

## GREEN BOND FINANCING AND ESG ISSUES IN JAPAN

Encouraging growth in its green bond market is one of Japan's key environmental priorities. The Ministry of the Environment (MoE) is seeking to increase green bond issuances and encourage green investments into Japan. Environment, society and governance (ESG) disclosure is also an area with discussions and developments underway.

### GREEN FINANCING IN JAPAN

#### MoE Initiatives

##### MoE's Green Bond Guidelines

The MoE has introduced Green Bond Guidelines (MoE's Guidelines) with a view to increasing the visibility of green bonds and to help reduce the cost and administrative burden relating to the issuance of green bonds, based on the following three approaches:

- due consideration should be given to ensuring consistency with the International Capital Market Association's Green Bond Principles (ICMA GBPs);
- the MoE's Guidelines should reflect the state of the green bond market in Japan, which is still under development (including lowering costs and administrative burdens); and
- to ensure both domestic and overseas investors feel safe when making green bond investments, the MoE's Guidelines should seek to prevent "green-washed" bonds (bonds labelled as "green" despite having exaggerated or no environmental benefits, or whose proceeds have not been appropriately allocated to green projects) from being issued and traded as "green bonds".

The MoE's Guidelines provide a general overview of green bonds, and the criteria and procedures for their issuance. In the same way as the ICMA GBPs, the MoE's Guidelines have four core components; (i) use of Proceeds; (ii) process for project evaluation and selection; (iii) management of proceeds and; (iv) reporting. The MoE's Guidelines also cover considerations relating to external review. These components are not legally binding and there are no governing law requirements in the MoE's Guidelines. However, by following the MoE's Guidelines, Japanese issuers may avail themselves of the support of the MoE as set out below.

##### MoE's Support Programmes for Green Bond Issuances

The MoE has established certain support programmes to promote green bond issuances in Japan (see further detail below).

Given this commitment by the MoE, the establishment of the MoE's Guidelines, increasing interest in ESG investment and issues by influential governments and governmental entities such as the Tokyo Metropolitan Government and Development Bank of Japan Inc. (DBJ), Japanese issuers have increasingly been exploring the option of domestic and international green bond transactions. The volume of green bond issuances, initially driven by governmental entities and financial institutions, by Japanese corporates and real estate investment trusts (J-REITs) has surged - with the issuance

#### Key issues

- MoE Initiatives in green financing in Japan
- Differences between MoE's Guidelines and ICMA's Green Bond Principles
- The TOKYO PRO-BOND Market's Green and Social Bond Platform
- Impact of METI's TCFD Guidance

volume by Japanese issuers more than doubled in 2018 as compared to 2017. In addition, 2018 saw the world's first green convertible bond issuance (Sumitomo Forestry's green convertible bonds), as well as the first green bond issuance globally by a shipping company (NYK's green bonds). In July 2019, the Japan Institute of Certified Public Accountants published a research report regarding green bonds to describe the roles a Certified Public Accountant could play in the issuance of green bonds.

### **Differences from ICMA's Green Bond Principles**

Key differences between the ICMA GBPs and the MoE's Guidelines are listed below. These differences have mainly arisen from Japanese market practice and the 2018 update of the ICMA GBPs.

- the MoE's Guidelines include more detailed suggestions and examples, taking into consideration the relative lack of maturity of the Japanese green bond market;
- under the MoE's Guidelines, the issuer does not need to segregate the proceeds from green bond issuances, although it should track the funds and balance the proceeds and the total amounts used, and to be used, for the relevant green project(s);
- under the MoE's Guidelines, external reviews on prior issuances can be reused for similar later issuances (to reduce costs and administrative burdens); and
- the MoE's Guidelines include suggestions on how to manage and disclose unallocated proceeds from green bond issuances.

The MoE's strategy of looking closely at international standards but adapting them to fit and support the nascent green bonds market in Japan, along with focussed financial and support, will surely help facilitate the growth of those early and promising shoots we have already seen emerging, and drive investment into the decarbonisation of the Japanese economy.

**Commented by Clare Burgess  
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Discussions are currently under way by a committee comprising academics and market participants organised by the MoE to consider revisions to the MoE's Guidelines and the establishment of MoE green loan guidelines. Following a period of public comment expected around the end of 2019/beginning of 2020, the current timeline aims for the final draft guidelines to be available in February/March 2020.

### **In the event of breach**

If it is concluded that bonds issued as green bonds do not meet the criteria set at the time of issuance, the subsidy from the MoE will be subject to refund. However, even if the issuer were to breach the committed use of proceeds, or ongoing reporting commitments after issuance, it would be difficult for the MoE to make a claim against the issuer to refund the subsidies, as the subsidies are given to the issuance supporters (not to the issuer itself). Although, if the issuer has undertaken to keep complying with the green bonds criteria in agreements such as subscription agreements, the issuer may be subject to liability for damage incurred by the underwriters based on breach of contract.

### **The TOKYO PRO-BOND Market's Green and Social Bond Platform**

The Tokyo Stock Exchange (TSE) launched a dedicated platform for green and social bonds listed on its TOKYO PRO-BOND Market (a debt listing market targeting professional investors only) in January 2018. The platform allows issuers to post information relating to its green or social bonds directly on the TOKYO PRO-BOND Market website. Information that can be posted includes use of proceeds, external reviews, reporting and other related information (such as eligible projects). The TSE does not itself impose any continuing reporting or other obligations in relation to the platform. At the time of publication, there was one issuer (Japan International Cooperation Agency (JICA)) which had repeatedly listed its TOKYO PRO-BOND Market listed social bonds on this platform.

### **Non-Japanese Issuers' Green Bonds Issued in Japan**

In January 2017, EDF issued the first ever green samurai bonds, aligned with the ICMA GBPs. In November 2018, Bank of China Limited Tokyo Branch issued euroyen and euroyuan green bonds and listed them on the TOKYO PRO-BOND Market. The proceeds of the issuances are allocated to eligible green projects in the sustainable water and wastewater management or clean transportation categories and they received a pre-issuance certification from the Climate Bonds Initiative (CBI), the first CBI-certified green bond for yen-denominated bonds. The bonds were however, not listed on the TOKYO PRO-BOND Market's green and social bond platform. Further, some non-Japanese issuers have been issuing green bonds from their usual debt issuance programmes and have offered them to the public in Japan on a secondary basis (so-called "uridashi" green bonds).

## **Green Loan**

An increasing number of Japanese borrowers have turned to alternative financing formats such as green loans. After the announcement of the Green Loan Principles by the Loan Market Association and the Asia Pacific Loan Market Association in 2018, Japan Credit Rating Agency, Ltd. (JCR) started offering new services of evaluating whether loans align with the Green Loan Principles, and some Japanese banks have started offering loan products which utilise such services of JCR.

## **ESG-RELATED ISSUES**

### **ESG-related Risk Management**

Interest in "ESG-type" financing has been increasing among Japanese issuers and investors. Corporate management is increasingly expected to recognise and deal with ESG issues as an important part of their risk management. In addition, investors and financial institutions are also expected to know how their investees and issuers manage ESG-related risks, and are required to engage in dialogue with them.

To cope with such ESG-related issues, the Japan Federation of Bar Associations has published a "Guide to ESG-related Risk Management" for Japanese companies, investors, and financial institutions, in addition to the lawyers who provide legal advice to them, to suggest to them how they can talk and work together to manage the risks related to ESG issues. It covers areas such as how to establish systems to deal with ESG-related risks and make disclosures, engagement in dialogue by institutional investors, and inspections by financial institutions regarding ESG investment.

### **ESG-related Disclosure**

Although discussions on, and improvements in, ESG disclosure are in progress, there is currently no law or regulation in Japan requiring disclosure of the management status of ESG-related risks or any other ESG matters specifically. The updated Japan's Corporate Governance Code provided by the TSE encourages the listed companies to disclose the ESG information as a non-financial information.

According to a survey conducted by a Japanese life insurance association of 573 listed companies and 114 institutional investors, 28% of companies self-rated their ESG disclosure as "full", while investors rated that only 1% of companies disclose sufficient ESG information. Based on this survey, 75% of the companies disclosed ESG information on their website and only 34% disclosed ESG information along with management strategies in their Integrated Reports or their Annual Securities Reports (the annual financial reports required under the Financial Instruments and Exchange Act of Japan, and to which legal disclosure liabilities attach).

### **Japan Exchange Group (JPX)**

JPX has been promoting sustainability initiatives on several fronts in Japan. It has formulated Japan's Corporate Governance Code, offers ESG-related indices and ETFs, and has launched an infrastructure fund market. JPX also recognises the outstanding efforts of listed companies in promoting women's empowerment and employee health and productivity.

JPX joined the Sustainable Stock Exchanges (SSE) initiative in December 2017, and it has recently published a Japanese version of the SSE Initiatives Model Guidance for Companies on Reporting ESG Information.

The above measures, while encouraging Japanese listed companies to disclose ESG information, do not make it a listing or regulatory requirement.

### **METI's TCFD Guidance**

At the same time as signing up to and declaring its support for the Recommendations of the Financial Stability Board's Task Force on Climate-related Financial Disclosures (TCFD Recommendations), the Ministry of Economy, Trade and Industry of Japan (METI) formulated the TCFD Guidance in December 2018, based on the TCFD Recommendations. The TCFD Guidance recommends companies disclose financial risks or opportunities arising from climate change and contains detailed commentary and case studies, including sector-specific guidance, with the aim of promoting TCFD-based disclosure by Japanese companies. The TCFD Recommendations suggest that companies implement climate-related financial disclosure in "(publicly available) general annual financial filings". In Japan, as in other parts of the world, there have been arguments as to whether or not climate-related financial scenario analyses, or major financial issues based on

the uncertain and long-term outlook of climate change, should be disclosed in companies' Integrated Reports or Annual Securities Reports since such matters are not necessarily compatible with disclosure liabilities.

In May 2019, a "TCFD Consortium" was established for companies and institutions in Japan which support the TCFD Recommendations, with the Japanese Financial Services Agency, MoE and METI as observers, as a forum for discussing effective disclosures and appropriate investment decisions.

As of June 2019, 178 Japanese companies and institutions have expressed their support for the TCFD Recommendations, and companies have been making climate-related financial disclosure, but mainly in "voluntary" disclosures such as CSR/Environmental reports on their websites.

## **ONWARD TRENDS**

Business activities are now beginning to be determined from the perspective of "whether the act is legal from the perspective of corporate responsibility/social roles" rather than merely "is the act legal?" Green bond financing and ESG are a "soft-law" area that incentivise Japanese companies to issue or at least support green bond issuance and expand ESG disclosure from such perspective. We would recommend catching up with these movements of governmental bodies and each industry group, distinguishing soft-law matters and legal requirements, and participating in all the various aspects of this market.

## **MOE'S THREE-PRONGED SUPPORT PROGRAMME FOR GREEN BOND ISSUANCES**

First Prong - The MoE has implemented a pilot project concept in which it selects "model issuances" with the aim of disseminating information relating to examples of best practice for green bond issuances which meet the criteria of the MoE's Guidelines and which have model characteristics that may promote the issuance of further green bonds in Japan.

Second Prong – The MoE provides subsidies with respect to the expenses of certain parties who support the issuers, and potential issuers of green bonds ("issuance supporters"), by granting external reviews, providing consultation on establishing a green bond framework, and so on (however, the cost of structuring a green bond is not covered). To be eligible for this financial support, the issuers, or the potential issuers, must be based in Japan, and the proceeds must be used for businesses that contribute principally to domestic decarbonisation (such as renewable energy businesses and the construction of energy-saving buildings), or businesses that have a great effect on the decarbonisation and local revitalisation. It is not necessary for the external review to be based on the MoE's Guidelines to be eligible for these subsidies; the guidelines with which to comply may be chosen based on the issuance market and the relevant investor groups as long as compatibility with the MoE's Guidelines is reported to the MoE. As such, green bonds aligned with the ICMA GBPs, ASEAN Green Bond Standards or Climate Bond Standards could also be eligible for subsidies. Subsidies are currently subject to a maximum of 90% of the total expenses relating to the support provided or JPY40 million, whichever is lower. The maximum amount of subsidies is expected to decrease gradually over time. If the green bonds are not issued within three years after eligibility has been granted or if the bonds issued do not meet the criteria, the subsidy has to be refunded.

Third prong - The MoE has established a system for announcing the names of issuance supporters on its "Platform for Promoting Green Bond Issuance", and issuance supporters who have registered with the MoE are deemed eligible for subsidies. Foreign companies can register as issuance supporters if they have an office in Japan, such as a Japanese subsidiary or branch office, or if they have a presence such as a service desk within a business partner's location in Japan.

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