

## **Basic Approach to Sustainable Finance on Climate Change and Concrete Actions**

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### 1. Introduction

Today, “sustainable finance,” which aims to build a sustainable society through fund mobilization has become the global trend. Building a sustainable society requires not only climate change countermeasures, but a broad range of measures to achieve all goals of the UN SDGs, including securing energy access, developing resilient infrastructure, and eradicating poverty. Particularly, the world currently shares a heightened sense of urgency about climate change; and given recent developments, such as the EU Green Deal, that aims to simultaneously solve the issues of economic recovery from COVID-19 and climate change, governments are seeking policies to promote climate change countermeasures through finance.

In the world of private finance as well, ESG investment has gained wide support, based on considerations of corporate social responsibility and the impact that climate change has on corporate management.

Governments used to bear the role of providing funds to build a sustainable society. However, given the frequent occurrence of extreme weather events and the emergence of global issues, such as public health, poverty and economic disparities, it has become apparent that government funds are no longer enough to fully solve these issues<sup>1</sup>. It is estimated that a total of 71 trillion US dollars will be required from 2019 through 2040

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<sup>1</sup> For example, the United Nations Conference on Trade and Development (UNCTAD)’s “World Investment Report 2014” estimates that a funding gap of 2.5 trillion dollars exist globally in achieving the SDGs.

for solving climate change issues, which is one goal of the SDGs<sup>2</sup>.

In the Japan's Long-term Strategy under the Paris Agreement, Japan seeks to achieve a "virtuous cycle of environment and growth" through business-led innovation towards a decarbonized society. One of the pillars of the strategy is to promote the development of financial flows and the enhancement of ESG financing.

In September 2020, the Government's Study Group on Environmental Innovation Finance published the "Climate Innovation Finance Strategy 2020," in which it presented its basic approach to sustainable finance and future strategies.

## 2. Basic Approach to Sustainable Finance

In order to achieve a decarbonized society while pursuing a "virtuous cycle of environment and growth," we need not only to bring down further the cost of zero emission technologies, which are already being deployed, and to accelerate their social implementation, but also to simultaneously and comprehensively promote the development of innovative technologies and firmly deploy and utilize transition technologies that contribute to significant emission reductions and play an important role in the transition to a decarbonized society.

From this standpoint, Keidanren launched the "Challenge Zero" project in June to promote the research & development and deployment of both "net zero emission technologies" and "transition technologies," and to support these activities financially.

The aforementioned "Climate Innovation Finance Strategy 2020" also promotes financing "innovation," "transition" and "green,"<sup>3</sup> and this concept coincides with the

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<sup>2</sup> The Sustainable Development Scenario of the IEA *World Energy Outlook 2019* estimates that in order to achieve the Paris Agreement goal, a cumulative total of 71 trillion dollars in investment would be required from 2019 through 2040. This would require investment amounts that can only be achieved by mobilizing funds for not only technologies, such as renewable energy and nuclear energy, that have already attained net zero greenhouse gas emissions, but also various investment opportunities such as energy-saving technologies that serve to improve the status quo.

<sup>3</sup> Each term is defined as follows:

Innovation: Development, deployment and social implementation of innovative technologies,

Transition: Deployment and social implementation of technologies that do not achieve net zero but contribute to significant global reductions and are essential for the shift towards decarbonization,

Green: Deployment and social implementation of technologies that have already achieved net-zero.

views of Keidanren.

The Government and the business community are required to enhance such efforts and further encourage Japanese economy and society to shift toward a decarbonized society through finance.

In addition, with industrial structures and energy mixes varying from country to country, Japan should lead global decarbonization by internationally communicating the effective sustainable finance concept that will enable the mobilization of funds for a broad range of technologies and economic activities serving the shift to a decarbonized society.

### 3. Actions to Further Promote Sustainable Finance

#### (1) Innovation Finance

The Government recently announced the launching of the “Zero Emission Challenge<sup>4</sup>” in partnership with Keidanren and NEDO to promote innovation finance.

Listing and visualizing information on what kind of innovation each company is engaged in and on where they stand in terms of technology development and social implementation facilitates the provision of information required for investment decisions and contributes to forging dialogue and engagement, and developing financial products. Such visualization of information (listing and mapping companies) should be undertaken and enhanced early, and proactively encourage investors, including asset owners, and financial institutions to develop stock indices in order to facilitate funding for innovative efforts made by these companies. The business community will actively cooperate in these efforts.

On the other hand, investment in innovative technology development that are key to achieving a decarbonized society requires a long time before profits can be generated

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<sup>4</sup> A project to list and map companies that are engaged in innovations for the achievement of a decarbonized society, and to communicate the compiled output to investors in Japan and overseas for their reference when making investment or financing decisions.

and can be of high risk.

For example, the early stages of innovation, including basic and applied research and technology development, are difficult to manage with only private funds. Therefore, the Government should enhance and prioritize investment in research and development in its firm implementation of the “Environment Innovation Strategy,” formulated based on the Japan’s long-term strategy. In the following stage of deployment and implementation, the Government will need to support the formulation of a framework that enables comparison of the impacts of fund mobilization through developing common tools to calculate greenhouse gas emissions and avoided emissions. The Government will also be expected to offer a broad range of support beyond financing, such as creating initial demand and developing infrastructure through financial measures and government procurement, and securing marketability through the reform of inhibiting regulations and programs.

In addition, since discontinuous innovations can often be put in practical use or commercialized by combining different innovative technologies, the Government could also establish an open innovation-oriented platform for sharing knowledge, findings and challenges.

## (2) Transition Finance

Technologies and investments that can be covered by transition finance include promising projects covering a broad range of phases, from those that have already been put into practical use and deployment to those that will definitely contribute to significant global emissions reduction through their practical application. However, many of these projects have not been provided adequate funding for various reasons, such as that the relevant information has not been widely shared in society or that these projects bear low investment priority.

Therefore, the Government should establish a framework for transition finance that

has been designed to include adequate investment incentives, as well as various policy support measures to facilitate funding for these projects.

Japan has already proposed a basic approach to transition finance in discussions on formulating guidance on transition bonds at the International Capital Market Association (ICMA)<sup>5</sup>. The “Climate Transition Finance Strategy 2020” proposes the compilation of Japan’s basic guidelines and the formulation of industry-specific roadmaps with a focus on energy-intensive industries, from the viewpoint of establishing the credibility of transition finance.

The Government should seek to further develop these efforts in order to foster wider international understanding for transition finance and to facilitate engagement by financial institutions.

For more than 20 years, the Japanese economy has maximized the introduction of best available technologies (BATs) mainly through the Keidanren’s “Voluntary Action Plan on the Environment” and the succeeding “Commitment to a Low Carbon Society.” The Government should formulate effective basic guidelines, utilizing achievements of the business community, including its accumulation of BATs, engaging in close dialogue with the business community, which is most informed of the status and prospects of individual industries and technologies, while carefully considering the relationship between these guidelines and Japan’s NDC. The business community will proactively join discussions in the Government and offer insight on our experiences and the reality of business activities.

### (3) Green Finance

The Government should present clear-cut market scale outlook and deployment targets for zero emission technologies, and provide useful information for investment

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<sup>5</sup> In March 2020, the Government’s Study Group on Environmental Innovation Finance compiled “Concept Paper on Climate Transition Finance Principles,” stressing the importance of promoting transition finance for transition technologies to advance decarbonization, as well as promoting the financing of renewable energy and other existing technologies that have already reached levels of decarbonization.

decisions.

Furthermore, many zero emission technologies and investments that are covered by green finance are technologically established, but require some form of policy support because the market has yet to mature or because little progress has been seen in their autonomous deployment due to high costs. In order to implement such support measures, considerations should be made to achieve early autonomous deployment through cost reductions and creating new markets, avoiding market distortion and significant public burden over the long term. In particular, as Japan seeks to make renewables, which have been supported by the FIT scheme, major energy source, market integration of renewables will be required, while bringing down prices to levels comparable with international standards<sup>6</sup>.

#### (4) Disclosure

In order to create positive money flows in which companies taking concrete action toward achieving a decarbonized society are positively assessed by ESG investors as well as financial institutions in Japan and overseas, and thus gain access to funding, it is important that companies actively and effectively engage in climate-related disclosure on not only risks but also opportunities.

Japan has the largest number of entities supporting the TCFD Recommendations, and the TCFD Consortium has taken the initiative in pioneering efforts to compile guidelines to promote effective information disclosure in accordance with the TCFD Recommendations and to facilitate appropriate investment decisions. As written in the “ESG Report 2019” published by the Government Pension Investment Fund (GPIF), Japan’s business community expects increased business opportunities in addressing climate change; and therefore, further possibilities may be pursued, such as positioning

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<sup>6</sup> *The Long-term Strategy under the Paris Agreement* p. 23-24: “The Government will continue to actively promote smooth and large scale installation of renewable energy — solar energy, wind power, geo-thermal, hydropower , biomass etc. — so that it will be sustainable as a stable main power source in the long-term, reducing prices to the level comparable to the international standards and working towards self-reliance from the Feed-in Tariffs (FIT).”

innovation and transition efforts as “opportunities” under the TCFD Recommendations.

It will be important to accumulate best disclosure practices and to enlighten ESG investors in Japan and overseas, seizing opportunities such as the TCFD Summit. We must continue our efforts to increase the number of companies practicing disclosure in accordance with the TCFD Recommendations, encouraging constructive dialogue and engagement among companies and financial institutions/investors. Financial institutions and investors are expected to properly understand the novelty and challenges of corporate technologies and innovations and to play the role of coordinators that organize and facilitate partnership and collaboration among companies and industries that possess mutually complementary technologies and ideas.

There are ongoing discussions at the IFRS Foundation to set up a new board mandated with the development of sustainability reporting standards<sup>7</sup>. The new board will develop standards, with a focus on climate-related risk, based on existing frameworks such as the TCFD Recommendations. When the new board is launched, Japan should actively join discussions on developing standards.

Furthermore, with an Act on Promotion of Global Warming Countermeasures and the Japan’s Corporate Governance Code, Japan has already had an established domestic institutional foundation regarding disclosure of greenhouse gas emissions and ESG. However, given that the Japan’s Corporate Governance Code is to be revised next spring, Japan should also consider the need for further enhancement of existing institutional foundations, including clarifying the role of TCFD Recommendations in the field of climate change, while ensuring the independence and flexibility of corporate disclosure.

#### (5) International Communications and Alliance-Building

It is important for Japan to globally spread its comprehensive approach to sustainable

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<sup>7</sup> “IFRS Foundation Consultation Paper on Sustainability Reporting” (September 2020)  
<https://www.ifrs.org/news-and-events/2020/09/ifrs-foundation-trustees-consult-on-global-approach-to-sustainability-reporting/>

finance in its pursuit to lead global decarbonization and solve climate change issues. Particularly in emerging and developing economies in Asia, etc., where continued high growth is expected, the promotion of social implementation of energy-saving technologies and other transition technologies are essential for decarbonization. Therefore, Japan bears a significant role from licensing out technologies<sup>8</sup> to providing insight and organizing frameworks on finance.

It is important that the Government take part in IPSF (International Platform on Sustainable Finance) and actively introduces Japan's basic approach to sustainable finance on climate change and its best practices, thus gaining the understanding of major economies. Furthermore, Japan should actively seek collaboration and an exchange of ideas about sustainable finance with the EU, which has taken pioneering measures, as well as ICMA, Canada and Malaysia, where transition finance frameworks are being considered; and thus provide Japan's insight in sustainable finance into discussions in other countries and regions. While ICMA takes the lead in international standards in the financial sector, it is also important to closely watch ISO's activities.

Keidanren will also take collaborative measures to make sure that funds for a broad range of technologies and activities aimed at shifting to a decarbonized society are globally mobilized, by seeking partnership with business organizations in various countries and regions in Asia, Europe and the US at various international conferences, such as the Asia Business Summit, B20 and B7.

#### 4. Conclusion

Given developments in efforts made in the area of climate change, Keidanren has compiled basic approach to sustainable finance on climate change. However, as mentioned at the beginning, building a sustainable society essentially requires efforts toward the achievement of all SDGs. Based on this idea, Keidanren has promoted

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<sup>8</sup> Technology licensing from Japan to emerging and developing Asian economies will also require policy support, including reducing the credit risk of local companies shouldered by Japanese companies.



Society 5.0 for SDGs.

Keidanren will continue to promote the achievement of all SDGs and consider presenting a method for evaluating economic activities from the viewpoint of addressing all SDGs, instead of just the climate change goal.

(Table) Concrete Actions in Sustainable Finance

<p>(1) Innovation Finance</p>	<ul style="list-style-type: none"> <li>● Collaboration between the Government’s “Zero Emission Challenge” and Keidanren’s “Challenge Zero” project <b>【Government, Businesses】</b></li> <li>● Developing stock indices <b>【 Government, Financial institutions, Businesses】</b></li> <li>● Enhancing and prioritizing government R&amp;D expenditure <b>【Government】</b></li> <li>● Building frameworks enabling comparison of the impacts of mobilizing fund for innovation; e.g. common tool for GHG calculation <b>【Government】</b></li> <li>● Offering support for securing marketability through financial measures and government procurement, and reforming regulations and programs <b>【Government】</b></li> <li>● Establishing an open innovation platform for sharing knowledge, findings and challenges <b>【 Government, Businesses】</b></li> </ul>
<p>(2) Transition finance</p>	<ul style="list-style-type: none"> <li>● Formulating basic guidelines and industry-specific roadmaps for emission-intensive industries <b>【Government】</b></li> <li>● Active participation in discussions on basic guidelines and providing input on the status of technologies <b>【Businesses】</b></li> </ul>
<p>(3) Green Finance</p>	<ul style="list-style-type: none"> <li>● Clearly presenting market scale outlook and deployment targets <b>【Government】</b></li> <li>● Offering support for long-term cost reductions and creating a new market to realize autonomous deployment <b>【Government】</b></li> </ul>

<p>(4) Disclosure</p>	<ul style="list-style-type: none"> <li>● Accumulating TCFD disclosure best practices and enlightening ESG investors <b>【Government, Businesses】</b></li> <li>● Increasing the number of companies in line with TFCO Recommendations, promoting constructive dialogue and engagement, considering ways to disclose innovation and transition as an opportunity <b>【Government, Financial institutions, Businesses】</b></li> <li>● Organizing and facilitating partnerships and collaboration among different companies and industries <b>【Financial institutions】</b></li> <li>● Making further improvements to the existing institutional basis of ESG disclosure, including the Japan’s Corporate Governance Code <b>【Government】</b></li> <li>● Proactive involvement in discussions on developing sustainability reporting standards at the IFRS Foundation <b>【Government, Businesses】</b></li> </ul>
<p>(5) International Communications &amp; Alliance-Building</p>	<ul style="list-style-type: none"> <li>● Participating in IPSF and actively introducing Japan’s views, basic approach and best sustainable finance practices <b>【Government】</b></li> <li>● Offering inputs from Japan to discussions on sustainable finance in other countries and regions <b>【Government】</b></li> <li>● Working on ISO <b>【Government, Businesses】</b></li> <li>● Building partnerships with overseas business organizations in Asia, EU and the US <b>【Businesses】</b></li> </ul>
<p>(6) Others</p>	<ul style="list-style-type: none"> <li>● Promoting Society 5.0 for SDGs <b>【Businesses】</b></li> <li>● Considering methods to evaluate economic activities from the viewpoint of all SDGs <b>【Businesses】</b></li> </ul>