Guardians of Truth:
How to Ensure the Accuracy of ESG Information

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Introduction

Draft: pp.3-4, 11-13

What is ESG information?

Environment

- Greenhouse gas emissions
- Carbon emissions
- Energy efficiency
- Waste production
- Air and water quality

Social

- Employee wellbeing
- Data protection
- Privacy policy
- Health and safety
- Diversity in the workplace

Governance

- Business ethics
- Executive compensations
- Investment strategies
- Diversity within senior management and the board

Why ESG Disclosure Matters?

- Improving investment and voting decisions
- Improving corporate accountability and transparency
- Inducing influential companies to tackle ESG problems

Introduction

Draft: pp.3-4

Research Question

How can public and private enforcement mechanisms, along with *ex-ante* and *ex-post* approaches, be effectively structured to ensure the accuracy of ESG disclosures while balancing the interests of investors, stakeholders, and society?

Purpose

(i) To position Japan’s framework within the context of international systems and discussions

(ii) To highlight both the role and limitations of public approaches in enforcing the accuracy of ESG disclosures

Method

Comparative analysis mainly focuses on Japan with the US, EU

Overview of Enforcement Mechanisms

Draft: pp.13-14

Mechanisms for Ensuring ESG Information Accuracy

	Public	Private
ex-ante	- Orders to amend or suspend disclosure	- Board approval - **Third-party assurance**
ex-post	- Administrative fines or surcharges - Criminal liability	- **Civil liability** - Revocation of shareholder meeting resolution - Measures against listed companies by stock exchange (delisting, designation as a security on alert)

Overview of Enforcement Mechanisms

Draft: pp.15-16

Ex-ante & Private: Third-Party Assurance

- Independent experts assess whether ESG disclosure accurately reflects reality and, at minimum, complies with the established disclosure frameworks
  - EU and other jurisdictions (e.g. Australia) mandate acquiring limited assurance
- Challenges
  - Limited scope of ESG information eligible for assurance
  - Limited number of independent experts and the risk of conflicts of interest
  - High compliance costs

Overview of Enforcement Mechanisms

Draft: pp.16-18

Ex-post & Private: Securities Fraud Litigation

- Investors harmed by ESG misrepresentations sue companies and their directors
  - US is the most prominent jurisdiction of this enforcement mechanism
- Challenges
  - Who initiates lawsuits
    - Rational apathy, cost bearer, identification of misrepresentation
  - Difficulty in satisfying certain elements, especially materiality, scienter, and reliance
  - Limitation on types of ESG misrepresentations covered by securities fraud litigation

ESG Disclosure in Japan

Draft: pp.7-11

Various mandatory disclosure documents

◉ Listed companies in Japan must make at least three mandatory disclosure statements

- Business Report under the *Companies Act 2005*
- Annual Securities Report under the *Financial Instruments and Exchange Act 1948*
- Corporate Governance Report under the *Listing Rule of TSE*

◉ The mechanisms for ensuring accuracy vary across these disclosure documents

Enforcement Mechanisms in Japan

Draft: pp.18-24

		Bus Rpt	Ann Sec Rpt	CG Rpt
ex-ante	Orders to amend or suspend disclosure	X	✓	X
	Board approval	✓	X	X
	Kansayaku approval	✓	X	X
	Third-party assurance	X	△	X
ex-post	Administrative fines or surcharges	✓	✓	X
	Criminal liability	X	✓	X
	Civil liability	✓	✓	✓
	Revocation of shareholder meetings resolution	✓	X	X
	Measures against listed companies by TSE	X	✓	✓

Ex-Post Enforcement in Japan

Draft: pp.24-27

Features of *Ex-Post* Enforcement in Japan

◉ Focus on governance information

- Misrepresented ESG information mainly related to 'G', rather than 'E&S'

◉ Heavy reliance on public enforcement

- Public authorities (FSA and prosecutors) conduct *ex-post* enforcement
- Limited number of private enforcement cases

◉ Potential under-enforcement

- Few cases detected
- Limitation of public authorities' ability to detect false ESG disclosure

Enforcement Mechanisms in Japan

Draft: pp.28-30

- Variation in enforcement mechanisms across disclosure documents
  - path-dependent and with no strong rational justification
- Lack of enforcement for environmental and social (E&S) information
  - Not free from false E&S disclosure
  - Rather weak enforcement mechanism
- Excessive reliance on *ex-post* and public Enforcement
  - FSA and SESC play key roles in inspecting ESG disclosure
  - Securities fraud litigation initiated by harmed investors are rare

Conclusion and Takeaways

Draft: pp.28-30

- Ensuring ESG disclosure accuracy is critical for investors as well as various stakeholders
- Each enforcement mechanism has some strengths and limitations
  - Third-party assurance / Securities fraud litigation
  - Public enforcement
- Balanced Approach Required
- Cost Allocation in Enforcement Mechanisms
  - Private enforcement
  - Public enforcement