The Code of Conduct for ESG Evaluation and Data Providers

~~(Draft)~~

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1. Introduction

As sustainable finance (finance for realizing a sustainable society) is expanding around the world, the role of "ESG evaluation and data providers" (hereinafter, in some cases, "evaluation providers" or "providers"), which collect, provide, and evaluate information on companies' ESG[1] initiatives, the eligibility of green bonds and other ESG-related, or ESG-labeled, bonds and ESG-related loans, is increasing.

A report which the FSA's Expert Panel on Sustainable Finance (hereinafter referred to as the "Expert Panel") compiled in June last year[2] emphasized the importance of sustainable finance, which supports the development of economy, industry, and society toward an ideal state through the reflection in decision-making and actions for realizing a sustainable economic and social system.

The report pointed out several issues regarding ESG evaluation and data providers, such as transparency and fairness of evaluations. It called for discussions on codes of conduct and other measures to address these issues.

Internationally, the International Organization of Securities Commissions (IOSCO) published a report entitled "Environmental, Social and Governance (ESG) Ratings and Data Product Providers Final Report "[3] in November last year, compiling and publishing recommendations and expected actions for ESG evaluation and data providers, investors who use them, and companies subject to ESG evaluation and data. Jurisdictions such as the UK, Europe, and India are also discussing ways to improve the quality of evaluations, including the possibility of introducing regulations on ESG evaluation and data providers.

Based on these trends, the FSA established the Technical Committee for ESG Evaluation and Data Providers, etc. (hereinafter referred to as the "Technical Committee") in February 2022 under the Expert Panel, and this Code of Conduct is based on the report compiling the results of the discussions by the Technical Committee (hereinafter referred to as the "report" or "Technical Committee's report").

Below, 2. summarizes the current status of ESG evaluation and data provision and issues in view of future market development, and 3. summarizes specific actions expected to ESG evaluation and data providers as the Principles, Guidelines and Concepts~~-~~.

Sustainable finance has been making various progress, and the provision of ESG evaluation and data, which serve as an information intermediary between investors and

[1] There are various terms for sustainability-related issues, such as ESG and sustainability, but since there are many aspects that overlap with each other, this Code basically uses the term ESG in a unified manner, except for stylized expressions and the like.

[2] https://www.fsa.go.jp/en/news/2021/20210618.html

[3] https://www.iosco.org/library/pubdocs/pdf/IOSCOPD690.pdf

companies, is also expected to undergo further changes in service provision and market structure.

The FSA will ~~form~~disseminate the finalized Code of Conduct~~ for ESG Evaluation and Data Providers after public consultation, and disseminate it and to~~, grasp the situation ~~at an early stage and proactively and~~ continuously respond to such ~~changes~~progress, and consider in three-year-term whether or not to take further actions that are including but are not limited to revising the Code.

2. On this document –The Code of Conduct for ESG Evaluation and Data Providers

(1) Current status and issues surrounding ESG evaluation and data

With the rapid expansion of sustainable finance, the influence of "ESG evaluation and data providers", which collect, aggregate, and evaluate information on companies' ESG initiatives or eligibility of ESG-related bonds and loans, is increasing.[4]

Asset owners such as life insurance companies and asset management institutions are widely moving to promote so-called ESG integration (incorporation of ESG factors into investment decisions) when formulating investment policies and selecting portfolios.

Institutional investors[5], such as asset owners and asset managers, individually make investment decisions using ESG evaluations and data ~~issues~~ issued by providers. In addition, an increasing number of ESG evaluations and data providers create corporate indices (ESG indices) based on their ESG data and evaluations and more investors invest in companies that track these indices.

When issuing ESG-related bonds, it has become a common practice to obtain evaluation opinions etc., regarding compliance with, or eligibility in relation to, various domestic and international standards[6]. For example, the "Green Bond Principles" by International Capital Market Association (ICMA), which are often referred to as international guidance for green bonds[7], recommends that ESG evaluation and data providers individually confirm the status of compliance with the principles, such as the usage of funds raised and the method of selecting target projects.[8]

In addition, as institutional investors' engagement with issuers of equity, bonds, and other securities regarding ESG initiatives is spreading, ESG evaluation and data are

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4 According to the Japan Sustainable Investment Forum (JSIF), Japan's total sustainable investment in 2021 (as of March) was 514 trillion yen, up 65.8% year on year.

5 Investors engaged in ESG investment can be both retail and institutional investors. This Code is primarily aimed at institutional investors such as asset owners and asset managers, including those who are referred to as "investors" without any particular restriction.

6 The JPX Knowledge Hub also summarizes the status of ESG evaluation and data providers in Japan and internationally, including ESG finance evaluation organizations that evaluate bonds and other financial products. (https://www.jpx.co.jp/corporate/sustainability/esgknowledgehub/esg-rating/index.html)

7 Generally, they are bonds, etc. that are allocated to projects, etc. that have a clear environmental improvement effect.

8 In Japan, the Ministry of the Environment's Green Bond Issuance Support Program requires green bond issuers to obtain an evaluation from ~~rating agencies~~providers on compliance with Japan's "Green Bond Guidelines." Internationally, ESG evaluation are being used for certification on ESG products both in the private and public sectors, for example, the Climate Bond Initiative (CBI) certification.

widely referred to when selecting engagement targets and considering the content and methods of engagement.[9]

As the use of ESG evaluation and data is diversifying, companies[10] and business fields subject to ESG evaluation and data are expanding. For example, global ESG evaluation and data providers participating in the Technical Committee~~'s~~ report that they are evaluating more than 10,000 companies around the world[11].

As the use and scope of ESG evaluation and data expands, several issues have been identified with respect to how these services should be provided.[12] In the report of the Expert Panel, for instance, the following four points were identified as challenges[13]:

i) ensuring transparency and fairness with respect to evaluations that have different standards among ESG evaluation and data providers;

ii) addressing potential conflicts of interest, such as by providing consulting services for a fee to the company being evaluated;

iii) securing human resources to ensure the quality of evaluation;

iv) considering the burden on companies, which are required by many evaluation providers to check the evaluation details.

The IOSCO report states that amid growing interest in ~~the financial impact of ESG factors including climate change, demand for~~ ESG evaluation and data ~~is increasing sharply~~ as a means of evaluating ESG-related performance, there would potentially ~~raising~~ be concerns about risks related to investor protection, market transparency and efficiency, and appropriate pricing. The report states that from the perspective of users of ESG evaluation and data, there is room for improvement in ensuring the reliability of services, ensuring the transparency of evaluation methodologies, addressing conflicts of interest, and communicating with companies.

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[9] For example, "Climate Action 100 +," an international climate change initiative led by institutional investors, has made it clear that it uses ESG evaluation to examine strategies for dialogue in collaborative engagement ~~with large companies~~ (where multiple investors engage with a specific company under the same problem awareness and framework) with large companies.

[10] In addition to companies, there are various organizations that are subject to evaluations, such as public corporations and other public institutions as well as international organizations. All are ~~H~~hereinafter referred to as "companies" for convenience, including cases where they are usually called "issuers."

[11] The 2nd discussion of the Technical Committee

[12] For the purposes of this Code, the provision of a service refers to a series of steps from the product's construction stage to its sale to customers.

[13] It should be noted that each issue may not necessarily apply in the same manner, depending on the business model of ESG evaluation and data providers and if it does apply, the manner in which it applies may vary greatly (see page 15~~14~~).

(2) Overview of this Code of Conduct

Based on discussions at the Expert Panel and IOSCO, the Technical Committee held 8~~7~~ discussions with the participation of global and domestic ESG evaluation and data providers that provide services in Japan, with the aim of ensuring that ESG evaluation and data are used reliably throughout the investment chain.

Discussions at the Technical Committee pointed out that sustainable finance, which incorporates externalities into investment decisions, is important, and that ESG evaluation and data providers, which serve as intermediaries for market participants' information, play an essential role in fostering sustainable finance. It was also pointed out that ESG evaluation and data providers have to date contributed in clarifying where to focus attention in ESG investment and opened up the market.

On the other hand, it was pointed out that if evaluations and data are misleading, such information could be circulated from one to another, and a wide range of investors could invest in companies and businesses in a manner that they have not intended.

In this regard, it was pointed out that it is important to, by clarifying the ~~philosophy~~basic approach on quality of evaluation, improve the understanding of investors and companies and lead to improvement of companies' measures, and that it is not necessarily a problem by itself if evaluation results differ from one provider to another. It was also pointed out that as ESG evaluation encompasses various approaches, it would be difficult to define uniformly what is right or wrong, and that it would rather be important to clarify the evaluation methodology and ensure the evaluation are carried out according to the clarified methodology, thereby improving the quality of evaluations.

As the market for ESG investment ~~is~~ rapidly ~~expanding~~expands, ESG evaluation and data providers are expected to formulate their understanding of the developments in society as a whole regarding sustainability, and to~~appropriately~~ provide evaluation and data based on reasonable grounds and professional judgment~~, while accurately understanding the movement of society as a whole around sustainability~~.

In addition, constructive dialogue between providers and companies would increase the understanding of evaluations by companies, encourage companies to become more aware of their ESG-related initiatives or issues, then contribute to ensuring the growth and sustainability of companies and the economy. Although it would be difficult to obtain a complete understanding from all parties, ESG evaluation and data providers are expected to understand that their services as well as their dialogue with related parties could contribute to the improvement of the overall market and subject to their policies, promote their services and dialogues.

Companies subject to evaluation are generally required to constantly review and consider their business strategies and to improve corporate value and promote sustainable growth through appropriate business execution, and communication with ESG evaluation and data providers would expect to work for this purpose.

Institutional investors could, by deepening their understanding of corporate strategies and utilizing ESG evaluation and data in light of its characteristics and limitations, execute appropriate investment strategies, deepen dialogue with companies, and lead to sustainable development of their investment assets.

In this July, based on recognition of these issues, the Technical Committee compiled the report. From the perspective of encouraging constructive initiatives and dialogue throughout the investment chain[14], the report is a comprehensive compilation of recommendations on ESG evaluation and data providers, as well as on investors and companies.

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.

In the discussion at the Technical Committee, it was recommended that companies enhance understandable disclosure, considering the fact that as a precondition for the accurate provision of ESG evaluation and data, ensuring the quality of data disclosed by companies was also important. In this regard, The ~~JSF~~FSA's Working Group on Disclosure has simultaneously been~~is~~ discussing the~~se~~ issues~~, and the report also recommends that companies enhance understandable disclosure~~.[15]

In compiling this Code of Conduct, there are several points to keep in mind, such as that services for providing ESG evaluation and data are still developing, that there are various concepts in ESG, and that standards and regulations are in the process of simultaneous discussions in other countries. Although there are points that could be flexibly reviewed

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[14] In this Code, the investment chain refers to the flow of funds and information related to investments among the parties involved, including institutional investors who provide funds, companies that raise funds, and ESG evaluation and data providers that serve as information intermediaries between the two parties.

[15] The FSA is proceeding with system reforms such as creating a new section to provide sustainability information in an integrated manner in Annual Securities Reports (ASRs). In addition, Japan is actively participating in discussions toward the establishment of international standards in International Sustainability Standards Board (ISSB) and elsewhere, while collecting domestic opinions mainly through the Sustainability Standards Board of Japan (SSBJ). The SSBJ is considering specific details of sustainability disclosure in Japan, taking into account ISSB discussions.

and revised depending on future trends, this document summarizes these points as described in (3) below.

(3) Points to be considered of the Code of Conduct

(i) Improvement across market–

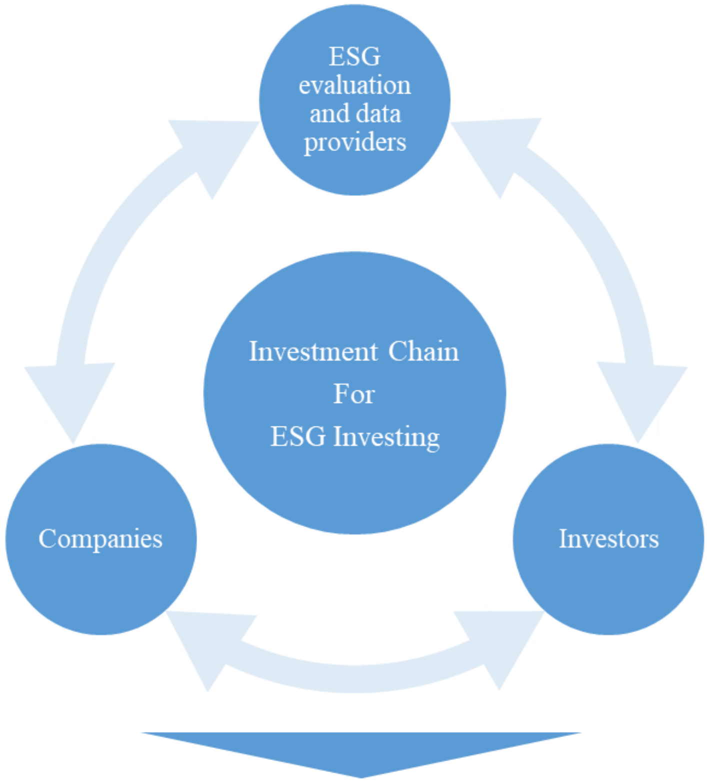
The Technical Committee's report summarizes recommendations concerning ESG evaluation and data providers, as well as regarding investors and companies, from the perspective of developing an environment for the entire those chain where ESG evaluation and data are appropriately used.

For example, ESG evaluation and data providers are currently facing demands on service provision from a large number of investors and companies. It would be beneficial to the market as a whole that providers which promote the quality of data and evaluation via dialogue with companies and investors are appropriately valued.

For this reason, investors and companies are expected to actively provide feedback on the services to ESG evaluation and data providers and encourage them to improve the quality of ESG evaluation and data and enhance capabilities.[16]

The recommendations for investors and companies in the Technical Committee's report are included in this document's appendix, as a reference and for readers' information purpose.

[16] Apart from this Code of Conduct, the Stewardship Code stipulates that when an institutional investor discloses a clear policy for fulfilling its stewardship responsibility, it should clearly indicate how it will consider sustainability issues in accordance with its investment strategy. Also, the Corporate Governance Code stipulates that listed companies should appropriately disclose their sustainability initiatives when disclosing their management strategies.



Improving the quality of evaluation, etc. through mutual encouragement

ESG evaluation and data providers and investors as well could benefit from companies' initiatives on various sustainability issues in that they promote companies' growth and business sustainability, leading further activation of the market for ESG investments, data, and evaluation

In order to encourage the establishment of an effective PDCA (Plan-Do-Check-Act) cycle at companies, it is important for evaluation providers and investors to clarify the concepts and methodologies of evaluation and investment, and help companies to understand and to be more convinced for the evaluation to themselves.

In order to encourage market participants including companies, investors, and evaluation providers to engage in collaborative dialogue, for instance, a stock exchange as market infrastructure may provide opportunities for mutual discussion on the current state of ESG evaluation and market issues.

(ii) Principles-based

The market for ESG evaluation and data provision has been developing rapidly in recent years. At present, there are varieties in ESG evaluation and data provision, such as the scope, forms and methodologies of service provision, and characteristics of entities; those may possibly change significantly in the future. A concept of ESG, which is a prerequisite for evaluation and data provision, also includes a wide range of elements and would evolve in response to changes in the social environment.

In light of this, this Code of Conduct is principles-based encouraging further improvements in ESG evaluation and data provision services based on their own initiatives and ensuring flexibility in response to future business model changes.

More specifically, the Code of Conduct for ESG ~~evaluation~~ Evaluation and ~~data~~ Data ~~providers~~ Providers are divided into the "Principles" that are the basic pillars of the recommendations, the "Guidelines" that summarize more detailed points to note and methodologies for implementing the "Principles", and the "Concepts" that summarize the background and reasons for setting these "Principles" and "Guidelines". They are all described on a principle basis. In summary, the Code of Conduct is positioned as such that each market participant would decide appropriate ways to implement the "Principles" and "Guidelines" according to their unique situation, considering contents covered in the "Concepts".

It is appropriate to review the content and positioning of the Code of Conduct as necessary in accordance with market developments.

(iii) Call for endorsement of the Code of Conduct

The Code of Conduct is principles-based rather than prescribing in detail what is expected of ESG evaluation and data providers, and similar to codes of conduct in other areas, whereby each institution will consider appropriate implementation in accordance with its own services and market environments.

For this reason, the Code of Conduct is not laws or regulations that uniformly require actions of parties concerned, but designed to be a voluntary code on a “comply or explain” basis, where the FSA calls for organizations to express their~~its~~ support for the Code via public announcement, and the organizations supporting the Code will either ~~they~~ comply with the principles and guidelines of the Code, or explain the reasons why they do not comply with a particular ~~item~~principle or guideline.

When implementing the principles or guidelines of the Code, it is important to provide easy-to-understand explanations so that readers can understand the specific status of compliance with each item of the principles and guidelines.

Even if an organization endorses the Code of Conduct, it does not mean that all principles and guidelines must be uniformly complied with by the organization. However, when the endorsing organization would not be implementing certain aspects of the Code, the organization should make an effort to explain the specific status of compliance with, and the reason for not complying with, each item of the principles and guidelines, so that investors and companies may understand its rationale and the status.

~~When the Code of Conduct is finalized after public consultation, the FSA will call~~The FSA calls for ESG evaluation and data providers to endorse the Code of Conduct and, if it is endorsed, to publish it on their websites and notify the FSA of it. The FSA will ~~also~~ publish the status of endorsement in a comprehensive manner~~.~~ around six month after the publication of the Code (with regard to the status of endorsement regarding data in the Code of Conduct, around further one year after the initial publication of the status of endorsement).

In light of nature of international operations of ESG evaluation organizations, the implementation of the Code may possibly, even with considerable intention, take certain amount of time such as those necessary for substantial changes in internal systems, depending on the circumstances of each provider. In such cases and at the beginning year of implementation, it would, for instance, be possible to clearly explain the plan~~schedule~~ of future measures~~initiatives~~ and the approximate timing of the implementation.

The support and endorsement of the Code of Conduct by an ESG evaluation and data provider will help investors and companies deepen their understanding of the quality improvement and transparency initiatives of the provider. By this way, the support and endorsement would, for example, deepen broad confidence and support from companies and investors for the provider or lead them to actively provide information to the provider.

Based on the fact that the Code of Conduct is principles-based, it is considered important for the parties concerned to share common understanding of the purpose of the Code of Conduct and encourage each party to act according to the purpose, rather than mechanically checking whether or not the Code of Conduct is compiled horizontally in a fit-for-all manner.

Therefore, in addition to the above dissemination, it is important to share expectations and current practices, limitations, and diverse aspects of evaluation methodologies through, for example, workshops attended by investors, companies, and evaluation providers.

(iv) Scope of services covered by the Code of Conduct

While taking into account international discussions, the Code of Conduct basically focuses on the provision of ESG evaluation and data that can be used for investment in the Japanese markets. Therefore, the scope of the Code of Conduct are ESG evaluation and data providers that participate in Japanese financial markets[17] or provide services to the participants Japanese financial markets.[18]

There are currently no specific statutory regulations for the businesses of, or statutory definitions for, ESG evaluation and data providers, so the scope of seeking support for the Code of Conduct is an issue. However, as the types of ESG-related evaluations and the market continues to change, it is not easy to establish a mechanically uniform definition at this point. In addition, data and evaluation are often provided together, and it is not easy in practice to make a clear distinction between the two.

To this end, based on the Technical Committee's report, this document clarifies *the basic concepts* regarding ESG evaluation and data providers covered by the Code of Conduct as per below, and calls on each institution to understand the principal purport of *the basic concepts* to judge their endorsement.~~.~~

Following *basic concepts* are intended to define which *services* this Code is applicable to, focusing on *services* to be provided. Therefore, when a provider provides services that meet *the basic concepts* at the same time providing those do not meet *the basic concepts*, the ~~Technical Committee~~FSA would call for support by the provider, regardless of the proportion of those two types of services. On the other hand, ~~the Committee expects~~ even when an organization clarifies that it supports the Code of Conduct, services that are provided by the organization but do *not* meet *the basic concepts* will *not* be subject to the Code of Conduct.[19]

[*Basic Concepts* to the Scope of ESG Evaluation and Data Providers that are to be Called for Support of the Code of Conduct]

A. An entity, participating in financial markets in Japan or providing services directly to such participants, that provides ESG evaluations and data services as part of its business, and as a service that would contribute to market participants' investment decisions.

B. The service is provided as part of its business, that is, repeatedly and continuously conducted as part of its own business operations.

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[17] Refers to financial markets including stocks~~,~~ and bonds (both listed and unlisted), loans and others.

[18] If services such as the provision of ESG evaluations fall under the category of *financial instruments business*, which includes the provision of advice on the value of securities for compensation, it is necessary to comply with relevant laws and regulations such as registration as a Financial Instruments Business Operator. Even if such registration is made, if the registrant's business falls under the "Basic concepts" above, it would still be the scope of this Code of Conduct as an "ESG evaluation and data provider".

[19] Either the entity that provides corresponding services, or the group that includes such entity may support the Code of Conduct. Even in the latter case, other services provided by the group (that do not fall under the concept) are not considered to be covered by the Code of Conduct.

C. Services as described above are considered to be covered by the Code regardless of the attributes of the entity which provide the services, such as for-profit corporation, non-profit corporation, domestic company, or foreign company.

D. In principle, the provision of ESG *data* is also covered by the Code, if A. to C. above are satisfied, and the service adds information on corporate data through calculations, estimates, etc.

Regarding A., one of the issues is whether various specialist institutions that provide data to ESG evaluation and data providers are covered by the Code. ESG evaluation requires a wide variety of knowledge, on factors including industrial production, temperature, sea level, ecosystems, and forests, even when looking at the environment alone. Evaluation providers often obtain specialized knowledge and data from academic or research institutions to compose their ESG evaluation and data to the market.

Such organizations, those who provide expert knowledge to ESG evaluation and data providers while conducting research on their normal course of business, are not, in principle, organizations that provide ESG evaluations and data directly to investors as part of their own business (A.), and therefore do not need to be included in the scope of the Code.

As services “that would contribute to market participants’ investment decisions," services such as providing evaluation by horizontally comparing listed companies from an ESG perspective, or more directly, services such as evaluation provided for assessing individual financial instruments, are expected to be covered by the Code. Therefore, for example, when providing only a service of advising individual companies on improvements from an ESG perspective, they are not by itself the scope of the Code.

In addition, for example, a media outlet’s case-by-case ad-hoc-basis ESG ranking in accordance with the particular content of their news would not to be the scope of the Code, since it does not provide the ranking repeatedly and continuously as part of its own business (B.).

On the other hand, there are various entities that provide ESG evaluation and data, including credit rating agencies, data service providers, proxy advisors, and NGOs and NPOs, both in and outside Japan. Each entity conducts evaluations with its own originality and ingenuity and has a presence. The importance of evaluation and data does not depend on the attributions of the organization, but on the services used. Basically, it is considered appropriate to call for support regardless of the attributions of the organization.

As pointed out in the IOSCO Report and the Technical Committee, ESG data used by ESG evaluation and data providers includes not only data disclosed by companies but also estimated data prepared by ESG evaluation and data providers[20], both of which form the basis of evaluation, and it is important to ensure their quality.

For the data that companies themselves disclose, the quality of the data, such as whether the accuracy of the data is ensured and whether necessary updates are made at appropriate timing, basically depends on the companies themselves that disclose the data.

On the other hand, data ~~proceeded by ESG evaluation and data~~that providers add information through estimates etc. using company data, has a wide range of estimation methodologies. Depending on the estimation methodology and presentation method, investors may misunderstand it[21], and in this case, there is a possibility that price formation may be affected outside the recognition of the company subject to the estimation data.

Given the importance of ESG data, therefore the Code of Conduct considers ESG evaluation and data provision as an integral activities. When the provision of ESG data falls under A. through C. above and adds estimates and other information about corporate data, it is considered as a provision of "ESG evaluation and data," thus subject to the Code of Conduct.[22]

For this reason, for example, information aggregation on a general website that compiles data by itself but does not add any particular information is not considered as a service covered by the Code, neither are survey statistics conducted by corporate information companies (since they provide information for a wider purpose ~~and~~ not limited to investment decision purposes).[23]

As described in 2. (2) above, ESG evaluation and data providers have pioneered the market in this field as intermediaries of information among market participants, and they are expected to continue to play innovative roles in identifying the focus of data and

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[20] Data disclosed by companies may also include estimated data, for example, emissions from suppliers (Scope3). The discussion here is whether companies themselves aggregate, estimate, and disclose the data, or third parties other than companies process and estimate the data.

[21] Some members of the Technical Committee pointed out that taking greenhouse gas (GHG) emissions as an example, the data for Scope 1 and 2 sometimes partly varies depending on the data provider, while data for Scope 3, which is calculated based on estimation, varies a lot depending on the provider.

[22] For so-called raw data, to which no information is added through calculations, estimations, etc., continuous management by the providers would be necessary as part of their quality controls, etc. Items such as Principle 1 Guideline 5, Principle 1 Guideline 6, Principle 4 Guideline 4, Principle 4 Guideline 5, Principle 6 Guideline 3, and Principle 6 Guideline 4 are those related to such treatment of raw data.

[23] Even for the data companies disclose, errors in transcription and aggregation might occur when the ESG evaluation and data provider aggregates it. In this regard, as described in (P 34~~●~~) below, it is desirable to establish a dedicated contact point where companies can make inquiries and raise issues regarding ESG evaluation and data provision.

evaluation in a wide range of ESG fields and formulating and providing data and evaluation on a practical basis. Given that the market for ESG evaluation and data is still in its development stage, it should be noted that creativity by the providers should be encouraged.

The scope stated above still has some room for judgment compared to the case where the scope is clearly defined by laws and regulations. If the scope were to be strictly defined without leaving any room for discretion, further refinement may be required.

However, for example, "setting a lower limit on the number of times a service can be deemed to have been provided directly to investors" or "setting an upper limit on the frequency of providing a service that is not deemed to be repeated or continuous" would not meet the purpose of the principles-based code. This would also raise issues such as an enormous cost for judgments.

It is assumed that service providers basically understand whether or not a certain number of investors are included in their own service. Moreover, organizations do not have to strictly examine whether their service does or does not cover at least one investor, but can judge whether or not investors are to be included in their service in a principle-based judgement.

With regard to whether data provision should be in the scope of the Code of Conduct, some members of the Technical Committee stated the view that, given ESG data provision services take a wide variety of forms, coverage of ESG evaluation alone would be a good start. Other members on the other hand stated that it is important to ensure data quality and that ESG data should be covered, as is covered in the IOSCO report.

Based on the recognition that ensuring the quality of ESG data, which forms the basis of ESG evaluation, is an urgent issue, the Technical Committee recommends, while keeping in mind that the scope of data provision services is broad as described above, that the FSA call~~s~~ for support for the Code of Conduct ~~based on the basic concept above~~including data element. The Code of Conduct is compiled ~~Based~~ based on this recommendation~~, this Code of Conduct is compiled~~.

~~On this basis, b~~Based on the principle-based approach, this document clarifies that when the degree of addition of information is low, concise information disclosure by ~~an institution~~a provider is just sufficient, compared with ~~ESG evaluation~~ cases where the degree of judgment is large. Also, with regard to ensuring the quality of data, on the condition that the accuracy of transcription, etc. is ensured, the quality of data disclosed by a company is obviously and primarily dependent on the company.

As a whole, based on the recognition that it is important to ensure innovation in ESG evaluation and data providers, the Code of Conduct is limited to basic matters, such as transparency of methodologies, and generally described based on principles, and leave room for exercising creativity and ingenuity by each organization.

With regard to the definition of ESG data provision services, the better approach is that technical issues are to be solved one by one. ~~Further opinions will be obtained through public consultation~~ ~~whether there are any significant problems in actual practices.~~ The FSA continuously collect feedback on whether there are any significant problems in actual practices~~.~~ even after the establishment of the Code of Conduct, and to make improvements as necessary.

(v) Business model

There are basically two types of ESG evaluation and data providers: the so-called "subscriber pay model," in which ESG evaluation is conducted and provided on an equity or company-by-company basis, and investors and other users of the evaluation and data bear the costs; and the so-called "issuer pay model," in which the company issuing the bonds bears the costs of issuing the bonds and assesses the consistency with various guidelines on the bonds to be issued.[24]

While the IOSCO report notes the existence of both models, many of the recommendations are written with ESG evaluation at the equity and corporate level in mind.

As the number of ESG-related bonds, including so-called "green bonds" and "transition bonds", is increasing rapidly in Japan and overseas, and the importance of the evaluation based on the "issuer pay model" is increasing, both models are included in the Code of Conduct.

According to the discussions of the Technical Committee, while there ~~were~~ would be some differences in details of required actions for each business model, many matters would be in common based on principles. There are also opinions that in recent years, even for bond and loan evaluation, there has been an increasing tendency to evaluate entire business entities, together with particular business projects in which funds would be allocated, and for this reason, the viewpoints of both models are getting closer, and presumably ESG evaluation and data providers could play a role in linking bond and loan evaluation with corporate and equity evaluation in the future.

In light of these points, this Code of Conduct provides an integrated description of the roles expected of the two business models, while also making separate descriptions when particularly necessary.

[24] It has been pointed out that business models are not limited to these. In such a case, each provider should judge what kind of adaptation is desirable according to its own business model.

(vi) Diversity of assessments

Regarding ESG evaluation, some researches point out that the correlation of evaluation results among evaluation ~~institutions~~ is low, in particular, with regard to corporate evaluation.

On this point, discussions at the Technical Committee pointed out that while there are opinions that seeks for standardized evaluation methodologies for specific items such as GHGs, it is important to clarify the ~~philosophy~~basic approach of evaluation, including its purpose~~, approach,~~ and basic methodology regarding ESG evaluation in general, and if evaluation is conducted in line with these, it does not necessarily matter that evaluation results differ from one institution to another. They also pointed out that ESG encompasses various concepts and values in the first place, and evaluation results will continue to be diverse in the future. The Code of Conduct are based on these views.[25]

For external evaluations of ESG-related bonds[26], since they include second party opinions, verification, certification, ratings, or other various types, those are summarized as follows along with the above-mentioned business models.

Types of ESG Evaluation

<table>
<tr><td>Types</td><td>Evaluation criteria and data collection methodologies</td><td colspan="2">Expression of evaluation</td></tr>
<tr><td>Evaluation of Corporate(Stocks)</td><td>・Conducted based on each ~~institution's~~ provider's own criteria (e.g. whether evaluation focuses on risks or comprehensive evaluation of risks and opportunities)
・Many based on subscriber pay model, and quantitative and qualitative data that forms the basis of evaluation is obtained through public information, questionnaires, etc.</td><td colspan="2">Various forms of evaluation expression, such as quantitative scoring and qualitative rating, depending on providers.</td></tr>
<tr><td>Evaluation of ESG related bonds and loans</td><td>・Usually refer to internal and external criteria related to bonds and evaluate the degree of compliance with them.
・Certain range and type of discretion and responsibility depending of classification summarized right.</td><td>Second Party Opinion</td><td>Opinions on consistency with relevant principles, and the eligibility of the fund allocation business and the eligibility of the issuer</td></tr>
</table>

[25] As shown in the table, when evaluating with reference to various criteria, such as the evaluation of ESG-related bonds, there is a certain level of common criteria among providers, but there would still be a certain range in terms of discretions, either.

[26] The ICMA "Guidelines for Green, Social and Sustainability Bonds External Review" provides details of the external review of ESG-related bonds, which is basically organized in the same way as above.

	・Many issuer pay model, and data that forms the basis of evaluation is obtained directly from companies.	Verification	Verification of consistency with external standards
		Certification	Certification necessary for assigning a specific bond naming in light of external standards
		Scoring/Rating	Scoring or rating

Although there are differences between equity and bond evaluations, such as the uniqueness of evaluations, the use of external criteria, and the categories of financial instruments subject to evaluation, the Code of Conduct is based on the idea that the two methods share common basic elements, such as clarifying the basic approach to evaluation.

As for the classification of bond evaluations, this would not make any particular difference in the Principles either. However, if the scope of evaluation differs depending on each category, it is desirable that the evaluation organizations clarify this point as part of ensuring transparency (P 28).[27]

The quality of ESG indices, which are based on the evaluation of companies, can also be improved through improvements in ESG evaluation and data.

(vii) Comparison with the IOSCO report

This Code of Conduct presents the state of ESG evaluation and data service provision in Japan as well as the recognition of issues, based on the IOSCO report and the Technical Committee's report which summarizes results of discussions at the Committee consisting of evaluation providers, companies, investors and other members.

To this end, although important points have been inherited over from the IOSCO report, further addition and reformation have been made especially on points the Technical Committee finds particularly important; some contents been strengthened and others practicalized. Several important commonalities and differences with the IOSCO report are summarized as below.

[Importance of Securing Quality]

[27] The Ministry of the Environment's "Green Bond and Sustainability Linked Bond Guidelines, Green Loan and Sustainability Linked Loan Guidelines" defines the items that bond evaluation agencies should follow in evaluating ESG-related bonds and loans.

As in the IOSCO report, the first principle of the Code of Conduct is to ensure the quality of ESG evaluation and data provision services, based on the recognition that ensuring the quality of ESG evaluation and other service provision is essential for the development of a sound market.

In the same order as in the IOSCO report, this Code of Conduct is structured in the following order: securing human resources necessary to ensure quality (Principle 2); managing independence and conflicts of interest, which is the basis for ensuring quality (Principle 3); transparency, which is also essential for ensuring quality and reliability (Principle 4) and confidentiality (Principle 5).

As a whole, given a wide variety of ESG evaluations and services are provided, it is not necessarily a problem that evaluation results differ from ~~institution~~ provider to ~~institution~~provider. The report assumes that it is important to clarify the basic concept of evaluation, by this way help investors and companies to better understand and be more convinced with evaluations, leading to improvement in practices in market as a whole.

[Human Resources Development]

As an important element for ensuring quality control, the description in the IOSCO report is elaborated to form independent Principle 2, which summarizes the development of human resources related to ESG.

With regard to ESG evaluation and investment, it is important to have both expertise in environmental and social aspects of ESG and expertise in financial aspects. The Technical Committee also pointed out that the market as a whole does not necessarily have sufficient human resources with such expertise. The Technical Committee's report recommends that it is important for the authorities to promote improvement of the market as a whole in collaboration with private-sector entities. This Code stipulates that it is also important for evaluation providers to take measures including the development of internal human resources as well as the utilization of external expertise as necessary.

[Scope (Data)]

With respect to the scope of ESG evaluation and data provision to be covered, this Code of Conduct, same as the IOSCO report, integrates "evaluation" and "data provision" and includes them.

In particular, the Code of Conduct extends the IOSCO report to help domestic and overseas ESG evaluation and data providers active in the Japanese market to understand the scope of data covered in the recommendations, while noting that the market is still in a developing stage and various services exist.

Specifically, as described in A. to C. under v) above, when calculations, estimates and other value added information related to the company data are provided, such services would be considered as "ESG evaluation and data provision" and be included in this Code. The scope of these services can be judged by each entity based on a principles-based-manner.

[Scope (two business models, equity/corporate evaluation and bond/loan evaluation)]

While the IOSCO report covers a wide range of ESG evaluations, it basically focuses on the evaluation of equity and corporate based on the subscriber pay model.

This Code of Conduct more explicitly includes the evaluation of bonds and loans based on the issuer pay model in the scope, taking into account the growing importance of the evaluation of green bonds and transition bonds in the markets in and outside Japan in recent years.

In general, in the case of the subscriber pay model, an evaluation is conducted in light of the evaluation provider's own methodology, not in response to a request from the company being evaluated. Therefore, there are issues such as communication with the company and disclosure of the evaluation methodology. On the other hand, in the case of the issuer pay model, an evaluation is usually conducted in response to a request from the company to be evaluated while referring to external standards, etc., thus there are issues such as appropriate management of conflicts of interest with the company.

Taking these points into account, the Code of Conduct organizes both business models and evaluation targets based on the premise that it can basically be applied to both. Specifically, it stipulates that any particular differences between each business model should be specified, and that each institution should be able to judge its application based on differences in business models, etc.

[Mutual dialogue among companies, investors, and ESG evaluation and data providers]

As stated in the IOSCO report, the Technical Committee's report stresses in particular that in order for ESG evaluation and data to be used reliably, it is important not only for institutions that provide ESG evaluation and data, but also for companies and investors to take action.

Based on the recognition that it is important for market participants to engage in dialogue with each other and work together to improve the overall market in a mutually beneficial manner, the Technical Committee's report includes recommendations on both companies and investors and encourages market participants, the three parties and others surrounding them, to engage in dialogue with each other, while paying attention to confidentiality and other matters.

Considering the importance of mutual dialogue, this Code includes in its appendix and as a reference and information purpose, the Technical Committee’s recommendations on investors and companies.

3. Principles, Guidelines and Concepts

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.**

Guidelines

In order to implement Principle 1, ESG evaluation and data providers should take necessary measures such as:

1. ~~Establishing~~For formulating and providing ESG evaluation and data, establishing necessary procedures to analyze in detail information that can be reasonably obtained.~~,~~ ~~and formulate and provide ESG evaluation and data~~.

2. Establishing ~~logical and~~ cross-organizational and continuously applied methodologies to provide high-quality ESG evaluation and data, and disclosing it while paying attention to confidentiality, intellectual property, etc.[28]

3. In order to ensure that the prescribed methodologies are applied consistently across the organization, disseminating them throughout the organization, as well as devising measures, such as horizontally reviewing under an appropriate system, or accumulating and sharing knowledge of evaluations to be provided.

4. Checking on a regular basis whether there would be any apparent discrepancy between the evaluation results and the service provision methodologies mentioned above, and updating methodologies as necessary (implementation of the PDCA cycle for evaluation).

5. Managing ESG evaluation methodologies and data on ~~an ongoing~~a continuous basis, checking or updating them regularly, and disclosing when the input data is usually obtained or updated by the providers (if evaluation and data items are diverse or of

[28] The term "disclosure" in this Code basically assumes public disclosure on the website or others. However, it may also include other ways such as disclosure only to subscribers, customers ~~or~~, and companies subject to evaluation at the discretion of each institution, taking into account the business models of the providers, the characteristics of the services and users, the confidentiality of information, and intellectual property related to service methodologies.

great numbers, doing this in a reasonable scope and manner, such as by consolidating or limiting the scope, taking into account their importance and usefulness based on user needs).

6. In cases where ESG evaluation and data providing services are outsourced, taking necessary measures for the quality of ESG evaluation and data to be ensured including the outsourced party, such as, as necessary and depending on the nature and importance of the outsourced service, requesting the outsourced party to comply with 1. through 5. above.

Concept

Quality control of services provided by ESG evaluation and data providers is the most fundamental and important issue.

It is important for ESG evaluation and data providers to establish and disseminate appropriate guidelines regarding evaluation standards, methodologies, and key points so that high-quality services are provided across the organization without any particular dispersion among personnel. In particular, it is important to establish necessary procedures to analyze in detail information that can be reasonably obtained on websites or other sources, and formulate and provide ESG evaluation and data.

In addition, it would be useful for each institution to define quality according to its own service as necessary, given that there are wide varieties of services in light of the way of service (e.g., evaluation based on public information or use of its own questionnaire), the target of service (e.g., bond evaluation or corporate evaluation), and the compensation system (e.g., subscriber pay or issuer pay).

In order to improve the quality of assessment, it is important to conduct cross-sectoral assessment under an appropriate system so that the guidelines are consistently applied, and to accumulate and share knowledge on factors that determined assessment through such evaluation.

In addition, if a series of service provision processes, such as information gathering, evaluation, and feedback after the disclosure of evaluation results, reveals there are still discrepancies between the evaluation and the evaluation results, there may be room for further update in the ~~evaluation~~ methodologies. In such cases, making the necessary updates and implementing the PDCA cycle will lead to continuous improvement in evaluation.

Furthermore, companies subject to evaluation make various efforts for disclosure and other improvement, and an evaluation made a year ago may not necessarily still be applicable today. From this perspective, it is important to disclose the date of the evaluation and when the data that serves as the basis for the evaluation is used or updated. It is also important for the evaluation ~~institution~~ provider to maintain records that include the point of time when such data is used or updated.

With regard to ensuring the quality of data, if there is an error when the ESG evaluation and data provider transcribes the data disclosed by a company, the responsibility would rest with the provider. Beyond that, however, the quality of data disclosed by a company is, obviously, primarily dependent on the company.

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.

Guidelines

In order to implement Principle 2, ESG evaluation and data providers should take necessary measures such as:

1. Collecting and analyzing information necessary to provide appropriate evaluation and data, and maintaining necessary professional resources and technologies to make relevant decisions.

2. In particular, taking necessary measures to ensure personnel engaged in ESG evaluation and data would have professional knowledge and carry out their duties in good faith.

3. Considering the nature of personnel evaluations that would appropriately evaluate personnel who engages in professional evaluations and working for providing high-quality evaluations.

4. Recognizing, as top management of the institution, that securing and developing human resources is important element for continuously providing high quality evaluations, and taking actions as necessary.

Concept

To ensure and improve the quality of ESG evaluation and data provision, professional knowledge of those who collect, analyze, and evaluate data are essential. In particular, as an organization, depending on the content of the evaluation, expertise related to ESG and expertise related to characteristics of financial instruments subject to evaluation are indispensable.

At present, however, as ESG initiatives are rapidly expanding, the market as a whole is facing a shortage of human resources who have such expertise.

For this reason, it is important for ESG evaluation and data providers to develop capacity building of human resources, as well as to cooperate with related external organizations as necessary to introduce and utilize expertise. Even if individual employees do not necessarily have all the necessary expertise, it is important for the entire organization to secure and provide the necessary knowledge.

In addition, in order to effectively secure human resources, it is important to review the nature of personnel evaluation so that human resources who engages in professional evaluation and works for providing high-quality services are appropriately assessed.

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.

Guidelines

In order to implement Principle 3, ESG evaluation and data providers should take necessary measures such as:

1. Identifying potential conflicts of interest that may affect the assessment and analysis conducted by the ~~institution~~ provider or its employees with respect to the services provided, and then establishing and ~~publicizing~~disclosing effective policies to avoid, or appropriately manage and reduce the risk of, the conflict of interest.

2. Taking appropriate measures to ensure that other business relationship with a company subject to ESG evaluation or data does not affect the ESG evaluation or data, such as establishing a firewall between sales and evaluation divisions.

3. In cases evaluations are developed through questionnaire, paying attention to the contents and structure of service and questionnaire, so that there would principally be no such situation where the content of the questionnaire is unreasonably too complicated or difficult to understand and effectively respond without using the ~~institution's~~ provider's paid services.

4. Taking appropriate steps to prevent their employees from engaging in securities or derivatives transactions that could create conflicts of interest with ESG evaluation and data provision services.

5. Developing appropriate work and compensation structures for its own employees, and avoiding, or appropriately managing and reducing the risk of, potential conflicts of

interest related to ESG evaluation and data provision services. For example, as necessary, assigning a staff member to conduct evaluation, separate from the staff member responsible for sales of ESG evaluation and data services.

6. ~~For an, disclosing~~Establishing measures to ensure that existing business relationship with ~~the company~~companies subject to ESG evaluation and data provision does not affect the evaluation to the ~~company~~companies.

7. For the issuer pay model where compensation is received from the company subject to the evaluation, implementing ~~more~~ detailed procedures to avoid conflicts of interests.

8. In cases where the same ~~institution~~ provider provides both the-subscriber-pay-model businesses and the-issuer-pay-model businesses, taking appropriate measures to prevent conflicts of interest in this regards.

Concept

Ensuring independence and appropriate management of conflicts of interest is fundamental to establish reliability of the quality of ESG evaluation and data provision, and appropriate policy formulation and implementation are essential.

With regard to independence, it is necessary to pay attention to both the independence of the company and that of the employees such as analysts. It is important to develop an environment in which evaluations can be conducted professionally with independence and without undue influence from companies subject to evaluation, investors and financial institutions, etc., depending on their business model.

With regard to the management of conflicts of interest, it is important for ESG evaluation and data providers to first review the services they provide and the situations in which they are involved with the company to be evaluated, then identify services that potentially cause conflicts of interest.

Based on this, when conflicts of interest are possible, it is important to avoid, or to have in place a specific framework to appropriately manage and reduce, the risks of the conflict of interests.

The specific nature of potential conflicts of interest may vary depending on the evaluation methodology and business model. For example, in the subscriber pay model, a typical example of conflicts of interest is when an ESG evaluation and data provider provides paid consulting services to the company subject to the evaluation.

Consulting services are meaningful from the perspective of making companies aware of their ESG initiatives and improving them. However, when simultaneously giving an evaluation to a company that receives a paid service, in general, it could incentivize the ~~institution~~ provider to give a relatively good evaluation to such company. In addition, when the evaluation and question items are excessively complex and a sufficient evaluation cannot be obtained without effectively receiving the paid service, it is particularly necessary to pay attention to the possibility that the business structurally may raise the possibility of conflicts of interest. Regardless of this, it is important that the questions and evaluation criteria are easy to understand for companies to be evaluated.

On the other hand, since the issuer pay model basically receives compensation from the company subject to evaluation, it has a structure in which conflicts of interest may likely to occur due to the nature of business. For this reason, it is important to implement ~~more~~ detailed procedures such as ~~stricter~~strict firewalls (e.g. separation of persons in charge of evaluation and sales) or requiring inspections by expert or upper committee in individual evaluations ~~than the subscriber pay model~~.

In addition, the management of conflicts of interest needs to be considered in conjunction with transparency. When an evaluation methodology is easy to understand from the viewpoint of a wide range of parties, such as investors and companies, the objectivity of the evaluation can be relatively-easily ensured and the risk of conflicts of interest can so be reduced. On the other hand, when the evaluation items are diverse or complex, or when there are many aspects~~, such as~~ relying on individual qualitative judgments, then the discretion of the institutions or employees involved in the evaluation relatively increases and it potentially raises the risk of conflicts of interest. Also, when using information related to evaluation for other services, it is necessary to pay particular attention from the viewpoint of managing conflicts of interest, in addition to confidentiality treatments.

For this reason, when the evaluation methodology is complex and especially when providing paid consulting services, more detailed disclosure, together with measures to prevent conflicts of interest, is important.

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

Guidelines

In order to implement Principle 4, ESG evaluation and data providers should take necessary measures such as:

1. While giving necessary consideration to intellectual property, etc., ensuring the transparency of their services by recognizing that it is an essential and prioritized issue.

2. In order for users of ESG evaluation and data provision services to understand the basic content of the services, including what the evaluation aims to capture and how this is measured, disclosing the ~~philosophy~~basic approach for providing services, including the purpose~~, concept,~~ and basic methodology of evaluation.

3. In order to enable users and companies subject to evaluation to understand the basic structure of the evaluation, disclosing sufficient information on the methodologies and processes for formulating the evaluation, including any major updates on them, if any. When inquiries are received from companies subject to evaluation through a contact point, providing careful explanations to the extent practically possible.

4. Disclosing the sources of information that are used in the development of ESG evaluation and data. In particular, if estimated data is used, disclosing this fact and the basic methodology of estimation. I~~; i~~f data sources and/or items are diverse or of great numbers, doing ~~this~~ these in a reasonable scope and manner, such as by consolidating or limiting the scope, reflecting their importance and usefulness.

5. Disclosing, in an easy-to-understand manner, the purpose, concept, and basic methodology of the evaluation; doing this in a reasonable scope and manner, such as by consolidating or limiting the scope, taking into consideration a provider's situation

and the importance and relevance of individual items. The items are for example the following:

- Purpose, approach, and intent of formulation of ESG evaluation and data
- Specific ~~details~~contents of evaluation methodologies (~~detailed~~specific evaluation criteria, important indicators and weights in evaluation, businesses and companies subject to evaluation, and other contents of methodologies that can lead to significant differences in evaluation results)
- Evaluation process (evaluation procedures and steps, checks and monitoring, etc.)
- Contact point where the evaluation results can be explained in detail
- Sources of information on which the evaluation is based, policy and status of estimated data usage, the update timings and estimation methodologies of data that is particularly important to the overall assessment
- With respect to the overall evaluation, the timing of evaluation and the timing of data creation, use, and update
- Changes made when the evaluation methodology is updated. Especially if any items are improved through the PDCA cycle, this fact and reasons for it.

Concept

~~In addition to ensuring the quality of ESG evaluation and data, e~~Ensuring transparency is extremely important as it leads to ~~improvement~~ improving ~~in~~ the reliability and understanding of data and evaluation among market participants and ensuring the quality of ESG evaluation and data.

For this reason, it is important for ESG evaluation and data providers to recognize that ensuring transparency is an essential priority issue and respond to it, while giving necessary consideration to transactions such as intellectual property.

To ensure transparency, in addition to evaluation methodologies and processes, it is important to publicly clarify the ~~philosophy,~~basic approach, including the purpose~~, approach,~~ and basic methodology of the evaluation that the methodologies are based upon.

ESG issues are wide-ranging, and there are various approaches to evaluation. For example, even when assessing the financial impact of ESG initiatives, there are different approaches to be used between when evaluating ESG-related risks and when evaluating the creation of future enterprise value based on ESG elements.

Therefore, it is necessary to clarify the basic concepts of evaluation, such as from what perspective evaluations are conducted, what they would capture, and how they would measure. By clarifying this ~~philosophy~~basic approach on evaluation, investors and other users of evaluation as well as companies that receive evaluation can easily gain a sense of understanding about the reasons for the evaluation results. Such sense of understanding is likely to lead to greater use of ESG evaluation results and to incentivizing improvement by companies evaluated.

At the same time, on evaluation methodologies, it is important to providing basic information on how evaluations are determined. It is pointed out that if evaluation methodologies are disclosed in excessive detail, intellectual property, business knowledge, and originality and ingenuity in evaluation methodologies may be lost. While paying attention to this point, it is important to disclose sufficient information to enable a wide range of users and companies subject to evaluation to understand the basic framework and reasons for drawing results. It is also important to disclose the details of any major updates in evaluation methodologies. In particular, in the case of improving evaluation methodologies through the PDCA cycle, it would be useful to disclose the reasons for the revisions so that the relevant parties can easily understand the evaluation issues and points for improvement.

Information sources used to develop ESG evaluation and data are also important in light of confirming the basis of evaluations. Similarly, when using estimated data, it is important to disclose when and how the estimated data is prepared and used. If data sources and/or items are diverse or of great numbers, it is possible to do this in a reasonable scope and manner, such as by consolidating or limiting the scope, reflecting their importance and usefulness.

As stated in Principle 6, it is important for ESG evaluation and data providers to address, in a timely and appropriate manner, important or reasonable issues raised by evaluated companies with respect to the information sources used for the assessment. In order to facilitate such mutual communication, the information sources and update dates of data are important. In addition, if it is disclosed that the company's own disclosure is used as a source of information, this may further incentivize the company's disclosure.

Some evaluation and data providers are already making creative efforts with regard to these disclosure items. However, in order to provide effective information to a large number of companies and users, it is important to disclose them in a comprehensive and easy-to-understand manner to the extent practically possible.

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With regard to ensuring transparency by ESG evaluation and data providers, there can be two types of information: information that should be disclosed to the general public and information that should be disclosed or explained only to customers or companies subject to evaluation.

For example, general matters, such as evaluation objectives, basic methodology, and evaluation procedures, may be made generally transparent for a wide range of stakeholders, while specific matters, such as details of data used for evaluation, may be disclosed only to the parties concerned. The latter may include cases such as where disclosure to the general public would involve the rights of the parties concerned, or where disclosing and examining every specific information about a large number of services would be burdensome on both the provider and the user of information. It would be possible, for example, to consolidate information, especially general information, on multiple services and provide them accordingly.

While this Code of Conduct basically assumes general publication, each ~~institution~~ provider should be able to make appropriate judgments including other ways of disclosures as described in footnote 28~~23~~, in light of the characteristics of such information and the type and number of services, etc.

With regard to generally-disclosed information, it would also be important, for example, when a company makes an inquiry subject to evaluation, to provide more detailed or the-company-specific information to the extent practically possible.

Furthermore, the level at which transparency is required also depends on the services provided. For example, in cases where the evaluation relies on many items with large room for the judgment or largely relies on qualitative judgement, it is important to present the basic concept of evaluation more carefully than in other cases.

On the other hand, with respect to services that usually involve provision of data that is less dependent on qualitative judgment, such as services in which the degree of processing of information is minimal and data utilized is mainly composed of publicly-disclosed information by companies, supplemented with a few estimates, simpler disclosure, such as disclosing basic processes in conjunction with other similar services would fully be expected.

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.

Guidelines

In order to implement Principle 5, ESG evaluation and data providers should take necessary measures, when they acquire non-public information in the course of business, such as:

1. Establishing, disclosing and implementing the policies and procedures to protect information provided as confidential in the course of ESG evaluation and data services.

2. Establishing, disclosing, and implementing the policies and procedures so that such confidential information will be used in accordance with the purpose of provision and not for the purposes other than ESG evaluation and data services, unless otherwise agreed.

Concept

So-called fair disclosure rule of the Financial Instruments and Exchange Act stipulates that when companies communicate non-public information that has a material impact on investors' investment decisions to securities companies, financial institutions, credit rating agencies, analysts, attendees of IR briefings, etc., the company is, in principle, required to disclose such information to the public at the same time.[29]

As the information on ESG-related business strategy are increasingly integrated in investment decisions, and the importance of ESG-related information increases, ~~thus more~~more market participants seem to think that due consideration should be given to the fair disclosure rule ~~among those involved in ESG investment.~~. It is noted that the materiality of ESG information, such as whether and how the information may affect the

[29] With respect to this rule, FSA Guidelines for Fair Disclosure Rules clarifies that
- information exchanged during constructive discussions between management and investors regarding corporate strategy, general business information provided at briefings, and detailed breakdowns and supplementary explanations of already publicly disclosed information are not, in themselves, subject to the rule,
- however, if such information exchange includes prior information that is likely to have a material impact on the value of securities, such as profit projections and changes in business performance, it may be subject to the rule.

value of securities, may vary depending on the field such as decarbonization, environmental protection, and gender diversity.

In these circumstances, it is pointed out that some companies pay careful attention to exchange of information in the dialogue with evaluation providers, while other companies proceed dialogue with as detailed information as possible while keeping compliance with laws and regulations.

Given these situations, some ESG evaluation and data providers have adopted their policy of not obtaining non-disclosure information.

With this background in mind, when conducting an evaluation based on information obtained from a client on the premise of confidentiality, ESG evaluation and providers should pay attention to ensure that the confidential information is not disclosed to other users or related parties in the end (in case providers decided not to obtain non-public information, they need not to establish same controlling framework as in the case of handling non-public information.).

In particular, as frameworks for sustainability disclosure in and outside Japan develop and data is standardized over time, added value could become increasingly important, potentially including the use of non-public information, therefore confidentiality is expected to be a key element.

Constructive dialogue among ESG evaluation and ~~rating and~~ data ~~providing organizations~~ providers, investors, companies, etc. is highly important from the perspective of improving the overall market, relevant parties are expected to actively engage in dialogue while mutually respecting compliance with laws, regulations, and contracts, etc. ~~(see P. 35, 36).~~

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 ~~that~~ 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.

Guidelines

In order to implement Principle 6, ESG evaluation and data providers should take necessary measures such as:

1. When and if collecting information through surveys from a company subject to evaluation, notifying the company of the collection period sufficiently in advance. If available and where appropriate, entering, prior to the request, information that is already known to the providers, such as those publicly disclosed or submitted in the past, then seeking verification by the company in question.

2. Establishing a dedicated contact point where companies can send inquiries and raise issues regarding ESG evaluation and data provision, and informing the companies concerned or posting it in an easy-to-find manner.

3. When disclosing ESG evaluation and data, subject to the institution's evaluation methodologies and customer service policies, to the extent practically possible, expeditiously notifying or communicating to a company of the essential information sources of the evaluation and data, thereby allowing time for the company to check whether there are any significant deficiencies in the sources, such as factual errors.

4. When a company subject to evaluation raises important or reasonable issues about the information source of evaluation and data, subject to its own evaluation methodologies and customer service policies, taking timely and appropriate measures such as allowing the company to at least ~~confirm~~assess the accuracy of the underlying important data and correcting errors if any.

5. As an ESG evaluation and data provider, disclosing a "procedures of engagement" regarding how it normally interacts with companies to be~~ing~~ evaluated with respect to the evaluation and data it provides. The procedures would include elements such as when it requests information from companies, when and what companies could check with, how they could raise issues if any, and how the ~~institution~~ provider would be able to respond to such issues.

6. Subject to providers' evaluation methods and customer service policies, considering the necessity of managing conflict of interest, and to the extent practically possible, conducting constructive dialogue with companies to be evaluated (for example, by providing feedback on evaluation results)

Concept

Smooth communication between ESG evaluation and data providers and companies subject to evaluation is an essential element for providing evaluation and data services in an efficient, effective, and sustainable manner.

With regard to the subscriber pay model, since it is common that ~~for the~~ evaluations are not ~~to be~~ based on a request from the company subject to evaluation, etc., smooth communication with the company is particularly important, in addition to providing information to general stakeholders, investors.

IOSCO report and the Technical Committee have pointed out issues regarding the current state of communication between evaluation providers and companies, especially on the subscriber pay model. It is important for evaluation providers to disclose the overall picture of how evaluation providers normally engage with companies to be evaluated (such as publishing terms of engagement).

Furthermore, it is important to carefully deal with matters that may significantly reduce the administrative burden on the companies subject to evaluation even if they might appear trivial, such as sharing schedules, entering necessary information, and understanding basic matters such as basic management policies in advance, and preparing possible responses for inquiries from companies.

In addition, it is important to establish a dedicated contact point through which companies can send inquiries and raise issues regarding ESG evaluation and data, and allow companies to at least ~~confirm~~assess the accuracy of the underlying data (input) when companies subject to evaluation ask questions or raise important or reasonable issues regarding the basis of evaluation and data, subject to its own evaluation methodologies and customer service policies.

Companies voluntarily provides information to evaluation providers and evaluation providers provide their services based on this information. Therefore the providers may, as each provider's original measures, provide feedback with companies, on areas such as companies' issues or comparison with other companies, based on the originality and ingenuity of each ~~institution~~provider, which would eventually benefit the market as a whole, including companies subject to evaluation.

In principle, ESG evaluation is conducted by evaluation providers in line with their own objectives and methodologies, and the views and perspectives on evaluation would not necessarily be identical among providers, as well as between companies and providers. It should be noted that the ESG evaluation, data, and other final products are the products issued by the providers, while taking into account communication with companies and other parties, under the own responsibility of ESG evaluation and data providers. In light of this, it would therefore be important that evaluation providers, in line with their own policies, elaborate their basic approach of evaluation and reasonably explain that they are conducting their evaluations appropriately based on such approach.

In any case, building trust between the ~~institution~~ provider and the company is important in a sense that it helps improve the quality of evaluation and encourage the company for the better, and serves as a basis for dialogue that brings positive changes in corporate behavior.

It is expected that providers publicly disclose the objectives and ~~philosophy~~basic approach of evaluation, work toward mutual understanding through interactive communication, and accordingly, a company is expected to promote the importance of ESG evaluation across the organization.

With that being said, while close communication between the ~~institution~~ provider and the company can improve the quality of evaluation and promote the efforts of the company, attention needs to be paid to ensure that the neutrality of evaluation is not undermined.

It is also pointed out, as a matter of fact, the burden of communication with companies exceeds the capacity of evaluation providers due to the large number of coverage. In such cases, for example, evaluation providers could disclose the basic policy of responses as much as practically possible beforehand and to set up a dedicated person in charge of communication.

* The following sentences are not parts of the "Code of Conduct for ESG Evaluation and Data Providers," but those that provide, as reference, excerpts from the Technical Committee’s report on recommendation to investors and companies published on July 2022, based on the its statement that improvement throughout the entire investment chain is essential for better use of ESG evaluation and data.

(Reference)~~Appendix~~

- Excerpts from the Technical Committee's report on recommendation to investors and companies -

Recommendations to investors

Concept

For investors[30] who use ESG evaluation and data, when making investment decisions in accordance with their own policies or those of asset owners and beneficiaries, it is important to publicly clarify how ESG evaluation and data is used in investment decisions.

For this purpose, it is important that they carefully understand the characteristics and differences of evaluations that differ by an evaluation institution. In particular, in the case of the subscriber pay model where there are many companies subject to evaluation and a wide range of sources of information, it is important to understand under what policies each institution conducts evaluation.

Based on this understanding, it would be the sake for investors to actively engage in dialogue with providers and companies when there is a gap between the evaluation policy and the results of each evaluation. In general, it would be important for investors, in order to make appropriate decisions based on their investment policies, that evaluation and data providers take appropriate steps to ensure services' quality with an appropriate consideration.

In addition, as investors, taking into account the revision of the Stewardship Code, it is important to disclose how they consider ESG in their investment, as well as their approach on their use of ESG evaluation and data for investment.

These investors' disclosure would enable companies to gain a concrete understanding of what business benefits improvements in evaluation results would bring about. Investors are expected to play a role in supporting companies' efforts through disclosure and dialogue with companies.

In addition, encouraging companies' understanding and efforts would enable evaluation providers to constructively and concretely conduct dialogue with companies.

[30] As noted above, as "investors," this Code assumes institutional investors. Since there are various entities among institutional investors such as asset owners and asset managers, they are expected to respond to the recommendations in accordance with their characteristics. As providers of funds, the recommendations can serve as reference also for providers of loans.

In recent years, an increasing number of investors use multiple evaluation providers, and compare evaluation results between the providers, together with investors' own perspectives[31]. In some cases, investors even set industry-specific KPIs or provide ratings by themselves (investors' in-house evaluations). It would be desirable for investors, and from the viewpoint of improving the entire investment chain, to clarify how they conduct in-house evaluations if any as part of their approach on the use of ESG evaluation and data.

When investors engage in dialogues with evaluation providers and companies, considering the purpose of this Code, it would be important for investors to utilize evaluation results in a manner enabling constructive dialogue with investee companies on their strategies, policies, and business environment, instead of mechanically adopting and using the evaluation results the evaluation providers issue.

In addition, while ensuring smooth communication, it is important to give appropriate consideration to the independence of evaluation by evaluation providers and the necessity of compliance with confidentiality and other related regulations by evaluation providers and companies.

Based on the above, the Technical Committee makes following recommendations:

Investors should carefully examine and understand the purpose, methodologies, and limitations of ESG evaluation and data they utilize for their investment decisions. When there are issues in the evaluation results, they should engage in dialogue with ESG evaluation and data providers or companies.

In addition, investors should publicly clarify the basic approach of how they utilize ESG evaluation and data in their investment decisions.

Specific recommendations

1. Investors should understand the basic objectives and policies of ESG evaluation and data they utilize for their investment decisions. They also should understand the evaluation and data's methodologies and limitations such as:
   - sources and timing of data used for evaluation, and estimation methodologies,

[31] Progress Report on Enhancing Asset Management Business 2022, Japan FSA https://www.fsa.go.jp/en/news/2022/20220527.html

- degree of quantitative and qualitative judgments, verifiability, consistency with other evaluation criteria,
- considerations and limitations when using such evaluation and data

If there is an unreasonable gap between the evaluation's policies and the results, investors should hold a dialogue with evaluation providers and the companies.

2. Investors should clarify how they utilize ESG evaluation and data, the way of use investment decisions in the case of active investing, and the way of selection of target indices in the case of passive investing, specifically such as:
   - what kind of ESG evaluation and data are used for what purpose in order to make investment decisions,
   - importance of the ESG evaluation and data in investment decisions,
   - data that is emphasized or matters that are particularly noted, if any,
   - reasons for selecting specific ESG indices for passive investing.

   Similarly, when an investor conducts and utilize in-house ESG evaluation in investment decisions, they should similarly disclose, along with above points, the criteria, purpose, and usage of the in-house evaluations, also in consideration with their fiduciary responsibilities.

3. Smooth and constructive communication should be conducted with ESG evaluations and data providers and companies with a view to improving the quality of evaluations. In doing so, care should be taken not to give impression to providers or companies that investors are exercising undue influence in individual evaluations in the context of their business relationships, etc.

Recommendations to companies

Concept

For companies subject to ESG evaluation and data collection, it is important to position sustainability-related issues as integral to maintaining and improving their medium- to long-term corporate values, and to take action as such.

With this in mind, it is important that they disclose and enhance information on their management strategies, policies, and initiatives in an easy-to-understand manner.

With regard to ensuring the quality of data, if there is an error when the ESG evaluation and data provider transcribes the data disclosed by a company, the responsibility would rest with the provider. Beyond that, however, the quality of data disclosed by a company is, obviously, primarily dependent on the company. The company therefore needs to ensure under appropriate system the quality of data it discloses.

Whether ~~A~~a company's information would be perceived as disclosed in an easy-to-understand manner can vary depending on the recipient of the information. In the discussions in the Technical Committee, some ESG evaluation and data providers pointed out, as essentials for easy-to-understand disclosure, that i) companies timely disclose information they themselves think would be important, ii) the disclosure covers entire corporates group including non-financial information, and iii) companies construct their websites in a manner investors or others could smoothly identify information in question.

Disclosure of corporate information is extremely important in the entire investment chain, as it forms ESG evaluation and data and serves as the basis for decisions by investors and providers.

Given much of ESG information is currently so-called unstructured data (data with no clearly defined structure such as the form and order of items), easy-to-understand disclosure could significantly improve the quality of evaluation and data by facilitating data compilation and examination.

In light of the significance of company information in the entire investment chain, and in order to have market participants accurately understand companies' strategies and initiatives, companies need to constructively provide information and engage in dialogue with various stakeholders.

In particular, while understanding that the approach to evaluation would differ among providers, if there are any issues in evaluation in light of providers' disclosed policies, companies should encourage providers' improvement through constructive dialogue. For example, when there is a problem in ESG evaluation or data for a company, the company should communicate with a provider for the evaluation and data and ask it to check the accuracy and timing of the information used for the evaluation, thereby contributing to the improvement of the quality of ESG evaluation and data.

With this in mind, basically, ESG evaluation is a service provided by an evaluation providers based on their own objectives and methodologies, and therefore the views and perspectives on evaluations are not necessarily the same among providers as well as between companies and providers.

When the basic approach to evaluation is clarified and appropriate evaluation is conducted based on this approach, it would be essential to understand that differences in the approach would remain in the end, and that given this perspective promoting mutual understanding and finding a practical solution would be rather important.

In addition, in order to provide information and facilitate dialogue, it is important for companies to establish and disclose a contact point where providers can make inquiries to the company when they have questions about company information, etc., in the same way as described in Principle 6 in the case of ESG evaluation and data providers.

While ensuring smooth communication, it is important for companies to give appropriate consideration to the independence of evaluation by evaluation providers and compliance with confidentiality and other related regulations by evaluation providers and investors.

Based on the above, the Technical Committee makes following recommendations:

Companies should disclose ESG information in an easy-to-understand manner, taking into account regulatory and other updates.

Specific recommendations

1. Companies should organize and disclose their ESG-related information in an easy-to-understand manner by, for example, organizing important matters for the entire company from the perspectives of both risks and opportunities and providing them in a form that is easy for market participants to identify the essentials. Companies should ensure the quality of the ESG information they disclose under an appropriate system.

2. Companies should disclose timing information in their websites and publications, such as the date of update of publicly disclosed content.

3. Companies should disclose a contact point, such as e-mail address, for responding to inquiries from domestic and foreign ESG evaluation and data providers regarding the company's strategy and policies.

4. Companies should provide sufficient opportunities for persons in charge of dealing with ESG evaluation and data providers to acquire knowledge on ESG issues that would clearly be necessary for the execution of their duties, as well as nurture personnel that have professional knowledge on ESG-related issues.

5. Companies should smoothly and proactively communicate with ESG evaluation and data providers and investors in order to improve the quality of evaluations. In particular, when there are issues in the evaluation in light of the policies clarified by the evaluation ~~institution~~provider, companies should encourage improvement through constructive dialogue. In doing so, companies should be careful not to give impression to ESG evaluation and data providers that they are exerting undue influence on individual evaluations in the context of their business relationships, etc.