

Japan: First exchange-based carbon market launched on 11 October 2023

In brief

The Tokyo Stock Exchange (TSE) launched Japan's first exchange-based carbon credit market ("**Market**") on 11 October 2023. Registered participants in the Market now have a more efficient platform for carbon credit trading in Japan and improved carbon pricing transparency.

As of October 2023, a total of 188 applicants — including many GX League Members — had registered as participants in the Market, enabling them to trade J-Credits — the only eligible carbon credit on the Market for the time being.

The launch of the Market encourages Japanese companies to curb greenhouse gas (GHG) emissions in Japan, the world's fifth largest CO₂ emitter. It also supports GX (Green Transformation) in Japan and bolsters the global supply of carbon credits to help the world meet its ambitious GHG emission reduction goals.

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Key takeaways

Solvent legal entities, including foreign corporations, can register and trade eligible carbon credits on the Market by meeting specific requirements and establishing the necessary accounts.

If you have any questions or would like further information about this topic, please do not hesitate to contact us.

In depth

Background

On 11 October 2023, the TSE launched the Market¹ to provide registered Participants (as defined¹ below) with a more efficient platform for carbon credit trading in Japan and to improve carbon pricing transparency.

The launch of the Market represents a pivotal step in establishing the pro-growth carbon pricing system in Japan envisaged under the Basic Policy for the Realization of Green Transformation (GX) ("**GX Basic Policy**"). The GX Basic Policy was announced by the Ministry of Economy, Trade and Industry (METI) in December 2022 and later officially approved by the Cabinet in February 2023 with minimal revision. Following the announcement of the GX Basic Policy, METI commissioned the TSE to carry out a Carbon Credit Market Technical Demonstration Project ("**Demonstration Project**") from September 2022 to January 2023, which laid the groundwork for the Market's rule framework.

The diagram below outlines the key steps leading to the establishment of the Market.

¹ <https://www.jpx.co.jp/english/news/2040/20230922-01.html>



Who can participate in the Market?

According to the specifications published by TSE, any solvent legal entity (including a government entity or unincorporated association (*nin-i dantai*)) with stable operations and sound management is generally eligible to register as a participant in the Market ("**Participant**"). To register as a Participant, an eligible entity must submit the requisite documentation to the TSE and meet the requirements, such as establishing a bank account and a J-Credit Scheme Registry Account (as defined below) in its own name, in addition to registering as a qualified invoice issuer.²

Foreign corporations are also eligible to register as Participants and trade on the Market, but they are subject to additional registration requirements and certain tax procedure-related complexities.

How the Market works

Once registered, Participants will be able to sell carbon credits or purchase other Participants' supplied carbon credits on the Market.

In recognition of anticipated early-stage liquidity constraints, the TSE decided to have no continuous auctions and to instead adopt the "*Itayose*" method, which allows Participants to make only two call auctions per day (once in the morning and once in the afternoon). Accordingly, a lower offer and a higher bid will have precedence — as will an earlier bid or offer — if two or more bids or offers are made at the same price. Non-Participants will also be able to view the execution prices.

For now, the basic fee, transaction fee and settlement fee have all been set at zero to encourage as many Participants as possible to register. Further, no registration fee or security deposit will be required. Additional details can be found in the "Overview of Specifications" in Appendix A of this Alert.

Types of carbon credits eligible for trading on the Market

At present, only J-Credits issued under the J-Credit Scheme are eligible for trading on the Market. The J-Credit Scheme is administered by METI, the Ministry of the Environment (MOE) and the Ministry of Agriculture, Forestry and Fisheries (MAFF).³ J-Credits have been traded over the counter on a voluntary basis since 2013.⁴ Among other requirements, projects eligible for J-Credit Scheme registration must be implemented within Japan and demonstrate additionality.⁵ Both Japanese and foreign entities that are not legally registered in Japan can open accounts in the J-Credit Scheme Registry ("**J-Credit Scheme Registry Accounts**"), enabling them to hold, buy, sell, transfer and retire J-Credits.⁶

J-Credits are currently usable on the domestic market in Japan. They may also be usable for the Carbon Offsetting and Reduction Scheme for International Aviation (CORSA) in the future. We understand that further information will be provided regarding this

² The registration requirements are listed on the following TSE website (English version):
<https://www.jpx.co.jp/english/equities/carbon-credit/participants/index.html>

³ For more details, please refer to the Outline of the J-Credit Scheme published in August 2023 at the following website:
https://japancredit.go.jp/english/pdf/credit_english_001_41.pdf

⁴ https://www.meti.go.jp/shingikai/energy_environment/carbon_credit/pdf/20220627_2.pdf

⁵ https://japancredit.go.jp/english/pdf/credit_english_001_41.pdf

⁶ <https://japancredit.go.jp/english/account/>

possibility. Furthermore, when offsetting is voluntary, retired J-Credits can offset GHG emissions that occurred outside Japan, such as in international aviation and shipping and overseas manufacturing.⁷

Role of GX League Members

As of October 2023, a total of 188 applicants — including corporations, financial institutions and local governments — have successfully registered as Participants in the Market.⁸ Many of these Participants are affiliated with the GX League, a group comprising various corporations and financial institutions ("**GX League Members**")⁹ established by METI in 2022. The GX League follows the principles of the Basic Concept released by METI in February 2022¹⁰ and aims to simultaneously facilitate GHG emissions reductions and industrial competitiveness by treating Japan's 2050 carbon neutrality goal as an opportunity for economic growth.¹¹ Each GX League Member sets a voluntary emissions reduction target (which it is obliged to achieve) and is required to disclose actions and investments related to its emissions goals.¹² Failure to meet these targets necessitates the purchase of "excess reduction quotas" or eligible carbon credits or an explanation. As a result, GX League Members are keen to participate in the Market to purchase eligible carbon credits on an enhanced, transparent trading platform when they fall short of their targets. Additionally, the Market offers an opportunity for GX League Members to monetize any surplus eligible carbon credits where they overachieve.

The GX League also collaborates with the Japanese government to achieve the GX Basic Policy¹³ and voluntarily steers Japan's first national level emission trading system (ETS). The ETS was launched in April 2023 under the GX Basic Policy (GX-ETS), which is slated for three phases of development. The initial phase, lasting until March 2026, features voluntary company participation and a baseline-and-crediting design. The second phase, commencing in 2026, transitions the GX-ETS into a more traditional ETS by introducing certain measures (e.g., government policies) aimed at facilitating greater participation and improving its effectiveness. From 2033 onwards, the focus will shift toward accelerating decarbonization in the power sector, incorporating auctions.¹⁴ This trajectory indicates that GX League Members will have a strong and growing incentive to engage in the Market to reduce their GHG emissions and assume a pivotal role in its growth.

Outlook

The launch of the Market not only supports the achievement of GX and encourages Japanese companies to curb GHG emissions in Japan — the world's fifth largest CO₂ emitter — it also bolsters the global supply of carbon credits and helps the world to meet ambitious GHG emissions reduction goals.

⁷ <https://japancredit.go.jp/english/account/>

⁸ <https://www.jpx.co.jp/english/news/2040/20230922-01.html>

⁹ <https://gx-league.go.jp/member/>

¹⁰ METI News — GX League Basic Concept Announced, Call for Endorsing Companies Starts:

https://www.meti.go.jp/english/press/2022/0201_001.html

¹¹ <https://gx-league.go.jp/en/>

¹² https://gx-league.go.jp/aboutgxleague/document/GX_League_Overview.pdf

¹³ The Basic Policy for the Realization of GX (Feb 2023): https://www.meti.go.jp/english/press/2023/pdf/0210_003a.pdf

¹⁴ https://gx-league.go.jp/aboutgxleague/document/%E5%8F%82%E8%80%83%E8%B3%87%E6%96%99_GX-ETS%E3%81%AE%E6%A6%82%E8%A6%81.pdf

Appendix A — Overview of Specifications¹⁵

	Overview
Items eligible for trading	J-Credits
Trading method	Call auction 1130 and 1500 (based on price priority)
Settlement date	Fifth business day from day of execution (T+5)
Types of orders	Limit orders (market orders will not be accepted)
Trading categories	Six categories sorted by project type (for J-Credits)
Order acceptance hours	0900-1129 / 1230-1459
Tick size	JPY 1
Trading unit	1t-CO2
Price limits	±90% of the reference price
Base prices	1. Final execution price of last auction 2. Base price of last auction
Settlement	Transfer of cash and credits between buyer and seller

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¹⁵ <https://www.jpex.co.jp/english/equities/carbon-credit/overview/index.html>