

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

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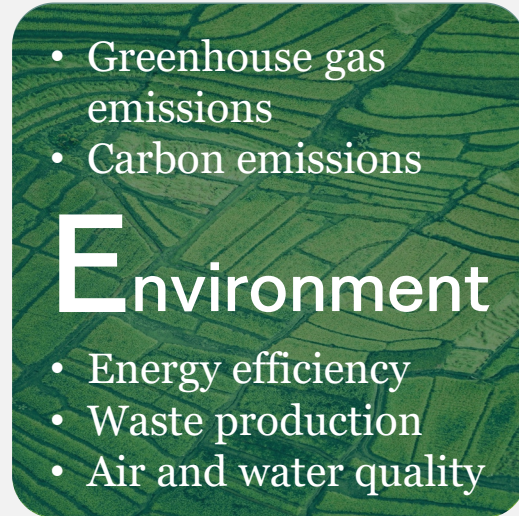
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## What is ESG information?



## Why ESG Disclosure Matters?

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

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

## ***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

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## ***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

## 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

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



## 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