CASE STUDIES ON ENVIRONMENTAL DUE DILIGENCE: EXAMPLES FROM JAPANESE BUSINESSES

OVERVIEW

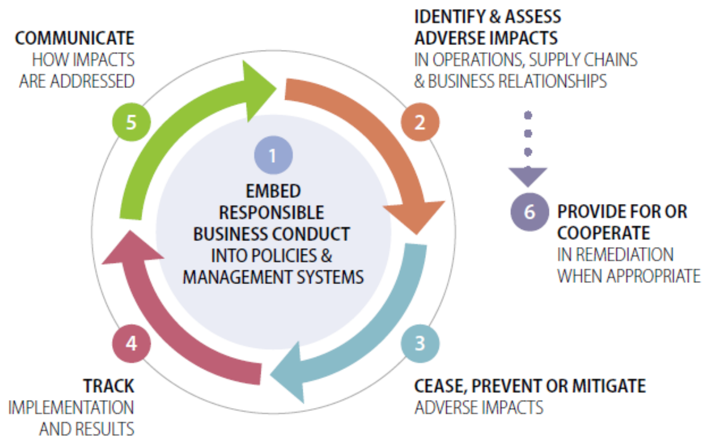
The six case studies enclosed in this series provide examples of corporate efforts to conduct environmental due diligence, drawing on the experience of Japanese companies. The case studies aim to support business in the practical implementation of environmental due diligence across supply chains. The OECD Guidelines for Multinational Enterprises (OECD Guidelines) and related OECD Due Diligence Guidance for Responsible Business Conduct (OECD Due Diligence Guidance) lay out the expectation that business contribute to sustainable development, while avoiding and addressing adverse impacts of their activities, including throughout their supply chains.

Risk-based supply chain due diligence to identify and address their adverse impacts on people and the planet is a means to implement the Responsible Business Conduct expectations outlined in the OECD Guidelines. This collection of case studies draws on the experiences of six Japanese businesses and organisations operating in various sectors and representing varying positions across the value chain, including: electronics and IT manufacturing; office supplies distribution; auto parts manufacturing; food ingredient manufacturing; financial services; and mega sports events organisation.

The case studies provide examples of actions taken to implement the OECD due diligence process and supporting measures as outlined in the OECD Due Diligence Guidance (see Figure 1 below), and in response to salient environmental risks or adverse impacts relating to climate change, biodiversity loss, use of plastics and deforestation. Not all six steps of the due diligence process are covered in each case study.

This series of case studies has been developed further to the OECD Centre for RBC's collaboration with the Japanese Ministry of Environment on the implementation of the Ministry's new Introductory Guide on Environmental Due Diligence along the Value Chain – Referring to the OECD Due Diligence Guidance for Responsible Business Conduct (August 2020).[1]

Figure 1: OECD DUE DILIGENCE PROCESS & SUPPORTING MEASURES



Source: OECD (2018), OECD Due Diligence Guidance for Responsible Business Conduct. Available in multiple languages at https://mneguidelines.oecd.org/due-diligence-guidance-for-responsible-business-conduct.htm

NOTES

[1] The Introductory Guide aligns with and references OECD RBC instruments and focuses on environmental aspects of supply chain due diligence. See: https://www.env.go.jp/press/108293.html

RESOURCES

OECD (2019), Due Diligence for Responsible Corporate Lending and Securities Underwriting: Key considerations for banks implementing the OECD Guidelines for Multinational Enterprises
http://mneguidelines.oecd.org/due-diligence-for-responsible-corporate-lending-and-securities-underwriting.pdf

OECD (2018), OECD Due Diligence Guidance for Responsible Business Conduct. Available in multiple languages at
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DISCLAIMER

RESPONSIBLE SUPPLY CHAINS IN ASIA

The Responsible Supply Chains in Asia (RCSA) programme is being implemented by the International Labour Organization (ILO) and the Organisation for Economic Co-operation and Development (OECD) with funding from the European Union. The RSCA programme aims to promote respect for human rights, including labour rights, and responsible business standards in global supply chains. This programme is carried out in partnership with Japan (an OECD member) and five partner economies, namely China, Thailand, Viet Nam, Philippines, and Myanmar.

With funding from the European Union

BETTER POLICIES FOR BETTER LIVES

CASE STUDY ON ENVIRONMENTAL DUE DILIGENCE ADDRESSING DEFORESTATION & CLIMATE CHANGE

These case studies provide examples of salient environmental risks and how companies are working to mitigate these risks through supply chain due diligence. They are designed to assist companies and other stakeholders in understanding how key processes outlined in the OECD Due Diligence Guidance for Responsible Business Conduct can be implemented in avoiding and addressing adverse environmental impacts associated with company operations, supply chains and other business relationships.

Each case study provides examples of company actions that relate to the six recommended due diligence processes set out in the OECD Due Diligence Guidance (see cover note). Not each case study includes examples across all six processes, rather, they draw on the relevant practical experiences of Japanese companies.

OVERVIEW

The organisation: The Company is one of the largest commercial banking groups in Japan. It provides banking and lending services to both individual and corporate clients, and manages assets for pension funds and other asset owners as an institutional investor through its asset management division. As of 2020, the Company held approximately JPY 28 trillion (Japanese yen) in assets under management.

Sector: Financial Sector
Scope of operations: Asia
Ownership form: Publicly listed company
Size: 20,760 employees (2020)

The Challenge: Financial institutions have a key role to play in driving sustainability by directing financing towards projects and businesses that support the Sustainable Development Goals (SDGs) and the goals of the Paris Climate Agreement. To contribute to sustainability goals, financial institutions should address environmental and social risks associated with their own activities and embed responsible business conduct (RBC) processes into their activities and value chains in line with the OECD Guidelines for Multinational Enterprises[1] and the related OECD Guidance on Due Diligence for Responsible Corporate Lending and Securities Underwriting and Responsible Business Conduct for Institutional Investors paper.[2]

Financial institutions can be a positive driving force in changing attitudes and practices in the management of supply chains. However, the inherent complexities in the financial sector such as extensive and complex business relationships or the rapidity of transactions can make practical application of effective due diligence systems challenging. In response to these challenges, the Company has developed responsible investment policies and strategies, and works to support its investees in identifying, preventing, and mitigating environmental and social risks.

This case study provides examples of how the Company is implementing supply chain due diligence, and in particular, its efforts to promote responsible investing in line with the Principles for Responsible Investment

(PRI)[3] and the Principles for Responsible Institutional Investors (Japan's Stewardship Code).[4] It focuses on two key environmental risks - deforestation and climate change, identified as key priorities by the Company through interaction with various stakeholders including non-governmental organisations (NGOs).

1 EMBED RESPONSIBLE BUSINESS CONDUCT INTO POLICIES AND MANAGEMENT SYSTEMS

By carrying out due diligence in line with the OECD Due Diligence Guidance for Responsible Business Conduct (OECD Guidance), banks can ensure that financing flows to projects and companies that behave responsibly, prevent negative impacts and ultimately benefit people and the planet. Due diligence can help banks identify, prevent or address adverse environmental impacts associated with their clients, as well as avoid financial and reputational risks.

Embedding RBC into policies and management systems and communicating expectations to clients and business partners is the first step of due diligence for RBC. It enables companies to articulate their company-wide vision and strategy, assign responsibility, support relevant business units in implementation and ensure accountability.

EMBEDDING RBC IN INVESTOR POLICIES

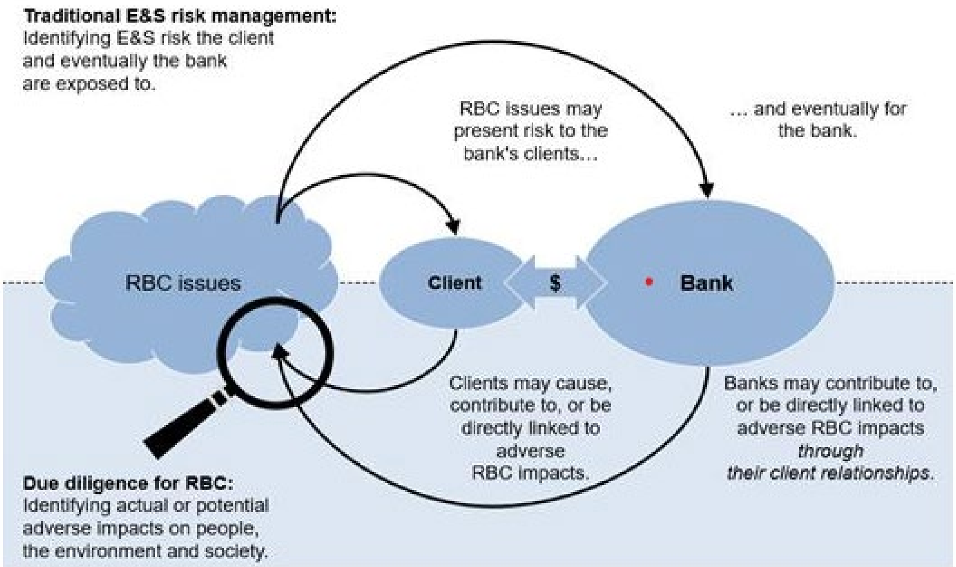
The Company is a signatory to the PRI since 2008. It promotes responsible investing policies and practices and supports investees in managing their environmental, social and governance (ESG) risks in line with its commitments under the PRI.[5] In 2014, the Company's asset management division adopted a policy on responsible investment. The policy clarifies the Company's commitment to social responsibility and achieving sustainable socioeconomic growth in the corporate value of investee companies as well as developing solutions to social challenges. It seeks to incorporate ESG factors into its investment decisions and to promote value creation and sustainable growth of investee companies over the medium to long-term. Box 1 outlines why there may be some difference in scope between ESG and RBC risks.[6]

Box 1: "RBC" and "ESG" criteria both relate to environmental, social and governance considerations, however, there may be some differences. RBC risk refers specifically to the risk of adverse impacts with respect to the issues covered by the OECD Guidelines — in other words, the risks to society and the environment, not to the company itself. Figure 1 illustrates the scope of RBC impacts and the difference to traditional Environmental & Social (E&S) risk management.

The Company has also signed Japan's Stewardship Code, published by the Financial Services Agency of Japan[7]. The Code encourages institutional investors and asset managers to monitor and engage with investees regarding the sustainable growth of their companies. The Company now monitors the ESG risks of investee companies and engages on ESG issues through stewardship activities.

For examples of practical actions that companies can take to build RBC expectations into business relationships, see page 60, Q18 of the OECD Guidance. See also the OECD report on RBC for Institutional Investors: Key considerations for due diligence under the OECD Guidelines. Pages 21-25 detail how investors can integrate RBC into existing risk management frameworks, including ESG criteria.

Figure 1. DUE DILIGENCE FOR RBC: AN OUTWARD FACING APPROACH



Source: OECD (2019), Due Diligence for Responsible Corporate Lending and Securities Underwriting.
https://mneguidelines.oecd.org/due-diligence-for-responsible-corporate-lending-and-securities-underwriting.pdf

COMMUNICATING RBC EXPECTATIONS IN BANKING TRANSACTIONS WITH CLIENTS

The OECD Guidance for Responsible Corporate Lending and Securities Underwriting recommends that the first step in communicating RBC expectations is to ensure that a bank's RBC policies are publicly available and are actively communicated to the client. Banks should articulate their RBC expectations in a way that can be understood by the companies the bank engages with.

As corporate lending and underwriting transactions represent the vast majority of the Company's banking activities, it promotes responsible lending through its banking division. The Company's lending policy publicly communicates its commitment relating to transactions in sectors that may negatively affect communities and the environment. It has said it will not engage in project finance activities for projects that may have serious adverse impacts on the environment or society. (see Box 2 for excerpts).

The Company has also set out additional lending policies for specific businesses and sectors that are categorised as high-risk such as: a) Coal-fired thermal power generation; b) Large-scale hydroelectric power generation; c) Coal mining; d) Palm oil farm development; e) Oil and gas extraction and pipeline construction; and f) Wood and paper pulp production and timber harvesting.

Box 2: EXCERPT OF THE BANK´S RESPONSIBLE LENDING POLICY

- *We will not lend to businesses that exert a seriously negative impact on wetland sites designated by the Ramsar Convention or the World Heritage Sites designated by UNESCO, neither will we provide lending to businesses in violation of the Washington Convention.*
- *We will take a cautious stance towards lending to businesses that negatively affect indigenous local communities and other areas of high conservation value and also exercise caution in lending to businesses that entail the involuntary resettlement of residents. To this end, we will give due consideration to their social, environmental, and other impacts and confirm the status of dealing to mitigate risks prior to lending.*

For examples of practical actions to develop RBC policies and to embed them into management systems, see pages 22-23, items 1.1 and 1.2, and pages 56-59, Q14-Q17, including Table 5 "Example of departments and functions potentially relevant to implementation of due diligence" of the OECD Due Diligence Guidance.

Detailed recommendations can also be found in the OECD report on Due Diligence for Responsible Corporate Lending and Securities Underwriting: Key considerations for banks implementing the OECD Guidelines. See pages 27-34 on embedding RBC into bank's policies and management systems.

3 CEASE, PREVENT AND MITIGATE ADVERSE IMPACTS

Once a company gathers information from risk assessments and prioritizes risks across its different portfolios, it can design and implement a risk management strategy to prevent and mitigate adverse impacts. Taking proactive measures to address risks facilitates progress towards meeting RBC expectations in a systematic way. This may include a conditioning provision on financing based on RBC performance, temporary divestment or a reduction in exposure to companies that do not demonstrate progress on RBC, and moving portfolio allocation towards responsible companies.

Adverse impacts caused by a client or an investee company of a bank would, in the majority of cases, be "directly linked" to the financing, underwriting or investment services of the bank, which has a business relationship with the client. In these situations, the bank is expected to use its leverage to influence the entity causing the adverse impact to prevent or mitigate, and where relevant, remedy the impact.[8] In cases where an enterprise is contributing to adverse impacts or risks caused by another entity, it should take the necessary steps to cease or prevent its contribution, and look to build and use its leverage to mitigate any remaining impacts to the greatest extent possible.

CARRYING OUT MEASURES TO ADDRESS DEFORESTATION RISKS IN PALM OIL SUPPLY CHAINS

> *The palm oil industry has been linked to several adverse environmental, social, and human rights impacts including deforestation.*

Adverse environmental, social, and human rights impacts have been linked to palm oil supply chains. Through engagement with its investee companies and by evaluating reports on their business practices, the Company has identified a number of investees that are potentially linked to negative impacts through palm oil supply chains. In response, the Company organised a task force on palm oil in 2016 which engaged experts and stakeholders, including environmental NGOs, to help shape the Company's strategy to address deforestation risks.

The Company also created and is maintaining a list of investees associated with palm oil supply chains. It conducted meetings with 52 of these investees between August 2017 and June 2019. The investees included 18 companies operating in the retail, restaurant, and service industries; 6 toiletry manufacturers; 18 food manufacturers; 5 oil and chemical companies; and 5 general trading companies. As part of these meetings, the Company shared information relating to environmental and human rights risks inherent in palm oil supply chains, highlighted progress made on investee initiatives for sustainable palm oil, and profiled examples of actions companies can take to address specific risks.

Between January 2018 and March 2019, the Company identified seven major high risk palm oil plantation operators in Malaysia and Singapore. The Company reviewed the operators' procurement practices and efforts to comply with No Deforestation, No Peat, No Exploitation (NDPE) policies,[9] and encouraged them to extend traceability efforts to the level of small independent plantation operators.

In October 2018, the Company participated in a working group at the PRI which contacted nine regional banks that provide funding to small and medium sized palm oil operators. The working group engaged directly with four of these banks to help improve frameworks for management and disclosure of ESG risks related to palm oil supply chains.

For information on addressing systemic issues, please see Box 6 "Addressing systemic issues" on page 76 of the OECD Due Diligence Guidance. Examples of practical actions to develop a company's leverage to prevent or mitigate risks can be found on pages 78-79, Q36-Q37.

USING LEVERAGE TO ADDRESS CLIMATE CHANGE

Based on an assessment of relevant ESG issues, including interaction with NGOs, the Company identified climate change and marine plastic pollution as significant and common risks among its investees. To prevent and mitigate these risks, the Company is working to increase its leverage in order to influence investee actions through investor-led collective initiatives and tailored support to SMEs (see Box X below).

The Company participates in Climate Action 100+,[10] an investor-led initiative that aims to facilitate collaboration with companies to transition to net-zero emissions and address climate issues at scale. The initiative identified industries producing high volumes of greenhouse gas (GHG) emissions such as the automobile, electronics, and oil & gas sectors, and targets engagement with companies with large market capitalization, which includes ten Japanese businesses.

Working in partnership other investors, the Company has engaged with these ten businesses to reduce CO2 emissions throughout their value chains, and to enhance climate-related financial disclosures in line with the Task Force on Climate-related Financial Disclosures (TCFD).[11] The Company monitored the progress of the target companies' CO2 emission reductions as well as governance and disclosure practices over five years. The Company also engaged with 20 investee companies on their use of plastics and the adverse impacts of plastics on marine life.

The majority of these investee companies are retailers that rely heavily on the use of polyethylene bags and beverage manufacturers that produce and sell drinks packaged in polyethylene terephthalate (PET) bottles. The Company conducted interviews to verify progress to reduce the use of plastic bags, single-use plastic straws and food containers, and promote a shift to using biomass plastic.

Box 3: PROVIDING SUPPORT TO SME'S FOR INCREASING THE UPTAKE OF DUE DILIGENCE FOR RBC

Most of the Company's borrowers are small and medium-sized enterprises (SMEs), with limited capacity and resources to address environmental and social impacts beyond direct (Tier 1) suppliers.

The Company's consulting division has developed tools and services to support SMEs in their supply chain due diligence processes. As part of its awareness raising of sustainability issues among SMEs, the Company developed a loan product for SMEs coupled with a free consulting service related to the Sustainable Development Goals (SDGs). When providing these services, the Company requests that their client SMEs assess their sustainability practices by using the common Supplier Assurance Questionnaires (SAQ) developed by the Global Compact Network Japan (GCNJ).

The SAQ covers questions related to RBC-related issues and supports companies in conducting broad scoping exercises to identify social and environmental risks in their supply chains. Based on this assessment, the Company provides their SME clients with tailored advice on preventing and mitigating RBC-related risks in the supply chain.

For examples of actions that companies can take to support business partners in their implementation of risk prevention and mitigation measures, see page 80, Q38 of the OECD Due Diligence Guidance.

For information on how companies can increase their leverage to effect change, see page 19, Box 2 "Collaboration in carrying out due diligence" and pages 78-80 Q36-Q38 of the OECD Due Diligence Guidance.

6 PROVIDE FOR OR COOPERATE IN REMEDIATION

Grievance and remediation processes support due diligence by providing channels through which companies can become aware of and respond to adverse impacts of their activities.

Effective implementation of grievance mechanisms can help companies enhance risk-based due diligence across all issues related to RBC. In 2019, the Company supported the UN Global Compact Network Japan and the Business and Human Rights Lawyers Network Japan in formulating the Engagement and Remedy Guidelines for Promotion of Responsible Business Conduct and Supply Chains.[12]

The Remedy Guidelines provide information to Japanese business on how to enhance their capacity to handle complaints raised by communities or workers along supply chains, for instance in setting up operational grievance mechanisms (OLGMs) to receive complaints from workers at plantations and oil extractors. The Company has been encouraging its investee companies to develop such operational-level grievance mechanisms (OLGM).

For examples of practical actions that companies can take to cooperate with legitimate remediation mechanisms and enable remediation, see pages 34-35, items 6.1 and 6.2 and pages 90-91, Q52-Q54 of the OECD Due Diligence Guidance.

Companies may carry out due diligence processes and supporting measures, including the raising of grievances, in collaboration with others, such as other industry actors and in partnership with trade unions or through multi-stakeholder initiatives. For information on determining whether a collaborative initiative is credible, see p.52 Box 3 "Good governance for due diligence collaborative initiatives".

NOTES

[1] OECD (2011), OECD Guidelines for Multinational Enterprises, Chapter VI. Environment, pages 42-46. http://dx.doi.org/10.1787/9789264115415-en

[2] Responsible business conduct in the financial sector. See: https://www.oecd.org/industry/inv/mne/rbc-financial-sector.htm

[3] The Principles for Responsible Investment. See: https://www.unpri.org/

[4] Principles for Responsible Institutional Investors. Japan's Stewardship Code. 2020. See: https://www.fsa.go.jp/en/refer/councils/stewardship/index.html

[5] Japan's Government Pension Investment Fund (GPIF), the largest asset owners in Japan, also became a signatory to the PRI in 2015. The GPIF has requested that the company promote responsible investing. https://www.gpif.go.jp/en/investment/esg/gpif_publishes_the_fy2019_esg_report.html

[6] There may be some difference in scope between ESG and RBC risks, so investors should seek to understand the content of Guidelines and assess the differences to ensure they understand the overlaps and differences. See OECD Responsible business conduct for institutional investors. 2017. https://mneguidelines.oecd.org/RBC-for-Institutional-Investors.pdfv

[7] https://www.fsa.go.jp/en/refer/councils/stewardship/index.html

[8] OECD (2019), Due Diligence for Responsible Corporate Lending and Securities Underwriting. http://mneguidelines.oecd.org/due-diligence-for-responsible-corporate-lending-and-securities-underwriting.pdf

[9] The NDPE policies were created in 2013, aiming to ensure sustainable palm oil supply chains. Many palm oil traders and refiners have NDPE policies in place to address risks beyond legal or certification requirements. Yet they are not controlled by a standard body, and the scope vary between companies or many company's policies are not consistently verified by an independent body.

[10] Climate Action 100+. See: https://www.climateaction100.org

[11] Task Force on Climate-related Financial Disclosures. See: https://www.fsb-tcfd.org/

[12] The Engagement and Remedy Guidelines for Promotion of Responsible Business Conduct and Responsible Supply Chains. 2019. https://www.bhrlawyers.org/en-erguidelines

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