cabinet Office entrusted with the Prime Minister's duties related to the *FIEA*.[206] The *FSAEA* also establishes that *KANTO-Zaimukyoku* is entrusted with the planning and drafting of systems related to domestic finance, which are among the duties of the FSA. The *KANTO-Zaimukyoku* is responsible for accepting and disclosing securities reports.[207] Publicly-held companies submit securities reports electronically through the EDINET (Electronic Disclosure for Investors' Network) to *KANTO-Zaimukyoku*.[208]

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[205] Janis Sarra, *Audit Committees and Effective Climate Governance, A Guide for Boards of Directors* (CCLI December 2020), https://law-ccli-2019.sites.olt.ubc.ca/files/2020/12/CCLI-Guide-for-Audit-Committees-on-Effective-Climate-Governance.pdf.

[206] The *Financial Services Agency Establishment Act* (Act No. 130 of 1998) [金融庁設置法] establishes the Financial Services Agency as an external bureau of the Cabinet Office, and entrusts the Prime Minister's duties related to the *Financial Instruments and Exchange Act* to the Financial Services Agency (Article 2). The *Ministry of Finance Establishment Act* (Act No 98 of 1999) [財務省設置法] establishes the local Finance Bureau (Article 12), which is entrusted with the planning and drafting of systems related to domestic finance which are among the duties of the Financial Services Agency (Article 13).

[207] Based on Article 218-2 of the Ministry of Finance Organization Regulation (Ministry of Finance Ordinance No. 1 of 2001) [財務省組織規則].

[208] Based on Guidelines for Electronic Disclosure Procedures, etc [ 開示用電子情報処理組織による手続の特例等に関する留意事項について（電子開示手続等ガイドライン）] 2-1-1, https://www.fsa.go.jp/common/law/kaiji/03_20240517.pdf (text in Japanese). KANTO-Zaimukyoku [Kanto Regional Finance Bureau] make the information disclosed by electronic also through the EDINET. EDINET is Electronic Disclosure for Investors' Network, which is run by the FSA based on Article 27-30-2 of *Financial*

The *FIEA* duty for all listed companies to disclose material business risks on a continuous and periodic basis includes material business risks arising from climate change.[209] To date, it is often reported as 'non-financial information' in annual reports, although regulators are increasingly recognizing that climate risks are financial risks,[210] as discussed in the next part.

### *i. Mandatory Disclosure in the Prime Market*

Companies listed on the Prime Market have been required, on a 'comply or explain' basis, to collect and analyze data on the impact of climate change-related risks and earning opportunities on their business activities and profits. Effective April 2022, TCFD-aligned disclosures have been mandatory in the TSE Prime Market, requiring companies listed on the Prime Market (banks, insurance companies, and companies with market capitalization of at least 25 billion yen on initial listing) to enhance the quality and quantity of disclosure based on the TCFD or an equivalent framework.[211] The Prime Market includes 68 banks.[212] At this stage, sustainability information is not required to be included in securities reports under the *FIEA.* It is considered sufficient to include sustainability information in an optional sustainability report issued by each company.

With respect to 'forward-looking' information, including information of the impact of climate-related risks, in 2023 the FSA published it's Guideline for the Disclosure of Corporate Affairs (Disclosure Guideline), which provides further detail regarding directors' duties relating to forward-looking information.[213] The Disclosure Guideline clarifies that the management of a company may be held liable if it fails to disclose material forward-looking information that could affect investors' investment decisions where the management was aware of the information as of the filing date and withheld said information, and also where management was not aware of the materiality of the information without reasonable grounds.[214]

The Disclosure Guideline confirms that a company will not be held immediately liable for false statements on account of forward-looking information to the extent that specific, generally reasonable explanations are provided; for example, it was appropriately reviewed internally on a reasonable basis, and where a summary of the review is disclosed with the forward-looking information stating the facts,

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*Instruments and Exchange Act.* FSA launched it March 17, 2008, <https://www.fsa.go.jp/en/news/2008/20080317.html>. English site for the filed documents in English https://disclosure2.edinet-fsa.go.jp/WEEK0020.aspx.

[209] Cabinet Office Ordinance Partially Amending the Cabinet Office Ordinance on Financial Instruments and Exchange Business, etc. and the Cabinet Office Ordinance on Disclosure of Corporate Affairs, etc. Cabinet Office Order No 53 of 2023 金融商品取引業等に関する内閣府令及び企業内容等の開示に関する内閣府令の一部を改正する内閣府令（令和 6 年内閣府令第 53 号）; *Financial Instruments and Exchange Act, supra* note 96, Article 24.

[210] Bank of Japan, *supra* note 12.

[211] *Ibid*. See also S Matsuzoe, H Watanabe, and T Nomura, 'Japan: Amendment to the Cabinet Office Order on Disclosure of Corporate Affairs in Japan', *Global Compliance News* (29 April 2023), https://www.globalcompliancenews.com/2023/04/29/https-insightplus-bakermckenzie-com-bm-capital-markets-japan-amendment-to-the-cabinet-office-order-on-disclosure-of-corporate-affairs-in-japan_04262023/ (hereafter Matsuzoe *et al*) reporting that the regulator plans to further revise the Disclosure Principles, including by clarifying the concept of materiality relevant to the disclosure of sustainability information, taking into account domestic and international trends.

[212] *Ibid.*

[213] Financial Services Agency, 'Points to Note Regarding Disclosure of Corporate Affairs' (Guideline for the Disclosure of Corporate Affairs) 企業内容等の開示に関する留意事項について (企業内容等開示ガイドライン) (hereafter FSA Guideline). Amended by Cabinet Office Ordinance Partially Amending the Cabinet Office Ordinance on Financial Instruments and Exchange Business, etc. and the Cabinet Office Ordinance on Disclosure of Corporate Affairs, etc. Cabinet Office Order No 53 of 2023 金融商品取引業等に関する内閣府令及び企業内容等の開示に関する内閣府令の一部を改正する内閣府令（令和 6 年内閣府令第 53 号）. https://www.fsa.go.jp/common/law/kaiji/230131_kaiji.pdf>. (currently only Japanese version is available).

[214] Financial Services Agency,「企業内容等の開示に関する内閣府令の一部を改正する内閣府令（案）」に対するパブリックコメントの概要及びコメントに対する金融庁の考え方 [translated title: Summary of public comments on the 'Cabinet Office Ordinance Partially Amending the Cabinet Office Ordinance on Disclosure of Corporate Affairs, etc. (Draft)' and the FSA's View on the Comments] No 16 https://www.fsa.go.jp/news/30/sonota/20190131/01.pd .

assumptions, and reasoning process on which it was based.[215] Companies and directors are held liable to investors if there are false statements about material matters.[216]

The FSA announced new rules effective 31 January 2023 (by amendments to the Cabinet Office Order on Disclosure of Corporate Affairs) that require all listed companies to disclose sustainability information—including climate-related information—in four categories generally aligned with the TCFD recommendations.[217] The rules apply to securities registration statements and annual securities reports for fiscal years ending on and after 31 March 2023.[218] The disclosure of information about governance and risk management is required, whereas the disclosure of information about strategy and metrics and targets is required only if the information is material.

Companies should also include business policies and strategies that take into account the management's view regarding opportunities and risks,[219] so even if a company decides not to include strategy, metrics and targets after determining their importance, it is expected to disclose that decision and the reasons for it ('comply or explain'). If management is aware of important future information that may affect investors' investment decisions as of the filing date of the securities registration statement, but deliberately fails to include it, or if management does not recognize or include the importance of the information without a reasonable basis, they may be liable for false statements.[220]

The four categories aligned with the TCFD framework are:

- *Governance* – disclosure of governance processes, controls, and procedures to monitor and manage sustainability-related risks and opportunities.
- *Risk management* – disclosure of processes for identifying, assessing, and managing sustainability-related risks and opportunities.
- *Strategy* – where material, disclosure of initiatives to address sustainability-related risks and opportunities that may affect the management policies and strategies of the submitting company and its consolidated subsidiaries in the short-, medium-, and long-term; and where a submitting company decides not to disclose after assessing them to be immaterial, the company should disclose the assessment process and reasons for determining immateriality.
- *Indicators and targets* **–** where material, disclosure of information to assess, manage, and monitor performance with respect to sustainability-related risks and opportunities of the submitting company and its consolidated subsidiaries on a long-term basis; and where a submitting company decides not to disclose indicators and targets, it should disclose the assessment process and reasons for the determination of immateriality.[221]

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[215] FSA Guideline, *supra* note 213 at para 5-16-2.

[216] *Financial Instruments and Exchange Act,* Act No 25 of 13 April 1948, 金融商品取引法（昭和 23 年 4 月 13 日法律第 25 号）, Article 21-2, 22.

[217] Cabinet Office Ordinance Partially Amending the Cabinet Office Ordinance on Financial Instruments and Exchange Business, etc. and the Cabinet Office Ordinance on Disclosure of Corporate Affairs, etc. Cabinet Office Order No 53 of 2023 金融商品取引業等に関する内閣府令及び企業内容等の開示に関する内閣府令の一部を改正する内閣府令（令和 6 年内閣府令第 53 号）.

[218] Cabinet Office Ordinance, *ibid.* IFRS Foundation, *Progress on Corporate Climate-related Disclosures—2024 Report* (12 November 2024) at 132-133.

[219] Financial Services Agency, 記述情報の開示に関する原則（別添） —サステナビリティ情報の開示について—(translated title is 'Document of Principles Regarding the Disclosure of Narrative Information: Concerning Disclosure of Sustainability Information, https://www.fsa.go.jp/news/r4/sonota/20230131/07.pdf (hereafter FSA, Principles Regarding the Disclosure of Narrative Information).

[220] Financial Service Agency, *supra* note 213, at 5-16-2.

[221] FSA Weekly Review No 524 (9 February 2023) https://www.fsa.go.jp/en/newsletter/weekly2023/524.html.

The new FSA rules represent a first stage of mandatory sustainability disclosure rules in Japan.**[222]** These rules mandate the creation of a new section for sustainability-related information, サステナビリティに関する考え方及び取組 ('Sustainable Policy and Initiatives') in the annual securities report (the statutory report).[223] There is not yet an official English translation of the title of this new section required by the FSA; it is also being referred to in various documents as 'Sustainable Policy and Initiatives', 'Sustainability Perspective and Measures' and 'Sustainability Approach and Measures'.[224]

Under the rules, all listed companies in Japan (approximately 4,000 companies, including foreign companies listed in Japan) are required to disclose sustainability-related information using the TCFD pillars (strategy, metrics and targets, governance and risk management). They require all companies to include a new section in their Securities Registration Statement and Annual Securities Report (collectively, 'disclosure statements') to report how the company perceives and intends to address sustainability issues.[225] The Amendment applies to disclosure statements for fiscal years ending on or after 31 March 2023.

As a guideline for filling out the new section of the securities report titled Sustainable Policy and Initiatives, the FSA issued 'Principles Regarding the Disclosure of Narrative Information (Appendix) -- On Disclosure of Sustainability Information' in 2023.[226] Narrative information should reflect the discussions at the board of directors and the executive committee, in order to enable investors to understand the company through the eyes of management.

The new section for describing sustainability policy and measures in the annual securities report is designed to provide stakeholders with a comprehensive view of a company's approach to sustainability.[227] 'Governance' and 'risk management' are required to be included, while 'strategy' and 'metrics and targets' are optional depending on their importance. Sustainability information under the new sustainability section includes matters related to the environment, society, employees, respect for human rights, anticorruption, governance, cybersecurity, and data security.[228]

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[222] 「企業内容等の開示に関する内閣府令」等の一部改正（案）に対するパブリックコメントの結果等の公表について：金融庁 and Number of Listed Companies/Shares | Japan Exchange Group. 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; UN PRI, Policy Briefing, Japan's *Financial Instruments and Exchange Act:* Integrating ESG into the Regulatory Framework (November 2024), https://www.unpri.org/download?ac=22350 (hereafter Policy Briefing 2024).

[223] サステナビリティに関する考え方及び取組 [clear translation not available so far, [*eg* Sustainability Approach and Measures; 企業内容等の開示に関する内閣府令 Cabinet Office Order on Disclosure of Corporate Affairs, 2023, 昭和四十八年一月三十日大蔵省令第五号 Ministry of Finance Order No 5 of 30 January 1973; 第４号様式 Form 4.

[224] See for example, FSA,サステナビリティに関する考え方及び取組, Informal Translation of Special Page on Disclosure of Sustainability Information, サステナビリティ情報の開示に関する情報; Kazuma Osaki and Aina Urano Menneken, UN PRI, *Policy briefing: Japan's Financial Instruments and Exchange Act: Integrating ESG into the regulatory framework* (29 November 2024) calling it 'Sustainability Perspective and Measures', https://www.unpri.org/download?ac=22350; Shiseido, 'Sustainability Approach and Measures', https://corp.shiseido.com/en/ir/library/financial_statements/pdf/2023/annual_securities_report.pdf; Nisshin Seifun Group, 'Sustainability Approach and Measures', https://pdf.irpocket.com/C2002/Rhyn/Rluc/IB8K.pdf; Nissan Motor Co, Approach to Sustainability and our initiatives, https://www.nissan-global.com/EN/IR/FINANCIAL_RESULTS/ASSETS/FR/2023/PDF/fr2023.pdf; Brother Industries, 'Approach to and initiatives relating to sustainability', https://download.brother.com/pub/com/investor/annual-securities/pdf/2024/2023-asr.pdf.

[225] FSA Weekly Review, *ibid.* See also Matsuzoe *et al, supra* note 211.

[226] FSA, Principles Regarding the Disclosure of Narrative Information, *supra* note 219.

[227] *Ibid.*

[228] Matsuzoe *et al, supra* note 211.

The Disclosure Principles expect companies to proactively disclose GHG emissions, particularly Scope 1 emissions (direct emissions by a company itself) and Scope 2 emissions (indirect emissions associated with the use of electricity, heat, and steam supplied by other companies, etc), based on the importance to each company's business type and business environment.[229] The Principles do not mention Scope 3 emissions. The expectation that disclosure be made 'especially' for Scope 1 and Scope 2 emissions means that there is no expectation for Scope 3 disclosure, or that there is an expectation, but not to the same extent as with respect to Scope 1 and 2 emissions disclosure. This point is subject to interpretation, but in practice, it is not recognized as something that should be proactively disclosed.[230] The Disclosure Principles require that companies determine whether or not to disclose narrative information depending on the materiality of the impact of narrative information on their own corporate value and business performance.

In 2024, the FSA indicated its intention to require TSE Prime-listed companies with a market capitalization of 3 trillion yen or more to disclose their Scope 1 and 2 GHG emissions as early as the fiscal year ending March 2027, and to disclose the emissions of all of their business partners along the supply chain, such as during the procurement of raw materials, production, transportation, and sales (Scope 3 emissions).[231] A revised proposal was made based on the opinions received on the public draft in November, and the standard was finalized in March 2025 (see the discussion in Part 4.3(ii)). The disclosure standards of the SSBJ are the accounting standards for Japanese domestic companies, and must be processed in accordance with them under the *Financial Instruments and Exchange Act* and the *Companies Act*. The timing of application of SSBJ's disclosure standards will depend on the rules of the Financial Services Agency.

These changes are being implemented after extensive consultation with the FSA Financial System Council with respect to making the disclosure system enhance constructive dialogue between investors and companies.[232] The Financial System Council set up the FSA Disclosure Working Group, and the changes are based on its findings that companies' securities reports should appropriately disclose their sustainability-related initiatives to make Japanese capital markets more attractive globally.[233]

The TSE has also strongly endorsed ESG disclosure, including disclosure of climate-related risks.[234] Starting with the fiscal year ending March 2025, sustainability disclosure was optional because the SSBJ standards had not yet been finalized at that time. After the sustainability accounting standards are

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[229] Minister for Financial Services, Taro Aso, Consultation Paper to Financial System Council (25 June 2021), (document in Japanese) https://www.fsa.go.jp/singi/singi_kinyu/soukai/siryou/20210625/5.pdf (hereafter Minister for Financial Services, Consultation Paper).

[230] According to a survey by Detroit Tohmatsu, of the 3,553 listed companies, only about 20% disclosed their Scope 1 and Scope 2 reduction results in their fiscal year 2023 securities reports. Only 4% disclosed their Scope 3 reduction results. (2024/12/11 04:00 Nikkei News Archive: 「温暖化ガスの排出量開示義務化へ　課題と対応を聞く」 [ translated title is Greenhouse gas emissions disclosure to become mandatory: Issues and responses] According to another survey, of the 2,336 listed companies that submitted securities reports for the fiscal years ending February and March 2023, 14% (320 companies) disclosed Scope 1 reductions, 14% (318 companies) disclosed Scope 2 reductions, and 4% (86 companies) disclosed Scope 3 reductions.(KPMG AZSA Sustainability Co., Ltd.,有価証券報告書　サステナビリティ情報開示に関する調査 2023 (October 2024)[translated title is "Survey on sustainability information disclosure in securities reports submitted in fiscal year 2023"] https://assets.kpmg.com/content/dam/kpmg/jp/pdf/2024/jp-sustainability-disclosure.pdf).

[231] 2024/12/11 04:00 Nikkei News Archive: 「温暖化ガスの排出量開示義務化へ　課題と対応を聞く」 [ Japanese Article: Greenhouse gas emissions disclosure to become mandatory: Issues and responses] . FSA, F*SA Strategic Priorities July 2024 - June 2025,* strategicpriorities_jul24-jun25.pdf.

[232] Minister for Financial Services, Consultation Paper, *supra* note 229.

[233] Financial Services Agency, 'Summary of Report by the Working Group on Corporate Disclosure of the Financial System Council' (13 June 2022), https://www.fsa.go.jp/singi/singi_kinyu/tosin/20220613/03.pdf. See, Satoshi Agari, Wakako Kasai and Kiyotaka Morioka, 企業内容等の開示に関する内閣府令等の改正 [translated title is" Revision of Cabinet Office Ordinances on Disclosure of Corporate Information, etc." ], 2320 Shoji-Homu 4 (March 2023).

[234] Tokyo Stock Exchange, 'Japan's Corporate Governance Code Seeking Sustainable Corporate Growth and Increased Corporate Value over the Mid- to Long-Term' (as revised 11 June 2021), at 3, https://www.jpx.co.jp/english/news/1020/b5b4pj0000046kxj-att/b5b4pj0000046l07.pdf .

finalized, sustainability disclosure is scheduled to become mandatory for TSE-listed companies with a market capitalization of 3 trillion yen or more, starting with the fiscal year ending March 2027.[235]

The FSA also published 'Supervisory Guidance on Climate-related Risk Management and Client Engagement' as non-binding guidance to form the basis of supervisory dialogues regarding financial institutions' climate-related risk management and engagement with their clients to support clients' responses to climate-related opportunities and risks.[236] The FSA is also co-host of the Advisory Council on Scenario Data for Climate Change Risk and Opportunity Assessment; its mandate is to enhance and exchange climate-related data to support effectively addressing climate change.[237]

### *ii. Sustainability Standards Board of Japan and Draft Climate-related and Sustainability Accounting Standards*

The International Financial Reporting Standards (IFRS) are one of four permitted financial reporting frameworks in Japan.[238] For companies that use IFRS for accounting and financial reporting, the IFRS Foundation issued guidance in 2020 that stated that material climate-related financial information should be reported under many of its standards, including IAS 1 Presentation of Financial Statements, IAS 2 Inventories, IAS 12 Income Taxes, IAS 16 Property, Plant and Equipment, IAS 38 Intangible Assets, IAS 36 Impairment of Assets, IAS 37 Provisions, Contingent Liabilities and Contingent Assets, IFRS 7 Financial Instruments: Disclosures, IFRS 9 Financial Instruments, and IFRS 13 Fair Value Measurement.[239] In addition to this specific disclosure, the IFRS states that it is important for companies whose financial position or financial performance is particularly affected by climate-related matters to provide overarching disclosure.[240] Directors of companies using IFRS need to ensure their financial reporting meets these standards.

In June 2023, the ISSB finalized two new accounting disclosure standards, effective 2024: IFRS S1 General Requirements for Disclosure of Sustainability-related Financial Information (IFRS S1) and IFRS S2 Climate-related Disclosures (IFRS S2). The TCFD's framework has now been absorbed into the IFRS ISSB accounting standards for climate-related and sustainability related disclosure. The G7 countries, of which Japan is a member, have indicated their intention to adopt ISSB-aligned reporting requirements. The Sustainability Standards Board of Japan (SSBJ) was established to develop Sustainability Disclosure Standards to be applied in Japan and to contribute to the development of international sustainability disclosure standards in conjunction with the ISSB. Japan's long-term approach to disclosure is aligning towards IFRS S1 and IFRS S2.

In March 2024, the SSBJ issued its Exposure Drafts of Sustainability Disclosure Standards aligned with IFRS S1 and IFRS S2.[241] The proposed standards were revised based on the opinions received on the

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[235] Financial Services Agency, 事務局説明［Explanation by the Secretariat］at the 3rd meeting of the Financial System Council's Working Group on Disclosure and Assurance of Sustainability Information, (2024 年 6 月 28 日), https://www.fsa.go.jp/singi/singi_kinyu/sustainability_disclose_wg/shiryou/20240628/01.pdf.

[236] Financial Services Agency, *Supervisory Guidance on Climate-related Risk Management and Client Engagement,* (29 June 2018), 02.pdf (fsa.go.jp).

[237] Financial Services Agency, (28 March 2024), FSA Weekly Review No.580 March 28, 2024.

[238] The others are Japanese GAAP, Japan's Modified International Standards (JMIS), and US GAAP; IFRS Foundation, 'Japan' (2020), https://www.ifrs.org/use-around-the-world/use-of-ifrs-standards-by-jurisdiction/japan/.

[239] IFRS, 'Effects of climate-related matters on financial statements', (20 November 2020), at 1, https://www.ifrs.org/news-and-events/2020/11/educational-material-on-the-effects-of-climate-related-matters/. See also https://www.ifrs.org/content/dam/ifrs/supporting-implementation/agenda-decisions/2024/climate-related-commitments-apr-24.pdf and https://www.ifrs.org/news-and-events/news/2024/07/iasb-improve-reporting-climate-related-other-uncertainties-fs/.

[240] *Ibid.*

[241] Sustainability Standards Board of Japan, 'The SSBJ issues Exposure Drafts of Sustainability Disclosure Standards to be applied in Japan' (29 March 2024), https://www.ssb-j.jp/en/exposure_drafts/y2024/2024-0329.html.

public draft in November, and were finalized in March 2025.[242] Japan's sustainability accounting standards include transitional provisions that exempt companies from applying Scope 3 emissions disclosure (disclosure along the supply chain) for the first fiscal year reporting period after the standards are adopted,[243] with the earliest implementation date being the fiscal year ending March 2028. Companies may choose to voluntarily apply the standards from March 2025. The Exposure Drafts were developed under the assumption that the Sustainability Disclosure Standards issued by the SSBJ will eventually be required under Japanese securities law and regulations for companies listed on the TSE Prime Market, potentially commencing March 2027, and could be applied to financial reporting under Japanese GAAP, US GAAP and/or IFRS.[244] This framework is maintained in the finalized SSBJ standards. Currently, discussions are underway regarding the scope of other companies that will be required to disclose pursuant to the SSBJ standards; who will guarantee the veracity of the disclosed information; the standards, scope, and level of assurance; and the establishment of an assurance system.[245]

The SSBJ decided to incorporate all the requirements of IFRS S1 and IFRS S2 in the Japanese sustainability and climate-related disclosure standards, and to add, when considered necessary, any jurisdiction-specific options the entity can choose to apply.[246] For example, in measuring GHG emissions, if an entity is subject to Japan's *Act on Promotion of Global Warming Countermeasures* and chooses to report the GHG emissions measured under that *Act,* the entity shall use the latest GHG emissions data that have been submitted to the authorities as of the date authorized for the issuance of the sustainability-related financial disclosures.[247]

Among other things, it should be noted that the SSBJ's Climate Exposure Draft requires the company to disclose Scope 1, 2, and 3 GHG emissions; climate-related transition risks; climate-related physical risks; climate-related opportunities; capital deployment; internal carbon prices; and climate-related considerations in remuneration.[248]

The SSBJ reports that it developed the Exposure Drafts following the FSA's direction that the scope of companies that would be required to apply the SSBJ standards should be those companies that centre their business on constructive dialogue with global investors (all or a portion of companies listed on the TSE Prime Market); and the standards can be applied by companies other than those listed on the Prime Market where other laws require sustainability-related financial disclosures, or for companies that prepare sustainability-related financial disclosures on a voluntary basis.[249]

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[242] *Ibid.* SSBJ, About SSBJ Standards (06 March 2025), https://www.ssb-j.jp/jp/wp-content/uploads/sites/7/20250305_e.pdf. See also E de Wit *et al*, 'Review of climate-related financial disclosure regimes around the world', (Norton Rose Fulbright, June 2024), https://www.nortonrosefulbright.com/pt-br/knowledge/publications/9261bbcf/review-of-climate-related-financial-disclosure-regimes-around-the-world#section7. IFRS Foundation, 'Progress on Corporate Climate-related Disclosures', (12 November 2024) at 132; *Progress on Corporate Climate-related Disclosures—2024 Report*.

[243] (Paragraph 103(2) of Theme-based Sustainability Disclosure Standard No. 2 "Climate-related Disclosures" [サステナビリティ開示テーマ別基準第 2 号 103 項(2)]).

[244] Sustainability Standards Board of Japan, *ibid.*

[245] The Financial System Council under the Financial Services Agency established the Working Group on Sustainability Disclosure (Reporting) and Assurance on 26 March 2024. See, Financial Services Agency, Press Release (English Summary) on 25 March 2024, https://www.fsa.go.jp/en/newsletter/weekly2024/581.html#e10 金融審議会「サステナビリティ情報の開示と保証のあり方に関するワーキング・グループ」（第１回）議事次第 (26 March 2024), https://www.fsa.go.jp/singi/singi_kinyu/sustainability_disclose_wg/shiryou/20240326.html.

[246] Sustainability Standards Board of Japan, *supra* note 241.

[247] *Ibid* at 4, citing paragraph 53 of the Climate Exposure Draft.

[248] *Ibid,* paragraphs 46 through 88 of Theme-based Sustainability Disclosure Standard Exposed Draft No 2 "Climate-related Disclosure" dated March 2024 (or the Climate Exposure Draft), 2024ed01_04.pdf.

[249] Secretariat of the Sustainability Standards Board of Japan, 'Summary of Differences between IFRS Sustainability Disclosure Standards and the SSBJ Exposure Drafts', (March 2024), 2024ed_01_e.pdf at 1.

Sustainability issues are diverse and affect all aspects of a company's business activities. Legal obligations for companies to disclose sustainability information will affect the decision-making process for corporate activities. It puts directors in the position of having to stand by the quality of the practices that these disclosures reveal, in effect creating a clear obligation to address climate-related risks and opportunities to an adequate standard. Heightened disclosure creates a *de facto* expectation of a higher standard of care.[250] In particular, company representative and chief executive officer are listed in a company's statutory annual securities report.

### *iii. Financial Policy and Regulation are Relevant to Directors' Duties*

Financial sector regulation is important for companies as financial institutions supply both debt and equity capital to companies, and thus requirements that they have plans to oversee and manage climate-related risks and opportunities and to measure and manage the carbon footprint of financed transactions directly affects companies' access to capital.

The Bank of Japan, in launching its 2021 Strategy on Climate Change, announced that it will require financial institutions to make disclosures on results and targets on green loans and investments.[251] The Strategy on Climate Change requires financial institutions to disclose information on their efforts to address climate change; encouraging financial institutions to enhance their TCFD-aligned disclosures and to promote investments in climate-related financial products.[252] In this way, the Bank of Japan is actively supporting financial institutions in identifying and managing their climate-related financial risks, with a view to maintaining the stability of the financial system and the smooth-functioning of financial intermediation.[253] The strategy includes on-site examinations of measures financial institutions are taking, and working with financial institutions to enhance their disclosures, both qualitatively and quantitatively.[254]

In October 2023, the Japan Public and Private Working Group on Financed Emissions to Promote Transition Finance published a paper titled 'Addressing the Challenges of Financed Emissions'. In July 2024, the Expert Panel on Sustainable Finance of the FSA published its fourth report,[255] highlighting sustainability finance from July 2023 to June 2024. This report introduces efforts to incorporate transition plans as part of internal risk management and customer support for financial institutions, as well as efforts to position decarbonization transition strategies in financial institutions' future business strategies and capital policies.

As part of its monetary policy under the Strategy on Climate Change, the Bank of Japan introduced the 'Funds Supplying Operations to Support Financing for Climate Change Responses', allowing financial institutions to receive funds from the Bank against their investment or loans that contribute to Japan's actions to address climate change, using counterparties.[256] From 2021 to January 2024, with 81 eligible counterparties, it provided loans amounting to 8.1 trillion yen and plans to continue to offer loans

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[250] Tomoyo Matsui, サステナビリティ開示の現況 [translated title: Current Status of Sustainability Disclosure] 1598 Jurist 16 (June 2024). See Yamada, Sarra, and Nakahigashi, *supra* note 143 at 39.
[251] Bank of Japan, *The Bank of Japan's Strategy on Climate Change* (16 July 2021), The Bank of Japan's Strategy on Climate Change.
[252] *Ibid.*
[253] Kuroda Haruhiko, Governor of the Bank of Japan, 'The Bank of Japan's Strategy on Climate Change', (27 July 2021), The Bank of Japan's Strategy on Climate Change (boj.or.jp). Bank of Japan, 'Climate Change Initiatives: Disclosure Based on TCFD Recommendations', (27 May 2022), https://www.boj.or.jp/en/about/climate/tcfd22.pdf (hereafter Bank of Japan Climate Change Initiatives).
[254] *Ibid.* Bank of Japan, Climate Change Initiatives: Disclosure Based on TCFD Recommendations" (29 May 2024), tcfd24.pdf (boj.or.jp).
[255] FSA, *The Expert Panel on Sustainable Finance, The Fourth Report* (9 July 2024), https://www.fsa.go.jp/singi/sustainable_fina(nce/siryou/20240709/01.pdf (Text in Japanese).
[256] Bank of Japan, *supra* note 251 at 5-6.

biannually (in principle) while accepting additional counterparties. The Bank requires counterparties to disclose a certain level of information based on the TCFD recommendations, including disclosure of the criteria used to determine which investment or loans can be used so as to ensure disclosure in accordance with international standards. Counterparties will be able to receive funds until the end of fiscal 2030. Given that efforts to address climate change will advance over time, the counterparties can make rollovers while determining yearly which investment or loans can be used for the Bank's fund provisioning.

The Bank of Japan is actively promoting investment in climate-related financial products as part of international financial cooperation in Asia and has committed to purchasing green bonds issued by foreign governments.[257] The Bank of Japan set up a Climate Coordination Hub (CCH), an internal network, with members from the Secretariat of the Policy Board, the Monetary Affairs Department, the Financial System and Bank Examination Department, the Payment and Settlement Systems Department, the Financial Markets Department, the Research and Statistics Department, and the Institute for Monetary and Economic Studies.[258]

Another policy signal is that in 2019 the Bank of Japan joined the Network for Greening the Financial System (NGFS), a group of central banks and supervisors concerned with the systemic risks of climate change to the global financial system.[259] Other member banks, such as in the UK, the European Union (EU), and Australia, require stress-testing of domestic and cross-border financial institutions, and the Bank of Japan in 2022 introduced its Financial Macro-econometric Model (FMM) that it employs in its macro stress testing to examine the risk resilience of Japan's financial system in a comprehensive and quantitative manner.[260] The Bank of Japan now semiannually publishes the results of its analyses based on this model.[261]

The Bank of Japan’s 2024 report emphasizes that banks need to continue to properly manage risks related to digital technologies and climate-related financial risks.[262] The Bank reports that climate change could affect the stability of Japan’s financial system and financial institutions therefore need to grasp the impact of climate change in a forward-looking manner, assessing climate-related financial risks using scenario analysis, understanding the financial impact of significant adjustments that could occur in the short term. It reports that while developments in climate-related loans and investments in Japan, especially green finance, have been relatively weak since the start of 2024, transition finance, which supports steady decarbonization, has remained on an uptrend.[263]

In cooperation with the FSA, the Bank of Japan has been carrying out pilot exercises of scenario analysis based on common scenarios since financial year 2021, targeting major financial institutions.[264] Based on these pilots, the Bank’s May 2024 report highlights the importance of financial institutions developing their climate scenario analyses in line with their size and characteristics.[265] It is conducting

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[257] Bank of Japan, *ibid.*
[258] Bank of Japan Climate Change Initiatives, *supra* note 253 at 2, citing the *Bank of Japan's Strategy on Climate Change, supra* note 251.
[259] Bank of Japan, *supra* note 12.
[260] Bank of Japan, ‘The Financial Macro-econometric Model (FMM, 2022 Version)’ (30 March 2023), “The Financial Macro-econometric Model (FMM, 2022 Version)”.
[261] Bank of Japan, Financial System Report (October 2024), Financial System Report.
[262] *Ibid.*
[263] *Ibid* at 66.
[264] The Bank has committed to measure and disclose direct (Scope 1) and indirect (Scope 2) carbon dioxide ($CO_2$) emissions arising from its own business operations every fiscal year (Chart 4). Efforts so far have yielded a decrease in $CO_2$ emissions in recent years compared to previous levels.
[265] *Financial System Report Annex Series: Regional and Shinkin Banks' Recent Efforts to Address Climate Change* (FY2023); *Scenario Design for Climate-Related Risk Analysis: Application and Challenges of Integrated Assessment Models; Top-Down Scenario Analysis of Climate-Related Financial Risks*: *Perspective from Time Horizon and Inter-Industry Spillovers;* and

Market Functioning Surveys concerning climate change, covering a broad set of market participants, in order to assess the functioning of Japanese financial markets in relation to climate change.[266] In May 2024, the FSA and Bank of Japan published the framework for the second climate-related scenario analysis exercise, which will be conducted in financial year FY2024, and will focus on the impact of climate-related risks on loans over a shorter horizon.[267]

### *iv. Greenwashing Concerns*

In 2022, the FSA was concerned that the number of investment products that incorporate ESG factors in their names and investment strategies was increasing but that their actual investments may not be commensurate with such ESG claims ('greenwashing'). It conducted a survey of 225 publicly-offered investment trusts managed by 37 asset managers in Japan. It then issued 'Seven Expectations for Asset Management Companies managing ESG Investment Trusts'.[268] In addition, in 2023, the FSA revised its 'Comprehensive Guidelines for Supervision of Financial Instruments Business Operators' to define specific points for supervisors to check the disclosure on publicly-offered investment trusts, and the organizational resources and due diligence of asset managers regarding potential greenwashing.[269]

As has been observed in other countries with respect to greenwashing:

> Directors and fiduciaries must now approach their governance of climate change in the same way as they would any other financial matter. The only safeguard against liability exposure will be a proactive, dynamic and considered approach to the impact of climate change on strategy, risk management oversight and reporting... here are a number of disclosure omissions that are amongst those most likely to present a risk of misleading disclosure in practice, particularly for companies in those sectors highly exposed to physical or economic transition risks associated with climate change within mainstream investment and planning horizons. These include:
>
> - a failure to disclose material economic transition risks or physical risks to a company's financial prospects, especially in the narrative portions of the annual report…
> - denial or material understatement of risk exposure or material overstatement of strategic preparedness or risk management of relevant climate-related financial risks;…
> - an inconsistency between internal assessments on climate risk and external disclosures, such as where internal reports from management and experts indicate the impact on the business of a proposed regulation to implement the goals of the Paris Agreement would be severe, but disclosures deny that the company is able to assess those impacts; and
> - a high-level boilerplate forward-looking risk statement about the predicted impacts (or lack of impacts) of climate change on the company's operations and assets, including a statement of opinion or belief, that is not supported on reasonable grounds or not accompanied by adequate, specific disclosures on the limitations or uncertainties that materially impact on the achievement of the statement.[270]

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*Visualization and Indexation of Climate Change Narratives Using BERT and Causal Knowledge Extraction,* cited in Bank of Japan, 'Climate Change Initiatives: Disclosure Based on TCFD Recommendations' (29 May 2024), tcfd24.pdf (boj.or.jp) (hereafter Bank of Japan, Climate Change Initiatives 2024).

[266] Bank of Japan, Climate Change Initiatives 2024, *ibid.*

[267] Financial Services Agency, Bank of Japan, 'Climate-Related Scenario Analysis - Next Step in the Banking Sector' (10 May 2024), <https://www.fsa.go.jp/news/r5/ginkou/20240510/02.pdf>.

[268] Financial Services Agency, 'Seven Expectations for Asset Management Companies managing ESG Investment Trusts', in *Progress Report on Enhancing Asset Management Business 2022* (May 2022), 金融商品取引業者等向けの総合的な監督指針 新旧対照表, 02.pdf (fsa.go.jp).

[269] Financial Services Agency, *Revised Comprehensive Guidelines for Supervision of Financial Instruments Business Operators, etc,* (2023), 03.pdf (fsa.go.jp).

[270] Barker and Mulholland, *supra* note 161 at 6, 14-16.

These insights are equally applicable for companies and their directors in Japan. Disclosure of oversight and management of climate-related risks is likely to generate enhanced corporate governance as institutional investors increasingly insist that their investee companies report their management of climate-related risks and opportunities and metrics relating to decarbonization.

## 5. RESOURCES TO SUPPORT DIRECTORS

Both government and private sector resources are available to support directors in meeting their fiduciary duty to identify, oversee, and manage climate-related risks and opportunities. This part highlights several important resources.

### 5.1 Ministry of the Environment Practical Guide for Scenario Analysis in Line with the TCFD Recommendations

In 2023, the MOE issued updated guidance, 'Practical Guide for Scenario Analysis in Line with TCFD Recommendations' (Practical Guide), expressly recognizing that climate change can present clear risks and opportunities for business management.[271] The Practical Guide offers practical examples and useful materials for scenario analysis, with the goal of managing climate-related issues and increasing corporate value at the same time.[272]

The Practical Guide reports that financial impacts from moving to more efficient renewable energy include reduced exposure to future fossil fuel price increases; reduced exposure to GHG emissions and therefore less sensitivity to changes in the cost of carbon; returns on investment in low-emissions technology; increased capital availability; reputational benefits resulting in increased demand for goods and services; and a better competitive position to reflect shifting consumer preferences, resulting in increased revenues.[273]

### 5.2 Ministry of Economy, Trade, and Industry's Guidance for Integrated Corporate Disclosure and Company-Investor Dialogue for Collaborative Value Creation

The Japan Ministry of Economy, Trade, and Industry's (METI)'s 'Guidance for Integrated Corporate Disclosure and Company-Investor Dialogue for Collaborative Value Creation, 2.0' was updated in 2022 from its original publication in 2017.[274] The METI guidance is aimed at 'Sustainability Transformation (SX)', emphasizing the importance of long-term sustainable value provision by companies towards the achievement of a sustainable society.[275] The Guidance helps corporate directors and managers communicate key information regarding their business models, strategies, and governance systems as a set of value-creation scenarios to investors, based on integrated thinking.

The Guidance aims to enhance the quality of corporate information disclosure and company-investor dialogue. It reports that ESG factors are important to investors in evaluating their investments and that it is essential for companies to indicate within their strategies whether and how they recognize ESG factors, including climate-related factors, not only as risks, but also as opportunities to strengthen and transform their business models.[276] It offers advice on how companies can respond effectively to climate-related disclosure requirements, integrally organizing value elements such as values, long-term visions, business models, implementation strategies, and governance, and by clearly positioning climate-related efforts in their own value-creation scenarios.[277]

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[271] *Practical Guide for Scenario Analysis, supra* note 57.
[272] *Ibid.* Practical Guide for Scenario Analysis, 3rd Edition, (March 2022) https://www.env.go.jp/content/900498777.pdf at 6; Practical guide for Scenario Analysis in line with the TCFD recommendations 2022 (March 2023), https://www.env.go.jp/content/000120602.pdf.
[273] *Ibid* at 14.
[274] METI, 'Guidance for Integrated Corporate Disclosure and Company-Investor Dialogue for Collaborative Value Creation, 2.0' (30 August 2022), guidance_for_collaborative_value_creation_2.0_en.pdf (hereafter METI Guidance).
[275] *Ibid* at 4.
[276] *Ibid* at 28, 34.
[277] *Ibid* at 30.

### 5.3 FSA Code of Conduct for ESG Evaluation and Data Providers

In December 2022, the FSA finalized the 'Code of Conduct for ESG Evaluation and Data Providers'.[278] This voluntary code of conduct provides for ESG evaluation and data providers to endorse it on a 'comply or explain' basis. The Code of Conduct sets principles on matters such as quality of the service of ESG evaluation, managing independence and conflicts of interest, and ensuring transparency of methodologies and processes for the evaluation of companies' ESG activities.

### 5.4 The JPX-TSE Practical Handbook for ESG Disclosure

The JPX and TSE published a 'Practical Handbook for ESG Disclosure' (Handbook), aimed at supporting listed companies in their efforts to improve ESG disclosure, recognizing that many of the global frameworks for sustainability disclosure have not been translated into Japanese.[279] 'Environmental' is defined as including climate change, resource depletion, waste, pollution, and deforestation.[280] It draws on the work of the UN Sustainable Stock Exchanges initiative's 'Model Guidance on Reporting ESG Information to Investors',[281] the METI's Guidance discussed above, the TCFD recommendations, and the SASB standards.[282] The Handbook proposes four steps:

- Step 1: ESG Issues and ESG Investment. Understand ESG issues and the current situation around ESG investment.
- Step 2: Connecting ESG Issues to Strategy. Decide on what ESG issues are material to your company's strategy.
- Step 3: Oversight and Implementation. Put in place an internal structure for oversight and implementation of ESG issues and set metrics/targets, to enable steady progress on ESG activities.
- Step 4: Information Disclosure and Engagement. Having linked ESG issues to corporate value, disclose ESG information so it can be used for investment decisions, aiming for mid- to long-term corporate value creation by actively seeking dialogue with investors and other stakeholders.[283]

The Handbook recommends that identification and discussion of ESG issues should take place at the board level, given its oversight role, and should include outside directors.[284] It notes that the board of directors is responsible for oversight of whether the response to ESG issues is being suitably carried out and leading to corporate value creation. ESG issues should be included as part of board discussions on strategy, risk management, and business planning, and the board should monitor and oversee progress towards targets related to ESG activities.[285] It also recommends that listed companies disclose and provide their ESG information in English so that overseas investors can easily access the information, taking into account the proportion of the company's investors that are overseas.[286]

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[278] FSA, 'The Code of Conduct for ESG Evaluation and Data Providers', (15 December 2022), "the Code of Conduct for ESG Evaluation and Data Providers"：17 ESG Evaluation and Data Providers have endorsed the "Code of Conduct".

[279] Japan Exchange Group, Inc and Tokyo Stock Exchange, Inc published a *Practical Handbook for ESG Disclosure,* (31 March 2020), [English translation 25 May 2020], at 17, https://www.jpx.co.jp/english/corporate/sustainability/esg-investment/handbook/index.html (hereafter Practical Handbook for ESG Disclosure).

[280] *Ibid* at 9.

[281] Sustainable Stock Exchanges (SSE) Initiative, 'Model Guidance on Reporting ESG Information to Investors', https://sseinitiative.org/wp-content/uploads/2017/06/SSE-Model-Guidance-on-Reporting-ESG.pdf (hereafter SSE Model Guidance).

[282] Practical Handbook for ESG Disclosure, *supra* note 279 at 5.

[283] *Ibid* at 7.

[284] *ibid* at 33.

[285] *Ibid* at 33.

[286] *Ibid* at 48.

The Handbook recommends setting suitable metrics to measure progress on GHG emissions reductions, emissions intensity, energy usage, intensity and mix, water usage, environmental operations and oversight, and climate risk mitigation, in line with the company's strategy or ESG action plan.[287] Suitable metrics should be set based on where and in what way the chosen material issues will affect the company's business, recommending use of SASB and other metrics already established.[288] In terms of how to set specific targets, the Handbook recommends that each company should use a process suitable for its circumstances, but in general, the company should calculate future predictions by looking at past achievements and set targets by looking to targets set by domestic or overseas organizations, 'backcast' as endorsed by the TCFD recommendations.[289]

The Handbook notes the Guidance issued by the World Federation of Exchanges, a global industry association for the world's main exchanges, that there should be a board statement setting out material issues that are identified and embedded in its strategy, and how the board reviews progress against identified targets. Boards should make clear how their selected ESG issues link to value creation/destruction; companies should explain to investors how they identify their material issues; and they should ensure that their reporting is accurate, timely, and follows one of the internationally recognized reporting standards.[290]

The publication of the Handbook reflects the JPX's and TSE's strong endorsement of ESG disclosure, including disclosure of climate-related risks.[291] The JPX is an active member of the Sustainable Stock Exchanges Initiative, aimed at building the capacity of stock exchanges and securities market regulators to promote responsible investment in sustainable development and advance corporate performance on ESG issues.[292]

### 5.5 Japan's TCFD Consortium Guidance

In 2019, a Japanese 'TCFD Consortium' was launched as a platform for debate on how to make company disclosure based on the TCFD recommendations more effective, and how to make sure that it leads to more appropriate investment decisions from financial institutions.[293] The FSA, the METI, and MOE supported the establishment of this industry-led TCFD consortium.[294] METI had established the 'Study Group on Implementing the TCFD Recommendations for Mobilizing Green Finance through Proactive Corporate Disclosures' to consider methods of disclosure in accordance with the TCFD recommendations, leading to the development of the TCFD Consortium's guidance for utilizing climate-

[287] *Ibid* at 45.
[288] *Ibid* at 36. SASB has published standards for 77 industries, SASB Standards, https://www.sasb.org/standards-overview/download-current-standards/.
[289] Practical Handbook for ESG Disclosure, *supra* note 279 at 36.
[290] *Ibid* at 67, citing WFE ESG Guidance and Metrics, https://www.world-exchanges.org/news/articles/world-federation-exchanges-publishes-revisedesg-guidance-metrics, and the Global Reporting Initiative Standards, https://www.globalreporting.org/standards. Japanese: https://www.globalreporting.org/standards/gri-standards-translations/gri-standardsjapanese-translations-download-center/.
[291] Practical Handbook for ESG Disclosure, *supra* note 279.
[292] Sustainable Stock Exchanges Initiative (2024).
[293] TCFD Consortium Japan, 'Guidance for Utilizing Climate-related Information to Promote Green Investment', https://tcfdconsortium.jp/en/news_detail/19100802) and https://tcfd-consortium.jp/en. SASB has also published a TCFD Implementation Guide (https://www.sasb.org/knowledge-hub/tcfd-implementation-guide/) in co-operation with the Climate Disclosure Standards Board, and has translated this guide into Japanese (https://www.sasb.org/knowledge-hub/tcfd-implementation-guide-japanese/).
[294] UN PRI, *Final Report on Fiduciary Obligation in the 21st Century,* at 43, https://www.unpri.org/download?ac=9792.

related information to promote green investment.[295] In October 2022, the TCFD Consortium released *Guidance on Climate-related Financial Disclosures 3.0*.[296]

The work of Japan's TCFD Consortium aligns with global developments. In February 2025, support for the TCFD governance and disclosure framework had grown to over 5,000 organizations globally.[297] As noted earlier, the TCFD ended its mandate in favour of the ISSB standards and companies are moving to use the ISSB Standards.[298] In 2023, JPX reported survey results of 400 surveyed companies that make up 76% of the total market capitalization of all companies listed on TSE.[299] It found that of TCFD's 11 recommended disclosures, more than 65% of companies were disclosing governance, risks and opportunities, and Scope 1 and Scope 2 emissions. 48% were disclosing Scope 3 emissions, and 47% were integrating climate into their overall risk management strategies or assessing the resilience of their strategies based on scenario analysis.

In September 2024, the TCFD Consortium released its *Transition Plan Guidebook,* a detailed guide to companies formulating transition plans.[300] It defines transition plans as 'decision-useful information that provides the clearest possible picture of how a company can balance value creation with the transition to a low-carbon, decarbonized society' and identified three basic concepts, (1) transition to a low-carbon, decarbonized society, (2) alignment with business strategy, and (3) reaching out to others. On this basis, the guidebook explains how transition plans should be formulated.[301] It acknowledges that while discussion of the transition plan for climate-related disclosure is in its early stages, transition plans are an integrated form of the current TCFD-based disclosure and the disclosure based on IFRS S2, in alignment with the business strategy.[302]

The TCFD Consortium also reports that the 'GX League', established in 2022 with the support of companies and commencing full scale activities in 2023, requires participating companies to declare carbon neutrality by 2050 and to formulate and announce their own transition strategies to achieve it.[303] The TCFD Consortium reports:

> The GX League was established in 2022 with the support of companies and began full scale activities in 2023 with the participation of companies. The GX League states that participating companies are required to declare carbon neutrality by 2050 and to formulate and announce their own transition strategies to achieve it. Participating companies are required to set their own emission reduction targets and conduct emissions trading according to their level of achieving the targets. The transition strategy in the GX League is considered to include (1) the target year for carbon neutrality, (2) the independently determined domestic reduction target in the GX-ETS or quantitative reduction target for fiscal 2030, (3) specific measures with time limits, and (4) the governance system for implementing the strategy.

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[295] TCFD Consortium, *Guidance on Climate-related Financial Disclosures 2.0* (TCFD Guidance 2.0), TCFD Guidance 2_0_2_e.pdf. TCFD Consortium Japan, 'Guidance for Utilizing Climate-related Information to Promote Green Investment', *supra* note 293. Ministry of Economy, Trade and Industry, 'Guidance for Climate-related Financial Disclosures', https://www.meti.go.jp/english/press/2018/1225_006.html.
[296] TCFD Consortium, 'The TCFD Consortium announces the release of Guidance on Climate-related Financial Disclosures 3.0 (TCFD Guidance 3.0)' (5 October 2023), The TCFD Consortium announces the release of "Guidance on Climate-related Financial Disclosures 3.0 (TCFD Guidance 3.0)" | TCFD Consortium.
[297] TCFD, *Task Force on Climate-related Financial Disclosures 2023 Status Report* (October 2023), *Task Force on Climate-related Financial Disclosures 2023 Status Report*.
[298] IFRS Foundation, ISSB and TCFD, https://www.ifrs.org/sustainability/tcfd/.
[299] JPX, 'Survey of TCFD Disclosure in Japan (FY2022)' (January 2023), <https://www.jpx.co.jp/english/corporate/news/news-releases/0090/tcgh510000005j2x-att/TCFDsurveyen.pdf>.
[300] TCFD Consortium, *Transition Plan Guidebook* (18 September 2024), TCFD Consortium has published the "Transition Plan Guidebook" | TCFD Consortium.
[301] TCFD Consortium, *supra* note 296 at 3, 57.
[302] *Ibid.*
[303] *Ibid* at 10.

Recommendations for the transition strategy include (1) specificity and ambition, (2) feasibility, and (3) transparency. Among these, feasibility is defined as the alignment with the medium-term management plan and other management strategies and business plans, and transparency is defined as the disclosure of the transition strategy consistent with the existing framework. It is also recommended to include measures in the supply chain. The transition strategy in the GX League can be said to be consistent with the transition plan described in the TCFD and IFRS S2. However, while the former focuses on demonstrating that measures for decarbonization can be implemented as part of achieving Japan's goals, the latter focuses on explaining how to transition to decarbonization in the process of increasing the value of companies operating globally.[304]

[304] TCFD Consortium, *Transition Plan Guidebook, supra* note 300 at 14.

## 6. SHAREHOLDER ENGAGEMENT AS A DIRECTOR ACCOUNTABILITY STRATEGY

Shareholder engagement with investee companies is another avenue to hold directors and officers accountable for their oversight and management of climate-related risks and opportunities.

In Japan, a shareholder can bring a shareholder proposal to the directors convening the general shareholders' meeting seeking to amend the articles of incorporation. A resolution of a shareholder proposal is passed, if it receives a majority of two-thirds or more of the votes of the shareholders present at the meeting.[305] In Japan, the resolution of a shareholder proposal at the general shareholder's meeting can directly amend the articles of incorporation, and directors are bound by the amended articles of incorporation. Note that it is the votes exercised by shareholders present and voting at the meeting; it does not include any unexercised votes. The corporate articles can specify a higher threshold of votes required before the corporate articles can be revised.[306] Article 355 of the *Companies Act* requires directors and officers to obey resolutions of shareholders' meetings that receive the requisite level of shareholder support.[307]

For example, if a resolution is passed at a shareholder meeting by the requisite majority to amend the articles of incorporation to state that the company must promote climate change mitigation and adaptation, directors and managers have an obligation to comply in accordance with article 355 of *Companies Act*. Failure to comply could result in personal liability. Remedies include that directors have to compensate the company for damages to the company incurred by the execution of business contrary to the articles of incorporation, as a violation of the directors' obligation to comply with the articles of incorporation (Article 423, *Companies Act).* Damages can be enforced by a shareholder representative derivative action by a single shareholder (Article 847, *Companies Act*). Liability may also constitute justifiable grounds for dismissal (Article 339, *Companies* Act).[308]

Amendments to the *Companies Act* in 2019 included changes to the rules governing shareholder proposals. Only shareholders that hold at least 1% of total votes (usually one unit of 100 shares) or 300

[305] *Companies Act of Japan, supra* note 95, Article 309 (2).

[306] *Companies Act of Japan, supra* note 95, Article 309 (2)(xi) and Chapter 5, article 466.

[307] See for example, UK, the Barclay's resolution. Resolution 29, setting the goals of Barclays to be net-zero by 2050 and commits it to a strategy, with targets, for alignment of its entire financing portfolio to the goals of the Paris Agreement; Barclays PLC Notice of Annual General Meeting 2020, Letter from Group Chairman (2020), at 1, 4, 13, https://home.barclays/content/dam/home-barclays/documents/investor-relations/reports-and-events/AGM2020/NOM-2020.PDF. See also Barclays, 'Update on Barclays' ambition to be a net zero bank by 2050' (30 November 2020), https://home.barclays/society/our-position-on-climate-change/highlights/.

[308] Article 339(1) Officers and financial auditors may be dismissed at any time by a resolution at a shareholders meeting. (2) A person dismissed pursuant to the provisions of the preceding paragraph is entitled to demand damages arising from the dismissal from the stock company, except in cases where there are justifiable grounds for the dismissal, *Companies Act of Japan, supra* note 95. Effective 1 March 2021, a Japanese company can enter into an agreement under the *Companies Act* to indemnify its directors against damage awards or settlement amounts paid or owed by directors to third parties (but not the company under a derivative lawsuit or otherwise) on claims arising from their performance as directors (except criminal or administrative fines or surcharges), and pay reasonable expenses incurred by its directors to defend themselves in proceedings. Regarding indemnification for damages paid by a director, a director is not entitled to receive indemnification if he/she is found to have acted in bad faith or with gross negligence. A defendant director may require the company to indemnify him/herself against the costs of defending any prosecution for a breach of criminal, antitrust or other law in connection with the conduct of the company's business, or against the costs of defending shareholder representative suits, even if the director is found to have acted in bad faith or with gross negligence. If the company learns that the director sought unlawful gain for his/herself or a third party or performed the duties set forth in that item with the intent of causing harm to the company, the company may make a demand to the defendant director for return of monies corresponding to the entire amount of the indemnification. Directors can also be covered by director and officer (D&O) insurance, but for both indemnification and insurance, it must be approved by majority of the board of directors or approval of shareholders owning a majority of the company's outstanding voting rights if the company has not adopted a board of directors corporate governance form. If the company is a public company, then the material provisions of the D&O policy also must be disclosed to its shareholders in the company's annual business report (*jigyo-houkoku*), S Bohrer and H Kaga, Nishimura & Asahi, 'The Corporate Counselor - Insights into Japanese Corporate Law' (August 2022), https://www.nishimura.com/sites/default/files/images/88379.pdf.

votes can make a shareholder proposal.[309] Pursuant to the amendments, shareholders are now limited in the number of proposals that they can make each year to ten proposals. The amendments came into effect 1 March 2021, with some amendments, such as providing shareholder meeting materials through the internet, in effect in 2023.[310]

### 6.1 The Growing Number of Climate-related Shareholder Proposals

Investors have made it clear that climate change is a financial risk that needs to be managed, placing climate-related proposals squarely within the duties of directors to undertake oversight and management in the best interests of the company. Shareholders are increasingly persuaded that companies should act on climate change mitigation and adaptation, and there is growing interest in pressing for transition by utilizing shareholder proposals.

While shareholders that hold the requisite votes can propose agenda items, including amending the corporate articles to require consideration of climate and other ESG matters, to date, institutional investors interested in ESG do not constitute the majority at shareholders' meetings in Japan, so it is difficult for them to have the articles of incorporation amended to state that the company must set targets for decarbonization. That situation is likely to change as climate change becomes even more urgent and regulatory disclosures requirements increase. However, it is difficult to determine whether the society-wide aspects of the climate crisis will be reflected in shareholder interests regarding the business policies of individual companies; rather, it is likely to be as a result of concern about the sustainability of the company.

Shareholder activism is starting to draw attention to the need for effective climate-related risk management. For example, in June 2020, a shareholder proposal at Mizuho Financial Group, Japan's third largest bank, proposed amending the articles of incorporation to state: 'Noting the company's support for the Paris Agreement and the Task Force on Climate-related Financial Disclosures (TCFD), the company shall disclose in its annual reporting a plan outlining the company's business strategy, including metrics and targets, to align its investments with the goals of the Paris Agreement'.[311] This resolution garnered 34.5% of votes cast, short of the two-thirds required to pass, but was supported by a significant number of global investors and two major proxy advisory services.[312]

Power companies that operate coal-burning power plants have received shareholder proposals to add a 'forbidden clause' that would amend the corporate articles to prohibit the company from operating coal-burning power plants. An example is the general shareholder meeting of Chubu Electric Power Co, Inc on 25 June 2020, in which 28 shareholders with an aggregate of 428 votes proposed adding a clause to the company's articles to prohibit operating coal-burning power plants for the purpose of adapting

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309 *Companies Act of Japan, supra* note 95*,* Article 303(2). Usually, one unit of 100 shares gives one vote to the shareholders, therefore the *Act* indicates number of votes (not number of shares). Listed companies are requested to make one unit by 100 shares by Tokyo Stock Exchange and/or other domestic stock exchanges. 'Standardization of Trading Unit', https://www.jpx.co.jp/english/equities/improvements/unit/.

310 Yamaguchi *et al, supra* note 103.

311 Mizuho Financial Group , 'Mizuho Financial Group Convocation Notice of the 18th Ordinary General Meeting of Shareholders', (20200 at 55, https://www.mizuhogroup.com/binaries/content/assets/pdf/mizuhoglobal/investors/financial-information/stock-information/meeting18_1_eng.pdf.

312 'Mizuho investors reject Japan's first shareholder climate resolution', *The Japan Times* (25 June 2020), https://www.japantimes.co.jp/news/2020/06/25/business/corporate-business/mizuho-investors-reject-shareholder-climate-resolution/#:~:text=Mizuho%20investors%20reject%20Japan%27s%20first%20shareholder%20climate%20resolution,-Sorry%2C%20but%20your&text=Mizuho%20Financial%20Group%20Inc.,-investors%20rejected%20a&text=The%20resolution%2C%20which%20its%20sponsor,aligned%20with%20the%20Paris%20Agreement.

to climate change.[313] The proposal was rejected, although it received 191,056 votes (3.3% of total votes) in favour.[314]

Similar proposals submitted to the annual general shareholder meeting of Tokyo Electric Power Company Holdings, Inc in 2020 lost the vote, but garnered 550,632 and 225,715 votes in support respectively.[315] Two municipal governments, Osaka City and Kyoto City, which hold 724,965 votes in Kansai Electric Power Co, proposed (Bill No 29) adding a clause to replace atomic-power plants with renewable energy power plants for the purpose of building a sustainable electric supply service.[316] While the proposal did not garner enough support to be passed and to amend the articles of incorporation, it received 1.32 million votes in favour, about 18.7% of total votes.[317] In these examples, the company directors opposed the shareholder proposals because they did not want a narrowing of their managerial discretion.

Osaka City has been continuing to pursue its efforts to make Kansai Electric Power Company take positive action to replace atomic-power plants with renewable energy power plants, a particularly important safety issue after the Fukusima nuclear accident in 2011.[318] In 2024, Osaka City requested that the articles of incorporation include a provision to promote the introduction of diverse energy sources and the development of new technologies that will lead to the realization of zero carbon and to make nuclear power plant operated at the minimum level. The proposal received 1.06 million votes in favour, about 15.1% of total votes. Kyoto City's 2024 proposal to Kansai Electric Power was to add a clause to the articles of incorporation stating that it will actively introduce diverse energy sources that will lead to the realization of zero carbon, and promote the use of renewable energy as the main power source, in order to reduce overall $CO_2$ emissions associated with its business activities, including power

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[313] Chubu Electric Power Co, Inc, *Dai 96 kai Teijikabunushisoukai Syousyu-go-tuchi* [Notice of Calling of 96th general Shareholders Meetings] No 8 bill [in Japanese], https://www.chuden.co.jp/resource/ir/ir_kabunushi/ir_sokai/ir_sokai_96_01.pdf.

[314] Chubu Electric Power Co, Inc, *Rinji Houkokusyo* [Extraordinary Report requested by Financial Instruments and Exchange Act] (2020/06/26) [in Japanese], https://www.chuden.co.jp/ir/ir_siryo/yukashoken/__icsFiles/afieldfile/2020/06/26/96rinzihoukokusho_3_1.pdf.

[315] Tokyo Electric Power Company Holdings, Inc, general shareholder meeting on June 25th of 2020. No 4 bill, 215 shareholders who totally have 1753 votes proposed to add a forbidden clause to operate coal-burning power plants for the purpose of adapting climate change to the articles of incorporation. Tokyo Electric Power Company Holdings, Inc*, Dai 96 kai Teijikabunushisoukai Syousyu-go- tuchi* [Notice of Calling of 96th general Shareholders Meetings] No 4 bill [in Japanese], https://www4.tepco.co.jp/about/ir/stockinfo/pdf/200526_1-j.pdf. This bill proposed a clause forbidding operation of coal-burning power plant was rejected, although 550,632 votes, about 2.12 % of the total votes, supported it. Tokyo Electric Power Company Holdings, Inc*, Rinji Houkokusyo*[Extraordinary Report requested by Financial Instruments and Exchange Act] (2020/07/02) [in Japanese] https://www4.tepco.co.jp/about/ir/library/securities_report/pdf/200702-j.pdf. The Kansai Electric Power Co, Inc, The 96th general shareholder meeting on June 25th of 2020, No 8 bill; 28 shareholders who totally have 424 votes suggested to add a forbidden clause to operate coal-burning power plants for the purpose of adapting climate change at the articles of incorporation.

[316] Osaka City, *Kansai Denryoku Kabusikikaisya nitaisteno Kabunushiteian* [The shareholder's proposal to the Kansai Electric Power Co., Inc.](2020.06.30) [in Japanese], https://www.city.osaka.lg.jp/kankyo/page/0000264358.html#r020427. The Office of Adopting Global Warming at the Bureau for Environmental Policy of Kyoto City, *Datsu Genpatu Syakai no Jitsugen he* [Getting out from depending Nuclear Plant] (2020.06.11)[in Japanese], https://www.city.kyoto.lg.jp/kankyo/cmsfiles/contents/0000271/271137/R2koho.pdf; The Kansai Electric Power Co, Inc, *Dai 96 kai Teijikabunushisoukai Syousyu-go-tuchi* [Notice of Calling of 96th general Shareholders Meetings] No 8 and No 29 bills [in Japanese], https://www.kepco.co.jp/ir/stockholder/meeting/96kai/__icsFiles/afieldfile/2020/05/26/96_syosyu.pdf. It received 225,715 votes, about 3.2 % of total votes.

[317] The Kansai Electric Power Co, Inc, *Rinji Houkokusyo* [Extraordinary Report requested by *Financial Instruments and Exchange* Act] (2020/06/26) [in Japanese](2020/06/29), 臨時報告書.

[318] Osaka City, *Kansai Denryoku Kabusikikaisya nitaisiteno Kabunushiteian* [The shareholder's proposal to the Kansai Electric Power Co., Inc.](2024.07.08) [in Japanese], https://www.city.osaka.lg.jp/kankyo/page/0000264358.html. Since 2012, Osaka City has been making shareholder proposals at Kansai Electric Power's general shareholders' meeting every year.

generation operations primarily based on renewable energy, to zero by 2050. It received 1.51 million votes in favour, about 21.3% of total votes.[319]

In 2024, numerous climate proposals were filed in respect of annual general meetings of leading listed corporations in Japan, most of them received higher levels of support than in preceding years.[320] Two shareholder proposals at Nippon Steel, Japan's largest steel producer, on alignment of CAPEX with climate commitments and financial incentivization of directors to deliver climate commitments received 21.48% and 23.01% support respectively.[321] Climate proposals filed by investor-led groups in 2022 and 2023 influenced J-Power's (Electric Power Development Co Ltd) announcement in May 2024 of a new medium-term management plan in which it will close up to 5 domestic coal plants by FY2030.[322]

ISS Corporate reported in 2024 that shareholder proposals in Japan are expected to increase, with environmental proposals becoming more sophisticated, addressing target compliance with the Paris Agreement. Companies falling short in strategic alignment and transparency, particularly in corporate finance and decarbonization initiatives, may encounter increased investor scrutiny.[323] Proposals call for enhanced transparency in lobbying activities, the development of clear transition plans, resilience of assets in the face of climate change, and the integration of environmental targets into executive compensation structures. They have garnered levels of support between 10% and 36%.[324]

ISS Corporate reports that while some companies have set net-zero targets for 2050, there is a call by shareholders for more specific transition roadmaps and time-bound targets that address climate risk mitigation, emission reductions, and a strategic shift towards low-carbon products and services.[325] Given the binding nature of successful shareholder proposals, shareholders could eventually require companies to amend their articles of incorporation to require specific actions on climate change risk management, including disclosure of their action plans and measurable targets to decarbonize.

### 6.2 Direct Engagement with Directors

Increasing shareholder engagement has also resulted in direct meetings between institutional investors and corporate boards. For example, the Climate Action 100+ network, which includes over 600 investors responsible for over 60 trillion USD in assets under management, is engaging companies on improving climate change governance, cutting emissions, and strengthening climate-related financial disclosures.[326] It is seeking commitments from corporate boards, including Japanese boards, to implement a strong governance framework that clearly articulates the board's accountability and oversight of climate change risk; to take action to reduce GHG emissions across the value chain, moving towards net-zero emissions by 2050 or sooner; and to provide enhanced corporate disclosure in line with the TCFD and sector-specific guidance - Global Investor Coalition on Climate Change Investor Expectations on Climate Change Guidelines.[327]

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[319] *Ibid.* The Kansai Electric Power Co., Inc., Notice of The 100th Ordinary General Shareholder's Meeting at 43,45-46. https://www.kepco.co.jp/english/corporate/ir/bond/meeting/pdf/e_100th.pdf The Kansai Electric Power Co., Inc., Rinji-Houkokusho [Interim Report](2024/06/24) [In Japanese].
[320] ClientEarth, 'Shareholder Proposals in Japan' (30 September 2024), Shareholder proposals in Japan | ClientEarth Asia.
[321] *Ibid.*
[322] *Ibid.*
[323] I Tietboehl and J Frank, "Japan Shareholder Proposal Landscape 2024: Shareholder Proposals to Focus on Capital Efficiency Long Term Value Creation" ISS Corporate (11 June 2024).
[324] *Ibid* at 6.
[325] *Ibid*.
[326] Climate Action 100+, https://www.climateaction100.org/about/.
[327] Climate Action 100+, 'The Three Asks', (2020), https://www.climateaction100.org/approach/the-three-asks/.

Climate Action 100+'s 'Net-Zero Company Benchmark', developed in 2020 in collaboration with EY, almost 50 signatory investors, and leading climate research and data non-governmental organizations, urges companies to establish assessment indicators that are robust, fair, and applicable to local markets and across sectors.[328]

[328] Climate Action 100+, 'Net-Zero Company Benchmark', (2020), https://www.climateaction100.org/progress/net-zero-company-benchmark/.

## 7. CONCLUSION

Japan is on track in its pledge to reduce Japan's GHG emissions, having already achieved a reduction of 20%.[329] In December 2024, the Japanese Government released a draft of a new global warming countermeasure plan, setting targets for reducing GHG emissions at 60% reduction from fiscal 2013 levels by fiscal 2035; 73% by fiscal 2040; and net-zero by 2050.[330] Japan is currently the world's third largest solar energy provider and has an active goal of tripling renewable energy capacity and doubling the global average annual rate of energy efficiency improvements, with the aim of creating a just and sustainable business environment to diversify the clean energy supply chain.[331] In line with its pathway to net-zero, Japan announced in December 2023 that it will end new construction of domestic unabated coal power plants, while securing a stable energy supply.[332]

### 7.1 Looking Ahead

Directors need to be highly attentive to changing regulatory requirements and market expectations regarding their duties to oversee and manage climate-related risks and opportunities. Many resources are available to support the design and implementation of transition plans.

#### *i. Transition Planning*

A growing number of companies in Japan have recognized the seriousness of climate-related financial risk in their securities law annual reports and the new rules will amplify this trend.[333] Key to decarbonization is transition planning. An example is Seiko Epson Corporation's Annual Securities Report, which commits Epson to becoming carbon negative and underground resource free by 2050 to achieve sustainability and enrich communities; and has the goal of reducing total emissions in line with the 1.5°C scenario by 2030.[334] It is committed to reducing the environmental impacts of products and services in its entire supply chain; achieve sustainability in a circular economy; advance the frontiers of industry through creative, open innovation; and contribute to international environmental initiatives.

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[329] Statement by Prime Minister KISHDA Fumio at COP28, *supra* note 11.

[330] 環境省地球環境局総務課脱炭素社会移行推進室「「地球温暖化対策計画（案）」に対する意見募集について」（E-GOV パブリックコメント）［Carbon-Free Society Transition Promotion Office at General Affairs Division in Global Environment Bureau of the Ministry of the Environment, "Request for opinions on the 'Global Warming Countermeasures Plan (draft)'" (E-GOV public comment)], https://public-comment.e-gov.go.jp/pcm/detail?CLASSNAME=PCMMSTDETAIL&id=195240104&Mode=0. 2024/12/25 Nihon Keizai Shimbun Morning Edition article, at 5: 「温暖化ガス、４０年度７３％減　新目標、家庭８割／産業６割減　省エネや行動変容必須」.

[331] *Ibid.*

[332] *Ibid.*

[333] See for example, Ricoh Company, Ltd., Annual Securities Report, (The 120th Business Term) From 1 April 2019 to 31 March 2020, https://www.ricoh.com/-/Media/Ricoh/Sites/com/IR/financial_data/securities_report/pdf/AnnualSecuritiesReport_120th.pdf, which discusses the need to identify medium- to long-term sustainability risks and opportunities as well as material issues faced by the corporate group, including investment decisions on risks and opportunities related to climate change recommended by the TCFD; supervise and advice on sustainability strategies, material issues, and progress against ESG targets for each business division throughout the entire Group; identify sustainability issues to be submitted for discussion at the Board of Directors and report them to the Board of Directors and the Head of the Sustainability Management Division; and reviewing its greenhouse gas reduction goals and stepping up efforts in that regard while sharing information better in keeping with the TCFD recommendations. See also Komatsu Ltd., Annual Securities Report From April 1, 2019 to March 31, 2020 (The 151st Fiscal Year), which observed: Komatsu is investing a significant proportion of its management resources, such as research and development expenditure, to comply with environmental and other related regulations and to respond to climate change issues. If Komatsu is required to incur additional expenses and make additional capital investments due to future revision of environmental regulations or future impacts of climate change, or if its development, production, sales and service operations are adversely affected by such revised regulations, Komatsu may experience an unfavorable impact on its business results, https://home.komatsu/en/ir/library/annual-security-report/sir_info_02/__icsFiles/afieldfile/2020/07/06/151th_q4_houkokusyo_e.pdf

[334] Seiko Epson Corporation Annual Securities Report (82nd term) From 1 April 2023 to 31 March 2024, https://corporate.epson/en/investors/publications/pdf/ar2024.pdf.

Its new Sustainability Reporting in its Annual Statement sets out its governance, risk management, strategy, and targets and metrics.

The corporate culture in Japan is more one of relationship than litigation, and recent innovations in corporate and financial service law have not changed that dynamic. Relationships and presenting one's best face may mean that it is difficult for outsiders to assess the dynamics of the board's oversight of climate risk, although all of the above-mentioned advances in corporate disclosure are likely to increase transparency. Transition plans will gain momentum as regulatory and market expectations increase.

Japanese companies are also looking at upside opportunities in their transition planning. For example, MS&AD Insurance Group Holdings Co, Ltd and MS&AD InterRisk Research & Consulting, Inc, in collaboration with Jupiter Intelligence, have started providing a service known as 'Climate Change Impact Assessment Service for TCFD', having 'developed a next-generation climate risk analytics system for predicting multi-hazard risks such as floods and windstorms caused by climate change', the first Japanese insurance/financial group able to provide a global climate change impact assessment by simulating various catastrophe indicators and financial impacts for different climate scenarios, time axes, and return periods based on data from the latitude and longitude.[335]

### *ii. Finance*

The Government of Japan has committed to mobilizing approximately 70 billion USD in climate finance from both public and private sources. It also announced it will contribute to the expansion of lending capacity of 9 billion USD through the provision of credit enhancements to the World Bank and the Asian Development Bank and will make contributions to the new fund of the African Development Bank. In 2023, Japan renewed its support to developing countries on climate change with an additional 23.6 million USD.[336]

In terms of developing a green and transition finance taxonomy, METI issued basic guidelines on climate transition finance aimed at transitioning Japan to carbon neutrality by 2050.[337] METI also issued 'Transition Finance Guidance' in 2021 with definitions of what constitutes green versus transition finance and 'Transition Finance Follow-up Guidance' in 2023 setting out guidance for financing to develop and disclose a credible transition strategy that will attract investors.[338] Shortly after the first guidelines, in July 2021, shipping company NYK Line issued a pair of transition bond tranches worth 20 billion yen (182 million USD).[339] METI also issued sector-specific roadmaps for promoting transition finance to support companies in raising funds for activities that can be labelled as transition finance.[340] In 2022, Japanese issuers raised almost 3.2 billion USD from 19 transition bonds, with Japanese issuers accounting for 91% of transition bonds by value.[341]

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[335] MS&AD, 'Launching Climate Change Impact Assessment Service for TCFD with Jupiter Intelligence -Global impact assessment of natural catastrophe risk from climate change' (7 July 2020), https://www.ms-ad-hd.com/en/news/irnews/irnews-5593844501232751076.html.

[336] Alexander Kirubi, "Japan renews support to developing countries on climate change with new $23.6 million", (1 May 2023) UNDP Kenya, Japan renews support to developing countries on climate change with new $23.6 million package | United Nations Development Programme (undp.org).

[337] Japan Financial Services Agency, Ministry of Economy, Trade and Industry, and Ministry of the Environment), Basic Guidelines on Climate Transition Finance (May 2021).

[338] Ministry of Economy, Trade, and Industry, 'Transition Finance Guidance', Transition Finance / METI Ministry of Economy, Trade and Industry (2021, updated 2024)); Transition Finance Follow-up Guidance ~ Guidance for an effective dialogue with fundraisers (June 2023).

[339] Environmental Finance, *COP29: Financing Net Zero* (November 2024) at 18.

[340] Ministry of Economy, Trade, and Industry, 'Toward a Transition to Decarbonization - Transition Finance', (8 February 2024), <https://www.meti.go.jp/english/policy/energy_environment/transition_finance/index.html>.

[341] Environmental Finance, *supra* note 339 at 19.

### *iii. Circular Economy*

Japan has embraced the move to a circular economy, in which there are net-zero emissions or climate positive emissions (going beyond net-zero). METI's 'Circular Economy Vision 2020' urges a shift to new business models with higher circularity, aims at acquiring appropriate evaluation from the market, and results in early establishment of a resilient resource circulation system.[342] In addition, the Japan Partnership for Circular Economy (J4CE) is a public-private partnership between the Government and Keidanren (Japan Business Federation) aimed at fostering a circular economy.[343]

These efforts are supported by organizations such as the Japan Climate Leaders' Partnership (JCLP), a coalition of more than 250 Japanese companies that believe that economic prosperity and sustainability go hand in hand; and the Japan Climate Initiative, a network of over 800 companies, local governments, research institutions, and non-governmental organizations committed to strengthening communication and exchange of strategies and solutions among all actors that are implementing climate action in Japan.[344]

### *iv. Protection of Biodiversity*

Globally, the Taskforce on Nature-related Financial Disclosures (TNFD) has now developed a set of disclosure recommendations and guidance that encourage and enable business and finance to assess, report, and act on their nature-related dependencies, impacts, risks, and opportunities, aimed at enabling businesses and finance to integrate nature into decision making. Its aim is to support a shift in global financial flows away from nature-negative outcomes and toward nature-positive outcomes, aligned with the Global Biodiversity Framework.[345] It has released sector guidance using the four TCFD pillars as a starting point for disclosures. In 2024, the ISSB announced that it will commence work on disclosure requirements relating to risks and opportunities associated with biodiversity, ecosystems, and ecosystem services.[346]

Biodiversity management will increasingly become an issue for Japanese directors. Japan has rich biodiversity and Japan's capital market and companies face moderate to high dependency on nature, especially in the energy, food, beverages, and tobacco sectors.[347] These developments are relevant to directors' oversight of climate-related risks because many Japanese companies have high direct dependency on nature. It is estimated that public equities in Japan are particularly exposed to nature-related risks, with 18% (938 billion USD) of the local stock market's capitalization comprised of companies in sectors with a higher direct dependency on nature.[348] In particular, biodiversity risks may constitute material financial risks that directors have a duty to oversee. The Japanese Business Initiative for Biodiversity is exploring the links between business and biodiversity best practice.

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[342] METI, 'Circular Economy Vision 2020', (22 May 2020), https://www.meti.go.jp/english/press/2020/0522_003.html; in Japanese: 循環経済ビジョン 2020（概要）https://www.meti.go.jp/press/2020/05/20200522004/20200522004-1.pdf.

[343] Ministry of Foreign Affairs of Japan, *Climate Change Japan's initiative toward net-zero GHG emissions by 2050,* (October 2021), https://jprsi.go.jp/files/event_material/d1_1_03_en_meti.pdf.

[344] Japan Climate Leaders' Partnership, https://japan-clp.jp/en. Japan Climate Initiative, Japan Climate Initiative (2024).

[345] Taskforce on Nature-related Financial Disclosures, The Taskforce on Nature-related Financial Disclosures (2024).

[346] ISSB, 'ISSB to commence research projects about risks and opportunities related to nature and human capital' (23 April 2024), IFRS - ISSB to commence research projects about risks and opportunities related to nature and human capital.

[347] CCLI/CGI, *Directors' Duties Navigator: Climate Risk and Sustainability Disclosures* (Fourth edition, September 2024), https://hub.climate-governance.org/Resource/directors-duties/directors-duties-in-japan/pdf.

[348] Asia Investor Group on Climate Change, Japan's capital market is exposed to nature-related risks: new research by AIGCC, (June 2024), Japan's capital market is exposed to nature-related risks: new research by AIGCC - Asia Investor Group on Climate Change.

Japanese companies make up the largest cohort of early adopters of the TNFD. As of January 2025, 44 Japanese companies/organizations have adopted the TNFD recommendations.[349] Japan has also established a TNFD consultation group, co-convened by Keidanren Committee on Nature Conservation, Norinchukin Bank, and MS&AD Insurance Group, to bring together private sector organizations to discuss nature-related business and finance issues and the future adoption of the TNFD framework.[350]

#### *v. Impact of International Regulation on Japan Company Exports*

Regulation from other jurisdictions will also impact Japanese businesses. For example, automobile emission regulations introduced in Europe effective 2021 have resulted in some Japanese companies expressing concern that they may not be able to achieve emissions reductions targets, which could result in substantial fines and loss of business.[351]

On 25 July 2024, the EU *Directive on corporate sustainability due diligence* entered into force, aimed at fostering sustainable and responsible corporate behaviour in companies' operations and across their global value chains by requiring companies in scope to identify and address adverse human rights and environmental impacts of their actions inside and outside Europe.[352]

Another EU measure likely to affect Japanese companies operating in Europe is the Carbon Border Adjustment Mechanism (CBAM), fully in effect in 2026, which is the EU's tool to put a fair price on the carbon emitted during the production of carbon intensive goods that are entering the EU, and to encourage cleaner industrial production in non-EU countries; the CBAM is aimed at ensuring the carbon price of imports is equivalent to the carbon price of domestic production, and that the EU's climate objectives are not undermined.[353]

As all these developments unfold, corporate directors will be expected to stay current and exercise effective oversight of climate-related financial risks and opportunities.

### 7.2 Practical Implications for Directors

Given that Japan's Government and regulators have become increasingly emphatic regarding the need for companies and their directors to adopt climate resilience measures in business practices and disclosure. Well-counselled boards of directors will:

- Ensure climate-related risks and opportunities are integrated into board governance, strategy, and oversight responsibilities and are receiving timely consideration and focus, as well as giving climate-related issues sufficient time on the board agenda.

- Ensure climate-related issues are fully integrated into strategic planning and oversight of risk management, including financial and operational risk management, and that the board understands the relevant risks and opportunities for the company in the short, medium and long term.

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[349] Taskforce on Nature-related Financial Disclosures, Adopter by Country (2025), https://tnfd.global/engage/tnfd-adopters-list/?_sfm_adoption_year=2025&_sfm_hq-country=Japan.

[350] CCLI/CGI, *supra* note 346 at 17.

[351] Nikkei Business Newspaper, Nihon Keizai Simbun morning edition, (8 September 2020) (in Japanese only). The title of the article in English is 'Climate change risk, disclosure 4 times, 264 companies in the previous term'（気候変動リスク、開示４倍 前期 264 社）.

[352] European Union, Directive on corporate sustainability due diligence (Directive 2024/1760) in force, 25 July 2024 Corporate sustainability due diligence - European Commission.

[353] EU, Carbon Border Adjustment Mechanism (CBAM), (8 January 2025), https://taxation-customs.ec.europa.eu/carbon-border-adjustment-mechanism_en. CBAM will apply in its definitive regime from 2026, while the current transitional phase lasts between 2023 and 2025.

- Ensure that responsibility for climate risk identification, management, and evaluation is assigned to a clearly-identified management team that reports directly to the CEO and the board, and ensure that the board has effective oversight of that management.

- Ensure that a process is on the board agenda, to develop and continue to enhance a climate transition roadmap, plan, or strategy to 2050, in accordance with best practice, with transparent net-zero or reduction targets and clear interim targets to 2030 and 2040 and within the current rolling multi-year strategic plan; and that there is a process for annually reporting to the board on progress in meeting the targets. For corporations that already have a transition plan, the board should ensure that strategies and risk management systems are effective in meeting interim and long-term goals.

- Delegate to the appropriate committee(s) of the board the task of translating the company's long-term strategy into a structured decision-making process for each aspect that is relevant to each committee's terms of reference.

- Ensure that material climate-related issues are being disclosed in accordance with legislative and regulatory requirements, and where necessary, consult with expert advisors.

- Ensure that the board is receiving information/education to stay current on regulatory and policy developments regarding climate-related, sustainability, biodiversity, and other evolving risks and opportunities.

By Dr Yoshihiro Yamada, Dr Janis Sarra, and Dr Masafumi Nakahigashi
March 2025

CCLI Commonwealth Climate and Law Initiative

Canada Climate Law Initiative L'Initiative canadienne de droit climatique

## APPENDIX I FSA PRINCIPLES FOR RESPONSIBLE INSTITUTIONAL INVESTORS STEWARDSHIP CODE AND THE ASSET OWNERS' PRINCIPLES

The FSA has specified that the fiduciary duties of institutional investors include the duties of prudence and loyalty, requiring directors, trustees, and administrators to avoid conflicts of interest and provide services and advice in the best interests of their beneficiaries.[354] Institutional investors need to consider the intergenerational impact of their investment decisions, which means that climate change is a material consideration.[355]

In July 2022, the Expert Panel on Sustainable Finance of the FSA published its second report on the direction of policy measures for sustainable finance.[356] The report emphasizes that institutional investors must deepen their knowledge of the sustainability practices of their investee companies in order to increase the growth and sustainability of assets under management and expand the benefits for the ultimate beneficiaries over the long term.

In March 2020, the FSA issued Japan's Stewardship Code (second revised version).[357] This Stewardship Code refers to the responsibilities of institutional investors, including pension funds, to enhance the medium- to long-term investment return for their clients and beneficiaries (including ultimate beneficiaries) by improving and fostering the investee companies' corporate value and sustainable growth through constructive engagement or purposeful dialogue, based on in-depth knowledge of the companies and their business environment and consideration of sustainability (medium- to long-term sustainability including ESG factors) consistent with their investment management strategies.[358] The Stewardship Code is not legally binding regulation; however, institutional investors who adopt the Stewardship Code will voluntarily make their intentions public.

The Stewardship Code emphasizes promoting sustainable growth and consideration of ESG factors when making investment decisions.[359] It adopts the approach of comply or explain why they are not complied with.[360] The Stewardship Code emphasizes the need to monitor investee companies' governance, strategy, performance, capital structure, business risks, and opportunities, including arising from climate change, and to monitor and assess how the companies address them.[361]

The FSA publishes a list of institutional investors who have notified the FSA of their intention to accept the Stewardship Code. As of 30 June 2024, there are 334 institutional investors who have accepted the Stewardship Code.[362] Japan's Government completed the signing of the Stewardship Code by major public pension funds, such as the Government Pension Investment Fund, annually reporting on their efforts in sustainable investment.[363]

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[354] UN PRI and Baker Mackenzie, 'Recommendations of Task Force on Climate-related Financial Disclosures , review of local relevance JAPAN' at 7, https://www.unpri.org/download?ac=1406.
[355] Mizuno *et al, supra* note 52 at 1.
[356] FSA, *The Second Report by the Expert Panel on Sustainable Finance* (13 July 2022), 02.pdf.
[357] Financial Services Agency, 'Finalization of Japan's Stewardship Code (Second revised version)' (effective 24 March 2020), https://www.fsa.go.jp/en/refer/councils/stewardship/20200324.html.
[358] The Council of Experts on the Stewardship Code (FY2019), Principles for Responsible Institutional Investors: Japan's Stewardship Code (March 24, 2020) Principle 1 Guidance1-1, 01.pdf (fsa.go.jp).
[359] *Ibid.* It also and establishes a new principle regarding the provision of appropriate services to institutional investors by service providers, such as proxy voting advisors and investment consultants.
[360] The Council of Experts on the Stewardship Code (FY2019), 'Principles for Responsible Institutional Investors: Japan's Stewardship Code', (March 24, 2020) Principle 1 Guidance1-1,01.pdf (fsa.go.jp), Background at paras 13,14.
[361] *Ibid* at 10.
[362] Financial Services Agency, Stewardship Code : 334 institutional investors have signed up to the Principles for Responsible Institutional Investors as of June 30, 2024 (fsa.go.jp).
[363] Cabinet Secretariat, Grand Design and Action Plan for a New Form of Capitalism (2024 Revised Version) 55-56 (21 June 2024) ap2024.pdf (cas.go.jp). See also Stewardship Activities Report 2023-2024 (March 2024), Stewardship_Activities_Report_2023-2024.pdf.

On 28 August 2024, the Government of Japan published the 'Asset Owner Principles'. [364] Asset owners are a broad range of organizations, including but not limited to public pension schemes, mutual aid associations, corporate pension schemes, insurance companies, the funds of JST, educational corporations. The Asset Ownership Principles encourage asset owners to accept Japan's Stewardship Code.[365] In this way, the Japanese government is calling on a wider range of investment entities, not just institutional investors, to comply with the Stewardship Code.

The UN PRI observes that a growing number of Japanese institutional investors now view consideration of ESG factors when making investment decisions as an important part of fulfilling their fiduciary duty and accountability as investors.[366] They also understand the importance of reporting this process and its results to beneficiaries.[367] The UN PRI report on Japan notes that institutional investors in Japan are increasingly understanding and creating capacity to act on the stewardship responsibilities within their fiduciary duties.[368] However, it also highlighted an important aspect of Japan's corporate governance: Central to engagement with Japanese corporations is an understanding of the culture and history of each corporation and taking the time to build the trust on which effective engagement depends – an expectation highlighted in Principle 7 of the Stewardship Code.[369]

Thus, the growing recognition by institutional investors globally that their fiduciary obligation includes considering how their portfolio investing is addressing climate-related financial risk is likely to result in an increasing number of Japanese institutional investors becoming active in oversight of how their investments are reducing their carbon footprint or carbon intensity or both. Many global investors now use ESG factors in financial reporting, as part of the financial statements and the management discussion and analysis (MD&A).

The UN PRI *Final Report on Fiduciary Obligation in the 21st Century* specifies that the fiduciary duties of investors require them to incorporate ESG issues into investment analysis and decision-making processes, consistent with their investment time horizons; to encourage high standards of ESG performance in the companies or other entities in which they invest; to understand and incorporate beneficiaries' and savers' sustainability-related preferences, regardless of whether these preferences are financially material; to support the stability and resilience of the financial system; and to report on how they have implemented these commitments.[370] Commitment to these UN PRI duties regarding responsible investment has grown to over 2,500 signatories globally, investing 90 trillion USD.[371]

In 2024, ESG Research Center of QUICK Corp released the results of 'ESG Investment Survey 2023', an annual survey of Japan-based institutional investors,[372] with 73 institutions responding (46 asset managers and 27 asset owners). It reported that the proportion of institutional investors with a ratio of ESG investments to total assets under management of '90% or more' is expected to increase from the current 33% to 46% in five years. Regarding sustainability information in annual securities reports, 85% of respondents answered that they were using ESG information. Regarding the implementation status of ESG investments by methodology, 90% use 'ESG integration' to incorporate ESG factors into

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[364] Secretariat of New Form of Capitalism Realization Headquarters Cabinet Secretariat, Asset Owner Principles, https://www.cas.go.jp/jp/seisaku/atarashii_sihonsyugi/pdf/assetownerprinciplesen.pdf.
[365] *Ibid,* Supplement Principle 5-1.
[366] *Ibid* at 10.
[367] *Ibid* at 10.
[368] *Ibid* at 8.
[369] *Ibid* at 10.
[370] UN PRI, *Final Report on Fiduciary Obligation in the 21st Century,* https://www.unpri.org/download?ac=9792.
[371] UN PRI, 'ESG incorporation is an investment norm', (2020), https://www.unpri.org/pri/fiduciary-duty-in-the-21st-century-final-report/4998.article.
[372] ESG Investment Survey 2023 — Institutional Investors with ESG Investment Ratio of "90% or More" Approaching Majority in 5 Years - QUICK Corp.

investment analysis and decisions; 84% use 'engagement (dialogue)' to encourage companies to engage in ESG, and 76% exercise voting rights at general shareholders' meetings.

### 1. Case Example: the Japan Government Pension Investment Fund

Japan's Government Pension Investment Fund (GPIF) has provided leadership in disclosure of climate-related financial risk.[373] It reports that GPIF, both as a 'universal owner' (broadly diversified investor in capital markets worldwide) and a 'cross generational investor' (a super-long-term investor), must ensure the sustainable and stable growth of capital markets as a whole to earn stable returns over the long term.[374] Based on this idea, GPIF is incorporating ESG factors into its investment decisions with the expectation of improving long-term returns. All of its 246 trillion yen assets under management are now being tracked based on ESG factors.[375] It has an A+ rating from the UN PRI. Its investment principles include that: 'In order to enhance long-term investment returns and fulfill our stewardship responsibilities, we shall advance various initiatives (including the consideration of ESG factors) that promote long-termism and the sustainable growth of investee companies and the capital market as a whole.'[376]

In its FY2019 ESG Report released in August 2020, for the first time, GPIF quantified the physical and transition risks and opportunities of climate change inherent in its portfolio in terms of the potential change in the value of these securities.[377] Its annual ESG Report now presents not only the performance of ESG indexes and other direct investment results, but also quantitative analyses of trends in ESG ratings of portfolios and Japanese companies.[378] GPIF has established an investment platform that provides asset managers with an opportunity to invest in green, social, and sustainability bonds issued by multilateral development banks including the World Bank Group and government finance agencies of individual countries, which provide external asset managers with an opportunity for ESG integration in fixed income investment.[379] GPIF is also investing in the Climate Transition Bonds issued by the Japanese government in accordance with the *GX Promotion Act.*[380]

GPIF reported in March 2024 that it requires its external asset managers to proactively engage with investee companies on material ESG issues, identifying information disclosure and climate change as critical issues for fiscal year 2023. It reports that domestic equities passive managers have been recognizing long-term issues including E (environmental) and S (social), such as diversity, supply chain, human rights, and local communities as critical ESG issues, whereas this year, biodiversity was newly cited as a critical ESG issue by all passive managers.[381]

GPIF's 2020 climate change report measures the carbon footprint and GHG emissions per unit of revenue (value added) for its investee companies, examining Scope 1, 2 and 3 carbon emissions, setting

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[373] Japan Government Pension Investment Fund, 'GPIF Publishes the 'Analysis of Climate Change-Related Risks and Opportunities in the GPIF Portfolio'' (2 October 2020), https://www.gpif.go.jp/en/investment/esg/gpif_publishes_the_analysis_of_climatechange-related_risks_and_opportunitiesin_the_gpif_portfolio.html (GPIF 2020).
[374] Government Pension Investment Fund, *Annual Report Fiscal Year 2023*, (March 2024) at 18, annual_report_fiscal_year_2023.pdf.
[375] *Ibid.*
[376] *Ibid.*
[377] Government Pension Investment Fund, *For All Generations, ESG Report 2019*, https://www.gpif.go.jp/en/investment/GPIF_ESGREPORT_FY2019.pdf.
[378] Government Pension Investment Fund, *For All Generations, 2023 ESG Report* (27 September 2024), GPIF Publishes the 2023 ESG Report|Government Pension Investment Fund.
[379] Government Pension Investment Fund, *Annual Report Fiscal Year 2023*, *supra* note 374 at 82.
[380] *Ibid.*
[381] *Ibid* at 76.

out its methodology in great detail.[382] It measures carbon intensity of its portfolios by asset.[383] Compared to the prior fiscal year, GPIF reduced the carbon intensity and the carbon footprint of its portfolios by 15.3%.[384] GPIF reports that two main drivers affected its carbon footprint – changes in the quantity of GHG emissions by investee companies and changes in the types of investment held in investees.[385] It also discloses in detail the challenges due to inadequate reporting by investee companies of their carbon intensity, planning to accelerate its efforts to obtain accurate information.[386]

GPIF conducts scenario testing under 1.5ºC, 2ºC, and 3ºC scenarios, finding 1.5ºC scenario had the highest positive effect on its equity portfolios.[387] It conducted a 'portfolio potential warming' analysis regarding the future potential contributions of investee companies to global warming, and potential fossil fuel exposure, as well as risks and opportunities in its government bonds portfolio.[388] It details the emissions in its sovereign bond investments, explaining its methodology for calculating carbon footprint.[389] It undertakes predictive analysis regarding investments in new technologies and potential value diminution in sectors with high traditional environmental impacts and energy needs. GPIF also introduced a 'transition pathway initiative management quality score' (developed by FTSE), which measures the extent to which investee companies manage GHG emissions and how they respond to risks and opportunities in the transition to a lower carbon economy.[390]

In September 2024, GPIF published its 2023 ESG Report.[391] This report includes an enhanced analysis based on the TCFD recommendations, and GPIF conducted a trial analysis concerning natural capital, including biodiversity, based on the Taskforce on Nature-related Financial Disclosures analysis framework.

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[382] *Ibid* at 11 – 13.
[383] *Ibid* at 15.
[384] *Ibid* at 4.
[385] *Ibid* at 16.
[386] *Ibid* at 20-22.
[387] *Ibid* at 4.
[388] *Ibid* at 5.
[389] *Ibid* at
[390] *Ibid* at 5.
[391] Government Pension Investment Fund, GPIF Publishes the 2023 ESG Report (September 2023), https://www.gpif.go.jp/en/investment/esg/gpif_publishes_the_2024_esg_report.html.

Commonwealth
Climate and
Law Initiative

www.commonwealthclimatelaw.org
info@commonwealthclimatelaw.org