

Guidance for Utilizing Climate-related Information to Promote Green Investment (Green Investment Guidance)

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TCFD Consortium



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Chapter 1 Introduction

Purpose of This Guidance

The number of organizations supporting the TCFD recommendations is increasing currently at 855 organizations worldwide, of which 194 are from Japan (as of October 1, 2019). In Japan, the TCFD Consortium was established on May 27, 2019, as a forum for companies and financial institutions, etc. supporting the TCFD recommendations to have discussions on effective information disclosure and its utilization. It is expected that in the future investors and other stakeholders (including asset owners, asset managers, banks, insurers, and other users of the information: hereinafter, referred to as “investors and other stakeholders”) will appropriately evaluate and utilize information disclosed by companies for their investment decisions.

Disclosure based on the TCFD recommendations is still at an early stage, and investment to support corporate activities to address climate change, (green investment) using the information disclosed is expected to increase, along with the future progress of disclosure. Also, providing perspectives specific to investors and other stakeholders in evaluating and utilizing the disclosed information is considered useful for facilitating proactive disclosure by companies.

In that context, in order to facilitate green investment, this Guidance provides commentary on perspectives needed by investors and other stakeholders when understanding the information disclosed based on the TCFD recommendations. To help investors and other stakeholders better understand information disclosed, this Guidance also provides examples of investment practices utilizing that information as well as viewpoints on assessments that recognize industry-specific situations while considering the alignment between the TCFD Recommendations and discussions about current state of corporate disclosure such as integrated reporting.

Basic Approach

In light of the national “Long-term Strategy under the Paris Agreement” decided by Japan’s Cabinet in June 2019, this Guidance aims to realize a “virtuous cycle of environment and growth,” based on the following three perspectives.

The first perspective is to promote constructive dialogue (engagement) with companies, leading to enhanced corporate value. As a practice of investors and other stakeholders, it is more important to be engaged in dialogue with companies to facilitate their climate actions than to simply divest based on superficial criteria; engagement can

lead to the enhancement of corporate value through improved efforts, thus increasing opportunities for investment.

The second perspective is to identify and assess the risks and opportunities posed by climate change. Climate-related information includes uncertainty, and the implications of climate change vary by industry. Considering their preconditions and characteristics, investors and other stakeholders will be better able to implement well-balanced corporate evaluation between risks and opportunities if they not only appropriately identify and assess risks but also evaluate their potentials for gaining opportunities through climate actions.

The third perspective is to promote innovation for decarbonization, and to create mechanisms for appropriate flow of funds. To promote climate action, funding needs to be provided appropriately for various innovations needed for companies to make the transition to a decarbonized society. If climate risks are being addressed appropriately, there could be greater opportunities for transition in industries that have higher emissions and countries and regions that have lower carbon efficiency.

Target Audience

The main target audience for this Guidance is investors and other stakeholders that utilize the information disclosed by companies for investment and lending decisions. The Guidance is also expected to assist them in their investment and lending decisions through direct discussion, their engagement with borrowers and investees, and the development of green financial products. Since it is important for companies to disclose information in ways that provide a common basis for discussions in order for investors and other stakeholders to implement effective engagement and make appropriate investment decisions, this Guidance is also expected to help companies better understand the perspective of investors and other stakeholders.

Context of this Guidance

The ultimate purpose of this Guidance is to create mechanisms to smoothly provide funding to promote companies' efforts that facilitate the transition to a decarbonized society, thus promoting the virtuous cycle of environment and growth, by facilitating the appropriate evaluation of those efforts - through dialogue between companies and investors and other stakeholders - in terms of responding to climate-related risks as well as gaining opportunities through innovation. As a starting point, this Guidance provides perspectives needed by investors and other stakeholders to interpret information disclosed by companies based on the TCFD recommendations and make their

investment decisions. Therefore, it does not call for any disclosure by companies in addition to disclosure under the TCFD recommendations, but intends to support companies that actively promote their climate actions through efficient dialogues also giving consideration to burdens of their disclosure.

“Guidance on Climate-related Financial Disclosures” (TCFD Guidance) prepared by Japan’s Ministry of Economy, Trade and Industry in 2018 and this Guidance are mutually complementary, with the former being for companies engaging in disclosure and the latter for investors and other stakeholders who will use the information disclosed. The TCFD Guidance will be further upgraded and revised through future discussions within the TCFD Consortium.

This Guidance has been developed based on inputs from the members of the TCFD Consortium as a first step for future promotion of “green investment.” Inputs and topics that have not been addressed this time will be reflected in future revisions of this Guidance along with future developments in green investment.

Chapter 2 Structure of This Guidance

This Guidance has been prepared with an emphasis on the use of insights accumulated to date through discussions on existing corporate disclosure frameworks. This section summarizes some key points in this Guidance by comparing the items recommended for disclosure by the TCFD with the International Integrated Reporting Council (IIRC) framework – a typical framework being used by companies, investors and other stakeholders around the world - and the “Guidance for Integrated Corporate Disclosure and Company-Investor Dialogue for Collaborative Value Creation”(Guidance for Collaborative Value Creation), which has been discussed recently mainly by Japanese practitioners (Figure 1).

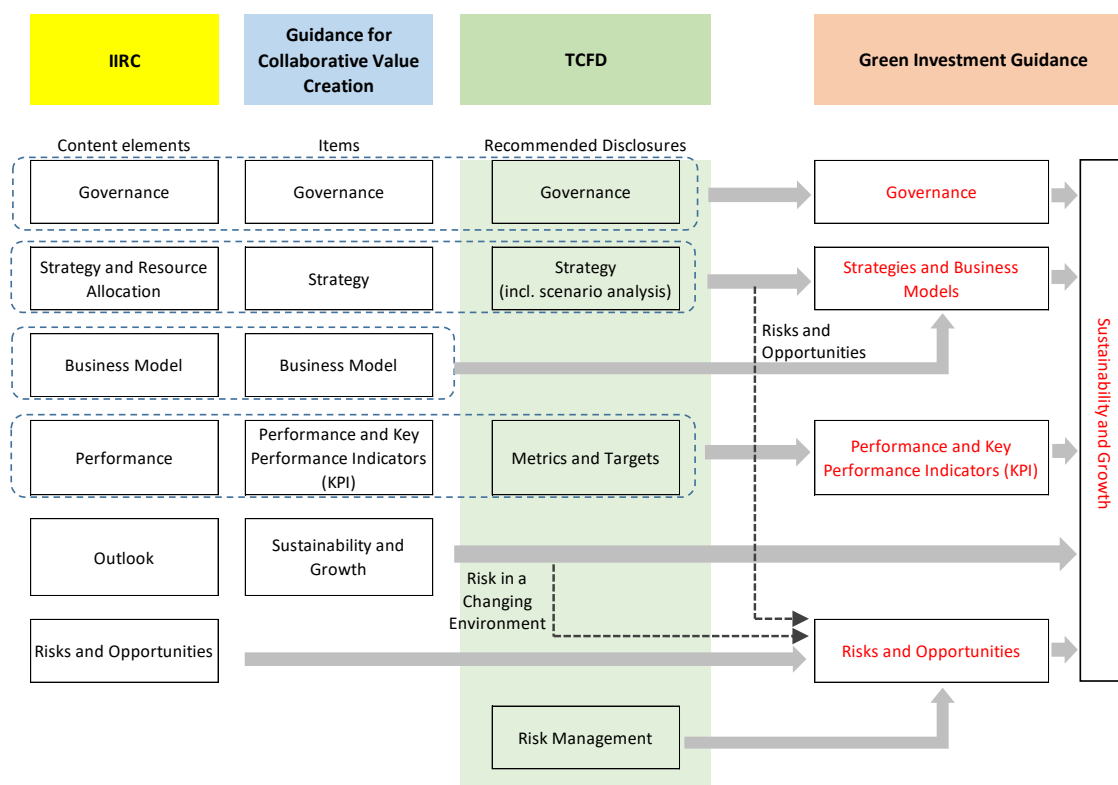


Figure 1 Relationship between this Guidance and Other Frameworks

The comparison shown in Figure 1 leads to the conclusion that all the frameworks have similar content for Governance as well as Metrics and Targets, suggesting that disclosure based on the TCFD recommendations can be considered and evaluated as an extension of past discussions relating to integrated reporting.

Strategy is also common in all the frameworks as well, but the TCFD recommendations differ significantly from the other frameworks in that they recommend “scenario analysis” to develop Strategy, given the uncertainties relating to the medium- to long-term impacts of climate change. To understand the information that has been disclosed based on recommendation on Strategy in the TCFD recommendations, a deeper understanding of scenario analysis — which is a tool to identify potential influence of the climate change on business — and the appropriate evaluation of the results of the analysis will lead to a better understanding and evaluation of business models, which consist the basis of Strategy. Based on this thinking, therefore, this Guidance includes a section on Strategies and Business Models.

Risks and Opportunities, a content element in the IIRC framework, is addressed as a part of Strategy in the TCFD Recommendations. As stated in Chapter 1, in order to realize the “virtuous cycle of environment and growth,” it is important for companies to disclose both such risks and opportunities, and for investors and other stakeholders to incorporate them into their investment evaluation. Therefore, in this Guidance, Risks and Opportunities are treated as one distinct element. Under Risk Management, which is one of the core elements of the TCFD recommendations, companies are encouraged to explain their internal processes to identify, assess and manage risks. In this Guidance, Risk Management is dealt with under Risks and Opportunities as one of the perspectives for investors and other stakeholders to judge the adequacy of a company’s risk awareness.

Moreover, as for Sustainability and Growth, the “Guidance for Collaborative Value Creation” states: “For companies to grow their corporate value in a sustainable manner, it is essential not only that they have clear business models but also that their business models are sustainable and have growth potential,” then explaining the importance of being aware of ESG, maintaining relationship with key stakeholders, and disclosing information and having dialogue about risks relating to the change of business environment. This element of “Guidance for Collaborative Value Creation” is not explicitly included in disclosure under the TCFD recommendations, but investors and other stakeholders can ultimately determine whether companies satisfy the general concept of Sustainability and Growth, by checking each item of this Guidance. In other words, investors and other stakeholders can assess whether a company can realize its sustainability and growth in terms of climate by identifying Risks and Opportunities to understand the company’s long-term Strategy, confirming its Performance and KPIs, and checking to see if the company’s Governance is functioning to those ends.

Based on the above, Chapter 3 of this Guidance builds upon previous discussions in

terms of four elements (1. Governance, 2. Strategies and Business Models, 3. Risks and Opportunities, and 4. Performance and KPIs) to explain what is needed from the perspective of investors and other stakeholders to look for sustainability and growth in the information disclosed by companies.

Chapter 3 Detailed Discussions

3.1 Governance

It is important for investors and other stakeholders to consider a company's organizational structure in terms of governance to address climate change, and also whether it is actually functional and effective to that end.

Governance, whether it relates to climate change or otherwise, is a critical factor for investors and other stakeholders to consider in building confidence and making decisions to invest in a company.¹ IIRC expects integrated reports to include “how the organization’s governance structure supports its ability to create value in the short, medium, and long term,” and the TCFD recommendations state that understanding the corporate board of directors’ oversight of climate-related issues and its role in assessing and managing climate-related risks and opportunities can help investors and other stakeholders evaluate the adequacy of company’s governance². In other words, as for governance, in addition to having well-structured organizational systems in place, those systems need to be functional and effective in terms of the roles of management.

Investors and other stakeholders identify the organizational structures and functions of corporate boards as well as environmental and sustainability committees, which include the management, and verify that board oversight of climate-related governance is being effectively implemented, or that the equivalent to board oversight is being ensured through reports to the boards from the relevant committees. This verification enables judgment of how the company is considering climate change and how it is reflecting that consideration in corporate management.

To this end, investors and other stakeholders are encouraged to understand the management structures related to governance, and also to verify their specific roles of each organizations and the management, as well as processes to reflect their deliberations in management. Dialogue with the company will provide the company a chance to improve its own governance, leading to the enhancement of corporate value,

¹ Guidance for Collaborative Value Creation, p. 30: “6.01. It is imperative for investors that companies steadily execute the strategies that underpin their business models and possess appropriately functioning governance systems that exert discipline to grow corporate value in a sustainable manner. By confirming the functioning of corporate governance, investors can trust and invest in companies with confidence.”

² TCFD Final Report, p. 19: “[investors and other stakeholders] are interested in understanding the role an organization’s board plays in overseeing climate-related issues as well as management’s role in assessing and managing those issues. Such information supports evaluations of whether climate-related issues receive appropriate board and management attention.”

which will also be beneficial for investors and other stakeholders in the long term.

Examples of verification on governance through engagement by investors and other stakeholders are provided below.

Case 1: Verification of top management commitment

Investor A checks with the CEO of the investee company to identify any issues with governance related to climate change: for example, whether or not climate related issues are being addressed above the level of the company's environment-related departments. Through dialogue, the Investor checks whether the CEO provides specific instructions regarding policies indicated in the company's integrated report and other documents, and whether the CEO is committed to KPIs and strategies necessary for addressing issues.

Case 2: Verification of effectiveness

Investor B engages with different counterparts of a company depending on the topic of interest, seeking dialogue with the CEO to check the company's commitment to climate-related issues, but going to the director(s) responsible for specific implementation systems and their effectiveness. Such engagement can change the attitude of the whole company including management, leading to the creation of an appropriate governance system, such as building climate-related organizational systems or bringing about discussions in board meetings.

Case 3: Verification of processes

For companies that have environmental committees, etc. attended by corporate management, Investor C checks how the decisions by the relevant committees are subsequently circulated within the company and put into practice. Through engagement, the Investor checks whether the governance is functioning by identifying the content of the deliberations at the committees and their subsequent reflection into management strategy, as well as the process of reporting to the board.

3.2 Strategies and Business Models

It is more important for investors and other stakeholders to check and assess the alignment between the decision-making processes that led to a company's strategies and the scenarios used as well as their appropriateness within the industry and the company's responses to the strategies it has developed, than the accuracy of scenario data and analytical results provided by the company.

For investors and other stakeholders, a company's business model is the most important blueprint in evaluating its sustainable profitability.³ The TCFD recommendations state that strategy refers to an organization's desired future state, and establishes a foundation against which it can monitor and measure its progress in reaching that desired state. Strategy refers to a foundation for a company to set its medium- to long-term targets and manage its progress, in order to develop a business model that can address climate change.⁴

In order to address climate change, companies need to develop their strategies to ensure their sustainability with a medium- to long-term perspective. The TCFD recommendations encourage implementation of scenario analysis in developing strategies. It is important for investors and other stakeholders to understand and evaluate the persuasiveness and appropriateness of the scenarios as a tool to upgrade a company's current business model and to develop strategies to enhance future corporate value and reduce risks in addressing climate change. Investors and other stakeholders are encouraged to consider disclosure related to scenario analysis not necessarily as the company's commitment based on the future forecast, but as a narrative for the company to consider a path toward its future business model based on its strategy,⁵ and to verify the context of the narrative through engagement.

To this end, it is more important for investors and other stakeholders to check and assess the alignment between the decision-making processes that led to a company's

³ Guidance for Collaborative Value Creation, p. 9, 2.03: "Therefore, the business model is the most important blueprint for investors in evaluating the company's sustainable profitability."

⁴ IIRC, p.28-31: "... business model is its system of transforming inputs, through its business activities, into outputs and outcomes that aims to fulfill the organization's strategic purposes and create value over the short, medium and long term", "... how its strategy and resource allocation plans relate to the organization's business model and ...are influenced by / respond to the external environment and the identified risks and opportunities"

⁵ TCFD Final Report, p. 25: "Instead, scenarios provide a way for organizations to consider how the future might look if certain trends continue or certain conditions are met."

strategies and the scenarios used as well as their appropriateness within the industry and the company's responses to the strategies it has developed, than the accuracy of scenario data and analytical results provided by the company.⁶ The TCFD recommendations, anticipating that a number of companies will conduct qualitative scenario analysis, state that organizations with more significant exposure should undertake more rigorous qualitative and quantitative analysis.⁷ However, given the current situation with the disclosure and use of such climate-related scenario analysis still in their infancy, investors and other stakeholders are encouraged to deepen their understanding of the company's strategies and business models through engagement.

Investors and other stakeholders will be able to better understand the strategies and business models of a target company by identifying the following about the scenarios disclosed by the company:

- context of the relevant scenarios selected and developed, and any assumptions behind the scenarios;
- alignment of a company's underlying future vision with its business model;
- expected timeframe and verification methods; and
- risks and opportunities recognized through scenario analysis and processes to incorporate them into the company's strategy and financial plans.

In addition, such engagement is expected to lead companies to identify additional risks and opportunities related to climate change and review their strategies and business models, which could lead to further enhancement of corporate value.

Meanwhile, investors and other stakeholders should note the following to understand the scenario analysis:

- In some cases, disclosures may be limited, and not all of the scenarios that have been used by that company for decision-making in strategy development may be disclosed.⁸

⁶ TCFD Final Report, p. 25: "Scenarios are hypothetical constructs and not designed to deliver precise outcomes or forecasts."

⁷ TCFD Final Report, p. 27: "... for many organizations, scenario analysis is or would be a largely qualitative exercise. However, organizations with more significant exposure to transition risk and/or physical risk should undertake more rigorous qualitative and, if relevant, quantitative scenario analysis with respect to key drivers and trends that affect their operations."

⁸ Since consideration of scenarios often includes the latest information related to the key points of a company's latest technology development strategy, companies do not always disclose all scenarios.

- Climate-related information, such as IPCC scenarios and other existing scenarios,⁹ inevitably includes uncertainty.
- One should not expect to see disclosures based on a unified scenario, because different companies face different national policies and business conditions, and diverse scenarios could be disclosed including those independently developed by a company.¹⁰

The most crucial issue for investors and other stakeholders in evaluating a company's strategies and business models is whether the scenarios are being utilized appropriately to derive persuasive and reasonable results of analysis, or narratives, and whether the companies have taken the necessary measures aligned with the narratives, rather than which scenarios have been used.

Examples of evaluation by investors and other stakeholders on the relationship of scenario analysis and strategies and business models of companies are provided below.

Case 1: Evaluation of strategies based on a long-term vision

Investor A requires a company to describe its long-term vision under the envisioned future market environment. As additional points of evaluation, it also looks at the extent to which management takes into consideration substantial uncertainty of the future market environment, as well as whether its narrative of value creation is persuasive and logical.

Case 2: Scenario assessment, Example 1

Investor B is aware that scenarios should be understood as narratives based on multiple assumptions. What is important is not credibility of the results of analysis, but the responses to the expected futures, so in evaluation, it checks whether the companies have taken such measures.

Case 3: Scenario assessment, Example 2

Investor C focuses on processes toward scenario disclosure, to see whether they are reasonable or not. It realizes that long-term predictions for 2050, for example, are

⁹ In many cases, scenarios referred to include greenhouse gas concentration and socio-economic pathway scenarios by the Intergovernmental Panel on Climate Change (IPCC) and scenarios by the International Energy Agency (IEA), etc.

¹⁰ Note that TCFD encourages organizations to describe the resilience of their strategies based on consideration of various climate scenarios, including scenarios with warming of less than 2°C.

difficult, and does not require corporate commitments based on such predictions. It expects a company to show what it will be like in a society envisaged in its scenarios.

Case 4: Assessment of a company's own scenarios and continuous improvement through engagement

Investor D is aware that the corporate vision presented by a company is the result of its analysis using multiple scenarios. However, companies that focus on “complying” with disclosure requirements by presenting tidy narratives based on a given template or guidelines tend to end up with similar outcomes. Thus, Investor D gives a more favorable evaluation to companies that focus on “explaining” their own unique vision that is aligned with their corporate strategies.

3.3 Risks and Opportunities

It is important for investors and other stakeholders to have a balanced evaluation of a company's risks and opportunities, by understanding a company's efforts to address risks, while also actively evaluating the potential opportunities of climate actions.

Risks and opportunities caused by climate change could significantly influence a company's business model. The TCFD recommendations, therefore, encourage companies to disclose information on processes used to identify climate-related risks and opportunities as well as their influence on business, strategy, and financial planning.¹¹ As for risks, TCFD recommendations encourage disclosure of specific processes in which the companies identify, assess and manage the risks, and whether they are incorporated into their organizational risk management processes.¹² IIRC also encourages this disclosure: "What are the specific risks and opportunities that affect the organization's ability to create value over the short, medium and long term, and how is the organization dealing with them."¹³ Investors and other stakeholders, therefore, would be able to appropriately evaluate the impacts of climate change on a company's business model by understanding how it identifies and manages climate-related risks and how it takes advantage of opportunities.

Investors and other stakeholders are able to make investment decisions on the basis of ascertaining whether or not a company has secured the ability to create value in the medium to long term, by understanding the company's efforts to address risks and opportunities as well as its operational systems, organizational arrangements, and operational conditions relating to monitoring. Therefore, it is important for investors and other stakeholders to ask a company to appropriately identify, manage and disclose risks, and to engage in dialogue with the company regarding their impacts on corporate value. Meanwhile, from the perspective of gaining return on investment to a company that undertakes climate actions, investors and other stakeholders are encouraged to have a balanced evaluation of a company's risks and opportunities by also actively evaluating the potential opportunities of climate actions. The TCFD recommendations have introduced two types of climate-related risks: those related to transition to a low-carbon

¹¹ TCFD Final Report, p. 14

¹² TCFD Final Report, p. 14

¹³ IIRC, p. 27

economy (transition risks) and those related to the physical impacts of climate change (physical risks). Transition risks include policy and legal risk, technology risk, market risk, and reputation risk, while physical risks include acute risk (e.g., increase of extreme weather events) and chronic risk (e.g., sea level rise).¹⁴

The TCFD recommendations also refer to resource efficiency, adoption of low-emission energy sources, and the development of new products and services, etc., as climate-related opportunities.¹⁵ Opportunities through efficient use of resources and low-emission energy sources include CO₂ recycling and those using innovative technologies (e.g., CCUS¹⁶ or carbon recycling, and hydrogen and fuel cells). Opportunities from development of new products and services include those that would contribute in reducing risks of other companies from the lifecycle perspective through their value chains (e.g., supply of highly-efficient equipment and components) and those that would contribute to climate adaptation (e.g., technologies to reduce the impacts of extreme weather events, etc.).

Examples of evaluation by investors and other stakeholders on risks and opportunities are provided below.

Case 1: Evaluation of climate-related opportunities

Although many companies are concerned about a possible drop in their share prices due to disclosure of risk-related information, Investor A assesses not only risks but also opportunities from good practices implemented by companies. It understands that balance between risks and opportunities is important, since such efforts lead to the enhancement of corporate value.

Case 2: Positive evaluation for risk information disclosure

Investor B positively evaluates such companies that disclose their risk information. Although many companies are concerned with negative impacts of risk information disclosure, companies demonstrating in detail that they have properly identified and managed their risks can provide investors with more sense of security than those not doing so, when compared within the same industry.

¹⁴ An example to reduce physical risks by companies is impact assessment of the climate change to address adverse effect to their business activities utilizing publicly provided natural disaster information (hazard map etc.).

¹⁵ TCFD Final Report, p. 6

¹⁶ Carbon capture, utilization and storage technologies

Case 3: Facilitation of proactive disclosure of opportunities through engagement

Investor C is engaging not only with manufacturers of final products but also with those providing technologies and components that support the final products, to discuss their future revenue opportunities and social innovation opportunities. It has the view that enhanced corporate value will result if investors discover such opportunities and encourage their active disclosure.

Case 4: Engagement with car manufacturers to address risks

Investor D knows that car manufacturers need to have flexible responses to climate-related risks in light of worldwide trends relating to emission controls. In engagement with them, therefore, this Investor verified their commitment to introduce next-generation low-emission vehicles for overseas markets, their efficient allocation of resources, including for such technologies, etc., and their policies to prioritize actions with respect to the CASE trend.¹⁷ This was useful for developing a shared perspective with management regarding these issues, as well as regarding challenges for appropriate disclosure of climate-related risks.

Case 5: Evaluation of opportunities through climate actions by companies seeking to reduce environmental impacts

Investor E not only assesses the environmentally unfriendly aspects of corporate activities, such as GHG emissions from its business operations, but also positively evaluates climate actions by the company or its affiliates such as their R&D efforts for CO₂ capture and reuse (carbon recycling).

¹⁷ Connectivity, Autonomous, Shared, Electric

It is important for investors and other stakeholders to recognize the importance of a company's efforts toward innovation as a climate action, and to positively evaluate the relationship between innovation and the company's long-term strategies, as well as organizational structure to promote innovation.

Innovation through efforts such as technology development, R&D and alliances is an important part of efforts by companies to take advantage of climate-related opportunities. Disclosure and utilization of information on climate-related innovation has only just begun. However, it is anticipated that, as more progress is made with disclosure under the TCFD Recommendations, such efforts will become more visible, and engagement with companies will help investors gain a better understanding of the issues, resulting in innovation-related information being more effectively utilized in investment decisions.

Innovation means not only efficiency improvements and new combinations of existing technologies, but also solutions associated with a long-term vision as well as those that may appear to be disconnected from or discontinuous with current business activities. It is useful for investors and other stakeholders to proceed with engagement on the attitude and intention of such companies that seek innovation, in order to improve understanding on their long-term strategies. Therefore, investors and other stakeholders are encouraged to confirm that a company's long-term strategies and underlying perceptions about the future business environment are aligned with the direction of its innovation efforts. In addition, regarding the management systems of a company engaged in innovation, it is also important to have dialogue on issues such as the commitment of its management organizational design, processes, and organizational culture.¹⁸ Such dialogue will also serve as an opportunity for a company to objectively review its strategies for innovation.

¹⁸ The international standard of "Innovation management system - Guidance (ISO56002)" was issued on July 15, 2019 for checking a management system of a company that creates innovation.

Examples of evaluation by investors and other stakeholders relating to innovation are provided below.

Case 1: Evaluation of efforts to foster innovation

Investor A evaluates a company's climate-related efforts that will increase its revenues. Specifically, it evaluates the company by considering its development of environment-friendly products and services and creation of innovation, as well as GHG emission reduction efforts, while also looking to see if the company is making efforts to visualize and further enhance its internal and external value created from such efforts (e.g., amount of environmental contribution). The Investor makes an assessment based on systems and specific initiatives in the company, how it is making an effort to create new value and innovation in order to take advantage of opportunities, especially in light of the emerging social issues including climate change and changes in the business environment based on a long-term vision beyond 2030.

Case 2: Evaluation of strategic investment and innovation

For Investor B, the most important aspect to take into consideration is whether innovation is incorporated into management strategy. Thus, when evaluating a company's long-term vision, Investor B looks at factors such as its readiness to make use of environment- or climate-related actions for product innovation, measures to reduce climate-related risks, and efforts to limit GHG emissions to a level consistent with the 2°C target in line with Paris Agreement.

Case 3: Proactive evaluation for disclosure of information related to innovation

Investor C pays special attention to information about how innovative technology, which can also contribute to a higher level of ambition, can be monetized. For example, Company A has not provided much information about technology development for addressing climate change because it is still at the demonstration stage. However, this Investor wishes to understand the prospects for such technology and evaluate the company's long-term readiness, so it encourages the company to proactively disclose more information.

3.4 Performance and Key Performance Indicators (KPIs)

It is important for investors and other stakeholders to understand a company's rationale for establishing the specific KPIs that it manages and discloses, and confirm its alignment with the company's strategies.

Key performance indicators (KPIs) serve as metrics for a company to materialize its corporate philosophy and enhance corporate value, and are crucially important as information to be disclosed to investors and other stakeholders.^{19,20} In the TCFD recommendations, the relevance of a company's KPIs to its climate-related Risks and Opportunities is considered important in terms of targets to assess and manage.²¹

Climate-related KPIs disclosed by a company need to be verified for consistency with the companies' long-term strategies. When the relationship is not clear between a company's strategies and business model vis a vis its KPIs and their rationale as disclosed by the company, it is important for investors and other stakeholders to seek an explanation through dialogue with the company, and to confirm an improvement in the alignment between the two. This will promote the reduction of risks and creation of opportunities, leading to an enhancement of corporate value. In addition, by checking not only the levels of KPIs but also their trends (level of improvement), investors and other stakeholders will have a better understanding of a company's climate-related efforts. The proactive efforts of investors and other stakeholders to check and evaluate KPIs for a company's climate actions (including the company's own management indicators) can strengthen the companies' motivation relating to climate action.

¹⁹ Guidance for Collaborative Value Creation, p. 27: "5.02. ... it is beneficial for companies to set key performance indicators (KPIs) as benchmarks for growing corporate value throughout their businesses and as a yardstick to measure the achievement of their objectives and share the KPIs with investors."

²⁰ IIRC p. 8: "Quantitative indicators, such as KPIs and monetized metrics, and the context in which they are provided can be very helpful in explaining how an organization creates value and how it uses and affects various capitals."

²¹ TCFD Final Report, p. 14: "Metrics and Targets: Disclose the metrics and targets used to assess and manage relevant climate-related risks and opportunities where such information is material."

Examples of evaluation by investors and other stakeholders on alignment between KPIs and strategies are provided below.

Case: Verification of alignment of KPIs and strategies

Investor A assesses climate-related KPIs, which is set by a company, from the perspective of both environmental and business advantages. In doing so, the Investor looks not only at increased revenues but also at what corporate value is created and what business benefits can be anticipated.

In comparative evaluation of KPIs, it is important for investors and other stakeholders to consider the relevant industry characteristics.

Investors and other stakeholders should note in evaluating KPIs that the calculation and disclosure methods of KPIs will vary by company due to differing business environments and conditions, and that this can sometimes make simple comparisons difficult.²²

GHG emissions are a typical climate-related KPI. As the mechanisms producing GHG emissions and efforts required for emission reduction vary by industry, investors and other stakeholders are encouraged to classify companies into smaller industry categories for comparative evaluation, taking into account the appropriateness of the targets to be compared. Meanwhile, the business portfolio of any given company may be involved in multiple industries, and in such a case, investors and other stakeholders are encouraged to evaluate the company by giving due consideration to that company's business model. In addition, total GHG emissions are an important metric to evaluate climate-related risks for industries and companies, but on the other hand, in order to understand factors such as a company's technological level or climate resilience, evaluations based on the

²² For example, since GHG emissions resulting from consumption of electricity purchased externally depend on the utility that supplies the electricity, care must be taken when comparing GHG emissions resulting from electricity consumption (Scope 2). In addition, attention must also be paid on how the disclosed GHG emissions are derived (such as boundaries for calculation), as well as for difficulties in comparing Scope 3 emissions among different companies.

emission intensity or total GHG emissions within a given industry can also be useful.^{23,24}

Examples of evaluation of KPIs by investors and other stakeholders in light of industry characteristics are provided below.

Case 1: Evaluation of KPIs in light of industry characteristics

Investor A has set industry-specific metrics to evaluate four elements of the TCFD recommendations, as a part of evaluating non-financial metrics, elaborating them by putting them into practice. Its industry analysts quantify the metrics based on their qualitative judgment in addition to disclosed information and the result of engagement, for comparison within the same industry, using them for part of their investment decision-making.

Case 2: Evaluation of KPIs in light of industry characteristics

Investor B conducts evaluation based on the understanding that climate actions are industry-specific. For example, in dialogue with the electricity and gas sector and the transportation sector where climate-related impacts on business continuity is considered to be larger, it asked companies that had not disclosed their efforts and policies for GHG emission reduction although they belong to industries with higher dependency on natural resources like water, forests, and fossil fuels, to establish guidance or targets for emission reduction.

Case 3: Intra-sector comparison of KPI evaluation

To evaluate a company, Investor C looks at corporate advantage and competitiveness that is useful for gaining opportunities, hence puts more focus on a company's relative ranking within a sector rather than using one-dimensional information like GHG emissions.

²³With regard to emission intensities, it is recommended to gain an understanding through dialogue about companies' technology levels and ability to respond to climate change, while noting that simple comparisons within an industry may be difficult due to differences in product lineups and business portfolios.

²⁴ It is also worth considering the use of indicators that indicate the state of industry responses to climate change and other sustainability issues, such as those developed by the Sustainability Accounting Standards Board (SASB) in the United States.

Investors and other stakeholders are encouraged to evaluate companies by considering not only their GHG emissions through the entire value chain but also their contributions to emission reduction at the usage of their products and services.

A further point that investors and other stakeholders should note is that even within the same industry, GHG emissions through the entire value chain could differ by company due to different product line-ups and business portfolios, as well as reporting boundaries set by each company. For example, some products and services can contribute to a reduction in GHG emissions at the point of use (included in Scope 3 emissions) or at the point of installation, although their GHG emissions may be relatively higher at the production phase (Scope 1 and 2 emissions).²⁵ Demand for such products and services is anticipated to grow as the importance of climate actions increases. Thus, investors and other stakeholders are encouraged to evaluate in a comprehensive manner by considering emissions throughout the entire value chain (including overseas for some products and services) as well as contributions to reduction at the use phase of products and services.²⁶ In evaluation, investors and other stakeholders are encouraged to pay attention to intermediate products that would bring reduction contributions at a point of usage, and urge manufacturers and suppliers of such intermediate products to actively disclose information, while at the same time actively evaluating their contributions.

Examples of evaluation throughout the entire value chain by investors and other stakeholders are provided below.

Case 1: Comprehensive evaluation through the entire value chain

Investor A considers it important to cover the entire value chain in evaluation, and evaluates companies with consideration of how their products are used downstream and why they are necessary. In doing so, it requires companies not only to provide GHG emissions during production but also to explain how the products contribute to GHG emission reductions downstream.

²⁵ Scope 1 emissions are direct emissions due to fuel consumption, etc. Scope 2 emissions are indirect emissions due to electricity consumption, etc. Scope 3 emissions are other indirect emissions in the entire supply chain, including the procurement of raw materials, the use of products, and waste disposal, etc.

²⁶ One indicator in the TCFD recommendations is a description of “avoided GHG emissions,” which have been avoided throughout the product life cycle. By disclosing GHG emission reductions when products and services are used, in contrast to a company’s GHG emissions, it is possible to show how much the company has contributed to global GHG emission reductions through those products and services.

Case 2: Evaluation for manufacturers of low-emission products

Investor B evaluates manufacturers of GHG emitting products positively, based on their contributions by having low emissions at the time of use. Through extensive dialogue about both risks and opportunities as part of its engagement, Investor B analyzes how products contribute to GHG emission reductions throughout the entire product value chain.

Case 3: Evaluation on disclosure of Scope 3 emissions

Investor C is of the view that a company that goes as far as disclosing its Scope 3 emissions is probably very capable of controlling risks throughout the supply chain, having enough capacity to address those risks when they become evident, since it considers climate actions along the entire supply chain.

Case 4: Evaluation on disclosure of emission reduction contributions

Investor D focuses on company's disclosure of emission reductions that would contribute to reduced GHG emissions for society as a whole, even if the company's business expansion would increase emissions in its value chain (Scope 1, 2 and 3 emissions). This Investor considers that information on GHG emission reductions in society as a whole (outside of the company's Scope 1, 2, and 3 emissions) due to the company's efforts to let customers choose its high-efficiency facilities or low-carbon energy is useful for duly evaluating a company that is making an effort to reduce GHG emissions.

Column 1: Flexibility in medium of disclosure

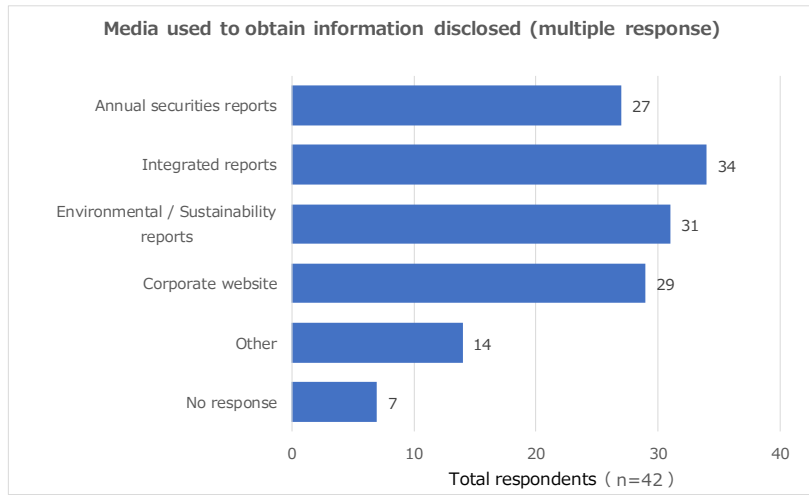
The TCFD recommendations states that disclosures related to the Governance and Risk Management recommendations should be provided in financial filings, and that, for the Strategy and Metrics and Targets recommendations as well, companies should provide such information in financial filings when the climate-related information is deemed material.²⁷ Meanwhile, more progress in information disclosure is expected for the sake of investors and other stakeholders as the importance of climate actions increases.²⁸

Climate-related information involves uncertainties, especially if it covers a longer time period. Therefore, it is sometimes difficult to comprehend the whole picture of a company's climate-related efforts just by reviewing statements in financial filings, which are required to be accurate and rigorous. In practice, companies often disclose information related to their climate actions through multiple media, such as integrated reports and environmental reports, and attempts can be seen to facilitate cross-referencing of information.

Therefore, investors and other stakeholders are encouraged not only to review statements relating to climate change in financial filings but also to refer to various other disclosure documents. With this in mind, many investors and other stakeholders already make an effort to refer to multiple reports and documents for the evaluation of a single company (Figure 2). Reviewing multiple documents is burdensome for investors and other stakeholders. Nevertheless, promoting efforts for efficient disclosure such as cross-referencing not only allows investors and other stakeholders to reduce their own workload, but can also make companies review the consistency of their own disclosed information as well as their disclosure practices.

²⁷ TCFD Final Report, p. 34

²⁸ TCFD 2019 Status Report, p. 7: "Many companies disclose some climate-related information, but more progress is needed." "The percentage of companies disclosing climate-related information has increased, but overall is low."



Source: Survey of TCFD Consortium members

**Figure 2. Sources of information disclosed by companies
(multiple responses accepted)**

Column 2: Evaluation on collaboration with external climate-related initiatives

Recently, more companies are declaring their participation in initiatives related to climate actions, such as RE100 and SBT (Science Based Targets), and setting targets based on such initiatives. Participation in them serves as an indicator for investors and other stakeholders to understand a company's stance regarding climate actions.

What is important for investors and other stakeholders is the future enhancement of corporate value. Therefore, an important perspective for evaluation is how a company is involved in such initiatives, how it has committed to its targets, and how the commitments relate to the company's strategies. In that sense, in evaluation, investors and other stakeholders are encouraged not only to look superficially at whether or not a company is participating in such initiatives, but also to consider factors such as the company's comprehensive strategies and specific efforts to achieve their long-term objectives (capital investment, R&D investment, and alliances, etc.).

It should be noted that even if they may not be participating in initiatives such as those mentioned here, many companies have given climate actions a priority in their management strategies. To evaluate such companies, it is helpful to look at Governance, Strategy, Risks and Opportunities, and Performance and KPIs, etc. in order to achieve the evaluation of their climate actions that goes beyond the superficial assessments. Such efforts by investors and other stakeholders will also serve as an opportunity for the target companies to continue reviewing their approaches to such initiatives.

Examples of External Climate-related Initiatives²⁹

Name	Explanation
RE100	An initiative where companies are committed to sourcing 100% renewable energy for the power consumption necessary for their activities and reporting their progress. With the last target year in 2050, it requires the participants to increase their percentage of renewable energy to 60% by 2030, and more than 90% by 2040.
EV100	An initiative where companies make commitments including the replacement of their commercial fleets with electric vehicles by 2030.
SBT	An initiative where companies set, announce, and verify their scientifically-consistent GHG emission reduction targets, in order to limit the global temperature increase to “well-below 2°C” or “1.5°C level.” The appropriateness of their targets is to be reviewed by SBT in light of specific standards.

²⁹ RE100 website: <http://www.there100.org>

EV100 website: <https://www.theclimategroup.org/project/ev100>

SBT website: <https://sciencebasedtargets.org/>

References

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2. The International <IR> Framework, International Integrated Reporting Council (IIRC), (December 2013). Abbreviated in this report as "IIRC".
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