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Impact Investment & Fiduciary Duty

Consideration of the legal environment for the GPIF to engage in impact investing

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The PRI, a UN initiative launched in 2006 as an ESG investment platform, has stated in its 2017 Blueprint[1], which outlines its strategy for the next 10 years, that "we aim for a world where the SDGs are realized". It has taken a step away from responsible investment, and has moved towards promoting impact investment with the intention of contributing to the SDGs, including publishing guidance[2] for signatories. Impact investment is an investment that aims to solve social and environmental issues (SDGs), such as those defined by the United Nations, through investment, in addition to conventional economic returns.

In order to solve the SDGs by 2030, which is the time frame set by the United Nations, "between 5 and 7 trillion dollars are needed, but if the current situation remains unchanged, the amount will be reduced to 2.5 to 7 trillion dollars per year.
However, at the current rate, it is estimated that there will be an annual shortfall of $2.5 trillion, mainly in infrastructure investment in emerging economies[3].

However, the GPIF (Government Pension Investment Fund), a PRI signatory with assets of 201 trillion yen (as of the end of 2021), states that it does not engage in impact investments[4]. As the GPIF should invest "exclusively for the (financial) benefit of the insured and from a long-term perspective," the relationship between the pursuit of impact targets and fiduciary responsibility is complex. Then the report was compiled by PRI and published as the LFI project in July 2021. The following section discusses the overlap between ESG investments made by the GPIF and impact investments.

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1 https://www.unpri.org/download?ac=2973

2 https://www.unpri.org/download?ac=6517

3 UNDP(2017)Impact investment to close the SDG funding gap. UNDP Business Solutions for the SDGs. How private sector and UN can partner to achieve the Global Goals

4 https://www.gpif.go.jp/investment/GPIF_ESGReport_FY2020_J.pdf

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1.1 The evolution from ESG investment to impact investment

Pension funds in Japan have until now been positioned as fulfilling one of the functions of a welfare scheme. However, since the Abe Administration's Growth Strategy redefined a pension fund as an "asset owners" which is an institutional investor, they are now expected to play a role at the top of the investment chain. The role is to influence the way business activities are conducted through asset management in order to protect the interests of beneficiaries from negative externalities, such as environmental and social damage caused by business activities. The compatibility between long-term economic stability and sustainable livelihoods, which is a precondition for the interests of beneficiaries (especially future generations), is now threatened by, for example, increasing climate change risks, loss of biodiversity, growing inequality, lack of gender diversity and dysfunctional corporate boards of management. Beneficiaries' livelihoods would not be possible without the sustainability of the environment and the various mechanisms that make up society. Pension funds, as institutional investors, are therefore increasingly required to evolve their investments in line with the changing role expected of asset owners, while adhering to the principle of fiduciary responsibility, in order to safeguard the environmental and social sustainability under threat.

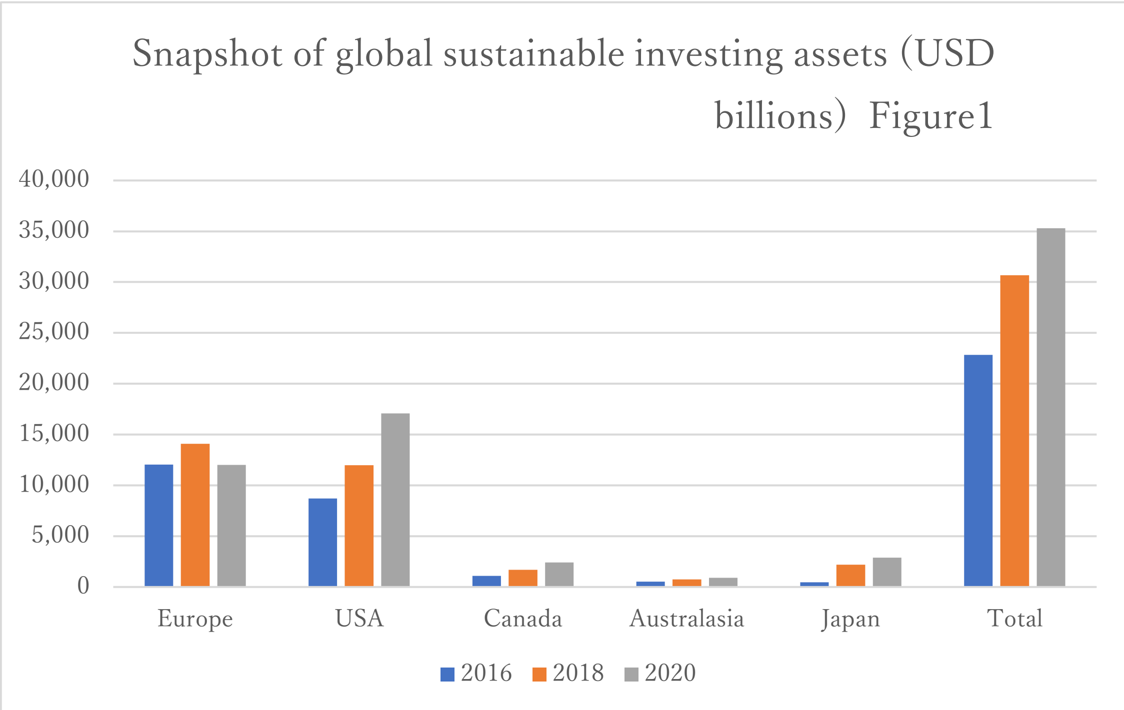
Globally, the number of asset managers who have signed up to the Principles for Responsible Investment (PRI)[5], has increased rapidly in recent years. Academic research has not yet established whether ESG investment improves long-term returns, but it is believed to have a risk-reducing effect. Accordingly, ESG considerations have become an industry standard in asset manager practice, as asset owners and other clients increasingly demand that ESG considerations are taken into account in the management of their assets[6]. The Global Sustainable Investment Alliance (GSIA), which aggregates global ESG investment balances, has announced that by 2020, total global ESG investment will amount to USD 35.3 trillion, a

[5] https://www.unpri.org/download?ac=10971
[6] From Russell Investments 2021 ESG Manager Survey
https://russellinvestments.com/jp/blog/2021-annual-esg-manager-survey

55% increase on the 2016 total. This represents 35.9% of all assets under management of the institutional investors surveyed and is on the rise. This means that approximately 40% of all global assets under management now fall into ESG investments.

The PRI's promotion of the Principles for Responsible Investment has thus taken a giant leap forward in a quarter of a century to over 4000 institutional investors signing on. “It is not the same as ethical investment, socially responsible investment or impact investment[7]", the PRI states that it will "promote impact integration", as it will not be fulfilling its responsibility to invest responsibly unless the actions of investee companies actually move in the direction of contributing to the SDGs[8].

Figure 1



Source: Global Sustainable Investment Alliance 2021
“GLOBAL SUSTAINABLE INVESTMENT REVIEW 2020”

Impact investing is "investment that is intended to generate positive and measurable social and environmental impacts simultaneously alongside economic returns. Investment decisions are based on a three-dimensional assessment of risk, return and impact."
The four elements of impact investment:

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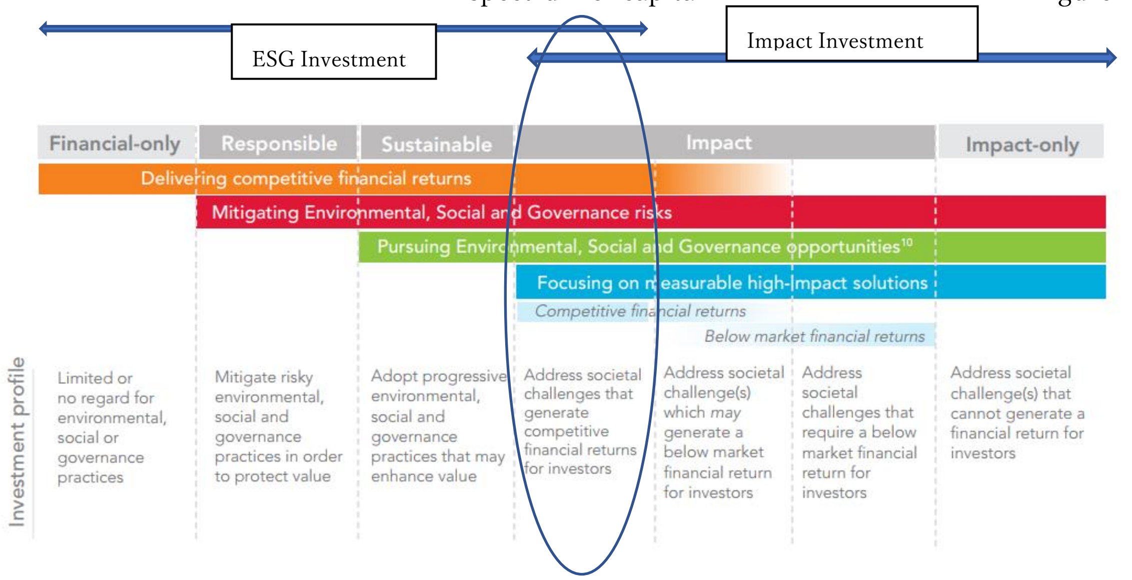
7 Principles for Responsible Investment (2018) p4

8 Interview with PRI board member, ESG investment in 2022 - focus on impact and fulfil your responsibilities, Nikkei ESG. Jan. 19th 2022

(1) Intentionality
(ii) Financial Returns
(iii) Range of asset classes
(iv) Impact Measurement (social impact assessment)[9]

ESG investments aim to reduce long-term risk and maximise returns, whereas impact investments have the explicit intention of addressing specific social issues. ESG investment is a framework that aims to improve economic returns in the "two dimensions of risk-return". In other words, the logic is not to invest for social impact, but to invest in companies that are environmentally, socially and governance-conscious, which will generate higher returns in the long term. Impact investment, on the other hand, is a three-dimensional framework with the intention of solving specific social issues (to varying degrees).

A spectrum of capital Figure2



Source: Based on "Allocating for Capital" by G8 Social Impact Investment Task Force, Japanese National Advisory Committee for GSG devised this chart[10]

Previously, impact investment has been small-scale investments in private equity, private debt and other forms of funding for unlisted companies and community projects to solve social issues, and it has been practically difficult for institutional investors, including large pension funds, to engage in such investments in terms of liquidity and transparency. In recent years,

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[9] SIIF Fumi Kanno, CFA Japan webinar, 'Introduction to impact investing - latest global and domestic trends' (11.5.2020).

[10] https://impactinvestment.jp/user/media/resources-pdf/impact_investment_report_2019.pdf

however, there has been a gradual increase in large-scale impact investments, mainly by asset managers in Europe and the US, using green bonds, social bonds and sustainability bonds, which are newly introduced to the capital markets as bond investments, and listed equities as equity investments, also known as mainstream impact investments[11]. This has opened the way for long-term investment in companies that are working to achieve a sustainable society on a global scale with regard to social issues that contribute to the achievement of the SDGs, such as climate change and water conservation, which need to be addressed on a global scale.

The GSG (Global Steering Group for Impact Investment) Japanese National Advisory Committee, established to promote ESG investment, classifies ESG investment and impact investment as shown in Figure 2. ESG investment and impact investment are adjacent concepts, the key point being that impact investment is an investment that also pays attention to social issues and aims to achieve both social outcomes and economic returns. The difference between ESG investment and impact investment is that while the ultimate objective of ESG investment is to maximise economic returns, impact investment evaluates social returns, or impact, quantitatively and qualitatively. However, a closer look at Figure 2 shows that **ESG investment and impact investment overlap in some areas. In other words, some ESG investments generate market-competitive economic returns while at the same time providing environmental and social returns, i.e. they are sustainability impact investments.**

The SDGs, unanimously adopted at the UN Summit in 2015, are globally agreed goals to address pressing global challenges such as poverty, hunger, energy, climate change and peaceful societies. SIIF (Social Innovation Institute Foundation in Japan) Kanno summarises IFC (International Finance Corporation) data as follows: "ESG investment alone is not sufficient to achieve the SDGs, and impact investment is expected to make a significant contribution:

1) SDGs as goals: IFC estimates that the SDGs are being used as a universal framework to assess impact, but that $2.6 trillion is insufficient to achieve the five main goals, and governments and international organisations are promoting the use of private capital.

2) Business opportunities from the SDGs: The IFC estimates that the economic value of SDG-related businesses is approximately USD 12 trillion per year, and it is necessary not only to link existing businesses to the SDGs but also to create and expand new businesses that contribute to solving social and environmental challenges.

3) Investment opportunities through the SDGs: Individual investors, especially millennials

[11] PRI, Impact Investing Market Map, 2018 https://www.unpri.org/download?ac=5426

and Gen Z, are becoming increasingly impact-oriented, while institutional investors are seeking to discover new investment opportunities. There is a need for financial products that contribute to increasing the impact of new businesses that help solve social and environmental challenges[12].

In corporate financing, investors have the power to influence private companies to change their behaviour, which in turn drives them to shift to sustainable business models. In fact, an increasing number of companies listed on the Prime Market of the Japanese stock exchange are now discussing their medium to long-term plans for enterprises in relation to the SDGs, and engagement with institutional investors is increasingly focusing on how the companies in which they invest can contribute to the SDGs. This is because the SDGs expect private companies as the main actors in solving social issues, and if each company takes on business activities that are appropriate for their company among the 17 SDGs, this will create 'shared value'. This will lead to a sustainable increase in corporate value, which in turn will lead to a higher long-term return on investment for investors.

Many institutional investors actually want to include the SDGs in their investment perspectives, and asset managers are increasingly aware of the importance of SDG-oriented investment. For example, an investor survey in Share Action's 2016 Transforming our world through investment found that many institutional investors recognised the importance of the SDGs, stating that "following the SDGs is not only good for their reputation, but also improves their investment returns[13]". 95% of respondents plan to undertake SDG-related engagement, 84% intend to allocate funds to investment projects to achieve the SDGs and 89% support regulatory reforms to achieve the SDGs.

The UNDP (United Nations Development Programme) is promoting an initiative called 'SDG Impact[14]' , which aims to organise and certify investment criteria that contribute to the achievement of the SDGs in order to increase the flow of private capital towards the achievement of the SDGs. The first pillar, 'Impact Management', is a set of measurement and management criteria that investors can refer to when making investments to realise the SDGs, and when they do so, they are issued with an 'SDG Impact' seal. The second Pillar, 'Impact Intelligence' is an investor publication developed by the UNDP Secretariat in each country

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[12] SIIF Fumimi Kanno, Japan CFA Association webinar, 'Introduction to Impact Investment - Latest Trends in the World and Japan', 11 May 2020

[13] https://baringfoundation.org.uk/blog-post/transforming-our-world-through-investment/

[14] https://www.jp.undp.org/content/tokyo/ja/home/sdg-impact.html

that focuses on a sector, region or other theme in that country. The third pillar, 'Impact Facilitation', is a networking initiative in which the UNDP Secretariat matches SDG investors with investee companies, bringing them together.

The PRI, which promotes impact investing, published a booklet, "The SDG Investment Case", in 2017 to address the question of why the SDGs are relevant to institutional investors. The SDGs clearly define what these social goals are. Five points are listed as answers to why the SDGs should be taken into account:

i) The SDGs are a globally recognised sustainability framework
ii) Macro risks: the SDGs force 'universal owners' to consider
iii) Macro opportunities: the SDGs drive global economic growth
iv) Micro risks: the SDGs are a framework of risks
v) Micro opportunities: the SDGs guide capital allocation

The SDGs are globally recognised common goals to 2030. As a universal owner, failure to achieve the SDGs will inevitably have a negative impact on its portfolio, as it will adversely affect all countries and industries and lead to macro-financial risks. Conversely, achievement of the SDGs will lead to global economic growth and ultimately to higher portfolio returns. In the micro context, the SDGs are also a risk framework, whereby external dis-economic costs, such as environmental damage, are bounced back to the company. Conversely, growth opportunities for companies that contribute to sustainability will increase with the achievement of the SDGs, which will lead to higher returns in all asset classes.

Impact investing is also said to be of growing interest to retail investors as the presence of Millennials and Gen Z investors grows. The SIIF, the secretariat of the GSG Japanese National Advisory Committee, has been continuously monitoring public awareness of impact investing and interest in actually making impact investments since 2019. According to the survey, around half of the respondents have invested before, but around 20% (17.2%) of consumers are interested in actually making an impact investment. Interest in impact investing is particularly high among those in their 20s and 30s with investment experience, and more than 70% of potential customers are positive about impact investing by the institutional investors who manage their assets[15].

However, according to a report by GIIN (Global Impact Investing Network), **the global**

[15] 2021 Consumer attitude survey on impact investing by SIIF

market for impact investing is still only USD 715 billion in 2020, although data show a 40% year-on-year increase[16] , and represents only 2% of total ESG investments. This is only about 2% of the total ESG investment balance.

So why is the balance of impact investment still so small? There are several possible reasons:
i) Insufficient awareness of impact investing across the investment chain.
ii) Methods for evaluating impact investment performance are immature.
iii) Insufficient disclosure of environmental and social data on impact investment outcomes
iv) Undeveloped relationship between impact investing and fiduciary responsibility.

This paper will therefore focus on the relationship between 'impact investing and fiduciary responsibility'.

2. the PRI's approach to 'impact investing and fiduciary responsibility'

The PRI, UNEP-FI and the Generation Foundation have developped “A Legal Framework for Impact: Sustainability impact in investor decision-making", prepared in collaboration with Freshfields Bruckhaus Deringer LLP ("Freshfields Report") in 2021. It analyses the impact of the legal framework on investment decisions with sustainability impact in 11 regions/countries (EU, Australia, Brazil, Canada, China, France, Japan, South Africa, Netherlands, UK and USA). It discusses whether the pursuit of impact investment goals is contrary to fiduciary responsibility.

This report represents the third generation of fiduciary duty considerations. The first generation report, issued in 2005 by the same law firm, concluded that 'it is clearly permissible, and even required, to consider ESG factors for investment returns'[17]. This is said to have resulted in the launch of PRI in 2006. The second generation of PRI and UNEP-FI research went further, concluding that "failure to consider ESG factors affecting corporate value in investment practice is a breach of fiduciary responsibility".

This third-generation report focuses on impact investing, but uses the term 'investing for sustainability impact' (IFSI) rather than ‘impact investing’. This **IFSI is defined as "an investment approach that seeks to deliberately influence the behaviour of investee companies**

[16] https://impactinvestment.jp/impact-investing/market.html
[17] Freshfields Bruckhaus Deringer LLP（2005）”A legal framework for the integration of environmental, social and governance issues into institutional investment”

and third parties in a measurable way". If an investment provides economic, environmental and social objectives at the same time, it may be included in impact investment.

IFSIs are classified into two types: - Instrumental IFSIs: where the achievement of sustainability impact targets is a means to an operational return objective.
-Instrumental IFSIs: where achieving sustainability impact targets is a means to an operational return target.
-Ultimate ends IFSI (IFSI): where the creation of sustainability impact is an end in itself, irrespective of the investment return target.

The conclusion of the report is that "if the former is an instrumental IFSI, then institutional investors are likely to be allowed to pursue impact because achieving specific impact targets is a means of achieving investment returns and, conversely, they pursue impact in order to achieve investment returns". In other words, the third generation of reports has revealed a positive conclusion: **'If it is effective in achieving investment returns, impact should be pursued in addition to ESG factors'**. It is envisaged that more than 4,000 signatory institutional investors worldwide will be encouraged to pursue impact investing in a way that leads to a return on their investments. While this will not immediately lead to a dramatic increase in the amount of impact investment, it is an important breakthrough, at least in terms of creating a legal environment.

３．GPIF's ESG Investment Initiatives and SDGs Initiatives

As an asset owner in Japan, the GPIF was a pioneer in the full-fledged promotion of ESG investment. An investor like GPIF, which has a gigantic amount of investments and manages a broadly diversified portfolio across global capital markets, is called a "universal owner". The pension funds managed by the GPIF are used to reduce the burden of insurance premiums on the working-age population in the future. **The GPIF is both a "universal owner" and a "cross-generational investor.**

In order for the GPIF to earn stable returns over the very long term, it is important not only that the value of individual companies in which it invests grow over the long term, but also that the capital markets as a whole to grow in a sustainable and stable manner.

The earth can no longer tolerate the damage done to the environment by corporations that have not paid the costs of their negative externalities. The negative impact of environmental problems (E), also known as "Planetary Boundary[18]," on capital markets is becoming more serious. Some companies are also experiencing significant social problems (S), such as human rights abuses, including child labor in their supply chains, where manufacturers outsource their production. There are also companies with governance problems (G), such as a dysfunctional board of directors that overlooks the CEO's misconduct, resulting in significant losses to shareholders. Thus, analyzing investments from an ESG perspective is essential to minimizing risk and pursuing sustainable investment returns.

The GPIF has been a full-fledged ESG investor since becoming a PRI signatory in 2015. The GPIF has made the PRI signature a requirement for asset managers when selecting external asset management firms. In addition, in FY2017, the company began investing in stocks based on 'ESG indices'. ESG indices are indexes in which ESG index companies such as MSCI, S&P and FTSE evaluate investee's ESG initiatives based on non-financial information disclosed by the company and decide which stocks to include in the index.

As of the end of FY2020, the total amount of assets under passive management linked to the seven ESG indices is approximately 10.6 trillion yen (as of the end of March 2021). In October 2017, GPIF revised its investment principles to promote investments that take ESG factors into account not only in equities but also in all other assets, including bonds.

Figure 3

Source: GPIF « ESG Report 2019 «[19]

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19 https://www.gpif.go.jp/en/investment/GPIF_ESGREPORT_FY2019.pdf

GPIF has summarized that ESG investment and SDG management of portfolio companies are two sides of the same coin, as shown in Figure 3[20]. The GPIF's "ESG Activity Report 2020" describes ESG & SDGs as follows:
'ESG issues considered in ESG investments and the goals and targets of the SDGs have many points in common, and as a result, ESG investments will make a significant contribution to the achievement of the SDGs. The achievement of the SDGs and the realization of a sustainable economy and society will lead to higher long-term returns for the GPIF on the assets it manages.'

However, in the column on the same page, GPIF states that the it does not engage in the impact investing:
'We will promote investments that consider ESG, and we thus integrate ESG factors into all aspects of our pension reserve management. On the other hand, GPIF does not conduct investment where the explicit purpose is to create some type of social impact, such as achieving the SDGs. As mentioned above, GPIF is required by law to manage pension reserves solely for the benefit of pension recipients from a long-term perspective, thereby helping to fund future pension benefits.
In this context, benefit is construed as economic benefit. The goal of GPIF's ESG investment is to ensure the economic benefit of pension recipients from a long-term perspective by reducing the negative impact of environmental and social issues on capital markets. For this reason, it was decided that, under existing legislation and the objective of investment behavior to be taken by the fund, GPIF would not make investments whose sole purpose was to "contribute to the solution of social problems." In general, there are many similarities between ESG investment and impact investment, and few investors may be clearly aware of the differences. We believe that GPIF's ESG investment will have an impact by enhancing companies' ESG activities and improving their ESG ratings, which will ultimately lead to the mitigation of risks and improvement of portfolio returns. Having said that, GPIF's ESG investment does not directly target social impact itself, which is the major difference with impact investment.[21]' (underlined part by author)

GPIF defines itself as a "universal owner" as well as a "trans-generational investor". As a Japanese national, I hope that GPIF will invest on the premise of maintaining a sustainable

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[20] ESG Report 2019, p8 https://www.gpif.go.jp/en/investment/GPIF_ESGREPORT_FY2019.pdf
[21] ESG Report 2020, p9 https://www.gpif.go.jp/en/investment/GPIF_ESGREPORT_FY2020.pdf

social environment that is livable for future generations. The investment period is extremely long because GPIF considers not only the current generation but also the future generation's retirement security. If the GPIF fails to achieve the SDGs by 2030 and net zero by 2050, the world in which the beneficiaries of the GPIF will live cannot be considered as a society that can be inhabited only because of the economic benefits. The risks associated with not acting now are extremely high, especially with regard to climate change, because if it moves beyond the "planetary boundary", it will be irreversible and we cannot avoid catastrophic changes.

Many of the global companies in which the GPIF invests also create KPIs to manage their progress in achieving their SDGs targets and how to align their business strategies with the SDGs. PRI has been actively communicating the importance of the SDGs to signatories including GPIF[22]. GPIF has been positive about ESG investment because the Basic Policy for Reserves (BPR), to which the GPIF adheres to, was amended to clearly state a positive approach to ESG investment. However, GPIF denies impact investment and says explicitly that *'ESG investments made by the GPIF are not directly aimed at social impact itself'* (ESG Report 2020, above).

In addition to climate change, the recent Corona Pandemic is bringing to an end the era of return maximizing within the certain risk investment schemes. There is even a view that a paradigm shift is taking place in society as a whole, in which the true purpose of investment can no longer be fulfilled unless it is accompanied by a social return. In this context, the Corona Pandemic has served as a catalyst for heightened interest in impact investing and the need to overcome new social issues through impact investing. In other words, it may be said that the future of sustainability is now in sight and impact investing can play a role in protecting a strong foundation for sustainability in the future.

GPIF recognizes that the achievement of the SDGs and the realization of a sustainable economy and society will lead to a long-term improvement in the overall return of the GPIF's assets under management. With the GPIF's mission to achieve "economic benefits," the practical choice is to implement ESG investments that address social issues as a means to improve long-term economic returns. If so, the following investments could be considered as aforementioned “Instrumental IFSI” in which "achieving sustainability impact goals becomes a means to achieve investment return goals.

[22] “SDGInvestment Case” https://www.unpri.org/download?ac=5909

For example, in bond investments, GPIF already invests in green bonds, social bonds, and sustainability bonds under the name of ESG investments, amounting to approximately 1.1 trillion yen as of the end of March 2021. This is simply a matter of classification, as ESG investments and impact investments are adjacent and overlap in some areas, as shown in Figure 2, and neither classification can be said to be wrong. For example, the "Study Session on Impact Investment" (a forum to deepen understanding of impact investment among financial market participants and government officials, and to discuss the significance and challenges of impact investment initiatives to solve social issues in Japan and abroad), jointly hosted by the Japanese FSA (Financial Services Agency) and the GSG Japanese National Advisory Committee, has been held to discuss the following topics: green bonds, social bonds and sustainability bond[23]. The purpose of the bond issue is to solve environmental and social problems, and is therefore discussed in the context of impact investing.

Recently GPIF has purchased the "Fight COVID 19" Social Bond, a corona bond issued by the African Development Bank (AfDB), as ESG investment. The project aims to support African countries in their response to the spread of the disease and mitigate the economic and social impact of the outbreak, and the funds raised through the bond issue are intended to create impact by promoting coronavirus antibody testing and supporting small and medium-sized enterprises. Similarly, GPIF has invested in corona bonds issued by the International Finance Corporation (IFC), the European Investment Bank (EIB), and the Islamic Development Bank (IsDB)[24].

There are guidelines for issuing green bonds, social bonds, and sustainability bonds, respectively, and each time they are issued, a procedure is taken to certify that the bonds are in compliance. The cost of this part of the process must be borne by the investor. For example, Japanese FSA has established a Social Bond Guideline[25]. It says the process of evaluation and selection of the social goals and projects to be realized should be explained. Even if GPIF did not have the policy intention to select the bond from the beginning, and the bond was chosen as the final choice in the process of constructing the optimal portfolio, GPIF understands how the money will be used and has information about the social goals and progress of the project as a result.

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[23] https://impactinvestment.jp/news/research/20210415.html

[24] GPIF ESG Report 2020, p. 21-22

[25] Outline of Social Bond Guideline (in Japanese)
https://www.fsa.go.jp/news/r3/singi/20211026-2/03.pdf

In equity investments, since 2017, GPIF has also been managing money based on ESG indices by creating indices as thematic investments related to several environmental and social issues, with a balance of more than 10 trillion yen as of March 2021. S&P's domestic and The MSCI Japan Women's Activity Index and the Morningstar Gender Diversity Index for Developed Countries (excl. Japan) are indices that assess companies' efforts to promote gender equality, actively promote women in their workplaces, and provide information on their performance and achievements. These indices are designed to evaluate a company's efforts to promote gender equality and to increase the weight of investment in companies that have policies to actively promote women, create an environment for women, and achieve results[26], which overlaps with SDG Goal 5 "Achieve Gender Equality. These "ESG index-based investments" are not simply the purchase of existing products because they provide economic benefits, but rather the GPIF deliberately chooses specific environmental and social issues on its own and uses them as a means to create an index on a theme related to that issue, selects entrusted asset managers, and makes ESG index investments. By selecting asset managers and investing in ESG indices, GPIF aims to achieve long-term economic returns.

In other words, GPIF's ESG investment activities, such as bond investments in the form of green bonds, social bonds, and sustainability bonds, as well as equity investments in themed ESG indices, do not primarily aim to solve environmental or social issues, however, they do aim to generate economic returns by investing in social and environmental issues as a means of generating economic returns. Therefore, they could be regarded as a type of instrumental IFSIs in that they are investments intended to simultaneously generate social and environmental impact as a means of generating economic returns (the area where the two overlap in Figure 2).

4. Japan's Legal and Regulatory Framework for Fiduciary Responsibility

The legal environment has been one of the factors that have enabled asset owners such as the GPIF to fully embrace ESG investment. In Japan, fiduciary responsibility is defined in the Civil Code and the Companies Act as "the fiduciary has the duty to handle entrusted affairs with the care of a good manager in accordance with the purpose of the entrustment". Under the Public Pension Laws (National Pension Law and Employees' Pension Insurance Law), it is understood that GPIF is obligated to endeavor to obtain positive investment returns during the investment mandate period by using the care and ability expected of the firm.

[26] ESG Report 2020, p19

However, it is stipulated that the investment of pension reserve funds is to be done "exclusively for the benefit of the insured”. The Ministry of Health, Labour and Welfare (MHLW) has stated that it is prohibited to invest funds outside of the "solely for the benefit of the insured." The question of whether ESG factors are for other policy objectives or not has been one of the hot issues for responsible investment by public pensions in the past, and there were many negative opinions about it in Japan. The rules governing ESG investment for public pensions are the " Basic Policy for Reserves (BPR)" established by the Ministry of Health, Labor and Welfare (MHLW) and three other ministries[27] under the jurisdiction of mutual aid associations. BPR forms the basic framework for the management of public pension funds and are legally enforceable, applying not only to the GPIF but also to other mutual aid associations.

BPR was revised in February 2020, and now says that, “the reserve funds shall implement necessary initiatives by individually examining the promotion of investments that consider ESG (environmental, social and governance) as non-financial factors in addition to financial factors, from the viewpoint of securing long-term returns in the interest of beneficiaries[28]”. Public pensions now have a legal basis for promoting ESG investments

When considering impact investments aimed at achieving the SDGs, it is clear from the perspective of fiduciary responsibility that, in principle, it is not possible to make investments that have an impact without regard to investment returns in the management of public pension funds' reserves. Therefore, we should be cautious about impact investing where investment returns have lost their market competitiveness. On the other hand, given that ESG investments are promoted from the viewpoint that they are beneficial for increasing investment returns over the medium to long term, it is important to choose environmental and social issues on one's own initiative and use them as a means to make "investments with sustainability impact" that can be reasonably considered to lead to higher investment returns over the medium to long term. In other words, **it may be possible to conduct instrumental IFSI.** Furthermore, in the case of GPIF, if the public is demanding the achievement of the SDGs as an expression of their will, it is highly likely that it will gain the support of its beneficiaries for "investments that bring about sustainability impact" that contribute to the achievement of the SDGs. If the public shows support for leaving behind a livable and

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[27] Ministry of Finance, Ministry of Internal Affairs and Communications, Ministry of Education, Culture, Sports, Science and Technology

[28] BPR Article 32, GPIF Investment Principal Statement Article 4

sustainable world for their children and grandchildren through public pension fund management, there may be no problem in fulfilling their duty of care from the perspective of fiduciary responsibility.

5. Personal Proposal for Future Direction

GPIF has developed a logic in its ESG Activity Report that ESG investments contribute to the achievement of the SDGs while skillfully steering the line between ESG investments and impact investments, but the following improvements could be made:

First, the GPIF should disclose the impact of green bonds, social bonds, and sustainability bonds in its ESG activity report to determine whether the purpose of the issuance has been achieved. Analyzing impact is not an easy task, but the impact-weighted accounting method[29], which has been rapidly developed in recent years, would be worth exploring for the GPIF. Impact-weighted accounting integrates impact and benefits by converting impact into monetary terms, with the aim of incorporating it into existing accounting systems.

Second, the report states, "In order to reduce the negative impact of environmental and social issues and improve the long-term return of the entire investment portfolio, we will promote ESG-conscious investment not only in equities, but also in other assets such as bonds[30]." However, there may be room for improvement in terms of accountability and how much additional cost was required for the issuance.

Thirdly, as far as possible, GPIF should disclose impact analysis information on equity thematic index investment, which tackles the SDGs goals. Specifically, the GPIF discloses the SDG positive impact of its entire domestic and international equity portfolio in the "Analysis of Profit Opportunities through Contributions to the SDGs" section of its ESG Activity Report. It is of great interest to the public to closely follow how domestic and foreign equity indices focusing on corporate greenhouse gas emissions contribute to SDG Goal 13 and how the "MSCI Japan Women's Index" and the "Morningstar Developed Countries (excluding Japan) Gender Diversity Index" have contributed to corporate efforts for gender equality, SDG Goal 5.

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[29] https://www.hbs.edu/impact-weighted-accounts/Documents/Impact-Weighted-Accounts-Report-2019_preview.pdf

[30] GPIF ESG Report 2020, p. 21

Fourth, the declining birthrate and aging society are serious social issues for Japan. Since one of the biggest challenges for the future of public pensions is "ensuring the sustainability of pension finances by increasing the labour participation rate[31]," why not develop an index that aims to "improve the labour participation rate" as an equity index for Japan's public pension funds? Since disclosure of information on ESG's 'S' has been progressing over the past few years, it would be a good idea to develop a new theme for ESG indexes.

Fifth, in engagement, the GPIF encourages asset managers to actively discuss critical ESG issues with investees[32]. Since GPIF already invests with an awareness of the SDGs, why not monitor the companies in which it invests in relation to the indexes and have the asset managers check their progress on how they are contributing to the achievement of the SDGs? ESG investments do not take into account the social return (impact) generated by the economic return. Impact investing, on the other hand, evaluates the intended social return (impact) in addition to the economic return. The GPIF also assesses the indirect contribution of its equity portfolio to solving the social issues identified in the SDGs. The GPIF also compares foreign and Japanese companies to see how much their stock portfolios are indirectly contributing to solving the social issues outlined in the SDGs. The analysis shows that "Japanese companies have a lot of room to grow in terms of contribution to the SDGs and earning opportunities,[33]" so it is particularly important to consider the contribution of Japanese companies to SDG Targets 5 and 13. The improvement process will become clearer if asset managers are asked to engage with Japanese companies as a means to encourage them to fill the gaps.

Sixth, I would like to request that GPIF improve its accountability to the public. In other words, **I would like to see the development of a system that allows for the description of the impact of investments that are effectively "investments with sustainability impact," i.e., Instrumental IFSIs.** This may be interpreted as an omission simply because impact investment is not allowed under the current Japanese legal system. However, as GPIF has already accumulated close to 12 trillion yen in investments designed to have a social and environmental impact, it is necessary that the analysis of these investments should be passed on to the public. I would like to see the results of this investment fed back to the public in a way that is easy to understand. To that end, I would like to see the GPIF use its network of overseas public pension funds and domestic research institutions to conduct multifaceted research on

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[31] Miki "The ESG Issues That Japan is First in Line to Face", 2016

[32] GPIF ESG Report 2020, p. 24

[33] GPIF ESG Report 2020, p. 24

Instrumental IFSI as a means of making investments that have a sustainability impact.

The seventh is the development of a legal environment in which the realization of sustainability impact becomes an important "means" for realizing economic return targets. The GPIF has traditionally employed an investment approach that can be seen as contributing to the resolution of SDG issues in both fixed income and equities, and has accumulated a sizable balance. If GPIF has been accumulating its balance by adopting the investment method that is regarded as the investment method for both bonds and stocks, why not consider revising BPR for the reserve fund to support the "instrumental IFSI (Investments with Sustainability Impact)" as stated in the Freshfields Report? In other words, "investments in which the achievement of sustainability impact goals is a means to realize the investment return goal" should be allowed. Contributing to the achievement of the SDGs is a way to avoid negative externalities and is essential to improving long-term economic returns and reducing risk. The concept of fiduciary responsibility, which only considers economic return, may also need to be reconsidered in light of the times.

Eighth. I would like PRI Japan to engage in constructive dialogue with GPIF and MHLW as a way to improve the legal environment. It may take time to revise BPR, but we need to persistently persuade the parties involved. I hope that the people of Japan should be able to create a sustainable, livable society for their children and grandchildren. I would like to see an objective survey conducted by PRI or a third-party organization to determine whether the public supports the idea of leaving a livable and sustainable world for their children and grandchildren.

GPIF is the world's largest asset owner with assets of ¥200 trillion. The era in which it is sufficient to invest only for the sake of Japan's insured population, as stipulated in the Employees' Pension Law, may be coming to an end. The world is taking the lead in achieving the globally agreed SDGs. The time has come for the GPIF to consider its role as an asset owner at the top of the investment chain that will lead the world in achieving the globally agreed-upon SDGs. The GPIF has a new mission: to encourage asset managers to help the companies in which they invest to achieve the SDGs through their asset management activities, based on the company's own corporate path. Of course, it is important to secure economic returns for the beneficiaries. However, the premise for this is a sustainable social and natural environment in which future generations can continue to live.

*The opinions and evaluations contained herein are the author's own and not those of his/her institution.

[References]

Ryujiro Miki [2019] "Introduction to Social Impact Investment"