

# Japan's disclosure and engagement guidance: facilitating the transition to a circular economy through finance



Part of a series of case studies that exemplify elements of the Universal circular economy policy goals (2021) in practice.



**To attract foreign and domestic investments into circular activities, in January 2021 two ministries of the Japanese government (the Ministry of Economy, Trade and Industry and the Ministry of the Environment) published the “Disclosure and Engagement Guidance to Accelerate Sustainable Finance for a Circular Economy”. It is the world’s first government-formulated non-mandatory guidance on disclosure and engagement specifically targeting the circular economy.**

**The guidance’s primary aim is to unlock more investment in the circular economy. It encourages companies to communicate to investors how, through their circular economy activities and innovative technologies, they can provide return on investments. Using existing financial frameworks and exchanging with other governments and institutions, the Japanese government is exploring ways to embed circular economy considerations into business strategies, investment decisions, and dialogues between companies and investors.**

## **Brief context to the guidance**

In 2000, the Japanese government established the Basic Act for Establishing a Sound Material-Cycle Society, taking a significant step forward in the country’s approach to waste management.<sup>1</sup> It led to the first Fundamental Plan for Establishing a Sound Material-Cycle Society in 2003, which laid the foundations for the development of a regulatory framework for a circular economy in Japan. The government revises the plan every 5 years to advance policies and actions for the sound material-cycle society and the 4th plan was published in 2018.

The 4th Fundamental Plan states that “Financial institutions and investors are expected to provide appropriate funds to companies and NPOs (Non-Profit Organisations) working to create a sound material-cycle society and projects that lead to the creation of a sound material-cycle society.” (Section 4.2.6).<sup>2</sup> As such, the “Disclosure and Engagement Guidance to Accelerate Sustainable Finance for a Circular Economy” can be seen as another step in Japan’s policy developments that are intended to support the transition to a circular economy.



## What does the guidance mean in practice?

The guidance outlines how companies can leverage private investments and the financial services sector to scale their circular activities. It complements and aligns with other disclosure efforts, whilst increasing the understanding of what circular economy investments look like. While the guidance is not prescriptive, it recommends impact reporting and the use of certifications.

### Companies can:

- Comprehensively communicate their values, business models, strategies, and governance to investors
- Refer to the guidance when preparing integrated reports and annual reports, identifying circular economy as corporate materiality

### Investors can:

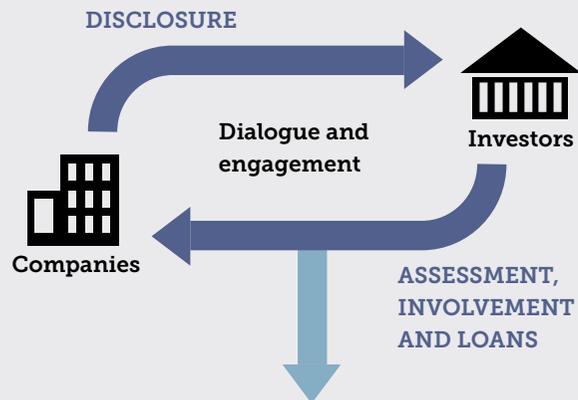
- Use the guidance in stewardship activities aimed at increasing corporate value and sustainable growth of investee companies from a medium to long-term perspective

The guidance outlines how companies can embed circular economy thinking into their business strategies, to scale circular economy innovations and relevant technologies, and increase their competitiveness. It also intends to help companies internalise circular economy thinking within their business activities. For instance, it encourages companies to embed circular economy principles into their corporate values, business models, annual reports, and to develop the appropriate key performance indicators (KPIs) to measure progress.

The guidance suggests that circular economy thinking should be embedded into business decisions across the different management levels of a company from the board of directors to the executive level. By aligning a "Plan-Do-Check-Act" (PDCA) cycle with circular economy targets, companies can measure progress towards the achievement of their KPIs. The guidance includes five case studies to demonstrate how Japanese companies are embedding circular economy considerations within their processes.

Circular economy strategies can help to de-risk investments and drive superior risk-adjusted returns for investors and financial institutions.<sup>3</sup> The ultimate goal of the guidance is to help investors to evaluate companies' circular economy initiatives, assess the risks and opportunities, make investment and financing decisions, and promote corporate value and the sustainable growth of companies. Investors can incorporate circular economy considerations into their engagement and stewardship activities with companies aiming to mitigate risk and increase long-term investment return. The guidance encourages dialogue between asset owners and asset management organisations on the opportunity for a circular economy approach to tap into new sources of long-term growth and value creation, whilst delivering on ESG-related goals and targets.

### Common language connecting companies and investors



Through the promotion of disclosure and dialogue, accelerate the transition to circular economy

## The six key points of disclosure and engagement in the guidance

The guidance is closely aligned with the 2017 Japanese "Guidance for Collaborative Value Creation",<sup>4</sup> as well as the internationally recognised Task Force on Climate-related Financial Disclosures' (TCFD) framework and other internationally recognised frameworks. In fact, four of the six disclosure points (risk and opportunities, strategy, indicators and targets, governance) in the "Disclosure and Engagement Guidance to Accelerate Sustainable Finance for a Circular Economy" overlap with the TCFD framework.

To tailor the guidance to encompass circular economy considerations, the Japanese government included two further disclosure points - one on values and one on business models.

## Overview of the six key points of disclosure and engagement in the guidance

### Values

It encourages companies to embed circular economy thinking into their corporate values and use it to guide their business decisions.

### Business model

It recommends that companies disclose how their circular economy activities will affect or change their business model, generate value, and maintain their competitive advantage in the market.

### Risks and opportunities

It suggests that companies should summarise the legal, technological, market, and reputational risks and opportunities that will arise from adopting a more circular business model. (aligned with the TCFD)

### Strategy

It outlines how companies should explain how they will secure and strengthen the management of the resources and assets that will support the competitive advantage of their circular business model, as well as manage risks in the medium to long term. (aligned with the TCFD)

### Indicators and targets

It encourages companies with circular economy ambitions to set their targets and key performance indicators (KPIs) to measure and report on their progress towards circularity. (aligned with the TCFD)

### Governance

To demonstrate to investors the effectiveness of their governance system, companies should show how management and the board of directors are actively involved in a company's circular economy activities and policies. (included in the TCFD)

## Going forward

As the circular economy guidance builds upon pre-existing guidance and ESG frameworks, it is likely that companies in Japan with circular economy ambitions will use it in dialogues with their investors. However, it is too early to assess the impacts of this guidance. The government is expected to revise and update the guidance to reflect future developments in qualitative and quantitative information disclosure as more companies and investors start using the guidance. As the guidance is non-mandatory, the government will be able to assess how the private sector is adopting these practices, helping to inform future fiscal policies or an updated version of the guidance.

### **More information:**

[Disclosure and Engagement Guidance to Accelerate Sustainable Finance for a Circular Economy](#)

This case study was published in January 2022 as part of the Ellen MacArthur Foundation's [Universal circular economy policy goals](#)

## Lessons learned so far

### **Ensuring alignment through collaboration**

The development of this disclosure and engagement guidance was the fruit of cross-ministerial collaboration, bringing together the Ministry of Economy, Trade, and Industry (METI) which is responsible for industrial and business policy and the Ministry of Environment (MoE) responsible for waste management. This collaboration was complemented by information exchange with the Financial Services Agency (FSA).

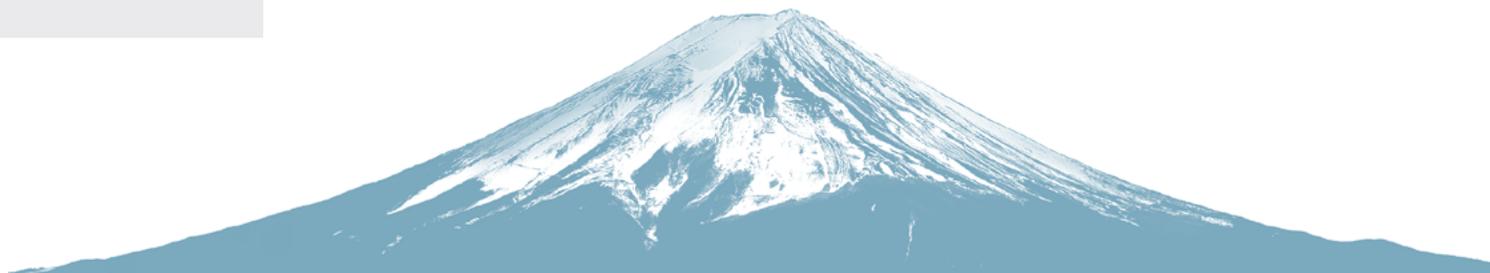
The two ministries were supported by a study group - composed of companies, business associations, financial institutions, research institutions, and academics - that reviewed and provided inputs on the guidance proposed by the ministries. This multi stakeholder engagement approach helped to develop a common understanding of circular economy financing.

### **Using existing ESG frameworks**

By building the guidance on existing Japanese guidance and the TCFD and other international frameworks, it is easier for companies to explore and work with these practices. Identifying how the circular economy contributes to existing ESG targets such as climate change mitigation, and biodiversity restoration can further help companies adopt a more circular approach.

### **Gathering information through disclosure and reporting**

Encouraging companies to disclose and report their circular economy activities can help in gathering information about the uptake of circular economy practices, and also support the development by companies of reporting metrics and data sets. These insights can help to inform investment decisions. It can also provide insight to the government and inform future policy developments.





## Leveraging sustainable finance for system change: how this policy example illustrates elements of the Universal Circular Economy Policy Goals framework



### GOAL 3

#### Make the economics work

Creating the right economic conditions is key in helping circular economy practices and solutions to scale. Economic policy measures affect how every organisation operates. Therefore, by working to align financial policies and disclosure requirements with circular economy principles, the Japanese government is enabling circular economy investment and business decisions to become the norm rather than the exception. By working with financial actors, businesses and verifiers, policymakers can create and align guidelines or regulations that inform investment decisions with a view to support the transition of the economy to a circular model. This in turn can lead to growth in circular economy activities.



### GOAL 4

#### Invest in innovation, infrastructure and skills

The Japanese government is encouraging companies to showcase their innovative approach and circular business ideas and pitch their ideas to investors. This in turn helps investors to identify investment opportunities and encourages investors to fund the development of circular economy activities. Capitalising on new opportunities can encourage the growth in innovation and circular economy activities. By leveraging private sector financing, policymakers can help to further scale the circular economy.



### GOAL 5

#### Collaborate for system change

Promoting alignment and harmonisation of frameworks, as well as indicators and standards, at the international level, can help to embed circular considerations into the global financial services sector. For instance, the EU and the Japanese government have been aligning and collaborating on the topic at the G20 fora.<sup>5</sup> Also, the cross-ministerial collaboration that has supported the development of the guidance helped to break policy silos and embed circular economy principles in new policy areas. Furthermore, engaging the private sector during the elaboration of this guidance helped to unite stakeholders from across companies, financial institutions, banks, research institutions, and academia behind the principles of the circular economy, as well as foster collaboration for system change.

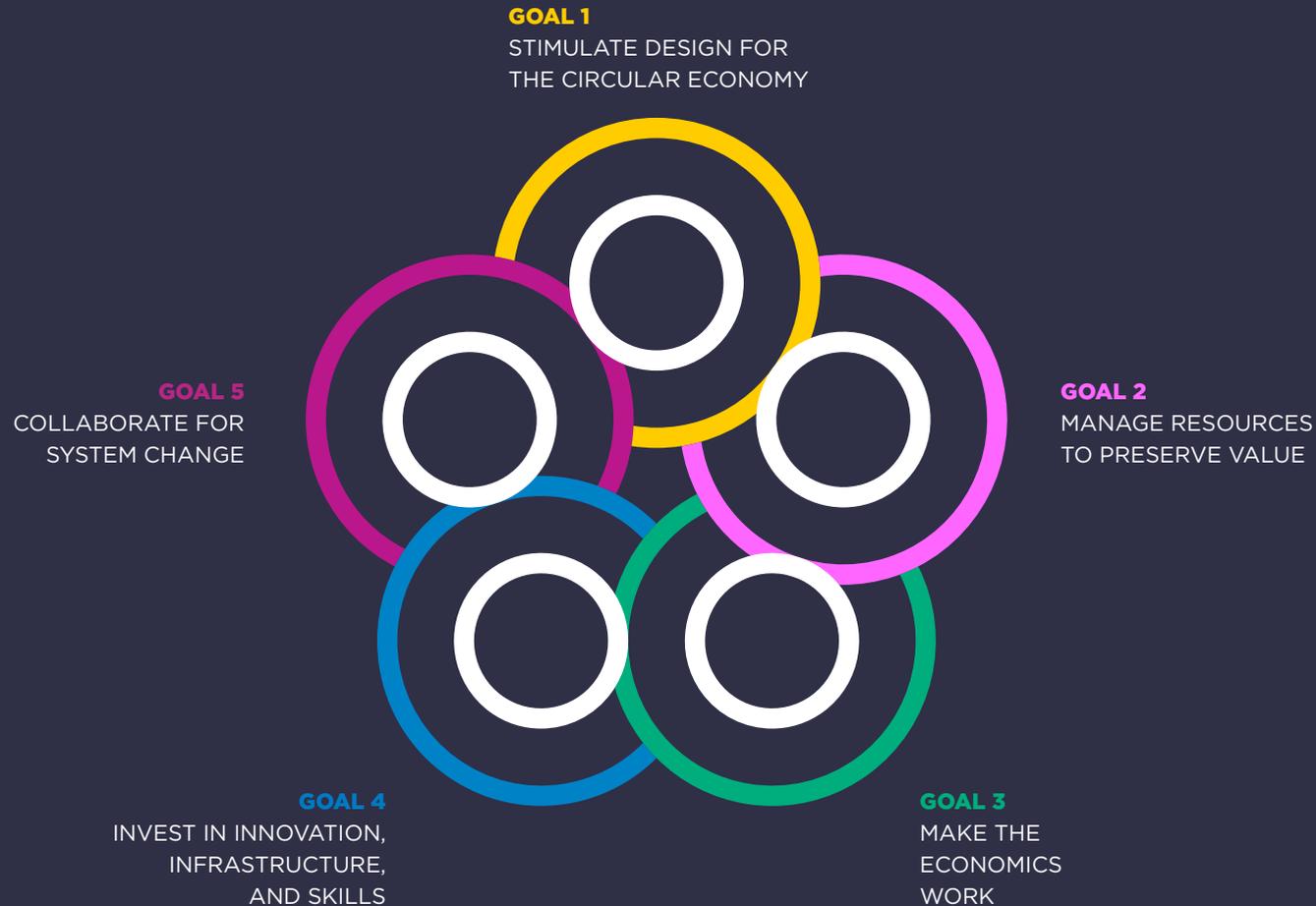
## Endnotes

- 1 Ministry of the Environment, Japan (MOEJ) (2014) History and Current State of Waste Management in Japan. <https://www.env.go.jp/en/recycle/smcs/attach/hcswrn.pdf>
- 2 Ibid.
- 3 Bocconi University, Ellen MacArthur Foundation, Intesa Sanpaolo, [The circular economy as a de-risking strategy and driver of superior risk-adjusted returns](#), (2021).
- 4 Guidance for Integrated Corporate Disclosure and Company-Investor Dialogues for Collaborative Value Creation [https://www.meti.go.jp/english/press/2017/pdf/0529\\_004b.pdf](https://www.meti.go.jp/english/press/2017/pdf/0529_004b.pdf)
- 5 [International Platform on Sustainable Finance](#)

### About Financing the circular economy - Capturing the opportunity

In 2020 the Ellen MacArthur Foundation published [Financing the circular economy - Capturing the opportunity](#), a report that offers new analysis that highlights rapid growth in circular economy financing and investment. It lays out the opportunities for investing, banking, and insurance - and calls on the financial sector to seize the full potential by scaling the circular economy in collaboration with governments and corporations.

## About the Universal circular economy policy goals



In January 2021 the Ellen MacArthur Foundation published a paper Universal circular economy policy goals: enabling the transition to scale, aiming to create a common direction of travel in policy development for a faster transition to a circular economy. The five circular economy policy goals detailed in the paper can offer solutions to key global challenges such as climate change, biodiversity loss, and pollution, whilst delivering economic development.



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