Concept Paper on Impact Finance

July15, 2020

ESG Finance High-Level Panel

Positive Impact Finance Task Force

Message from the Chair

Let's make an impact!

Reduce negative impacts and create positive impacts. By doing so, we will protect the foundations that support society and the economy. Ultimately, that's the message. It is a common interest for the financial and investment industries, an international trend, and a response to the expectations and needs of society.

The deadline for the SDGs is in ten years. One-third of the time has already passed since the agreement in 2015.

However, the confusion associated with COVID-19 has underscored that poverty and inequality remain extremely material social challenges. It has made it clear once again that a healthy economy is supported by a sound society. Accelerating climate change, frequent extreme weather events and rapid extinctions of species are crises that could destroy the foundations of a sound society. The next decade will also be a critical ten years for keeping the increase in global average temperatures to no more than 1.5°C.

I believe that such sense of crisis is already fully shared among members of the ESG Finance High-Level Panel. In order to translate such sense of crisis into concrete actions, it is necessary to pay attention to the impact of finance and investment. That was the intent behind establishing this Task Force under the High-Level Panel.

Looking at the world, there are already a number of international initiatives promoting impact investment and finance. I would like to express my respect for the efforts of many stakeholders who have opened up this field. This report is not intended to gild the lily. Nor is it trying to establish new standards or rules. Rather, it is a summary of the basic concepts that are relatively common to various initiatives that have been taken.

Specific styles of impact finance vary. For example, some take the view that it is important to consider the impact of all investments and loans, and therefore, various impacts should be comprehensively assessed. Others focus on particularly important social issues, developing financial products which channel funds into businesses that generate a significant positive impact. Believing that both positions are important, the Task Force has compiled this report taking both perspectives into consideration. As a result, there may be some descriptions that are not suitable for one of the positions. This reflects our intention to support both types of impact finance. Please read with that in mind.

The term "impact finance" is also used to include a wide range of initiatives, rather than focus on a specific position. While the term "impact investment" is also widely used internationally, the term "finance" is used to include all investments and loans, including indirect financing, to capture the nuance in the Japanese language. Accordingly, it does not propose something different from international trends.

There are still many issues to clarify in impact finance. For example, while impact finance may expand the definition of investments and loans from two dimensions of risk and return to three dimensions including impact, how should we understand the relationship between risk/return and impact, then? In addition, how should we assess and measure impact? We cannot easily find answers to these issues.

This report does not address these issues in depth. This is because we believe it is more important for institutional investors and financial institutions to expand their horizons by starting from what they can do and accumulating practices, rather than becoming petrified by getting into there. Then they can expand the scope of the things they can do little by little. The answers may come from practices.

Pioneers in this field have already started doing what they can from their own standpoint. These issues are also discussed in international initiatives. In Japan, the Financial Services Agency and the GSG Japanese National Advisory Board jointly set up a “Study Group on Impact Investment” and began discussing the issues. This Task Force will also continue studying these issues in close collaboration and cooperation with such developments as well as relevant organizations, ministries and agencies, without generating any inconsistencies with each other.

I would like to express my gratitude to the ESG Finance High-Level Panel for its decision to create this valuable forum. I am also grateful to the Task Force members and observers who participated in the intensive discussions in a short period of time, as well as to everyone who participated in the exchange of opinions. I would like to express my gratitude to the Secretariat for their support in setting up and running the Task Force meetings and preparing the report.

Finally, I would like to send a message to the institutional investors, financial institutions, and other parties concerned who have picked up this report. I believe Impact Finance aims for a socio-economic system in which finance and investment play a proper role, with society moving in a more sustainable direction through market mechanisms. Its need has never been more apparent for the new post-COVID 19 society. I hope you will read this and think, “Okay, let's do it.”

July 15, 2020

ESG Finance High-Level Panel
Positive Impact Finance Task Force
Chair　Takeshi Mizuguchi

Positive Impact Finance Task Force
List of Members, etc.

Chair

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Members (Japanese syllabary order)

Masaaki Amma	Social Innovation and Investment Foundation Executive Advisor
Akane Enatsu	Nomura Institute of Capital Markets Research Head of Nomura Research Center of Sustainability
Atsuko Kajiwara	Japan Credit Rating Agency, Ltd. General Manager, Sustainable Finance Evaluation Department
Tsukasa Kanai	Sumitomo Mitsui Trust Holdings, Inc. Executive Manager & Chief Sustainability Officer
Hitomi Kibo	AXA Investment Managers Japan, Ltd. Director, Core Client Group
Takanobu Suehiro	Sumitomo Mitsui Financial Group, Inc. General Manager, Corporate Sustainability Department
Naoto Takeuchi	The Dai-ichi Life Insurance Company, Limited General Manager, Credit Department
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Maiko Hachiya	Development Bank of Japan Inc. Senior Vice President, Sustainability Planning & Support Department
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Observers

United Nations Environment Programme Finance Initiative (UNEP FI)
International Finance Corporation (IFC)
Cabinet Office
Ministry of Economy, Trade and Industry
Ministry of Land, Infrastructure, Transport and Tourism
Financial Services Agency

Secretariat

Ministry of the Environment
CSR Design Green Investment Advisory, Co., Ltd

1. Intent and Purpose

> ○ This document is intended to mainstream impact finance, with the involvement of large-scale private funds, by positioning impact finance as a developed form of ESG finance to pursue impacts on the environment, society, and economy.
> ○ As a first step, it primarily aims to lead to the promotion of impact finance practices among major financial institutions, institutional investors and service providers in Japan.

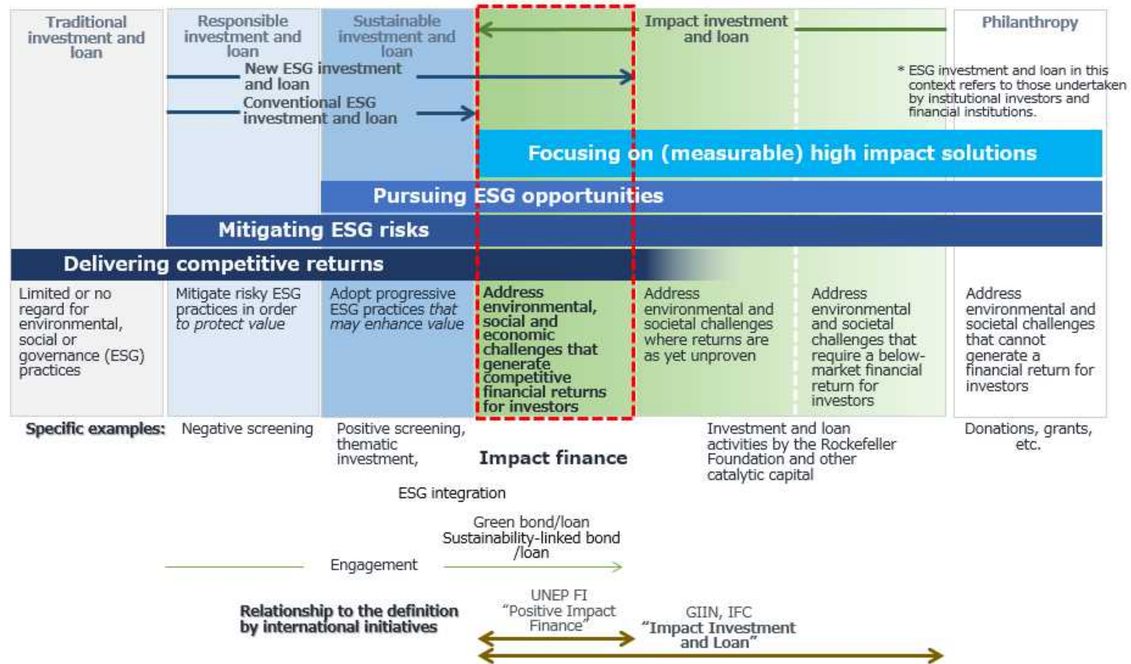
(1) The Positioning of Impact Finance and the Intent/Purpose of This Document

○ Positioning of "impact finance" as a developed form of ESG investment and loan

The term "impact finance" as used in this document refers to a developed form of ESG finance to pursue appropriate risk-return profiles, among a variety of developments in investments and loans that pursue impacts on the environment, society, and economy.

- ➢ The concept of financial return in investments and loans that pursue impact has been positioned in various ways depending on the international initiative, while there are a variety of concepts depending on the characteristics and objectives of initiatives by individual market participants. In light of this, this document defines "Ensuring appropriate risk-return profiles for individual financial institutions/investors from a medium- to long-term perspective" as "Impact Finance" subject to examination. As a result, it aims to promote and expand impact finance in Japan, targeting areas that financial institutions and investors can engage in as their core businesses. Although this document does not deny any investment or loan activities that pursue impact while allowing returns below the market level, it does not cover them for examination from the above perspective.
- ➢ As compared to conventional ESG investment and financing, impact finance is characterized by clearly intending and measuring impact. From this impact-oriented perspective, impact finance can be considered as a developed form of ESG investment and financing that seek to deepen the practice of ESG integration, engagement, and sustainability-themed investment.

[Figure 1: "Impact Finance" in This Document]



Source) Prepared by the Ministry of the Environment and CSR Design Green Investment Advisory Co., Ltd. based on Bridges Fund Management (2015) "The Bridges Spectrum of Capital" p.3

○ Potential of impact finance and expectations for mainstreaming with the involvement of large amounts of funds

ESG investments and loans in Japan have been growing rapidly at the fastest rate in the world. As of 2019, the market size of ESG investment in Japan was approximately[1] 336 trillion yen. However, the outstanding balance of impact/community investments, including thematic investments, is only about 3.5 trillion yen[2], with Japan said to account for merely 2%[2] of global impact/community investments.

The intent of this document is the mainstreaming of impact finance in investments and loans in Japan by paying attention to the great potential of large-scale ESG investments and loans to develop into impact finance. As a first step, the documentprimarily aims to lead to the promotion of impact finance practices among major financial institutions, institutional investors and service providers in Japan.

[1] According to Japan Sustainable Investment Forum (JSIF) "Sustainable Investment Survey 2019."

[2] According to the Global Sustainable Investment Alliance, "2018 Global Sustainable investment Review." Impact/community investments means the sum of impact investment and community investment. The GSG National Advisory Board "The Current State of Impact Investing in Japan 2019" estimates the impact investment market in Japan will be at least 448 billion yen as shown in the result of a questionnaire survey conducted in 2019.

(2) Global Trends of Impact in Investments and Loans

Investments and loans that aim to have positive impacts on the environment, society, and economy, as well as to generate financial returns, are becoming a global trend. A variety of groups, international organizations and initiatives have contributed to this trend.

In response to the growing public interest in the social impacts of investments, the GIIN[3] was established in 2009, developing the "IRIS," a tool for measuring impact. The "G8 Impact Investment Task Force," which was launched in 2013, has been transformed into the GSG[4] consisting of national advisory boards of countries, including Japan, and expanding its activities. Furthermore, in 2019, IFC[5] released the "Operating Principles for Impact Management," aiming to mobilize a large amount of capital by providing transparency on impact.

On the other hand, the PRI[6], an ESG investment initiative, advocated a change[7] from recognizing ESG as a risk factor to an impact in 2015, and published a consultation paper in 2020 requiring signatories to report on investment and loan outcomes. UNEP FI[8] has proposed the "Principles for Positive Impact Finance" towards the achievement of the SDGs, with the 2019 "Principles for Responsible Banking" (PRB) requiring the consideration of impact in the overall portfolio of financial institutions.

Incorporating these various trends, the IMP[9] was established in 2016 as a broad network including GIIN, GSG, IFC, PRI, and UNEP FI, to serve as a platform for global consensus-building on impact measurement, comparison, and reporting.

(3) Basic Perspective of This Document

○ International consistency

As mentioned above, various efforts are being made by international organizations/initiatives for impact finance. This document has taken care to be consistent with such international developments.

○ Voluntary efforts

This document is not of a mandatory nature and is intended to be used at the discretion of individual market participants seeking to address impact finance. In order to enable individual organizations to refer to it in accordance with their characteristics, common concepts to engage in impact finance have been sorted out.

○ Dissemination process in Japan

Impact finance is expected to spread widely to all concerned parties including individual investors and regional financial institutions in the future. In fact, some regional financial institutions and others have begun to take initiatives. On the other hand, from the perspective of mobilizing funds on a large scale and due to the human resources required for such engagements, the mainstreaming is assumed to take place mainly in major

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3 Global Impact Investing Network
4 Global Social Impact Investment Steering Group
5 International Finance Corporation (IFC)
6 Principles for Responsible Investment
7 PRI "From Awareness to Impact"
8 United Nations Environment Programme/Finance Initiative
9 Impact Management Project

financial institutions/institutional investors for the time being. To the extent not conflicting with international consistency, this document also takes into account the specific circumstances of Japan, so that such entities in Japan will be easily able to engage in impact finance within their core business.

2. Definition of Impact Finance

○ The term “impact finance” used in this document is defined as one that satisfies all of the following elements (1) to (4):

Element (1)	**Intended to have positive impact at least in one aspect**, on the assumption that a **material negative impact is appropriately mitigated/managed in all environmental, social and economic aspects**.
Element (2)	Conduct **Impact assessment** and **monitoring**
Element (3)	**Disclose information** on the results of impact assessment and monitoring
Element (4)	Seek to **ensure an appropriate risk-return profile** for individual financial institutions/investors from **a medium- to long-term perspective**

In line with the intent of this document, this definition is compiled based on the definitions in the UNEP FI, “Principles for Positive Impact Finance” (2017) and the GIIN, “Impact Investing,” and the IMP concept among others.

○ **Definition of impact**

In this context, “impact” refers to a positive or negative change caused by an organization to the environment, society, or economy[10], which is not a direct deliverable or result (output), but an effect (outcome) of how the organization has made a difference from an environmental, social or economic aspect.

○ **Intent of impact**

While the impacts of investments and loans may occur intentionally or unintentionally[11], it is assumed that impact finance is **conducted with the intention of generating impact**.

○ **Mitigation/management of negative impact**

Even if a significant positive impact is expected to occur, it will not offset an accompanying material negative impact that may arise. Therefore, **a material negative impact should be appropriately mitigated/managed**.

[10] The term "economy" here refers to the creation of economic value for people and society, including, for example, local economic development, support for small and medium-sized businesses and entrepreneurship, support for innovation, and rewarding employment. Considering that the United Nations has defined the SDGs as "harmonizing three aspects of the economy, society and the environment", the "economy" is included in an aspect of the impacts in parallel with the "environment" and "society." In Japan, however, it is believed that the elements of the "economy" are practically included in the elements of the "society."

[11] This idea of impact corresponds to the definition by IMP.

3. Significance of Impact Finance

○ Visualizing the intentions and commitments to positive impacts in investments, loans, and corporate business activities will help maintain and improve the value and competitiveness of the recipient companies, and financial institutions/investors themselves. Meanwhile, their expansion, as a closely connected element, will help to improve the sustainability of society as a whole, which is the axis for creating the post-COVID-19 society.

(1) Social significance

○ Building new impact-based business models and accelerating the paradigm shift in capital markets

The spread of impact finance is expected to **clarify the commitment of ESG investments and loans to environmental, social, and economic issues**. This will **accelerate the development of new impact-based business models and the paradigm shift in capital markets**, leading to the transition to a decarbonized society and the creation of a sustainable society/economy that embodies the SDGs.

○ Improvement of sustainability as the axis for creating a new society

In the world where developments in new coronavirus infections are still unpredictable, movements to create the post-COVID-19 society are accelerating. **Sustainability will be the axis for the creation of the post-COVID-19 society**, as the concept of a "green recovery," which aims to make a recovery from the coronavirus pandemic a foundation for a greener, safer and more prosperous future, has begun to spread mainly in Europe. **Impact finance**, intended to have a positive impact on the environment, society, and economy, **is precisely expected to play a significant role in supporting the improvement of social sustainability.**

(2) Significance of companies raising funds through impact finance

○ Visualizing commitments and strengthening trust with stakeholders

When procuring funds through impact finance, companies show their commitment to the impact they aim to achieve through their business activities, and financial institutions/investors conduct evaluations based on KPIs. As a result, **companies' commitment to environmental, social, and economic issues is "visualized."** By doing so, **companies themselves can objectively demonstrate that they are engaging in business activities in line with their objectives of solving environmental, social, and economic issues**, which can be expected to **win high evaluation from stakeholders and strengthen trusted relationships with stakeholders through more advanced engagement**.

○ Strengthening corporate sustainability management and increasing corporate value

Through the initiatives for impact finance, companies' own sustainability management will be strengthened, and as a result, **corporate value is expected to increase**. This is because the initiatives for impact finance can be expected not only to **promote the disclosure of ESG information**, but also to bring about **sustainable growth** for companies. This will occur through **the acquisition of new business opportunities in growth fields where**

social needs are large, **differentiation from other companies**, and **improvement of international competitiveness** through initiatives for problem-solving businesses that meet local needs.

- **Enhanced possibility of financing for new impact-based businesses**

  Looking ahead, it is expected that with the increase in financial institutions/investors seeking positive impact, **visualizing impact will increase the possibility of financing for venture companies and new businesses of large companies** that seek to solve environmental, social and economic issues through their own technologies and mechanisms.

(3) Significance of impact finance by financial institutions/investors

- **Realizing own philosophy of ESG investments and loans, gaining public support, and improving competitiveness**

  Impact-oriented investment and loan activities can develop ESG investment and loan efforts, demonstrate the commitment to impact, and **contribute to the purpose of financial institutions/investors to address their own environmental, social, and economic issues**. At the same time, the provision of impact finance can also **help the recipient companies of investments and loans to promote business activities in line with the purpose of solving environmental, social and economic issues**. These efforts are expected to aid **the acquisition of public support** from millennials and other people who are interested in realizing the environmental and social impacts of investments and loans, and to contribute to **maintaining and improving the competitiveness of financial institutions/investors**.

- **Contributing to ensuring appropriate risk-return profiles from medium- and long-term perspectives**

  For financial institutions/investors, impact finance can be seen as **contributing to the pursuit of an appropriate risk-return profile over a medium- to long-term horizon**, and thereby **ensuring an appropriate risk-return profile for the portfolio as a whole**, from the following perspectives:

  First, through **more in-depth engagement based on a multifaceted understanding of impacts by recipient companies of investments and loans**, financial institutions/investors can expect to **improve their "abilities to assess" corporate value and new business opportunities.**

  Moreover, since it provides recipient companies of investments and loans with business opportunities in growth fields with a high positive impact or high impact needs, it will be possible to expect an increase in the corporate value of the recipient companies.

  Furthermore, since impact is identified, assessed, and engaged for the recipient companies that may incur a material negative impact, it will lead to **the mitigation of negative impacts** and **reduction of downside risk** through the promotion of a transition.

- **Sustainable and stable growth of capital markets and maintenance and strengthening of financial institutions/investors' own management foundations**

  It is also very significant for financial institutions/investors to **contribute to improving the sustainability of society as a whole**. For universal owners and major financial institutions, which provide investments and loans to a wide range of companies,

particularly listed ones, promoting sustainable growth of society by reducing negative environmental, social, and economic impacts while increasing positive impacts will lead to **sustainable and stable growth of the entire capital market**. It will also **contribute to maintaining and strengthening the management foundations of financial institutions/investors themselves**.

By solving environmental, social and economic issues of local communities, regional financial institutions/investors are likely not only to obtain their own profit opportunities but also to contribute to the sustainable growth of local communities, and thus to maintain and strengthen their revenue bases.

○ **Relationship with fiduciary duties**

There are various ways of thinking and views on the relationship between impact finance and fiduciary duties at the time of reviewing this document. And it will be necessary to continue to review them going forward, taking into account the developments in global discussions [12]. On the other hand, there are many implications for financial institutions/investors as mentioned above, and the reality is that impact investment/loan products have already begun to be structured in Japan and other countries. Hence, it seems to be **quite possible to engage in impact finance without violating fiduciary duties**.

4. Basic Flow of Impact Finance in Individual Investments and Loans

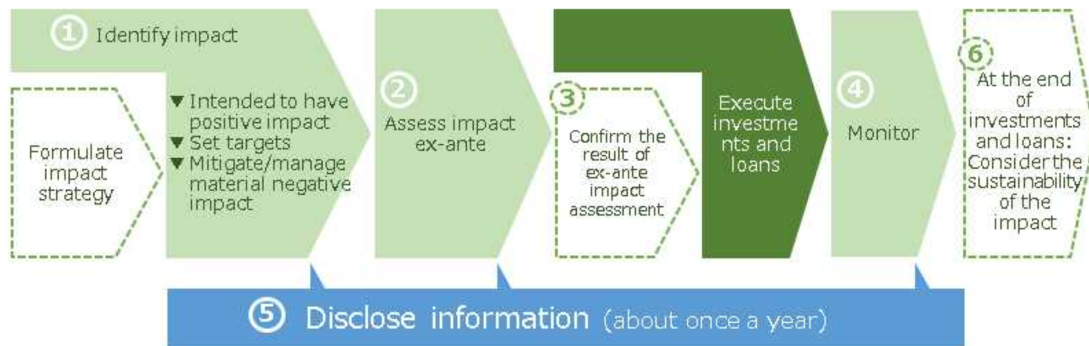
(1) **Identify impact**
(2) **Assess impact ex-ante**
(3) Confirm the result of ex-ante impact assessment (as needed)
(4) **Monitor Impact**
(5) **Disclose information**
(6) Consider the sustainability of an impact at the end of investments and loans (to implement as needed)

○ **Basic flow of impact finance**

While impact finance may involve a variety of investment and loan methods, asset classes, and impact areas, the basic flow common to individual investments and loans is shown in the diagram below. This basic flow is a comprehensive compilation of UNEP FI's "Principles for Positive Impact Finance" (2017) and "Model Framework: Financial Products for Corporate with Unspecified Use of Funds" (2018), IMP's impact assessment, and IFC's "Operating Principles for Impact Management" (2019), among others.

[12] The project "A Legal Framework for Impact," which has been promoted by UNEP FI and PRI since 2019, investigates and examines the legal status of impact within fiduciary duties.

[Figure 2 Basic Flow of Impact Finance in Individual Investments and Loans]



Before making an investment or loan, financial institutions/investors shall, for each project: (1) **identify impact**; (2) **assess impact ex-ante**; and after making an investment or loan, (4) continue **monitoring** as the ex-post assessment of impact throughout the period of investment or loan. (5) **Disclose information** on the identified impact and the result of ex-ante assessment at the time of making an investment or loan, while disclosing information on the result of monitoring after the investment or loan at the frequency of about once a year.

○ **Differences by type of investment or loan**

Depending on the type of investment or loan, there may be differences in the order of the process, etc. For example, in the case of PE funds and some listed equity funds, when they first formulate their impact strategies as funds, they may identify areas of positive impact that they intend to generate, and select recipients of investments and loans after conducting ex-ante assessments. On the other hand, for individual cases of corporate finance and project finance, the target companies and projects to be invested in or loaned to are selected in advance, and the impact may be assessed ex-ante from the perspective of whether the target falls under impact finance.

○ **When individual principles have been established taking impact into account**

Regarding other principles for which impact-oriented methods of identification, assessment, monitoring and disclosure are established separately, such as the Green Bond Principles, Social Bond Principles, and Green Loan Principles, impact will be addressed based on these principles.

(1) Identify impact

- ○ Identify impact that is considered particularly material in terms of both positive and negative (hereinafter referred to as the "Core Impact").
- ○ For positive impacts, targets should be set with the intention of generating the identified impact, while for negative impacts, the impact that would have a material impact, if generated, should be identified.

○ Identify Core Impacts to clarify the positive impacts to be generated by investments and loans as well as the negative impacts to be mitigated and managed.

○ Regarding positive impacts, it is important to have an intention to create impacts, and desirable to identify impacts that could be created in the future from a forward-looking perspective, rather than impacts that have already been generated.

○ When a secondary impact associated with the Core Impact is expected from both positive and negative aspects, it should be considered as an independent impact as much as possible, even if it is qualitative, from the specifying stage.

○ There are two types of ways to identify impacts: **A) comprehensively grasp the diverse impacts of a company**; and **B) target specific positive impacts on a project or fund basis.** Depending on the nature of the investment or loan project, financial institutions/investors can make use of whichever is appropriate.

○ Note that A) and B) are not mutually exclusive and may be used together within the same financial institution/investor.

A) Comprehensively grasping the diverse impacts of a company

○ Target investments and loans:

They include corporate finance, such as bank loans for companies with unspecified use of funds, and listed equity investment, which is premised on investments in a wide range of issues in the whole market.

○ Concept of comprehensively grasping impacts:

(i) In both positive and negative aspects, the first step is to identify areas where material impacts may occur based on countries/regions and business sectors.

- In principle, all impact categories should be comprehensively considered when the target of investments and loans is a large enterprise or others with a global supply chain.
- On the other hand, it is also effective to focus on the categories with high impact needs in the countries/regions where business activities are conducted, when mid-sized enterprises/SMEs, etc. are targeted for investments and loans whose business activities are conducted in limited areas. Since impact needs differ from region to region, first consider high impact needs in the areas where business activities are conducted.

(ii) Subsequently, specific impacts of the investment and loan project should be identified according to the characteristics of the business, products, or services of the individual company.

- A positive Core Impact should preferably result from the company's main business.

Identifying Impact Needs of Businesses in Japan

For comprehensive analysis and identification of impacts, it is effective to utilize items in SDGs and the Impact Radar developed by UNEP FI based on SDGs. However, in considering the impact needs of businesses in Japan, it is conceivable to simplify and apply as appropriate, taking into consideration the assessment of Japan in the SDG Index & Dashboards[13], priority areas identified in the SDGs Implementation Guidelines[14], etc. and the areas where sufficient measures are deemed to have already been taken. (See Reference at the end of the document.)

Points to note

- Negative impacts are not necessarily generated as the intention of individual companies. Therefore, they should be checked from a comprehensive perspective not only in the countries/regions where the target companies for investments and loans are engaged in business activities such as production and sales, but also in the entire supply chain, including the countries/regions where materials are procured. This should be done while taking into account the characteristics of regions and business sectors.

B) Targeting specific positive impacts on a project or fund basis

○ Target investments and loans:

They include impact finance in project finances, infrastructure/real estate funds, private equity funds, and some listed equity funds.

○ Setting specific impacts:

In such investments and loans, it is also desirable to consider each impact category comprehensively. Expected impacts may be identified first if there is a clear aim of the positive impact to be generated by the target project or fund for investments and loans, or a clear negative impact to have a material influence if generated.

Points to note

- When an impact strategy is initially formulated on a fund basis, such as a private-equity fund or some listed equity funds, the impact areas to be emphasized may be identified in formulating the strategy. However, since specific recipients of investments and loans are not necessarily selected at this stage, the impacts of each project should be identified at the next stage of ex-ante impact assessment.
- Even in the case of investments aimed at specific positive impacts, it is

[13] A report by the Bertelsmann Foundation and the Sustainable Development Solutions Network that analyzed the achievement of SDGs in each country

[14] Decision by SDGs Promotion Headquarters on December 22, 2016, partially revised on December 22, 2019

important to identify material negative impacts to mitigate/manage them.

(2) Assess impact ex-ante

○ The identified Core Impacts should be quantitatively assessed by setting measurable KPIs and numerical targets as much as possible.

○ In order to be able to measure the generation of impacts identified in the preceding paragraph after investments and loans, KPIs and numerical targets should be set for Core Impacts to be assessed quantitatively ex-ante as much as possible.

○ Impact assessment includes ex-ante evaluation before investments and loans and ex-post evaluation after investments and loans (hereinafter referred to as "Monitoring"). The ex-ante assessment assesses each investment and loan opportunity for the possibility of creating positive impacts identified in the preceding paragraph, and whether material negative impacts will be mitigated/managed appropriately.

○ Secondary impacts associated with the identified Core Impacts should also be assessed, to the extent that they can be captured, qualitatively or quantitatively.

Points to note

- Since this is a forward-looking assessment prior to investments and loans, it is deemed effective to assess the impact management system, the vision/mechanism for creating impact, the management's intentions and commitment to the goals, and the presence or absence of an impact strategy among others.

Specific examples)

In the case of investments and loans for a renewable energy power project, the Core Positive impact is assumed to be mitigation of climate change. It can be understood that the direct output will be the construction of renewable energy power plants, the outcome will be to reduce greenhouse gas emissions, the KPI will be the reduced greenhouse gas emissions (t-CO_2/year), and the target will be the reduction of XX t-CO_2/year or XX%. On the other hand, the Core Negative Impact may be the influence on the ecosystem and noise if the project involves deforestation. For these impacts and targets, assessment will be conducted on how the management commits to the targets, and whether there is a system to measure, manage, and disclose the impacts after investments and loans.

- It is preferable to consider the additionality of impact in the assessment as well. Additionality means whether a project has created an impact that would not otherwise have been provided, such as the provision of services to a new market or the improvement of the quality or quantity of services, etc. through new investment even in the existing business.
- In cases where an objective assessment of the impact finance framework and the results of ex-ante assessment thereof is required, it is desirable to ensure objectivity by undergoing an external assessment by an internal division[15] with

[15] Even if it is an internal division, it can be one that has secured a certain degree of independence from the division in charge. In general, external third parties are deemed to be more independent.

expert knowledge and a certain degree of independence, or a third-party organization.

When undergoing an external assessment, it is important to request assessment by an institution with sufficient expertise in impact finance.

(3) Confirm the result of ex-ante impact assessment (as needed)

○ Depending on the presence or absence of a positive impact and the mitigation/management status of a negative impact, by classifying into three stages[16]: **i) Positive impact, ii) Positive impact transition, and iii) Not positive impact,** and grasping/confirming the current situation, the assessment can be used as an incentive for recipient companies of investments and loans to move in a more desirable direction.

○ The results of ex-ante assessment may not necessarily meet the definition of impact finance, but even in such cases, the assessment results can be used to engage companies.

○ Mainly in A) comprehensively grasping the diverse impacts of a company, the results of impact assessment are expected to be used to motivate the recipient companies of investments and loans to move in a desirable direction with more impact by classifying the results as needed and grasping/confirming the current situation.

i) Positive impact — having a significant positive impact on at least one of the environment, society and economy, while appropriately mitigating/managing material negative impacts.

ii) Positive impact transition — having a significant positive impact on at least one of the environment, society and economy, although not appropriately mitigating (managing) negative impacts at present. However, in order to mitigate/manage material negative impacts, the process has entered a stage where they can move into the positive impact classification, as recipient companies of investments and loans have begun to formulate and implement medium- and long-term visions or transition plans, for instance.

iii) Not positive impact — With or without positive impact, negative impacts are not mitigated (managed) at all, while no process has been undertaken to enable the move into the positive impact classification.

Points to note

- In corporate finance and others, most recipient companies of investments and loans are selected from the outset. But if, as a result of ex-ante assessment, the recipient companies have a significant positive impact on at least one of the environment, society and economy, and material negative impacts are mitigated/managed appropriately, the recipient companies are deemed to be at the i) "Positive impact" stage. If this is not the case, investments and loans to the companies will not fall under the definition of impact finance.

[16] Based on the classification by UNEP FI "Corporate Impact Analysis Tool".

- In order to improve the sustainability of society as a whole, it is important for financial institutions/investors to actively encourage recipient companies of investors and loans to move in a desirable direction from iii) to ii) and from ii) to i). Therefore, although not falling under the definition of impact finance, the following can be deemed to be in line with the concept of impact finance: making investments and loans to encourage companies classified as "Positive impact transition" to move into the "Positive impact" classification; engaging with companies classified as "Not positive impact" and, depending on the results, deciding not to make investments and loans; and furthermore, monitoring the status of impact by companies.

(4) Monitor Impact

○ Identified Core Impacts should be monitored, periodically measured based on KPIs, and assessed on their achievement if quantitative targets are established.

○ After investments and loans are implemented, continuous monitoring should be conducted as to whether the intended positive impact is being realized and whether material negative impacts have actually been mitigated.

○ Other secondary impacts should also be monitored qualitatively or quantitatively to the extent that they can be captured.

○ Monitoring should be conducted at least once a year during the investment and loan period to confirm and follow up on whether progress at that point is consistent with the target.

Points to note

- Since adequate information disclosure by projects and recipient companies of investments and loans is important for effective monitoring, it will be effective for financial institutions/investors to encourage such disclosure through engagement if disclosure is insufficient.
- From the viewpoint of preventing "impact washing,"[17] it is desirable to ensure objectivity by undergoing an external assessment by an internal division with expert knowledge and a certain degree of independence, or a third party.

  When undergoing an external assessment, it is important to request assessment by an institution with sufficient expertise in impact finance.

[17] The term refers to the practice of asserting/advocating there are positive impacts while mitigating/managing negative impacts, although the reality is different as there are no positive impacts or they are improperly inflated, or not appropriately mitigating/managing negative impacts.

(5) Disclosure information on impact

○ Ensure transparency on the identified Core Impacts, KPIs, and ex-ante assessments at the time of making investments and loans, and do so on the results of monitoring after making investments and loans.

- ○ In order to claim/advocate impact finance to obtain public support, it is necessary to ensure transparency through information disclosure.
- ○ In the case of declaring impact finance, financial institutions/investors are required to disclose information on the framework used to identify impacts, identified Core Impacts, KPIs, ex-ante assessments, etc. at the time of making investments and loans, and on the results of monitoring at least once a year after making investments and loans.

Points to note

- The above information should be disclosed in the form of integrated reports, reports for asset owners, and websites to the extent that it is available according to the type of investments and loans, such as listing and private placement, and to the extent that it does not violate non-disclosure agreements.
- Moreover, other information related to impact finance, including impact strategies and impact management systems, should also be disclosed to the extent possible.

(6) Consider the sustainability of impact at the end of investments and loans[18] (as needed)

○ When investments and loans are terminated, there are high hopes that the concerned parties will consider the influence on the sustainability of impacts under the new ownership as necessary if the project continues afterward.

- ○ In order to maintain the sustainability of impacts under the new ownership, for B) project finance and PE funds and others, there are high hopes that the concerned parties will consider possible influences on the sustainability of an impact upon terminating investments and loans in the case of continuing the project afterward, including the timing of termination, structures and processes.

[18] It is based on the elements and principles of the investment process in the IFC (2019) "Operating Principles for Impact Management."

5. Impact Assessment at the Portfolio Level of Financial Institutions/Investors[19]

○ When investors[20], mainly financial institutions and asset owners, conduct a comprehensive impact assessment of their entire portfolio, the flow (such as identifying Core Impacts, assessing impacts with targets and KPIs, monitoring impacts, and disclosing information) is basically the same as that for individual investments and loans (4 above). .

○ Apart from individual investment and loan opportunities, investors that are also financial institutions or asset owners could conduct a comprehensive impact assessment of their entire portfolio.

○ The use of assessment results at the portfolio level is considered to be effective not only in finding industries or individual companies with a large positive impact for new opportunities of impact finance, but also in encouraging industries or individual companies deemed to have a large negative impact to reduce the negative impact through engagement to raise the level of the overall impact-oriented portfolio.

○ In a medium to long term, it would be desirable for investors that are financial institutions or asset owners to identify the Core Impact by conducting portfolio-level assessment and formulate an impact strategy for the entire portfolio.

6. Conclusion

Impact assessments are increasingly being incorporated into investment and loan decisions by various groups, international organizations, initiatives and private financial institutions/investors. In Japan as well, new perspectives and ideas are being presented day by day, and concrete efforts are in progress.

On the other hand, in order to fully disseminate impact finance in Japan, one of the challenges is to determine how financial institutions/investors will incorporate impact assessment into their project review and due diligence procedures. This will require financial institutions/investors to establish impact assessment methods and develop human resources for impact assessment.

This document has been developed as a first step for promoting impact investment and finance among major financial institutions/institutional investors/service providers in Japan. Closely watching the new trends and developments of impact finance both in Japan and overseas, the current document will be continuously revised and updated based on new discussions.

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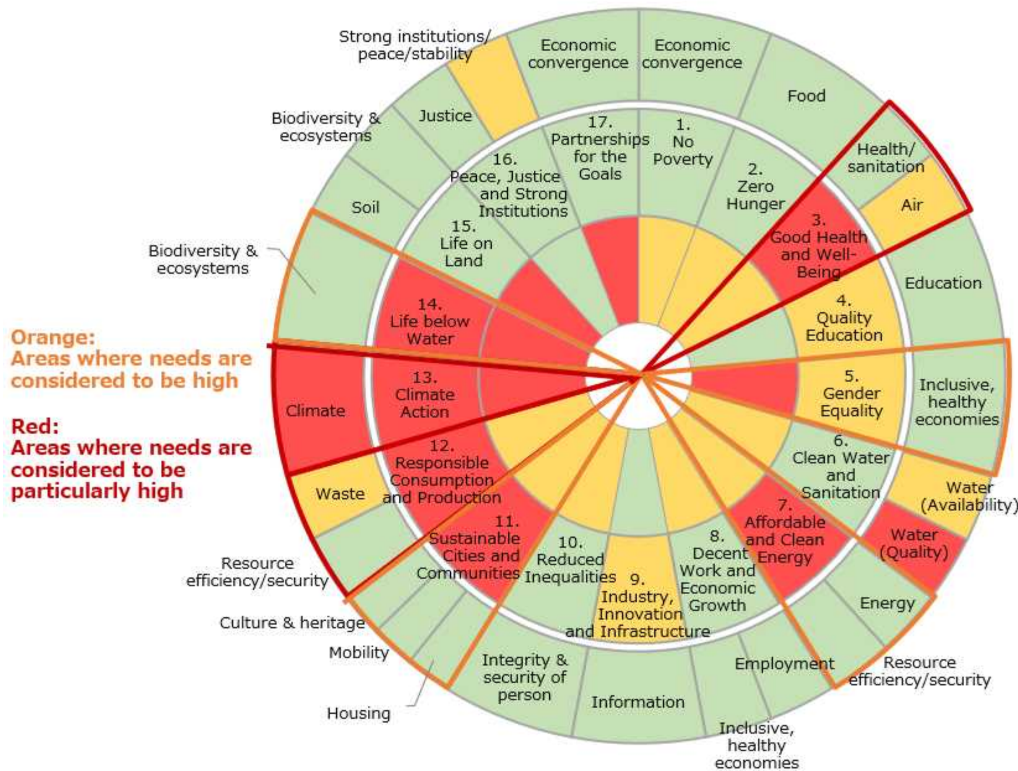
[19] It refers to the concept of UNEP FI (2018) "Principles for Positive Impact Finance."

[20] In the case of fund management institutions, it is conceivable to conduct a portfolio-level evaluation of all funds that are impact-oriented, depending on the intention of the asset owner and the product characteristics of each fund.

Reference: Identifying Impact Needs of Businesses in Japan

○ The following diagram sorts out the country needs of Japan by connecting them based on the SDG Index and Dashboards, the "SDGs Implementation Guiding Principles" by the Government of Japan, and the UNEP FI's impact assessment tool, to serve as a reference when identifying impact needs of projects in Japan.



Legend:

- Concentric innermost layer: **SDGs**

  Using the "**SDG Index & Dashboards Assessment** (2020)," the SDGs for which corresponding measures are deemed most necessary in Japan are shown in **red**, those for which corresponding measures are assessed as being taken in **green**, and others in **yellow**.

- Middle tier of concentric circles: **Corresponding Japanese government "SDGs Implementation Guiding Principles"**

  In the "Basic Policy on Economic and Fiscal Management and Reform 2019" mentioned in the Government of Japan "SDGs Action Plan 2020," the SDGs that Japan should lead are shown in **red**, those that should be promoted in **yellow** and others in **green**.

- Outer layer of concentric circles: **Corresponding major UNEP FI impact categories**

  For Japanese country needs, those rated as with the highest needs (Score 4) are shown in **red**, those rated as with the lowest needs (Score 1) in **green**, and others in **yellow**.