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How to avert a planetary tipping point: RI Japan forum

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With a focus on sustainability, human rights and the transformation of Japan into a net-zero-carbon economy, the Responsible Investor Japan 2023 conference, held at Toranomon Hills Forum on May 24 and 25, brought together opinion leaders, investors, nonprofits and government agencies to find out how theoretical and practical issues can meld with a new era of sustainability-conscious capitalism.

The two-day RI Japan in Tokyo's Minato Ward featured discussion panels on topics like the standardization of environmental, social and governance (ESG) metrics on a global scale, ESG disclosure with regard to Japan's financial markets, biodiversity loss, the greening of supply chains and mapping out scenarios for climate change.

Shinichi Kihara, deputy director-general for environmental affairs at the Ministry of Economy, Trade and Industry, provided a keynote address highlighting the importance of promoting transition finance in Japan to help corporations rapidly switch to more sustainable practices.

Greening business ecosystem

The conference also included a networking breakfast and other networking events that provided valuable opportunities for opinion leaders to make their case on a more personal level, and for key players to make contacts across the sustainable business ecosystem.

It also provided attendees a chance to speak with nonprofit and company representatives, some of which had set up information booths inside the forum. These included the FAIRR Initiative, a London-based collaborative investor network that raises awareness of ESG risks brought about by intensive livestock production. Sofia Condes, head of investor outreach at FAIRR, who presented information at the booth, spoke to participants about unsustainability in the aquaculture industry, where much of the overfishing is a result of feeding fish to other fish, and FAIRR's efforts to work with industry players toward more sustainable practices. Other information booths were attended by the investment bank Morgan Stanley, the investment research group Morningstar and the consultancy KPMG among others, all showcasing their ESG credentials.

Financing Japan's strategy

With over 30 discussion panels, forums and related events held over the two days, the conference managed to showcase some of the key industry leaders and opinion makers addressing the pressing environmental challenges faced by humanity.

Among them was a plenary session titled "Accelerating Japan's Path to Net Zero Through Green Transformation." The discussion featured Atsuko Kajiwara, managing executive officer and head of sustainable finance evaluation at the Japan Credit Rating Agency; Reiko Hayashi, director and deputy president at BofA Securities Japan; Satoshi Ikeda, chief sustainable finance officer at the Financial Services Agency; Fumihiro Kajikawa, environmental economy officer at the economy ministry; and Robert Youngman, team leader of green finance investment at the Organisation for Economic Co-operation and Development.

The key aims of the discussion were to assess how realistic green transformation policies for achieving carbon neutrality by 2050 are, as well as the role that transition bonds and transition finance can potentially play, plus gauging what lessons can be learned from other OECD countries.

Kajikawa began by saying that despite Japan being a laggard within the OECD, the ministry believes that the green transformation should be viewed as an investment rather than a cost: "Fossil fuels and hydrocarbons will become stranded assets." Ikeda was not convinced about Japan's laggard status, saying: "Since the 1970s energy shock, Japan has been working on energy conservation. Japanese business has been leading in energy-efficiency technology, and what we have already been building may fall behind without continued financial support."

Chris Russell, senior news editor at The Japan Times, moderated the session "Climate Change Scenario Planning." RI JAPAN

Hayashi saw Japan's green transformation from a global perspective and didn't share Ikeda's positive sentiment. Hayashi said that among the Group of Seven countries, Japan had consistently tried to water down agreements on carbon reduction, although she believes things are beginning to change. "Building consensus in Japan is a challenge," she cautioned. "We must build consensus with stakeholders across the board. We are in a huge international experiment, and it's important to align our goals."

Regarding transition finance, Kajikawa described the differing "carrot and stick" approaches being taken overseas. Europe is using regulations, while the U.S., especially in light of the recently passed Inflation Reduction Act by the Biden administration, is incentivizing the market mainly through targeted tax breaks and deregulation, and Japan is using a hybrid approach including tax incentives, regulation and the issuance of green bonds.

Investor-led rights revolution?

The forum "Integrating Human Rights Into the Investment Process" examined the extent to which financial institutions are responding to external pressures on human rights issues, the drivers of change, and practices taken by financial institutions. Joining the panel were Asako Nagai, managing director of the organization BSR (Business for Social Responsibility); Andrea Webster, financial system transformation lead at the World Benchmarking Alliance; Michiyo Morisawa, head of Japan at PRI (Principles for Responsible Investment); and Kana Kawasaki, head of business development for Morningstar Indexes, Japan and South Korea.

The discussion began with all the panelists agreeing that Japanese multinationals will have to ensure due diligence on human rights within their value chains. Kawasaki said that while each company makes its own investing decisions, Morningstar has the human rights data to allow corporations to integrate the cost of human rights into their investments. Morisawa expanded the definition of human rights: no discrimination by work style, no use of forced labor, ensuring clean water and hygiene, and protecting the environment. Morisawa called for greater transparency for multinationals' supply chains. Kawasaki agreed with Morisawa and said Morningstar's data could help companies identify areas for improvement.

Webster agreed there is a need for greater sharing, saying, "Companies need to break down the silos and share information with each other." European investment funds are very strong on ESG commitments, she said, and their data could be used by Japanese companies. "It's important that human rights should not be an afterthought. It shouldn't be a 'nice to have,' but should be central to investing stewardship." Webster added that companies should not let insufficiency in data keep them from moving forward on human rights. Kawasaki hoped for investor-led demand on human rights, which would be in their own interest: "Return always exceeds costs — investors will get a payoff if they push companies to be proactive on human rights."

Need to plan for the worst

Despite the best efforts toward a green transformation, the world also needs to plan for the worst, and in the forum "Climate Change Scenario Planning," panelists discussed financial risks associated with delayed action, the accuracy of modeling, and financial planning in uncertain times. Moderated by Chris Russell from The Japan Times, it was attended by Motoshi Tomita, a research scientist from Japan's Central Research Institute of Electric Power Industry; Yoko Monoe, a senior consultant at Mercer Japan; Tomohiro Kuchino, director at KPMG; and Simi Thandi, a climate economist at the FAIRR Initiative.

Tomita began the discussion by conceding that planning scenarios is very difficult because action is still not guaranteed. Monoe added some clarity by presenting a chart that could be used for investors, describing parameters for various investment scenarios — rapid transitions with a temperature rise of 1.5 degree Celsius, orderly transitions with a rise of 2.0 degrees, and failed transitions with 4.0 degrees and above — and juxtaposed the differing disruptions to business environments caused by climate change in quick and slow transitions. Monoe suggested that investors do investment modeling for all three scenarios.

Thanbi spoke about risks and opportunities in the livestock sector and the risk to food security, said only six out of 40 companies FAIRR dealt with had conducted planning on climate risk scenarios and added that she believes this is an urgent issue that needs to be addressed. Kuchino agreed, explaining that KPMG now provides climate modeling for clients to assess risk. "For a 1.5 temperature rise, a well-diversified portfolio will have the best return," he said. Monoe warned, however, that "for most companies, the tipping point has not been factored in."

The burden of knowledge

The first day finished with a cocktail reception at which many of the attendees and panelists had an opportunity to discuss and process the information they had heard. The atmosphere had grown increasingly subdued over the course of the day, with the alarming statistics leaving many of the attendees nearing their own tipping point.

To measure ecological impacts, companies first need good rulers

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How do big businesses reflect their impact on nature in their financial reporting? One of the sessions on the second day of the Responsible Investor Japan 2023 conference, May 25, focused on the challenges faced by companies whose business uses natural capital.

Companies are under increasing pressure to disclose risks and opportunities stemming from their ecological and climate impacts as people grow more concerned about overconsumption of natural resources that harms the diversity of wildlife and destroys ecosystems. According to a 2022 report by the World Wildlife Fund, global populations of mammals, fish, birds, reptiles and amphibians have declined 69% on average since 1970.

The Taskforce on Nature-Related Financial Disclosures, a U.N.-supported global organization that promotes sustainable business, in 2022 released a draft framework on nature-related risk management and disclosure to prompt corporations and financial institutions to take steps to report their impacts. The TNFD is slated to publish the final version in September.

At the session "Bringing the Biodiversity Challenge Into the Mainstream," panelists discussed how to manage biodiversity risks and how to collect reliable data for assessing them. Olivier Trecco, the head of ESG solutions for ASEAN, Japan and Australia at S&P Global Sustainable1, warned of the current speed and scale of biodiversity loss and ecosystem degradation and said it is the fourth urgent item on the agenda for the world to tackle over the next years, following climate change, failure to adapt to it, and natural disasters and extreme weather.

Attendees take a chance to network between sessions. RI JAPAN

The first issue pointed out by panelists was the traceability of raw materials and other components of products, especially those that are not core to companies' supply chains.

"For example, food companies know where the main materials of their products come from, such as tea leaves, cacao and coffee beans, and they have an impact on the producers. But if they are commodities, such as sugar and palm oil, it is hard for them to trace the distribution routes," said Junichi Adachi, the sustainable value service advisory lead partner for the consultancy KPMG in Japan. "They don't know where they come from or where they are produced."

Moreover, food makers often need to track their sources to specific farms or ranches, which are much smaller than the areas that biodiversity assessments usually involve, and so it is harder for companies to specify their biome, Adachi added.

While traceability across national borders is a big problem for some companies, others have issues involving dependency on existing ecosystems.

In the water-intensive chemical industry, for example, less than 60% of companies disclose the amount of water they draw from natural resources, which is the bare minimum that needs to be reported, said Yukie Shibano, executive director for ESG and climate research at the market index company MSCI.

Panelists reiterated difficulties associated with data collection from other countries. Although some Japanese startups specialize in collecting data related to biodiversity, they often focus solely on Japan. "What we need is global data," said Makoto Haraguchi, senior vice president for the sustainability section in the MS&AD Insurance Group.

Haraguchi, who is also one of the 40 senior executives at the top of the TNFD, pointed out a series of problems he often finds when corporations try to gather data to assess their global ecological impacts. Such data often has limited accessibility, and even if they can get it, some of it is irrelevant for business analysis purposes. Also, different countries cover different data and update it with different frequencies. Since all this makes it hard to evaluate business risks, Japanese startups and academia need to join global discussions to find solutions, he said.

Plenary 5 moderator and panelists, from left: Mutai Hashimoto, Hirotaka Hideshima, Junichi Adachi, Yukie Shibano, Olivier Trecco and Makoto Haraguchi RI JAPAN

Haraguchi also said that the TNFD hopes there will be a one-stop global platform where investors can find nature-related data from companies and their supply chains, and that such steps will require support from governments.

Another panelist maintained that any kind of index that can be used to gauge aggregated biodiversity impacts is necessary, at least temporarily. "From a financier point of view, without any indices to aggregate all data, it is hard to formulate a national goal and check how much each nation achieves the goal," said Hirotaka Hideshima, the counselor on global strategy to the president and the board of directors at Norinchukin Bank. He is also one of the TNFD members.

At the closing of the session, Adachi of KPMG said corporations and financial institutions need to set priorities in gathering data and analyzing positive and negative impacts, as a wide range of factors affect species and ecosystems. For example, soil loss due to deforestation and mining, the harvesting of minerals from seabeds, and marine and air pollution all do damage to terrestrial and sea habitats.

"Since this is a very difficult task to do, corporations need to make a consensus with investors to adapt an approach to first start working on at least a portion of their business with a high priority," Adachi said.

Investors at RI Japan developing tools to gauge firms' performance

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Impact investment has increasingly intrigued the financial world as a way to achieve returns at the same time as helping bring about solutions for the environment and society. But how do we measure its effectiveness, and can we trust it?

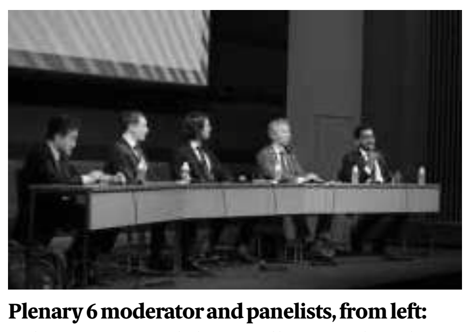
The last session of the Responsible Investor Japan 2023 conference shed a spotlight on this trend under the title "The Rise of Impact Investing as an Investment Strategy."

Recent warning signs on environmental damage, workplace stress and inequality have prompted companies and financial institutions to acknowledge these realities and act on climate and social issues.

A sense of crisis is rapidly spreading in the investment world. Out of the $130 trillion of assets under management worldwide, those related to the environment, society and governance (ESG) currently account for 30%, or about $40 trillion, and impact investing — a type of ESG investing — stands at $1 trillion to $2 trillion globally and $8.7 billion in Japan, according to Takuro Kimura, the chief executive officer for G-Cubed Partners, which provides support to early-stage ventures in emerging markets, and the moderator for the session. "It sounds very small, but the good news is that it is growing fast," Kimura told the audience at the start of the session.

GIIN (Global Impact Investing Network), the largest global community for impact investing, estimated worldwide impact investment assets at $1.164 trillion in a report published in 2022 — more than double the estimated $502 billion in its 2019 report. The network defines impact investments as those "made with the intention to generate positive, measurable social and environmental impact alongside a financial return."

Despite this sharp growth, impact investing faces challenges, including a lack of coherent ways to gauge positive effects. This problem of methodology has often invited greenwashing and misguidance by investees, panelists said. In discussing that, two panelists presented examples of measurement. One of them is methodology introduced by the International Finance Corp. (IFC), a member of the World Bank Group that gives financial support to the private sector in developing countries. In 2019, the IFC set up its Operating Principles for Impact Management, requiring signatory institutions to follow the principles and disclose the outcome. Also, the IFC launched an impact-rating tool, Anticipated Impact Monitoring and Measurement (AIMM), in 2017 to assess the impact of investment projects. The framework enables the IFC to conduct qualitative analysis of projects, which is followed by quantitative measurement scored between 10 and 100. The IFC intends to have all projects score at least 35.



Plenary 6 moderator and panelists, from left: Takuro Kimura, Philipp Müller, David Freiberg, Hiroshi Jinno and Hari Balkrishna RI JAPAN

The audience listens carefully to a discussion. RI JAPAN

"We are advocating this measurement be utilized by investors, and hopefully we will make sure the volume of impact investing will be increased and have a decent share of the global assets under management," Hiroshi Jinno, chief investment officer for IFC Tokyo, told the audience. Currently, there are more than 170 signatories to the IFC's principles in 39 countries. Among the signatories are six institutions in Japan.

Another example of methodology is impact-weighted accounts (IWAs), a way for companies to quantify their positive and negative impacts on the environment and society and disclose them in their financial accounting. A framework released by an initiative led by Harvard Business School and others proposed in 2022 how corporate financial statements could be supplemented by monetized measures of impacts.

"It allows us to create really strong, clear buckets of impact that we can then compare effectively to financial performance in a way that's understood and methodologically rigorous and open for discussion," noted David Freiberg, the impact-weighted account adviser on climate change and sustainability services for the professional services organization EY Japan.

Other panelists discussed examples of how to analyze investees' impacts when they make investments.

Philipp Mueller, the chief executive officer at BlueOrchard Finance, said it requires investees to first set their goals and specific key performance indicators (KPIs) so the Swiss-based global impact investor can understand what outcomes investees aim for. BlueOrchard then analyzes the KPIs and other corporate data by comparing them with those of companies of similar size.

Another impact investor, T. Rowe Price, uses "five dimensions of impact framework" on every potential stock before it makes an investment: the strategic goal of the impact; who experiences the outcome; the outcome's scale, depth and duration; the corporation's relative contribution; and the risk to people and the planet. The investor also utilizes a third-party impact measurement company to jointly conduct independent verification, said Hari Balkrishna, global equity impact portfolio manager at T. Rowe Price. The investment firm also takes company-specific approaches in its engagement activities with investees and conducts proxy voting to support its impact targets.

At the end of the session, panelists urged members of the audience to take steps to act as impact investors. "This is the time [when] investors, companies, borrowers and government regulators should get together to make sure everyone can be impact investors. If you don't do it this year, you will be late for the train. So, you must be on the train for the impact investing," Jinno of the IFC said.

Aiming to highlight issues related to sustainability, The Japan Times gave its support to this event by becoming a media sponsor.