Third Explanatory Briefing for Investors on the Shareholder Proposal for the 16th Annual General Meeting of Shareholders of Mitsubishi UFJ Financial Group (MUFG):

MUFG Climate Resolution is key to addressing Climate-Related Financial Risk; Proxy Advisor recommendations miss key risks

June 22 2021

This briefing constitutes the third and final explanatory briefing on the climate resolution filed by Kiko Network and 3 individuals on March 26 2021[1], ahead of the annual general meeting of shareholders for MUFG to be held on June 29 2021. In particular, this briefing aims to respond to the analyses recently provided by ISS and Glass Lewis on the said shareholder proposal, which seeks MUFG to adopt and disclose a plan, with essential metrics and targets, to align its financing and investments with the goals of the Paris Climate Agreement.

The co-filers of the resolution and the affiliated organizations who have authored this briefing understand that Glass Lewis and ISS have recommended against the proposal. While we disagree with the recommendations, we are particularly concerned by the poor quality of Glass Lewis' analysis, where numerous careless errors were made. Unfortunately, Glass Lewis advised that we would need to pay $6,000 in order to be able to respond directly to their reports, which in our view is in poor service to their clients and disadvantages smaller investors.

Key takeaways are as follows:

- While Glass Lewis alleges that a resolution seeking MUFG adopt and disclose a plan to align its financing and investments with the Paris Climate Agreement does not link to the protection of shareholder value, the Taskforce on Climate-related Financial Disclosures (TCFD) is clear that the transitional and physical risks associated with climate change can have significant impacts on the financial services industry. As the largest Asian banker of fossil fuels, with 20% of its total loans and underwriting in 2020 identified as fossil fuel financing,[2] MUFG has significant exposure to climate-related financial risk. Therefore, in order to protect shareholder value, MUFG's shareholders need to be able to assess if MUFG is managing its exposure to climate risk, making it integral that MUFG adopts and discloses a plan with measurable metrics and short, medium and long-term targets that demonstrate Paris alignment.

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[1] The resolution text and previous explanatory briefings are available at https://www.kikonet.org/press-release-en/2021-06-01/MUFG-investor-briefing2.

[2] Rainforest Action Network, BankTrack, Indigenous Environmental Network, Oil Change International, Reclaim Finance and the Sierra Club, *Banking on Climate Chaos: Fossil Fuel Finance Report 2021*, March 2021, https://www.ran.org/bankingonclimatechaos2021/, and *Methodology & FAQ*, p5, https://www.ran.org/wp-content/themes/ran-2020/inc/bcc-data-2021/Methodology FAQ_BOCC2021.pdf

- While Glass Lewis expresses discomfort with the format of the shareholder proposal, under Japanese law, amendment of the articles of incorporation is the only way to make a shareholder proposal related to management of climate risks. Further, although the proposal has "binding effect", under Japanese law, directors are also entitled to use their business judgment. Glass Lewis endorsed a similarly formatted proposal filed in respect of Japanese bank Mizuho Financial Group in 2020.

- ISS' recommendation is predicated on MUFG's commitment to the Net Zero Banking Alliance (NZBA), which is welcome but does not remove the need for the proposal. In MUFG's case, the NZBA commitment should not serve to allow MUFG to defer making Paris-aligned medium-term targets to as late as March 2023. Such delay would neglect the clear urgency of addressing the climate crisis and allow MUFG's continued financing of fossil fuel expansion and deforestation. MUFG's status as the sixth largest banker of fossil fuel expansion is in active opposition to the net zero pathway advised by the International Energy Agency in its recent Net Zero by 2050 report. MUFG's commitment to the NZBA does nothing to stop these activities for another two years.

We provide additional detail on these points below.

We therefore urge you to exercise independent judgment and vote for the shareholder proposal at MUFG's annual meeting.

1. Long-term shareholder value will be materially affected if MUFG does not demonstrate it can manage climate risks

Glass Lewis alleges in its report that the proponents fail to link any aspect of their request to the creation or protection of long-term shareholder value or to make any financial arguments whatsoever. This is incorrect. Protecting corporate value is very clearly stated in the reasons for the shareholder proposal.

The TCFD and the global financial community, including MUFG, have recognised climate risk as presenting material financial risks to the financial services industry. The TCFD is clear in its recommendations that in order to allow investors to "appropriately assess and price climate-related risk and opportunities",[3] companies should disclose how they will manage climate risks. This proposal goes to the heart of the TCFD's recommendations.

A. MUFG's targets and metrics are insufficient to align with the goals of the Paris Agreement

Setting appropriate metrics and targets is a key element of TCFD reporting. The TCFD recommends,"in describing their targets, organisations should consider including the following: whether the target is absolute or intensity based, time frames over which the target applies,

[3] TCFD Recommendations, https://assets.bbhub.io/company/sites/60/2020/10/FINAL-2017-TCFD-Report-11052018.pdf

base year from which progress is measured, and key performance indicators used to assess progress against targets."[4] These targets would need to demonstrate alignment with the Paris Agreement. MUFG's targets currently fail that test, and are particularly insufficient given its significant exposure to climate-related risk.

MUFG's exposure to material climate-related risk is predominantly through its financing and investment activities. In comparison to its global peers, MUFG has some of the most significant exposure to climate-related financial risk, as it ranks as the sixth largest financier of all fossil fuels as well as fossil fuel expansion since the Paris Climate Agreement,[5] third largest lender to the coal industry at large between Oct 2018-Oct 2020,[6] and the seventh largest financier of the palm oil sector since Paris.[7] All three areas of financing carry significant climate impacts.

Further, MUFG's disclosure that TCFD-defined carbon-related assets represented 6.2% of its lending portfolio would make any investor worry that its portfolio is susceptible to climate risk.[8] It is unclear whether this disclosure is accurate as other analysis shows MUFG's loans and underwriting to all fossil fuels between 2016 and 2020 constituted 16% of its portfolio of total loans and underwriting over the same timeframe, and 20% in 2020 alone.[9]

However, MUFG has failed to provide short or medium term targets or metrics that would assure a net zero pathway. In particular, MUFG's failure to address its financing of fossil fuel expansion at large is deeply problematic given the IEA *Net Zero by 2050* report, which concludes that all new oil, gas or coal development risks becoming stranded assets if the world is to reach net zero by 2050.[10]

Paris-Alignment Assessment of MUFG's Policies & Commitments as of May 2021

Indicator	Paris Alignment expectation (Source: ***Principles for Paris-Aligned Financial Institutions***)	MUFG Commitment
Short-term target	No financing of fossil fuel expansion	NONE
	From 2021, year on year reduction and ultimate phase out of fossil fuel financing on a 1.5ºC timeline.	NONE
	No financing for any project that involves degradation or loss of natural ecosystems, or any company that fails to	PARTIAL

[4] TCFD Recommendations
[5] *Banking on Climate Chaos: Fossil Fuel Finance Report 2021*
[6] Urgewald, *Groundbreaking Research Reveals Financiers of the Coal Industry, 2021,* https://coalexit.org/
[7] Forests & Finance, *White Paper on MUFG Forest Sector Financing*, March 2021, https://forestsandfinance.org/wp-content/uploads/2021/05/MUFG_white_paper_march2021.pdf
[8] MUFG, Responding to Global Warming and Climate Change-Based on TCFD Recommendations, https://www.mufg.jp/english/csr/environment/tcfd/index.html
[9] *Banking on Climate Chaos: Fossil Fuel Finance Report 2021*
[10] International Energy Agency, https://www.iea.org/reports/net-zero-by-2050

	comply with a No Deforestation, No Peatland, No Exploitation (NDPE) policy at a corporate group level.	
Mid-term target	Financed emissions at least halved from FY2010 by FY2030.	NONE
	All financing to the entire coal industry zeroed out by 2030 at the latest in OECD and 2040 in the rest of the world.	PARTIAL
Long-term target	Net Zero financed emissions by 2050 at the latest, without reliance on discredited schemes, carbon intensity metrics comparing emissions to revenue, or offsetting with financing for renewables.	YES (with reservations due to lack of disclosure of how the 2050 target will be achieved)
Metric	Disclosure of overall carbon footprint, encompassing all direct and indirect emissions caused by lending, underwriting, investment, insurance and other financial services, and inclusive of land use emissions. Methodologies for measuring must be transparent and verifiable.	NONE
	Explicit requirements of fossil fuel or deforestation-risk clients, including a clear compliance timeline and what consequences follow from failing to meet those requirements.	PARTIAL

B. MUFG's policies lag behind domestic and international peers

We understand that Glass Lewis, in its report, claims that MUFG has done enough to change its policy as it takes some steps to limit investment in carbon intensive industries. However, this analysis ignores that MUFG falls short of its Japanese and global peers in many areas. As policy is a key indicator of a company's business strategy, these shortfalls can have a direct impact on shareholder value.

- **Coal power**
  - **Project-tied finance:** MUFG updated its policy to rule out financing coal power projects, but this includes exceptions for coal-fired generation equipped with CCUS, mixed combustion and "other technologies necessary to achieve the Paris Agreement target." While Glass Lewis claims that this policy is reasonable, it is not founded on science, and MUFG's assertion that the continued use of coal power is compatible with Paris goes against the conclusions of the IEA.[11] The

[11] International Energy Agency, https://www.iea.org/reports/net-zero-by-2050

Bank of England notes that "if companies are relying on [NETs such as] CCS to achieve net zero carbon emissions, investors will want to assess how they plan to get there - and who they expect to pay for it."[12]

  - **General Corporate finance:** MUFG has committed to "aim to disclose the portfolio reduction target" for corporate finance given to companies "whose business largely involves coal-fired power generation" but sets no targets for a phase out of such corporate finance.[13] In contrast, international peer banks have already restricted corporate financing of companies engaged in the coal sector.[14]

- **Coal mining:** MUFG's policy only restricts mountain-top removal mining, falling behind its Japanese peer Mizuho Financial Group which restricts finance to all new thermal coal mining projects.[15]
- **Oil and Gas expansion:** MUFG has made no commitments to restrict any type of financing of oil and gas expansion, in stark contrast to its peers, and this point is significantly undervalued by Glass Lewis. MUFG currently has policies that merely promise enhanced due diligence on loans and underwriting to tar sands extraction and Arctic Oil & Gas projects. In comparison, 32 banks have already taken steps to fully or partially exclude tar sand projects or companies involved in tar sand operations including pipelines,[16] while 39 banks have already taken steps to fully or partially exclude Arctic oil and gas projects or companies involved in Arctic oil and gas operations.[17] Other banks such as BNP Paribas have also adopted policy measures on fracking and LNG terminals,[18] both of which MUFG heavily finances given their ranking as the 6th and 8th largest financiers respectively. Moreover, MUFG has no policy on corporate finance in the oil and gas sector, unlike Mizuho Financial Group which promises enhanced engagement on transition risk with companies reliant on oil-fired power generation, gas-fired power generation, and/or other oil and gas operations as their primary businesses.[19]
- **Deforestation-risk Commodities:** Land use is the second largest source of human carbon emissions, constituting nearly a quarter of total emissions, while halting degradation can play a significant role in climate mitigation. MUFG recently updated its policy on financing palm oil producers by adopting a 'No Deforestation, No Peatland, No Exploitation' (NDPE) standard. Yet it has left out palm oil traders that play a critical role

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[12] Mark Carney, Speech: Breaking the Tragedy of theHorizon - climate change and financial stability (2015)p.11, https://www.bankofengland.co.uk/-/media/boe/files/speech/2015/breaking-the-tragedy-of-the-horizon-climate-change-and-financial-stability.pdf

[13] MUFG CSR policies, https://www.mufg.jp/english/csr/policy/

[14] Institute for Energy Economics and Financial Analysis, https://ieefa.org/finance-exiting-coal/

[15] Mizuho, Strengthening our Sustainability Action, https://www.mizuhogroup.com/binaries/content/assets/pdf/mizuhoglobal/news/2021/05/20210513release_eng.pdf

[16] https://www.banktrack.org/page/banks_and_tar_sands_1

[17] https://www.banktrack.org/page/banks_and_arctic_oil_and_gas

[18] See also https://www.banktrack.org/campaign/banks_and_fracked_oil_and_gas and https://www.banktrack.org/campaign/banks_and_liquefied_natural_gas_lng

[19] Mizuho, Strengthening our Sustainability Action, https://www.mizuhogroup.com/binaries/content/assets/pdf/mizuhoglobal/news/2021/05/20210513release_eng.pdf

in the industry, and exempted their Indonesian bank subsidiary Bank Danamon from applying the bank policies, despite it being a major financier of Indonesia's second largest palm oil producer. Moreover, MUFG is a major financier of the largest pulp producers from tropical forest regions, and its financing of pulp production in Indonesia is particularly concerning given its high exposure to carbon-intensive peatland degradation and fires that pose significant climate and stranded asset risks. MUFG's policies remain inadequate to address such risks.

- **Investments:** MUFG has no sector policies governing its investments, in clear contrast to its peer Mizuho.

These failings in policy and lack of targets are particularly jarring when contrasted with the significant financing that MUFG directs to the fossil fuel industry as a percentage of its total lending and underwriting portfolio, creating significant doubt about how Paris -aligned MUFG's business strategy is and how they hope to change.

2. **Japanese corporate law requires that shareholder proposals follow the format of the MUFG shareholder proposals**

Under the *Companies Act* of Japan, shareholder proposals can only be made on matters that shareholders can exercise voting rights, which are limited to matters to be resolved at a shareholders' meeting provided in the Act or the Articles of Incorporation of the company. Any shareholder proposal that simply states its requirement without using the form of an amendment to the Articles of Incorporation and calls for a shareholder proposal would not be placed on the ballot as an agenda item at the shareholder meeting due to its illegality, unless it falls into a different shareholder resolution matter under the Act or the Articles of Incorporation of the target company.[20]

The proposal to amend the company's Articles of Incorporation in part is the most commonly used approach to make shareholder proposals, and the approach taken in this proposal. In addition, directors of the company would not lose discretionary business judgment within the amended articles of incorporation in the event that the resolution passes under the business judgement rule established by court precedents in Japanese corporate law.[21]

Glass Lewis fails to recognise that MUFG ranks highly among the Global Systemically Important Banks (G-SIBs) designated by the Financial Stability Board.[22] Given its significance, we are very concerned that, in their convocation notices for the AGM, MUFG mischaracterised adopting a Paris-aligned strategy and plan as a "specific business execution policy" rather than "the company's fundamental policy for its management."

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[20] Articles 304 and 295 (2) of Companies Act, Act No. 86 of 2005, http://www.japaneselawtranslation.go.jp/law/detail/?vm=04&re=01&id=320

[21] The judgment by the Supreme Court of Japan dated July 15 in the 22nd year of Heisei (2010)

[22] Financial Stability Board, https://www.fsb.org/2020/11/2020-list-of-global-systemically-important-banks-g-sibs/

While the directors can use their business judgement in determining how to operationalise the amendment, amending the Company's articles as proposed by the proponents provides a fundamental principle for management to uphold that MUFG must align its strategy to the Paris Agreement. It would undoubtedly and significantly contribute to protecting the value held by current and future shareholders of the Company, which we believe would make a compelling case for the benefit of shareholders as whole and the global financial system.

3. Joining the Net Zero Banking Alliance does not obviate MUFG's commitment to set Paris-aligned targets now

ISS' report details their concerns with MUFG's current targets but accepts MUFG's commitment to the Net Zero Banking Alliance, led by the UNEP-FI.[23] Joining this alliance means that MUFG has committed to setting targets by mid-2023. Banks then must report within a year on their financed emissions and their progress on reaching these targets. However, given the level of climate risk that MUFG faces owing to its financing and investments, investors cannot be satisfied with waiting years to understand MUFG's business strategy. This approach only defers what investors need to know now.

MUFG has made commitments to be Paris-aligned in the past. MUFG has signed the Principles for Responsible Banking in 2019 which committed banks to align their business strategy with the Paris Climate Agreement and set targets accordingly.[24] The shareholder proposal therefore asks MUFG to keep this commitment and not delay further in doing so.

MUFG has a long way to go to meet the asks in the shareholder proposal, and not voting for this proposal would signal to MUFG that they can continue along their current path, without a clear and effective plan to address their climate risks.

We urge shareholders to vote for MUFG to adopt and disclose a plan, with appropriate metrics and targets, to align its financing and investments with the goals of the Paris Climate Agreement.

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[23] Net Zero Banking Alliance, https://www.unepfi.org/net-zero-banking/

[24] Principles for Responsible Banking, https://www.unepfi.org/banking/bankingprinciples/. Glass Lewis mistakenly characterizes MUFG as a founding bank of the PRBs, which MUFG was not. Nor has MUFG joined the group of PRB climate leaders. https://www.unepfi.org/banking/bankingprinciples/collective-commitment/