

# **2007 Review of Socially Responsible Investment in Japan**

Social Investment Forum Japan(SIF-J)



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## Foreword

The Social Investment Forum Japan (SIF-Japan) was established as a not-for-profit organization in November 2003 with the mission of contributing to the spread and development of socially responsible investment (SRI) in Japan. Since then, it has carried out a variety of activities through various approaches, including holding symposiums and seminars for fund managers, analysts and individual investors, etc., conducting independent research on socially responsible investment, and so on.

This report, the *2007 Review of Socially Responsible Investment in Japan*, was undertaken to compile objective data and facts with the purpose of making the Japanese aware of the current state of the SRI market in this country. Recognizing the vitality and growth of the global SRI market, another purpose we set was to send out information from Japan to the world, particularly with a view toward fostering collaborative relationships with organizations and companies overseas that share a mission similar to ours.

This report is the first initiative of its kind in Japan, and we intend to continue issuing similar reports in the future and as part of the mission of SIF-Japan. We take this opportunity to express our deepest appreciation for the data and extensive cooperation we received in its preparation, not only from our own member companies, but also from SRI fund companies, asset managers, and others.

We sincerely hope that this publication will serve as a milestone for the healthy development and expansion of the SRI market in Japan.

4 December 2007

Social Investment Forum Japan (SIF – Japan)

Representative Director and Executive Director	Toshihiko Goto
Deputy Director	Hiroshi Matsuzawa
Secretariat Staff	Kumiko Matsumoto
Editorial Committee	
Chief editor	Mariko Kawaguchi
Committee members	Takeshi Mizuguchi
	Minako Takaba
	Toshiaki Yamamoto
	Tetsuro Yoshida

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## **Executive Summary**

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- The first publicly offered socially responsible investment trust (SRI) offered in Japan as a general investment instrument appeared in 1999 with the launch of a type of publicly offered SRI fund known popularly in Japan as an “eco-fund.”
- This fund launch was preceded by ground-breaking research by Japanese scholars, researchers, and the Valdez Society, which had been catalyzed into action by Ceres (a network in the United States working to integrate the environment and sustainability into capital markets).
- The new eco-funds appealed to individual investors and attracted much public attention, but the SRI market soon shrank due to the collapse of the high-tech stock bubble and the general slowdown of the stock market.
- The year 2003 marked a turning point, with the recovery of the stock market, the launch of several new SRI investment trust, and SRI-based asset management also being offered for corporate pension funds.
- As of 30 September 2007, the SRI market in Japan was estimated at 840 billion yen (\$7.3 billion), including 747 billion yen (\$6.5 billion) in SRI investment trusts, and the balance being managed assets in corporate pension funds, and so on.
- A major factor affecting the recent surge in managed assets in SRI investment trusts is the sudden popularity of so-called “theme funds”—mainly global equity funds that have a thematic focus on environmental technologies and global warming.
- The key features and prospects of SRI in Japan could be summarized with the following three points:
  - First, the use of negative screens (exclusionary criteria to rule out certain stocks) based on religious or ethical value is virtually non-existent in Japan. Most investments use the positive screen (or “best-in-class”) approach.
  - Second, the presence of institutional investors like public pension funds (including universities and public-interest entities) is extremely small in the SRI market in Japan compared to Europe and the United States, and SRI-style shareholder advocacy and engagement is next to nil. No policy measures yet exist to promote SRI among pension funds and the like.
  - Third, while the prospects for the development of SRI in Japan may appear pessimistic, Japan does have a high level of activity relating to corporate social responsibility (CSR), and the awareness of individuals about environmental issues is also high. If one considers the fact that Japanese personal financial assets amount to 1,555 trillion yen (\$13.5 trillion, according to Bank of Japan, 30 June 2007) and the fact that a large number of institutional investors are paying attention to the UN Principles for Responsible Investment, one could conclude that there is enormous latent potential for further expansion of socially

responsible investment in Japan.

In this report, we use the word “SRI investment trust” as an abbreviation of “publicly offered socially responsible investment trust.” In Japan, a large portion of SRI is invested through publicly offered socially responsible investment trusts with funds from individual investors. In other countries, the term “mutual fund” is commonly used for what would be called an “investment trust” in Japan.

In this report, yen values are converted into US dollars using the exchange rate of 115 yen per dollar (rate at end of September 2007).

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Translator: Randal Helten

Cover Design: Minako Izawa

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# Chapter 1. A Short History of SRI in Japan

## 1. The Dawn of SRI

Socially responsible investment (SRI) could be described as screening of investments based on social criteria, shareholder advocacy, and community investing, and among these, it could be argued that community investing in Japan traces back to the 1960s. The *Nihon Kyojo Kumiai* (Japan Credit Union) was established through a Catholic church in 1960, based closely on the American concept of a credit union for community development. In 1969, the *Shohisya Shinyo Seikatsu Kyodo Kumiai* (Consumers' Financial Co-op) was established in Iwate Prefecture; at the time it was the only lending cooperative in Japan, and to this day it continues to put a special effort into providing aid for heavily-indebted persons.

Years later, in 1989, the *Shimin Bank* (equivalent to “Citizens’ Bank”) was established through funds from the *Eitai Shinyo Kumiai* (Eitai Credit Union). The Shimin Bank is an organization that provides a portion of financing from credit unions and other funds for socially-beneficial projects of not-for-profit organizations (NPOs) and the like. Later, in 1994, the *Mirai Bank Jigyo Kumiai* (Mirai Bank Association) was created using capital raised separately to provide financing for projects beneficial to the environment and society, and its creation led to the phenomenon of “NPO banks” in Japan.

Shareholder advocacy in Japan appeared in the early 1970s with activists buying single shares of companies as a part of a citizens’ anti-pollution movement that was born in the wake of industrial mercury poisoning (Minamata disease), as well as the anti-war movement. The “TEPCO Anti-Nuclear Shareholder’s Group” is one example of a group of determined shareholder activists aiming to pass shareholder resolutions. This group was formed in 1989 and since 1991 has been making shareholder proposals every year to the Tokyo Electric Power Company.<sup>1</sup> In 1996, in response to a crisis in Japan with the chronic failure of housing loan companies, *Kabunushi Ombudsman* (Shareholders’ Ombudsman) was established and started making shareholder proposals.<sup>2</sup> Other than the activities of the anti-nuclear movement and *Kabunushi Ombudsman*, shareholder advocacy driven by social considerations has not grown noticeably in Japan.

## 2. SRI Research Begins

Over the years, a number of other activities appeared in Japan in the context of SRI, but it was

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<sup>1</sup> Largest electric utility in Japan and the third largest in the world.

<sup>2</sup> A not-for-profit organization consisting of lawyers, accountants, scholars, individual shareholders and other citizens, this was the first civic shareholders’ group in Japan organized to keep watch on the activities of businesses in Japan.

probably the Valdez Society, formed in 1992, that really introduced SRI to Japan as a systematic concept. The group was named after the Valdez Principles (now known as the Ceres Principles, a ten-point code of corporate environmental conduct), first promulgated in September 1989 by Ceres.<sup>3</sup> Ceres is a coalition of the Social Investment Forum (the United States' equivalent of SIF-Japan) and major environmental groups. It later established the Global Reporting Initiative (GRI) jointly with the United Nations Environment Programme (UNEP). The ten principles covered actions that corporations should take to protect the environment, and their original title comes from the Exxon Valdez, the Exxon Corporation tanker that ran aground in Alaska in March 1989 resulting in a devastating oil spill.

Ceres' joint representative at the time, Dennis Hayes, who was also one of the first proponents of Earth Day in 1970, introduced the Valdez Principles when he came to Japan to promote the first international Earth Day in 1990.<sup>4</sup> In response, individuals involved in Japanese corporations as well as researchers and journalists decided to launch the Valdez Society, create a Working Group on Socially Responsible Investment, and began to conduct research relating to SRI. In 1992, the group released "Environmental Information Disclosure as Seen from Corporate Reports" (published by Recycle Bunkasha, in Japanese), calling for the promotion of information disclosure as the basis for SRI. In 1994, Valdez Society volunteers released "Recommendations for Green Portfolios," which included a simulation of the performance of investments made into corporations selected for their environmentally-friendly policies.

### 3. Japan's First SRI Publications

In 1998, the study group also published "What is Social Investment?" which provided an explanation of SRI in the United States.<sup>5</sup> This was the first publication printed in Japan on the topic of SRI.

At the time, Japan's financial and securities industries were not yet ready to adopt SRI. Meanwhile, the country witnessed progress in terms of corporate initiatives toward environmental problems and well as information disclosure, eventually creating fertile ground for eco-funds and SRI funds. The launch of the ISO 14001 standard for corporate environmental management systems in 1996 added further momentum, the establishment of the Environmental Auditing Research Group in Japan in 1991, and later, the Environmental Reporting Network (now named the Network for Sustainability Communications) also played important roles in raising awareness.

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<sup>3</sup> Ceres was originally the Coalition for Environmentally Responsible Economies. [www.ceres.org](http://www.ceres.org)

<sup>4</sup> Another Ceres joint representative at the time, representing the SRI perspective, was Joanne Bavaria, then CEO of Franklin Research and Development.

<sup>5</sup> Coauthored by Takeshi Mizuguchi, Katsuhiko Kokubu, Takeo Shibata, and Toshihiko Goto, published by Nihon Keizai Hyoronsha.

In 1997, the Environment Agency (later promoted to Ministry of the Environment) released Japan's first official guidelines for environmental reporting, and in the same year, the Agency sponsored the Environmental Action Plan Awards (now known as the Environmental Communications Awards). In 1998 the Environmental Report Awards were jointly sponsored by the Green Reporting Forum and *Toyo Keizai Shinposha* (a publisher of economic journals). All of these further promoted the corporate disclosure of environmental and social information. Thus was created the scenario in Japan for manufacturing and service industries to move more quickly than financial and securities industries to proactively embrace information disclosure, and these developments also created the foundations for what we see today—eco-funds and SRI funds managed with an emphasis on positive screens for portfolio selection.

## **Chapter 2. Publicly Offered SRI Investment Trusts in Japan**

### **1. Trends in Managed Assets: SRI Market Drivers in Japan**

#### **(1) SRI History Starts with an “Eco-Fund” (1999)**

Due in part to the fact that Japanese institutional investors were not yet ready to accept SRI funds in Japan, publicly offered SRI investment trusts (hereinafter referred to as “SRI investment trusts”), purchased by individual investors, have been the driving force in the SRI market here.<sup>6</sup>

In Japan, the first SRI investment trust was the Nikko Eco-Fund, a Japanese equity fund launched in August 1999 by Nikko Asset Management Co. and managed based on environmental assessment criteria. Ms. Mizue Tsukushi, founder of Good Bankers Co. (Japan’s first SRI research firm), was in charge of environmental screening for this fund.

Thanks to an overwhelming response from individual investors, this fund quickly became a hit product, attracting over 100 billion yen (\$0.9 billion) in just four months, and reaching an asset valuation of 117.1 billion yen (\$1 billion) only a year later at the end of the subscription period in August 2000. Riding on the strength of this success, by the end of March 2001, five new Japanese equity “eco-funds” had been launched with similar asset assessment criteria.

#### **(2) A Surge in New Funds, Then Slowdown Due to Tech Bubble Collapse**

In September 2000, Asahi Life Asset Management launched a Japanese equity fund called the *Asu no Hane* (Wings of Tomorrow): Asahi Life SRI Social Contribution Fund, with evaluation criteria covering not only the environment but also other factors like employment, customer service, contribution to civil society, corporate ethics, regulatory compliance, and so on. A variety of SRI investment trusts was subsequently launched on the market, reaching the asset valuations of 220.7 billion yen (\$1.9 billion) as of 31 March 2000 (the Nikkei stock index on that day was 20,441 yen). Behind the growth in SRI investment trusts was the increase in individual investor support for SRI, as well as the strong stock market conditions.

After peaking at 20,883 on 12 April 2000, however, the Nikkei stock index plummeted the following Monday. This was the start of the bursting of Japan’s so-called “IT bubble” (Japan’s version of the collapse of “dot-com” stocks of Internet and information technology companies).

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<sup>6</sup> Individual investors accounted for about 6 percent of the SRI market in Europe (based on statistics from Eurosif—the European Social Investment Forum) and about 11 percent in the United States (calculated from fund balances). For details see page 16 of Reference 2 listed at the end of this chapter.

Shortly thereafter the United States experienced a series of terrorist attacks (11 September 2001) and then the collapse of Enron Corporation (October 2001) exposing major accounting scandals in the United States. Meanwhile, in Japan, the economy bottomed out in January 2002. As a result of a series of corporate scandals involving food poisoning, mislabeling of meat products, and so on, and even though the economy started to improve, stock prices continued to stay down.

The SRI market also felt the impact of these incidents to some extent; no new funds were launched between July 2001 and October of 2003, and asset valuations dropped to 64.1 billion yen (\$0.6 billion) on 31 March 2003 (Nikkei stock index at 7,972 yen).

### **(3) Market Recovery, New Activity in SRI investment trusts (2003 onward)**

After touching the bottom at 7,602 yen on 28 April 2003, the Nikkei stock index at last started on a path of reversal and recovery. New SRI investment trusts began to appear at the end of 2003, with the assets rising to 422.9 billion yen (\$3.7 billion) as of 31 March 2007 (Nikkei index at 17,287 yen). Even so, with the total valuation of SRI investment trusts as of 31 March 2007 at about 72 trillion yen (\$626 billion) and equity funds at 59 trillion yen (\$513 billion), one could say that SRI funds still have much room to grow.<sup>7</sup>

Japan's SRI investment trusts totaled 747 billion yen (\$6.5 billion) in 50 funds as of 30 September 2007 (of which 12 funds worth 378.8 billion yen (\$3.3 billion) were "theme funds" specializing in issues such as the environment and global warming). Around the same time, traditional SRI funds and eco-funds consisting only of Japanese equities totaled 231 billion yen (\$2 billion) in 21 funds.

## **2. SRI Asset Management Style: Positive Screens Only**

Screening methods for SRI funds can generally be described as either negative screens or positive screens. Negative screens exclude certain companies or industries as potential investments based on religious or ethical standards. Examples might include industries involved in tobacco, alcohol, military supply, nuclear, pornography, and so on. Conversely, positive screens help to identify investment candidates by identifying excellent corporations based on predetermined standards based on how they deal with social and environmental issues.

A major feature of Japanese SRI investment trusts today is that, almost without exception, they use positive screens. This is in sharp contrast to the European and American SRI markets' emphasis on negative screens.

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<sup>7</sup> For fund market data please visit the Investment Trusts Association of Japan website (limited data in English). <http://www.toushin.or.jp/cgi-bin/framed.cgi?67>

### 3. Three Options, But Most Funds in Japan Start with Social Screening

In order to select the stocks for portfolios, most active funds use a screening process that identifies a set of stocks for potential investment (a “universe”) from a range of listed stocks.

The most common screening process involves the fund manager conducting a financial information screening that identifies the potential investment universe, particularly covering a variety of financial indicators (profit growth ratio, ROE, capital to asset ratio, and so on) and the appropriateness of market valuation (PER, PBR, and so on).

On the other hand, SRI fund managers conduct a social (non-financial information) screening to identify excellent stocks in terms of corporate social responsibility, based on non-financial information relating to the environmental, social, and corporate governance (ESG) perspectives, gathered through corporate surveys, interviews, and so on. In many cases, the fund management company subcontracts this screening process to an SRI research firm that works in collaboration.

For positive screening applied to SRI investment trusts in Japan, companies that end up in both the universe identified through financial information screening and the universe identified through social (non-financial information) screening are considered to be the SRI fund universe. From that universe, fund managers make their stock selections, and these selections make up the portfolios.

There are three types of processes in the actual work of identifying an SRI fund universe. Here we refer to them as “entry,” “exit,” and “integrated” types.

**Figure 2.1. Three Possible Screening Processes to Create an SRI Portfolio**

Entry Screening	Exit Screening	Integrated Screening
Social screening	Financial information screening	Financial information screening Social screening
Financial information screening	Social screening	
Portfolio	Portfolio	Portfolio

Source: Prepared from page 120 of Reference 1.

The entry type first takes the universe of excellent companies in terms of CSR, based on non-financial information from an SRI research firm, then applies its own conventional financial screening to that universe, to create universe narrowed down by financial information. In terms

of the actual work involved for fund managers, this approach is very easy to introduce, because they can simply apply their financial screening to the input they have received. For example, a manager could replace a traditional universe of “stocks listed on the first section of the Tokyo Stock Exchange” with a universe of “stocks identified by the CSR research firm,” and then create an SRI fund universe using standard procedures.

With the exit type, the procedure is the reverse. The fund manager first creates the universe of excellent companies from financial information using conventional procedures for financial screening, and then to that universe an SRI research firm applies a social screening to create a universe narrowed based on by non-financial information. One advantage of this approach is that by putting the fund management company’s standard procedures first, it emphasizes the company’s originality and unique philosophy, but because the company also has a large bearing on the universe selected, the outcome also tends to be highly correlated with its traditional (non-SRI) fund management selections.

The integrated type is an approach to create a portfolio by processing both financial and non-financial information simultaneously. This type is suited to fund management companies that have an SRI funds philosophy, are able to collect and analyze financial and non-financial information, and able to control the actual fund management, but this type also involves a higher level of difficulty.

In Japan, most funds employ the entry type approach, including the Nikko Eco-Fund (mentioned above) and Japan’s largest SRI fund, Sumitomo Trust and Banking Co.’s SRI Japan Open Fund. Indeed, more than half of active SRI funds use this approach.

SIF-Japan conducted an independent survey of Japanese SRI research firms in 2005. The findings are posted on the SIF-Japan website under the heading “Status of SRI Research Firms in Japan 2005” (in Japanese).

#### **4. Asset Classes: Japanese Equities the Main Focus**

Classified by asset class, Japanese SRI funds include Japanese equity funds, international equity funds, mixed equity and bond funds, and balanced (equity/bond/other) funds. The most popular among these are currently the Japanese equity funds. Since the start of 2007, as described below, the so-called environment and global warming “theme funds” (mostly international equity funds) have also become popular.

#### **5. Performance: SRI Investment Trusts Doing Well**

Performance reviews by researchers show Japanese SRI investment trusts are generally

performing very well.<sup>8</sup>

According to Morningstar Japan, a provider of fund-related information, only two of ten Japanese equity SRI investment trusts for which at least three years of results are available performed below the TOPIX total return of 13.6 percent for the same period.<sup>9</sup> Eight performed better. Morningstar rated two of the ten funds with two stars, four with three stars, and four with four stars (30 September 2007). Evidently, Japanese SRI investment trusts perform better than average.<sup>10</sup>

## 6. SRI Investment Trusts: Future Trends

A recent trend for SRI investment trusts aimed at individual investors is the growth of "theme funds." There has been a surge in popularity of investment trusts known as "environmental theme funds" that invest in corporations with outstanding environmental technologies, due to a sense of crisis relating to the environment and global warming. The value of ten new such funds launched in 2006 and 2007 alone amounted to 278.4 billion yen (\$2.4 billion).

The screening of corporations that have technology solutions for the world's environmental problems leads to consideration of the environmental, social, and corporate governance (ESG) issues. This also creates the incentive for companies that already possess certain technologies to adapt them to environmental applications, so screening for environmental technologies should be seen as a positive development because it can be expected create benefits for society. Many feel that this new preference of investors must be nurtured so that it does not turn out to be just a passing fad.

### References (Chapter 2)

- (1) Eiichiro Adachi and Tsukasa Kanai, "CSR Management and SRI: Corporate Social Responsibility and Factors for Its Evaluation," Kinzai Institute for Financial Affairs, 2004 (in Japanese).
- (2) Mariko Kawaguchi, "Corporate Strategic Information: Recent SRI Trends—Trends in Europe and the United States, and Issues for Japan," Daiwa Institute of Research (Corporate Strategy Research Center), 6 July 2007 (in Japanese).
- (3) Toshitaka Saotome, "Current Status of SRI investment trusts in Japan," in Fund Management, 2007 summer issue No 51, Nomura Asset Management Research and Development Center, 2007 (in Japanese).

<sup>8</sup> See page 50 of Reference 3.

<sup>9</sup> <http://www.morningstar.co.jp/sri/index.htm> (in Japanese) Morningstar rates the performance of the SRI investment trusts with the number of stars on a scale of one to five, with five being the best rating. TOPIX:TOkyo stock Price Index

<sup>10</sup> For example, the SRI Japan Open Fund of Sumitomo Trust and Banking Co. won Morningstar's Fund of the Year Award two years running, in 2005 and 2006.

- (4) Takeshi Mizuguchi, “The Basics of Socially Responsible Investment (SRI),” Japan Standards Association, 2005 (in Japanese).

## **Chapter 3. SRI and Japanese Institutional Investors**

### **1. History**

The first institutional investor in Japan to invest in an SRI fund was probably the Mutual Aid Association for Tokyo Metropolitan Teachers. Media reported that this organization launched its own SRI fund in December 2000 (Good Banker provided corporate assessments, and fund management was provided by then-Kogin-Daiichi Mutual Life), but this has been the only such example to date.

In the area of defined-benefit corporate pension plans, Sumitomo Trust & Banking Co. was the first in Japan to offer SRI fund management, in July 2003. This was followed by Fukoku Mutual Life Insurance (May 2004), Chuo Mitsui Asset Trust and Banking Company (August 2004), and Mitsubishi UFJ Trust and Banking Corporation (June 2006). Then in 2007, AIG Investment Advisors, and Meiji Dresdner entered the market (July).

Furthermore, SRI funds were first offered for defined contribution pension plans (similar to 401(k)-style pension systems in the United States) in 2004, but they are still relatively small, with assets at about 6.7 billion yen (\$58 million) as of 30 September 2007.

### **2. Current Situation**

#### **(1) Rapid Growth of Corporate Pension Fund Market**

The providers of SRI funds for corporate pension funds are as indicated above, but no data have yet been released on asset size and performance. According to the industry journal *Nenkin Joho* ("Pension Fund Information" published by Rating and Investment Information, Inc., in cooperation with publisher Nikkei Inc.), perhaps the only information source on this subject, assets in this category have increased dramatically in recent years.

A plan started by Sumitomo Trust & Banking grew from 2.7 billion yen (\$23 million) at the end of 2003 to 7.4 billion yen (\$64 million) at the end of 2004, 17.6 billion yen (\$153 million) at the end of 2005, 87.1 billion yen (\$757 million) at the end of 2006, and 88.5 billion yen (\$770 million) at the end of September 2007. At the end of September 2005, its assets were 13.7 billion yen (\$119 million), implying an increase of 550 percent in just two years.

Behind the rapid market expansion is a strong commitment to the UN Principles for Responsible Investment and the thinking of fund management and financial companies that promoting these funds is a part of their own CSR activities. It also seems that companies saw the adoption of SRI approaches for their corporate pension funds as a demonstration of their

own CSR initiatives; they also made an effort to respond to the SRI investment concept. Some corporate pension funds—the Kikkoman Corporate Pension Fund, for example—even endorsed the PRI. (See References at end of chapter for a list of Japanese entities that have endorsed the PRI.)

## **(2) Shareholder Voting and Corporate Governance Funds**

In the area of public pension funds, there were no new developments in terms of SRI fund management, but regarding the exercise of shareholder voting rights, in October 2001 Japan's Pension Fund Association released its "Practitioner's Guide for the Exercise of Shareholders' Voting Rights," oriented toward fund management trustee companies in Japan. This was followed with the release of the Association's "Standards for the Exercise of Shareholder Voting Rights" in February 2003. As a part of these corporate governance activities, the Association established a 10 billion yen (\$87 million) Corporate Governance Fund in March 2004 (currently valued at about 35 billion yen, or \$304 million). Detailed evaluation standards were used for stock selection, all stocks incorporated into the fund were announced publicly (initially 43 companies, currently 72 companies), and the stock selection was reportedly done based on surveys and research involving visits to the companies.

## **3. Key Features of the Japanese SRI Market (Institutional Investors)**

### **(1) Pension Fund Market**

#### **a) The Debate that Never Happened: Fiduciary Responsibility and SRI**

Although it often becomes a topic of discussion overseas in the context of applying SRI investment approaches, the issue of the fiduciary responsibility of institutional investors of pension funds and the like has almost failed to attract any attention in Japan. Perhaps this is because the concept of SRI itself has a very short history in this country. The basic concepts of fiduciary responsibility (loyalty, prudence) also exist in Japan, similar to trust law in the United Kingdom and the United States, or legislated standards on the scale of the United States' Employment Retirement Income Security Act (ERISA). Japan, however, has never experienced SRI with the strong religious and social advocacy undertones that are present in the United Kingdom and the United States, and there has not been a single instance at the level of the law courts or government policies in which a decision or government directive deemed that SRI violates fiduciary responsibility.

Nevertheless, in order ensure that these issues do not become obstacles when SRI is promoted in the pension fund market, SRI fund management companies studied a legal opinion written by Freshfields Bruckhaus Deringer Law Office, which made a legal review of the PRI, and also took a statement of opinion from Professor Hideyuki Morito of Sophia University, and concluded that, theoretically, if SRI "was capable of competing with other investments

economically” it would not violate fiduciary responsibility.<sup>11</sup>

### **b) Japan’s SRI Sleeping Giants: Public Pension Funds, Postal Savings and Postal Insurance**

In Europe and the United States, public pension funds account for the dominant share of SRI in the pension fund market. In Japan, however, as stated above, SRI is gradually spreading into corporate pension funds, but it is virtually non-existent in public pension funds. Because of the enormous size of managed funds (about 220 trillion yen, or \$1.9 trillion), their impact is huge, but because of uncertainties such as the possible merging of pension systems, market experts are indicating pessimism about the adoption of new investment approaches.

Postal savings and postal insurance funds, reportedly on the scale of 8 trillion yen (\$70 billion market value, 31 March 2006) Japanese equity portion combined with both funds. Japan Post is now in the midst of dramatic reforms through privatization and separation, however, and it is not clear if SRI will be an option for fund management in the future (although SRI investment trusts are included in the Post Office product lineup of investment trust funds sold to individual investors).

### **(2) Other Players in the SRI Asset Management Market: Not-for-Profit, Educational, and Religious Organizations, etc.**

According to flow of funds accounts statistics by the Bank of Japan, private public-interest entities had financial assets about 50 trillion yen (\$435 billion) as of 31 March 2006. As explained in more detail in the chapter on international comparison below, whereas in countries like the United Kingdom and the United States, public-interest entities (foundations, public interest organizations, charities, etc.), educational organizations, and religious organizations are traditional SRI investors, in Japan these types of organizations have virtually no interest in SRI.

The biggest reason for this disparity may be the extremely rigorous and conservative directives and regulations of the government and other regulating authorities regarding asset management for these organizations. Thus, one might conclude that the climate for investing based on one’s own responsibility was never nurtured here. For example, government directives prohibit public-interest entities from investing in investment trusts (mutual funds) that use equity investment approaches and stocks that engender large price variation risks, and they also prohibit foreign-currency financial assets.

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<sup>11</sup> Mitsubishi UFJ Trust and Banking Corporation seminar papers (29 November 2006), Prof. Hideyuki Morito, “Fiduciary Responsibility of SRI and Pension Funds” (in Japanese). [http://www.tr.mufg.jp/ippan/csr/pdf/seminar\\_2006\\_03.pdf](http://www.tr.mufg.jp/ippan/csr/pdf/seminar_2006_03.pdf)

Today, dramatic framework reforms affecting these public-interest entities are underway in Japan. Deregulation of their asset management is also expected, but at this point the overall picture is still murky.

### **(3) SRI Asset Management Styles**

SRI based on negative screening is almost nonexistent in Japan, and almost all asset management styles use positive (also known as best-in-class) screening. If we also consider that the idea of divestment (excluding corporations from the investment universe due to their involvement with certain countries) is absent in Japan, one can see stark differences here compared to Europe and the United States.

The involvement of institutional investors in community investing (dealt with in the next chapter) is also extremely rare. As a result, on the question of whether or not SRI practices will spread to institutional investors in Japan, one could say that the real question is whether or not SRI will eventually be recognized as one possible style of active fund management.

## **4. Government Policies: A Key to the Future**

One aspect of the spread of SRI funds in European countries is the fact that governmental legislation played a positive role in the area of pension funds. Meanwhile, in Japan, the only guidance from government authorities is the stipulation that corporations and citizens shall “strive to include environmental information as a consideration in investing,” in the new Law Concerning the Promotion of Business Activities with Environmental Consideration by Specified Corporations, etc, by Facilitating Access to Environmental Information, and Other Measures, which went into effect in April 2005.

In 2006 the Ministry of the Environment created an “Advisory Group on Environment and Finance,” which released its report in July that year. A feature of the report was that it summarizes the tasks that should be undertaken by each type of economic entity in order to create financial conditions that are beneficial for the environment. (See References at end of chapter for related materials.) That ministry has conducted studies on related topics before, and continued in 2007 with a focus on SRI.

These kinds of initiatives deserve much praise. Indeed, even if these initiatives do not go as far as creating the legal obligation for pension fund managers to disclose information about SRI policies (as is the case in the United Kingdom), it would be desirable for Japan to have guidelines and other measures in this area. In order to overcome the typical fragmentation of authority among Japanese ministries—often said to impair government effectiveness—such guidelines should be developed with the involvement of other relevant authorities like the

Financial Services Agency and the Ministry of Health, Labour and Welfare.

### **Acknowledgements**

Because it is often difficult to collect information about corporate pension funds, we deeply appreciate the cooperation we received from the following companies in the form of data and other assistance.

- Chuo Mitsui Asset Trust and Banking Company
- Mitsubishi UFJ Trust and Banking Corporation
- Sumitomo Trust and Banking Co.

### **References (Chapter 3)**

- **Japanese Organizations That Have Endorsed the UN Principles for Responsible Investment** (Total 9 organizations as of November 2007)

Asset Owners (2)

- Kikkoman Corporate Pension Fund, Taiyo Life Insurance Company

Investment managers (7)

- Daiwa Asset Management, Mitsubishi UFJ Trust and Banking Corporation, Mitsui Asset Trust and Banking Company, Mizuho Trust and Banking Co., Nissei Asset Management, Sompo Japan, Sumitomo Trust and Banking Co.

- **Investor SRI Awareness Survey**

The three major findings of an SRI-related survey of 148 analysts and fund managers, conducted by Daiwa Investor Relations Co. in January 2007 are as follows: (1) Of the total, 77.0 percent responded that “SRI will expand in Japan,” an increase of 9.3 percentage points in two years. (2) Of the total, 23.0 percent responded that “SRI will not expand in Japan,” a decrease of 8.3 percentage points in two years. The impact of SRI on analysts of the sell side increased by 50 percent in two years. The influence of SRI on analysts and fund managers of the buy side increased by 40 percent in two years. (3) Almost 100 percent of respondents were aware of SRI and CSR. More details are posted here (Japanese only):

<http://www.daiwa-grp.jp/branding/news/pr070306.pdf>

- **“Report of Advisory Group on the Environment and Finance,” Ministry of the Environment (in Japanese), 2006:** [http://www.env.go.jp/policy/kinyu/rep\\_h1807](http://www.env.go.jp/policy/kinyu/rep_h1807)

## Chapter 4. Community Investing in Japan

### 1. Introduction

Community investing is one form of SRI. The United States has specialized financial organizations in the “community development financial institutions” (CDFIs) field, for which numbers are provided in Social Investment Forum (U.S.) reports. That organization’s “2005 Report on Socially Responsible Investing Trends in the United States,” defines community investing as “capital from investors and lenders that is directed to communities that are underserved by traditional financial services.” According to the report, the assets of community investment institutions based in the United States amounted to 19.6 billion dollars in 2005. This figure was less than 1 percent (more specifically, 0.9 percent) of the total SRI market size calculated by the organization.<sup>12</sup>

### 2. Overview of Situation in Japan

In a similar light, Japanese financial institutions and financial products involved in community investing can be found in three broad categories (see Additional Information 1 at end of chapter for types of financial institutions in Japan):

- NPO banks
- Social project funds and local funds (e.g., for wind power projects)
- Bonds issued by local governments for local community projects mainly for community resident investors (known here as “mini-public bonds”)

#### (1) NPO Banks

NPO banks are a breed of small not-for-profit “banks” established with the purpose of providing funding to NPOs, citizens’ groups, and individuals that conduct activities for the benefit of the community or for the environment. These are known in Japan as “citizen financing,” “citizens’ not-for-profit banks,” “community banks,” and so on.<sup>13</sup>

According to the Japan NPO-BANK Network, as of September 2007, there were nine NPO banks nationwide, and their cumulative new loans at the end of December 2006 amounted to about 1.45 billion yen (\$12.6 million).<sup>14</sup>

<sup>12</sup> According to the Social Investment Forum (U.S.), the total SRI market in the United States was 2.29 trillion dollars at the end of 2005. By type of financial institution, community investment sectors included banks (52 percent), credit unions (26 percent), loan funds (18 percent), and venture capital (4 percent).

<sup>13</sup> Based on analysis by Kazuyuki Tsuchiya, Mitsubishi Research Institute. Also, the book “Financial NPOs: Creating New Flows of Money,” by Yoshihiro Fujii (published by Iwanami Shoten, July 2007, in Japanese) provides a comprehensive explanation and vivid depiction of NPO banks and social project funds.

<sup>14</sup> Shunji Taga, “NPO Banks and Labor Union Financial Institutions,” in “Small and Medium Enterprise Research, Vol. 91,” Institute for Small and Medium Enterprise (*Chusho Shokogyo*

While not all identical in terms of operating style, NPO banks generally attract capital by accepting funds from citizens and NPOs and provide financing to community businesses and social entrepreneurs who would otherwise have difficulty obtaining financing from conventional financial institutions. (See Additional Information 2 at end of chapter for more details on the NPO banks.)

## **(2) Social Venture Funds<sup>15</sup>**

Social venture funds (*shakaiteki jigyo fund*) are created to receive small-sized capital injections from citizens and other parties in order to implement specific social projects (legal status in Japan is as a “silent partnership”).

One good example is the Japan Green Fund for Renewable Energy, which was created using citizen funding to promote wind power projects. To date, it has collected about 1.8 billion yen (\$15.7 million) in capital subscriptions for six separate funds. Because the fund pays dividends to investors from project revenues, people can participate in tangible businesses (wind mills) and feel the satisfaction of supporting renewable energy, almost all of the projects to date have attracted more than the expected number of willing investors.

Meanwhile, “local funds” (*chiiki fund*), are used to procure capital to support not-for-profit organizations, local venture businesses, and so on, by utilizing a charitable trust (*koeki shintaku*) framework with the local government acting as the sponsor. To date there have been successful initiatives in Iwate Prefecture, Kochi Prefecture, and elsewhere. The features of a charitable trust as a financial entity are that by being able to limit the amount of funds contributed, fiscal discipline can be maintained for the local government body, and it can serve as a highly transparent “host entity for donations” from local companies and citizens with the purpose of contributing to the local community. Thus the range of uses of these vehicles is expected to increase—for local community development, disaster relief volunteers, and so on.

## **(3) “Mini-Public Bonds” (Publicly Offered Bonds for Resident Participation)<sup>16</sup>**

Small bond issues (*mini kobosai*) are bond investments in which funds are accepted from local citizens specifically for projects of local governments (projects vary considerably, from hospital construction to community development projects and so on.). The first of these in Japan was the “*Aikensa*” bond issued by Gunma Prefecture in 2001 as a hospital bond.

This bond attracted a very favorable response from individual investors thanks to a number of

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*Kenkyusho*), in Japanese.

<sup>15</sup> Reference: Chapter 2 “The Significance of Citizen Capital and Recent Trends” (an article in Japanese by Nobuhisa Sano, Development Bank of Japan) in “Public Collaboration White Paper 2007-2008,” Jiji Press Publication Services, Inc.

<sup>16</sup> Reference: Japan Local Bond Association: <http://www.chihousai.or.jp/>.

factors—the purpose of financing was clearly defined; investors were satisfied knowing that they were contributing directly to society and the community; investors could make small contributions; and the investment yield was attractive.

With the finances of Japanese local governments being tight in recent years, they have been strongly motivated to issue bonds, and these bond issues raised a total of 1.45 trillion yen (\$12 billion) nationwide between the time the system was introduced in fiscal 2001 and the end of 31 March 2007.

These bonds could be considered as type of community investing if we consider that they attract funds from individuals who provide them voluntarily and are applied to specific infrastructure developments and projects at the local level.

### **3. Conclusion**

This section introduced the major types of investing and contributing funds in Japan in ways that resemble community investing elsewhere. They hold considerable potential to create new money flows, considering that none of them use traditional financial institutions as intermediaries. It would be fair to conclude that they have the potential to generate SRI-type investing activity among individual investors.

Despite the many positive aspects, many challenges still remain in terms of their market size, coverage, and so on.

#### **Additional Information 1**

Japan's depository financial institutions can be broadly classified as follows:

- Regular commercial banks: Major banks, regional banks, second-tier regional banks, foreign-based banks, others
- Long-term financial institutions: Long-term trust banks, trust and banking corporations
- Financial institutions for small business: Credit associations, credit cooperatives, labor credit associations, others
- Financial institutions for agriculture, forestry and fisheries: Agriculture and Forestry Central Bank, agricultural cooperatives, others

Among these, credit associations, credit cooperatives, and others, can be characterized as not-for-profit cooperative-type entities that receive funds from members, and they are also

restricted in terms of regional service coverage. Thus, they are essentially financial institutions at the community level, although they do not fulfill the community investing functions as a form of SRI in the sense defined by SIF (U.S.).

### **Additional Information 2**

The Japan NPO-BANK Network lists the following as major NPO banks: Mirai Bank Jigyo Kumiai (established 1994), Womens and Citizens' Collective Establishment Preparation Committee (1998), Hokkaido NPO Bank (2002), NPO Yume Bank (2003), Tokyo Community Power Bank (2003), ap bank (2004), Niigata Community Bank (2005), Community Youth Bank "momo" (2005), Iwate NPO Bank (2006), and others.

## **Chapter 5. Shareholder Advocacy in Japan**

### **1. Shareholder Proposals on Environmental, Social and Corporate Governance (ESG) Issues**

It is commonly said that shareholder proposals are much less common in Japan than in the United States, but various factors are beginning to trigger changes in shareholder advocacy here, including amendments to commercial law, the emergence of more proactive shareholders, an increase in merger and acquisition activity, and so on. Because of differences in regulatory frameworks, procedures and other aspects relating to shareholder proposals, any discussion of this topic must start with an understanding that Japan has fundamental differences compared to the United States (and other countries). This chapter covers the topic of exercising shareholder voting rights by describing the situation in 2007 from the perspective of corporate owners (activists), in the context of shareholder proposals on ESG issues.

The details of typical shareholder proposals relating to ESG issues are defined in Table 5-1. Under Japanese corporate law, the contents of proposals that shareholders can make are restricted to the objectives of the general meetings of shareholders. Thus, in most cases the actual ESG-related shareholder resolutions that get proposed are also in line with the purposes of the general meeting of shareholders—proposals to revise the corporate articles of association, the appointment or removal of directors, and so on. It is worth noting that Japanese corporate law stipulates that in order to have the right to make a shareholder's resolution, shareholders must possess voting rights representing at least one one-hundredth of total prescribed shares, or at least 300 votes, and that the shares must have been held continuously for at least six months prior to the general meeting.

**Table 5-1. Types of ESG Shareholder Proposals**

Shareholder proposals on environmental issues	Objective: To reduce environmental impacts associated with the business activities of the corporation. <ul style="list-style-type: none"> <li>• Proposals relating to environmental policies and strategies</li> <li>• Proposals relating to equipment/facilities associated with environmental pollution (closure, implementation of environmental safety assessment, etc.), etc.</li> </ul>
Shareholder proposals on social issues	Objective: To reduce or promote social impacts associated with the business activities of the corporation. <ul style="list-style-type: none"> <li>• Proposals on policies or strategies relating to labor issues and safety issues</li> <li>• Proposals relating to promoting communication with stakeholders</li> <li>• Proposals relating to measures to prevent criminal activity or misconduct, etc.</li> </ul>
Shareholder proposals on governance relating to environmental and societal issues	Objective: To establish organizational structures with the aim of reducing or promoting environmental and/or social impacts associated with the business activities of the corporation. <ul style="list-style-type: none"> <li>• Establishment of regulatory compliance committees, social/environmental assessment committees</li> <li>• Appointment of directors responsible for social or environmental issues, etc.</li> </ul>

## 2. Japanese Shareholder Proposals on ESG Issues

### (1) Shareholder Advocacy: A Fresh Success

Generally a group of individuals will join together in order to secure the right to make a shareholder's proposal, and in most cases the proposal relates to ESG issues. The *Kabunushi Ombudsman* is one good example of an organization supporting shareholder advocacy.<sup>17</sup> At the 2007 annual general meeting of Obayashi Corporation (a major Japanese general construction firm), this organization presented a shareholders' proposal to prevent the company from entering illegal bid-rigging arrangements with other parties by proposing an amendment to the corporate articles of association. Previously, the company had been involved in a number of bid-rigging groups for Defense Agency contracts (Ministry of Defense since January 2007), tunnel construction in Wakayama Prefecture, subway construction in Nagoya City, and so on,

<sup>17</sup> Name means "Shareholders' Ombudsman." This is a not-for-profit organization based in Osaka: <http://kabuombu.sakura.ne.jp/>

and company officials had been arrested. The proposal was endorsed by 26 shareholders (representing 581,315 shares) and submitted to company.

In response, the board of directors of Obayashi Corporation prepared a corporate proposal to amend the company's articles (additions to the articles prohibiting the company from violating criminal and antitrust legislation) and presented it to the annual general meeting in June 2007. The proxy statement carried wording about entrenching into the corporate articles the regret for past unethical actions and the strong commitment to regulatory compliance. The proposal passed.

There were no prior cases in Japan in which an ESG-related proposal from shareholders was taken up by a corporation and presented to the annual general meeting as a resolution. In terms of shareholder advocacy, the case of Obayashi Corporation symbolizes Japan's entry into a new era for the impacts of ESG issues on corporations.

## **(2) Shareholder Proposals on ESG Issues: Targeting Power Utilities**

Another feature of ESG shareholder proposals in Japan is the persistent and dynamic shareholders' movement targeting electrical power utilities, essentially a part of the citizens' movement against nuclear power.

As before, annual general meetings of major power utilities in 2007 received and debated shareholders' resolutions. The numbers of shareholders resolutions for major power utilities in 2007 are summarized in Table 5-2.<sup>18</sup> The most noticeable feature in the shareholders' resolutions is the high number of proposals to amend the corporate articles.

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<sup>18</sup> Excerpted from "Summary of 2007 Annual General Meetings, Chapter (2) Shareholders Resolutions and Resignation Demands," in *Keiei Senryaku Jyoho* (Management Strategy Information), 23 July 2007 issue, page 3, by Yutaka Suzuki, Daiwa Institute of Research (in Japanese).

**Table 5-2. Numbers of Shareholder Proposals to Major Power Utilities in 2007**

Company	Proponent	Number of Proposals		
		Article amendment	Increase dividends	Appointment or removal of director
Tokyo Electric Power Co.	Details not available	4	1	
Chubu Electric Power Co.	The Children's Investment Master Fund		1	
	Details not available	7		
Kansai Electric Power Co.	Details not available	6	1	1
	Details not available	8		
Chugoku Electric Power Co.	Details not available	3	1	1
Tohoku Electric Power Co.	Details not available	4		1
Kyushu Electric Power Co.	Details not available	6		
Electric Power Development Co. (known as J-POWER)	The Children's Investment Master Fund		1	

To date, still a relatively small number of shareholder proposals has been made in Japan relating to ESG issues, and Japan has not reached the point of having NGO-led social activist shareholders proposals. The three tables below summarize shareholder proposals made on ESG issues targeting power utilities as described above, based on excerpts and summaries from the statement of fiscal 2007 meetings posted on the websites of three major electric power companies in Japan, all of which generate a portion of their energy from nuclear power.

**Shareholder Proposals Targeting Tokyo Electric Power Company**

ESG issue	Proposal type	Details	Result
Governance	Article amendment	Article amendment for disclosure of directors' compensation and bonuses Reason for proposal: A series of problems, including falsification of data relating to nuclear power generation	Rejected
Social	Article amendment	Addition of section to articles relating to "system to prevent misconduct" Note: Proposed section included "purpose," "structure," "right to investigate," "reporting," and "emergency measures."	Rejected
Social	Article amendment	Addition of section to articles to prevent unethical public relations activities and announcements that will mislead consumers. Note: This proposal was triggered by company advertising implying that switching all household appliances to electric sources (away from other energy sources like gas for heating, etc.) was best for the environment.	Rejected
Social	Article amendment	Review of nuclear power generation operations in response to amendments of seismic design inspection guidelines	Rejected

**Shareholder Proposals Targeting Chubu Electric Power Company**

ESG issue	Proposal type	Details	Result
Governance	Article amendment	Article amendment for disclosure of directors' compensation and bonuses Reason for proposal: A series of problems, including falsification of data relating to nuclear power generation	Rejected
Environment	Article amendment	Addition of a new section to the articles stipulating proactive investments, development, and restructuring for new energy	Rejected
Social	Article amendment	Addition of a section to the articles stipulating the establishment of an evaluation/review committee relating to inspections/assessments of nuclear power generation facilities	Rejected
Environment	Article amendment	Addition of a section to the articles relating to high-level radioactive waste Note: Proposal was to prevent disposal of high-level radioactive waste if it is not specifically handled by final treatment sites.	Rejected
Environment	Article amendment	Addition of a section to articles prohibiting the use of MOX fuel (see references) at the Hamaoka Nuclear Power Plant, in the context of the "pluthermal" plan (plutonium thermal)	Rejected
Social	Article amendment	Addition of a section in articles requiring assessments by neighboring municipalities and residents regarding residual risks from nuclear power generation facilities due to vibrations caused by earthquakes,	Rejected
Social	Article amendment	Addition of a section in articles stipulating the provision of objective information to shareholders	Rejected

Note: MOX is the acronym for mixed oxide fuel (mixed oxides of uranium and plutonium)

**Shareholder Proposals Targeting Kyushu Electric Power Co.**

ESG issue	Proposal type	Details	Result
Social	Article amendment	Addition of paragraph to articles requiring political correctness as a public utility	Rejected
Environment	Article amendment	Addition of a declaration in the articles relating to equivalent exchange or restoration of land from high-level radioactive waste	Rejected
Environment	Article amendment	Addition of a paragraph to articles relating to establishment of a review committee on safety concerns	Rejected
Environment	Article amendment	Addition of a paragraph to articles relating to establishment of a committee to achieve 20 percent of power generation from new forms of energy	Rejected
Environment	Article amendment	Addition of a declaration to the articles relating to burial to dispose of high-level radioactive waste	Rejected
Environment	Article amendment	Addition of a paragraph to articles relating to establishment of a supervisory committee on quality assurance of MOX fuel	Rejected

To summarize, most of the proposals arose from problems relating to data falsification by power utilities, seismic concerns about nuclear facilities, the desire to promote better communication with the local community and stakeholders, the desire to address concerns about nuclear fuel, or the desire to promote the development of new forms of energy. The contents of proposals could be described as reflecting public concern on social and environmental issues, such as the power utility scandals of recent years as well as global warming, and these could also be seen as management issues for power utilities.

**(3) Other: Shareholder Proposals from Environmental and Social Funds**

Separate from the ESG shareholder proposals from shareholders at large, in June 2007, The Children's Investment Fund (TCI) submitted shareholder proposals to J-POWER and Chubu Electric Power Co., to increase dividend payouts. TCI is an activist-style British hedge fund that has about 10 billion dollars (about 1.2 trillion yen) in assets under management worldwide, and has chosen its name to reflect its commitment to donate a "significant" portion of its profits from fund management to The Children's Investment Fund Foundation (CIFF), a philanthropic organization that focuses on disadvantaged children in developing countries, especially children with HIV/AIDs in Africa. In making its proposal, TCI asserted that both companies' historical dividend payouts were too low. There are no SRI funds in Japan currently engaged in shareholder activism, but shareholder proposals from funds concerned about environmental and social issues are likely to attract more attention in the future.

## **Chapter 6.** Japan's SRI Market: International Comparisons

### **1. Introduction**

A comparison of SRI markets in Japan with Europe and the United States would reveal the following features of the Japanese market:

- The Japanese SRI market is currently extremely small compared to the other two regions.
- SRI investment trusts for individual investors account for the majority of SRI funds in Japan, and the involvement of pension funds—major players overseas—is extremely small in Japan. The absence of public pension funds in the Japanese SRI market particularly stands out. As a result, any analysis of SRI in Japan is essentially an analysis of SRI investment trusts.
- None of the Japanese funds use negative screens. Essentially, only positive screens are used by the funds.
- None of the funds have openly stated a commitment to engage in shareholder activism.

The analysis below examines these points in greater detail.

### **2. Market Size**

According to the Social Investment Forum (U.S.), the SRI market size in the United States in 2005 was 2.29 trillion dollars (about 270 trillion yen), accounting for 9 percent of funds under professional management.<sup>19</sup> These figures include three SRI strategies: social screening (screening applied to evaluate social and environmental factors in the course of fund management, at 1.685 trillion dollars), shareholder advocacy (proactive shareholders bringing social and environmental concerns to the corporation, at 703 billion dollars), and community investing (at 19.6 billion dollars). Assets connected with in both screening and shareholder advocacy amounted to 117 billion dollars.

In Europe, during the same year (2005) the total SRI market size was 1.33 trillion euros (about 150 trillion yen).<sup>20</sup> Major SRI strategies covered by this figure include fund management that includes the perspectives of governance, society, and the environment in corporate evaluation (73.0 billion euros), and shareholder advocacy (64.1 billion euros).

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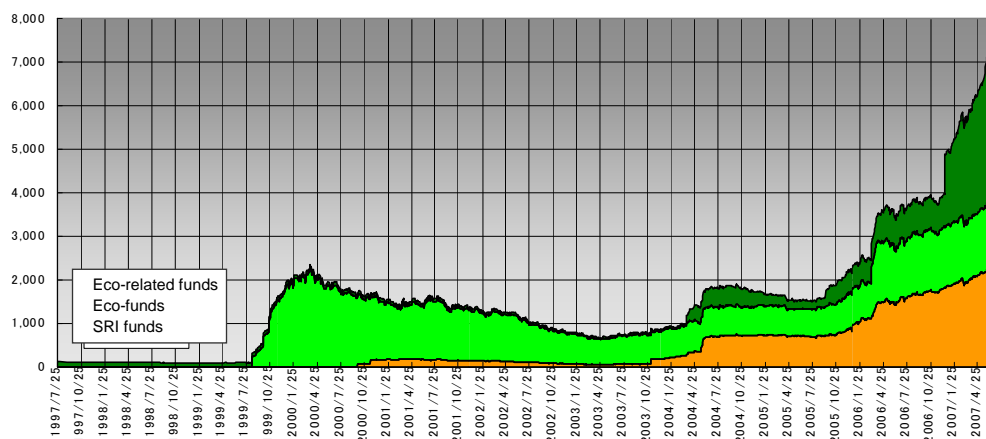
<sup>19</sup> Social Investment Forum, "2005 Report on Socially Responsible Investing Trends in the United States."

<sup>20</sup> EuroSIF "European SRI Study 2006." Countries covered included Austria, Belgium, France, Germany, Italy, the Netherlands, Spain, Switzerland, and the United Kingdom. Notably absent due to data unavailability were Scandinavian countries, which have very large funds that would fit into the SRI category.

By comparison, the Japanese SRI market in the summer of 2007 included only about 400 billion yen (\$3.5 billion) under management using conventional SRI approaches. This figure is a total of SRI investment trusts plus corporate pension funds managed by SRI methods. If we broaden the definition of SRI, however, to include the environmental “theme funds” (based on the concept of investing in businesses that benefit the global environment) that have grown rapidly in popularity in the past two years, the total would come to about 840 billion yen (\$7.3 billion) (see figure). While there is arguably a large difference between 400 billion and 840 billion yen, even the higher figure amounts to only about 0.5 percent of the market size in Europe and the United States, so the difference between the two estimates for Japan is relatively unimportant for this discussion. The main point is that the size of Japan’s SRI market is extremely small, relatively speaking, and thus does not represent an imposing presence in the market. Why is this situation so? The discussion below will clarify the situation by looking at the market participants and SRI methodologies used in Japan.

**Figure. Trends in Japanese “Eco-Funds” and SRI Funds**

(“Eco-related” in the legend refers to funds with themes associated with water, resources, etc.)



Source: Daiwa Fund Consulting

### 3. Market Participants

The biggest reason for Japan’s relatively small SRI market is the difference in participants compared to other regions in this comparison. In Japan, it is essentially only individual investors who are investing in SRI investment trusts. The reality that SRI investment trusts account for most of the Japanese SRI market is due to the fact that it is essentially only individual investors who are supporting the SRI market.

In contrast, in the United States, SRI mutual funds account for only about 10 percent of the 1.685 trillion dollars to which SRI screening is applied. The remaining 90 percent is accounted for separately, namely, as funds under the management of large institutional investors such as public pension funds, and so on. In Europe as well, individual investors account for only 6

percent of SRI, and the remaining 94 percent are institutional investors. In Europe too, public pension funds play a major role. Besides pension funds, in Europe and the United States, universities, religious organizations, labor unions and other organizations whose mission is essentially to contribute to society are engaged in SRI and make their presence felt as investors.

Meanwhile, although pension funds play such a major role and manage large amounts of money in Europe and the United States, in the case of Japan it has been less than four years since pension funds started participating in the SRI market and the current scale of their involvement is only about 88.5 billion yen (\$770 million). Furthermore, public-interest entities, religious organizations, labor unions and such organizations whose mission it is to contribute to society generally have little interest in SRI strategies for asset management. On this point, because no studies have directly addressed the question, it is not entirely clear whether these organizations simply have no interest in equity investment or whether they really do invest in equity in their portfolios but have no interest in SRI investment.

In this context, a survey of such public-interest entities in fiscal 2006 produced some very intriguing results.<sup>21</sup> Of the 1,161 organizations that responded to the survey, only 13.6 percent were engaged in equity investments, suggesting that this is not fertile soil for interest in equity investments at all. (Perhaps this is to be expected because, as mentioned above, Japanese public-interest entities are, in principle, prohibited by government regulation from investing in equity and foreign currency financial assets because of high price fluctuation risk). Furthermore, 97.6 percent of the organizations are not currently engaged in SRI, and 86.5 percent have no intention to consider it in the future. The most common reason for not being engaged in SRI was “does not match our organization's mission” (518 responses). This was also the same reason for not considering it further (500 responses). Thus, the concept of achieving their own organization's mission through financial functions is completely absent.

In this day and age when information moves globally, why is Japan still an isolated country when it comes to SRI? This could come from differences in society's expectations about the role of finance, or perhaps from differences in philosophy about finance. Public pension funds in Europe and the United States (and in recent years, in countries like Brazil and Thailand), and large institutional investors—particularly public pension funds that are entrusted with funds from citizens and manage assets in order to provide stable livelihoods for future citizens—are conscious of the scale of assets they manage, and are aware of the enormous impacts of their asset management on the development of society and the economy. In addition, they often hold

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<sup>21</sup> “SRI, New Corporations and Finance,” edited by Kanji Tanimoto, Chapter 12, Toyo Keizai Shinpou-Sha (in Japanese) 2007.

the philosophy that the mission of the fund is not simply to enhance asset performance for members, but also to have a positive impact on society and the economy by mobilizing the fund's economic power. Indeed, the societies in which these funds exist also have these kinds of expectations toward public pension funds. Similar things could be said about public-interest entities, religious organizations, labor unions, and so on. That is, they also think about the management of finances as a means to achieve their organizational missions.

Meanwhile, in Japan, the mainstream thinking is that the mission of the asset manager is to provide a return to fund contributors, and this does not leave room for consideration of social impacts of processes relating to asset management.” Furthermore, as Japan is a country that fails to provide an adequate financial education for the population, society as a whole does not expect the management of financial assets to play the roles that populations in other countries might expect. This type of conclusion could be drawn from the survey of public-interest entities. Under the current situation, this gap in awareness between Japan and the comparison countries is huge. Recently, however, signs have appeared that this awareness is gradually changing—for example, the small but growing popularity of citizen-sponsored wind power generation projects.

#### **4. SRI Asset Management Strategies**

There are also clear differences in the SRI methodologies used between Japan and the comparison countries. To begin with, all SRI funds in Japan only use positive screens, and there are none that use negative screens. Negative screens exclude certain industries based on ethical or religious grounds, so a fund manager for the likes of a religious organization should have little problem applying such a screen.

Nevertheless, in a society like Japan's, in the absence of social consensus on specific religious or ethical values, it would seem difficult to apply a negative screen when inviting the general public to invest in a fund, if we imagine the sales strategy of appealing up front to a specific sense of values. In particular, some may feel that a negative screen is not compatible with the polytheistic Japanese, because it would deem to exclude a specific business by judging it as malevolent for society based on religious values.

Another major feature is that Japan has no large-scale shareholder advocacy, which in Europe and the United States is next after social screening as an important SRI strategy. Incidentally, regarding shareholder advocacy, even in Japan there are efforts like those of the Kabunushi Ombudsman and efforts to pressure electrical power utilities to review their nuclear power policies, but these efforts are limited to NPO activities that target individual investors. Indeed, no SRI funds managed by any major institutional investor are engaged in shareholder advocacy. In

recent years, investors emboldened by efforts like the Pension Fund Association's guidelines for exercising shareholder voting rights have begun to make their voices heard regarding corporate governance, but there is still a long way to go before shareholders engage in shareholder activism to pressure corporations to consider the environment and social issues in their business practices.

## **5. Conclusion**

The discussion above suggests that Japanese SRI market could be summed up by saying that financial institutions are looking at SRI as a part of their business strategies or CSR activities, and have tentatively added SRI investment trusts to their product lines. Thus, SRI concepts are becoming known to a certain extent, but there is still a long way to go before financial institutions and pension funds participate in SRI in any major way in Japan.

### *Explanation on the SRI data in this report*

For this report, we have compiled data on “publicly offered SRI investment trusts” according to our own definition of “Broad SRI” (see below). Our figures exclude trusts that are not recognized as SRI by the offering fund management company, however, even if we consider them to be SRI by our own criteria. Publicly offered SRI investment trusts for defined-contribution (DC) pension plans are also excluded from these data.

We express our appreciation for support provided by Morningstar and SRI fund management companies in preparing this data.

### *DEFINITION OF “BROAD SRI”*

We define “Broad SRI” as socially-responsible investment that satisfies the following two principles:

Principle A: In a broad sense, the investment (note 1) should embody the intent of final investors (note 2).

Principle B: At least one ESG factor (environmental, social, or governance) should be taken into consideration in the investment decision process.

**Note 1:** Including not only ordinary securities investments (equities, bonds, investment trusts), but also financing or the provision of funds for community investment (e.g., investment for a windmill power plant). Although this financing or provision of funds may not be an investment in the strictest sense, we include them here as SRI investments, because the intent of the fund provider is very close to what one would expect for an ordinary securities investment.

**Note 2:** Final investors here include institutional investors such as pension funds and the like.

## Data & Chart on the Japanese SRI market

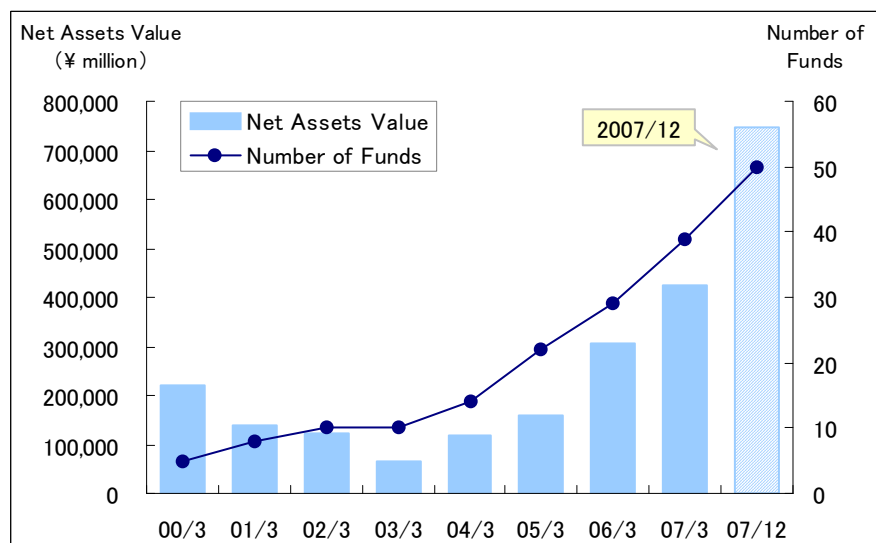
(Table) The Historical Data on Publicly Offered SRI Investment Trusts

(¥ million)

	Number of Funds	Net Assets Value		Number of Funds	Net Assets Value
1999/9	2	67,293	2003/12	12	85,426
1999/12	4	189,731	2004/3	14	117,639
2000/3	5	220,668	2004/6	17	178,675
2000/6	5	186,002	2004/9	18	179,561
2000/9	6	163,252	2004/12	19	168,594
2000/12	8	148,218	2005/3	22	157,533
2001/3	8	137,974	2005/6	23	147,371
2001/6	10	154,759	2005/9	24	151,925
2001/9	10	129,674	2005/12	26	201,138
2001/12	10	129,325	2006/3	29	306,518
2002/3	10	121,080	2006/6	33	337,414
2002/6	10	106,332	2006/9	35	360,293
2002/9	10	88,388	2006/12	37	376,677
2002/12	10	74,312	2007/3	39	422,905
2003/3	10	64,105	2007/6	40	502,312
2003/6	10	67,513	2007/9	50	747,035
2003/9	10	70,377	2007/12	50	745,515

SOURCE: Social Investment Forum Japan (SIF-J)

(Figure) Trends of Publicly Offered SRI Investment Trusts in Japan



SOURCE: Social Investment Forum Japan (SIF-J)



## **Social Investment Forum Japan(SIF-J)**

Shirokanedai Bld. 5th Floor, 19-6,Shirokanedai,3-chome

Minato-ku, Tokyo,108-0071,JAPAN

Fax : +81-3-5423-6921

**e-mail : [contact@sifjapan.org](mailto:contact@sifjapan.org)**