

MEMO# 34793

January 9, 2023

Japan FSA Finalizes Code of Conduct for ESG Evaluation and Data Providers

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January 10, 2023

TO: ICI Global Members

ESG Task Force

Global Regulated Funds Committee

Global Regulated Funds Committee - Asia SUBJECTS: ESG

International/Global RE: Japan FSA Finalizes Code of Conduct for ESG Evaluation and Data Providers

On December 15, 2022, Japan's Financial Services Agency (JFSA) released the final Code of Conduct for ESG Evaluation and Data Providers ("Code of Conduct").[\[1\]](#) The Code of Conduct includes six principles applicable to ESG evaluation[\[2\]](#) and data providers, building upon the discussions during 2022 of the JFSA Technical Committee on ESG Evaluation and Data Providers ("Technical Committee"), and the results of a public consultation held by the JFSA from July to September 2022.[\[3\]](#) The JFSA encourages ESG evaluation and data providers to endorse and implement the Code of Conduct, but doing so is voluntary.

In addition to releasing the Code of Conduct, the JFSA underscored the importance of mutual dialogue among ESG evaluation and data providers, companies (i.e., assessed entities), and investors (i.e., users of ESG data/evaluations), and reiterated the Technical Committee's previous non-binding recommendations for investors and companies that are intended to encourage this outcome.[\[4\]](#)

The Code of Conduct focuses on six key areas: (i) the quality of ESG evaluation and data, (ii) human resource development, (iii) management and mitigation of conflicts of interest, (iv) transparency of objectives and methodologies, (v) handling of confidential information, and (vi) communication with assessed entities. (See below for further details.) It largely tracks the high-level recommendations IOSCO published in November 2021,[\[5\]](#) but with additional attention to issues such as the differences between an equities-focused "subscriber pays" model and a bond-focused "issuer pays" model for ESG evaluations.

A Voluntary and Principles-Based Approach

The JFSA has encouraged ESG evaluation and data providers to endorse the Code of Conduct, but doing so is fully voluntary. Based on ICI Global's meetings with JFSA officials and other public statements, we understand the JFSA's intention is for endorsement of the

Code of Conduct to become a market signal for quality among ESG evaluation and data providers, such that market incentives drive broad adoption.

The Code of Conduct follows a principles-based approach and allows providers that have endorsed it to follow a "comply or explain" approach to implementing the various elements of the code. In its publication, the JFSA also explicitly recognizes the importance of allowing space for innovation within the market for ESG evaluation and data providers. ICI Global is pleased to see the JFSA take a principles-based approach to improving market practices of ESG ratings and data providers. ICI Global has encouraged European policymakers to take a similar approach to help drive convergence around best practices in the industry without stifling innovation or increasing costs of ESG data through more burdensome regulatory requirements.[\[6\]](#)

The JFSA encourages providers to endorse the Code of Conduct by publishing their endorsement on their websites and notifying the JFSA.[\[7\]](#) The JFSA will maintain and publish a list of providers that endorse the Code of Conduct, publishing a list in June 2023 of providers endorsing the evaluation components of the code, followed one year later by publication of the providers endorsing the data components of the code. The JFSA will review the effectiveness of the Code of Conduct after three years, and decide if any further actions, including revision of the code, are necessary.

The separate recommendations (provided for reference but not part of the Code of Conduct) published by the JFSA for investors and companies related to ESG market functioning are also voluntary and do not impose any binding obligations.[\[8\]](#) The recommendations for investors focus primarily on transparency in the sourcing and use of ESG evaluations and data for investment decisions, and ongoing constructive dialogue among investors, companies, and ESG evaluation and data providers. Notably, the recommendations for investors also encourage investors to disclose their development and usage of any in-house ESG evaluations.[\[9\]](#)

Scope of the Code of Conduct

The Code of Conduct is focused on the Japanese market, and as such is applicable to providers of ESG data and evaluations that participate in Japanese financial markets or provide services to the participants of Japanese markets. The JFSA does not specify the business models or specific types of providers that would be covered by the Code of Conduct, and notes that the ESG market and its participants continues to evolve. The JFSA instead outlines several "basic concepts" regarding the scope of the Code of Conduct, for use by firms in evaluating the code's applicability to their activities and informing their endorsement of the code. Broadly speaking, the JFSA's basic concepts for the scope of the Code of Conduct focus on ESG evaluation and data services that contribute to investment decisions, and that are repeatedly and continuously offered as part of the providers' business operations. The JFSA also indicates that the Code of Conduct would apply to ESG data that involves adding estimates, calculations, and other information, beyond a simple pass-through or compilation of publicly available data.

The Code of Conduct's Six Principles for ESG Evaluation and Data Providers

Principle 1 – Securing Quality: ESG evaluation and data providers should strive to ensure the quality of ESG evaluation and data they provide. The basic procedures necessary for this purpose should be established.

Principle 2 – Human Resources Development: ESG evaluation and data providers should secure necessary professional human resources to ensure the quality of the evaluation and data provision services they provide, and should develop their own professional skills.

Principle 3 – Ensuring Independence and Managing Conflicts of Interest: ESG evaluation and data providers should establish effective policies so that they can independently make decisions and appropriately address conflicts of interest that may arise from their organization and ownership, business, investment and funding, and compensation for their officers and employees, etc. With regard to conflicts of interest, providers should identify their own activities and situations that could undermine the independence, objectivity, and neutrality of their business, and avoid potential conflicts of interest or appropriately manage and reduce the risk of conflict of interest.

Principle 4 – Ensuring Transparency: ESG evaluation and data providers should recognize that ensuring transparency is an essential and prioritized issue, and publicly clarify their basic approach in providing services, such as the purpose and basic methodology of evaluations. Methodologies and processes for formulating services should be sufficiently disclosed.

Principle 5 – Confidentiality: ESG evaluation and data providers should establish policies and procedures to appropriately protect non-public information obtained in the course of business.

Principle 6 – Communication with Companies: ESG evaluation and data providers should devise and improve the way they gather information from companies so that the process becomes efficient for both service providers and companies or necessary information can be sufficiently obtained. When important or reasonable issues related to information source are raised by companies subject to evaluation, ESG evaluation and data providers should appropriately respond to the issues.

Additional guidelines for implementation of each principle are available in the JFSA's Code of Conduct publication.

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Notes

[1] The Code of Conduct for ESG Evaluation and Data Providers, December 2022, available at [The Code of Conduct for ESG Evaluation and Data Providers \(English\)](#) and [The Code of Conduct for ESG Evaluation and Data Providers \(Japanese\)](#).

[2] The term "evaluation" used by the Technical Committee and JFSA is intended to capture a broader set of practices and products than the more commonly used term "ratings." See Code of Conduct, supra note 1, at 6. "With regards to ESG evaluation and data providers subject to the Code of Conduct, this document as well as the Technical Committee's report covers issues on not just ESG evaluations conducted on a stock or company basis (corporate evaluation, ESG rating, etc.), but also ESG evaluations conducted on a bond, loan or project basis (bond evaluation, etc.), as well as qualitative and quantitative data provision related to these two types of evaluation and data provision."

[3] Invitation for Public Comments regarding the Code of Conduct for ESG Evaluation and Data Providers, July 2022, available at <https://www.fsa.go.jp/en/news/2022/20220712-2.html>. See also ICI Global Memorandum [34248], available at <https://www.ici.org/memo34248>.

[4] See The Code of Conduct for ESG Evaluation and Data Providers, supra, at (Reference) Recommendations to investors and companies

[5] See IOSCO FR09/21 Final Report - Environmental, Social and Governance (ESG) Ratings and Data Products Providers, November 2021, available at <https://www.iosco.org/library/pubdocs/pdf/IOSCOPD690.pdf>. ("IOSCO Report") See also ICI Memorandum [33922], dated 24 November 2021, available at <https://www.ici.org/memo33922>.

[6] In June 2022, ICI Global responded to the European Commission's Targeted Consultation on the Functioning of the ESG Ratings Market in the European Union and Consideration of ESG Factors in Credit Ratings. "Ultimately, we believe that improvements to market practices of ESG ratings and data providers are needed. As a first step, these improvements can be addressed by principles-based industry standards, such as a code of conduct, to help drive convergence around best practices in the industry." Available at <https://www.ici.org/system/files/2022-06/34175a.pdf>

[7] Details on how to notify the JFSA of the endorsement are available at <https://www.fsa.go.jp/en/news/2022/20221215/20221215.html>

[8] See Summary of opinions received concerning the draft Code of Conduct for ESG Evaluation and Data Providers and responses to them (Japanese and English), at item 106, Response to Opinions Received in English, available at <https://www.fsa.go.jp/news/r4/singi/20221215/03.pdf>.

[9] See The Code of Conduct for ESG Evaluation and Data Providers, supra, Specific recommendations 2, at (Reference) Recommendations to investors.