Overview of Green Investment Guidance (1)

- **Disclosure based on the TCFD recommendations is still at an early stage.**
- **With an aim to promote green investment, this Guidance provides commentary on perspectives needed by investors and other stakeholders when understanding the information disclosed.**
- **Expected to help companies better understand the perspective of investors and other stakeholders, leading to further disclosure.**

Basic Approach

- Promote constructive dialogue (engagement) with companies, leading to enhanced corporate value
- Identify and assess the risks and opportunities posed by climate change.
- Promote innovation for decarbonization, and to create mechanisms for appropriate flow of funds.

→ Aims to realize a **"virtuous cycle of environment and growth"**

Detailed Discussion

It is important that investors and other stakeholders understand the information disclosed based on the TCFD recommendations according to the following perspectives.

1.Governance

- 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.
  - ✓ Identify the organizational structures and functions of corporate boards as well as environmental and sustainability committees, which include the management.
  - ✓ Verify that board oversight of climate-related governance is being effectively implemented, or that the equivalent to board oversight is ensured through reports to the boards from the relevant committees.
  - ✓ Management structures related to governance, their specific roles of each organizations and the management, as well as processes to reflect their deliberations in management.

Example of verification on Governance through engagement by investors and other stakeholders

【Verification of effectiveness】 Investor A 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.

Overview of Green Investment Guidance (2)

2. Strategies and Business Models

- It is more important 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, than the accuracy of the data of the scenario or analytical results provided by the company.
    - ✓ Context of the relevant scenarios selected and developed, any assumptions behind the scenarios, and alignment of a company's underlying future vision with its business model.
    - ✓ Expected timeframe and verification methods, risks and opportunities recognized through scenario analysis and processes to incorporate them into the company's strategy and financial plans.
    - ✓ The most crucial issue 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.
    - ✓ 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, and climate-related information, such as IPCC scenarios and other existing scenarios, inevitably includes uncertainty.

Example of verification on Strategies and Business Models through engagement by investors and other stakeholders

【Scenario assessment】 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.

3. Risks and Opportunities

- 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.
    - ✓ Identify two types of climate-related risks: those related to transition to a low-carbon 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).
    - ✓ Identify climate-related opportunities such as resource efficiency, adoption of low-emission energy sources, and the development of new products and services.
        - ➢ Opportunities through efficient use of resources and low-emission energy sources include CO2 recycling and those using innovative technologies (e.g., CCUS 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.

Overview of Green Investment Guidance (3)

3. Risks and Opportunities (contd.)

- 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 systems to promote innovation.
  - ✓ Alignment of a company's long-term strategies and underlying perceptions about the future business environment with the direction of its innovation efforts.
  - ✓ Regarding the management systems of a company engaged in innovation, confirm commitment of its management organizational design, processes, and organizational culture

Example of verification on Risks and Opportunities through engagement by investors and other stakeholders

【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 is of the view that enhanced corporate value will result if investors discover such opportunities and encourage their active disclosure.

4. Performance and Key Performance Indicators (KPIs)

- Understand a company's rationale for establishing the specific KPIs that it manages and discloses, and confirm its alignment with the company's strategies.
  - ✓ Check not only the levels of KPIs but also their trends (level of improvement).
- Consider relevant industry characteristics upon comparative evaluation of KPIs.
  - ✓ 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.
- 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.
  - ✓ Evaluate in a comprehensive manner by considering emissions throughout the entire value chain, as well as contributions to reduction at the use phase of products and services.
  - ✓ Pay attention to intermediate products that would bring reduction contributions at a point of usage.

Example of verification on Performance and Key Performance Indicators (KPIs) through engagement by investors and other stakeholders

【Verification of alignment of KPIs and strategies】 Investor D 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.