Ref: KIG/71/2022
June 30, 2022

Financial Stability Board
Bank for International Settlements
Centralbahnplatz 2, CH-4002 Basel, Switzerland

Japanese Bankers Association

JBA comments on the FSB Interim Report: "*Supervisory and Regulatory Approaches to Climate-related Risks*"

Dear Sirs/Madams:

The Japanese Bankers Association[1] (JBA) appreciates the opportunity to provide our comments on the Financial Stability Board's (FSB) Interim Report: "*Supervisory and Regulatory Approaches to Climate-related Risks*"[2] released on 29 April 2022

We support the FSB's efforts to assist supervisory and regulatory authorities in developing their approaches to monitor, manage and mitigate risks arising from climate change and to promote consistent approaches across sectors and jurisdictions. We hope that our comments will contribute to further discussions at the FSB.

Responses to specific questions

Supervisory and regulatory reporting and collection of climate-related data from financial institutions

1. Does the report highlight the most important climate-related data (qualitative and quantitative) for supervisors' and regulators' identification of exposures and understanding of the impacts of climate-related risks of financial institutions and across financial sectors? Please provide examples of climate-related data deemed most relevant and that should be prioritised.

We agree that consistent and comparable climate-related corporate disclosures, based on a global baseline climate reporting standard, provide a good starting or reference point for the future development of regular standardised regulatory reporting requirements. We believe this will improve the quality of climate-related data in all sectors, including banking.

We believe that the disclosure of forward-looking climate-related data is more important than historical data

[1] The Japanese Bankers Association is the leading trade association for banks, bank holding companies and bankers associations in Japan. As of June 30, 2022, JBA has 114 Full Members (banks), 3 Bank Holding Company Members (bank holding companies), 77 Associate Members (banks & bank holding companies), 58 Special Members (regionally-based bankers associations) and one Sub-Associate Member for a total of 253 members.

[2] https://www.fsb.org/2022/04/fsb-launches-consultation-on-supervisory-and-regulatory-approaches-to-climate-related-risks/

and PDs (probability of defaults) to appropriately identify and assess climate-related risks. Specifically, the data that are considered to be important at this time are those related to the transition plan (including data such as targets, progress, GHG emission transitions and forecasts, and business plans), which is believed to correlate with corporates' (including financial institutions') transition risk and physical risk related to climate change. In measuring climate-related financial risks, forward-looking risk measurement is required in the event that climate change risks become apparent, so future transition plans (changes in carbon emissions, etc.) for each corporate's response to climate change are needed.

In addition, when financial institutions measure climate-related financial risks, the financial data and GHG emission data of each corporate that makes up the portfolio are given high priority as basic data. After collecting reliable data from corporates, financial institutions will be able to accurately measure the risks and subsequently report the data.

Therefore, we would like to ask the FSB to consider the current practice/situations on data availability for financial institutions when discussing the supervisory and regulatory reporting framework:

- Although qualitative climate-related data seems to be more available, we still find limited quantitative information on climate-related financial impacts from clients. Since the methodologies to quantitatively estimate climate-related impacts are currently under development, it is appropriate to begin with requiring the reporting of qualitative data as described in Recommendation 4. On the other hand, the content and mediums of disclosure of qualitative data vary depending on each jurisdiction, and careful consideration is required based on the progress of international disclosure frameworks when regulating it.
- Regulations on the disclosure of climate-related data vary from country to country. There are jurisdictions where mandatory disclosure has not been introduced and the availability of comparable data is limited. Also, although climate-related data on large corporates and sovereigns seems to be more available, we still find a lack of data from small and medium-sized enterprises and from emerging markets.

In addition, detailed examples of the information gathered by the authorities are shown on pages 13 to 15 of this report. Such concrete examples are easy to understand and will contribute to the advancement of climate-related risk measurement in the future. On the other hand, this report is limited to examples of individual data, and we believe that more detailed definitions and explanations are necessary in order for the parties concerned to collect data in the future. For example, the subject of data creation/collection and the purpose of its use should be clarified in the future. If the collection of such data is not based on the same definition across all jurisdictions, it will not lead to effective data utilisation and might result in increased burden and cost for the data provider. We would like the FSB to make sure to avoid such a situation.

2. Does the report draw attention to the appropriate areas to increase the reliability of climate-related data reported by financial institutions?

As mentioned in Recommendation 2, financial institutions' internal audit and third-party verification of climate-related data are considered to be one way to increase the reliability of the data. However, since the types of climate-related data and measurement methods are still under development and it will require adequate resources and skills to provide robust audit and verification on climate-related data, it is necessary to thoroughly consider whether appropriate reliability can be imparted by financial institutions' internal audit and third-party verification. For example, as points to be discussed in the future, the development of guidance on the qualification of verification bodies and verification methods based on international frameworks would be meaningful.

3. Does the report appropriately identify the elements of a common high-level definition of climate-related risks (physical, transition and liability risks)?

As mentioned in Recommendation 3, it is important to consider high-level definitions that are common internationally, in order to improve consistency across jurisdictions and sectors. For example, there are differences between the definitions in this report and the definitions in "*Climate-related Risk Drivers and Their Transmission Channels*"[3] published by the Basel Committee on Banking Supervision in April 2021. In this regard, it is necessary to ensure further consistency with the definitions used by the standard-setting bodies and the authorities in each jurisdiction, and to consider clarification of the definitions. We note that physical risk largely depends on geographical characteristics, and transition risk depends on the industrial structure of each sector, so these characteristics should be kept in mind when clarifying the definitions.

In measuring climate-related financial risks, we understand that physical risks and transition risks are risk drivers for climate-related financial risks. Liability risk is a part of operational risk rather than a risk driver, because it can result from manifestations of physical and transition risks as mentioned in this report. If liability risk is defined as a risk driver, we would like the FSB to clarify the reason.

4. Do the proposed recommendations help accelerate the identification of authorities' climate related information needs from financial institutions and work towards common regulatory reporting frameworks? Please elaborate on areas where the recommendations could be enhanced, if any.

(Recommendation 2)

Regarding third-party verifications, since the financial data and GHG emission data of each corporate that makes up the portfolio are needed as basic data for financial institutions to measure climate-related financial risks, we believe that the introduction of third-party verifications in corporate disclosures should first be considered.

Regarding the framework for third-party verifications, since the assistance of third parties who have deep insight into the system and decarbonisation technology is required, a sufficient amount of time is needed to provide training for human resources. In addition, the extent to which third-party verifications are required should be considered in the future.

(Recommendation 3)

[3] https://www.bis.org/press/p210414.htm

Regarding the common definition, we believe that the scope of definitions should be expanded further. For example, we believe that a common global definition should be established for each information on pages 13 to 15 of this report.

(Recommendation 4)

We agree that the authorities would begin with asking financial institutions to report qualitative information to the extent that more specific climate-related information is required for supervisory and regulatory objectives. All sectors still face challenges in the disclosure of the financial impacts of climate risks in their financial statements and time is required to establish a quantitative financial risk management framework. Therefore, we believe that a phase-in approach would be appropriate for reporting quantitative information.

(Recommendation 5)

Currently, the authorities of each jurisdiction are developing data formats (data items/reporting templates) in their own ways. From the perspective of reducing the burden on international corporates, we would like for the formats between each jurisdiction to be made as consistent as much as possible. We also believe that consistent definitions for data will improve the comparability and reliability of the data.

In order to improve the quality of climate-related reports from financial institutions, it is essential for clients to respond to climate change and to make progress in disclosing information. To this end, it is important to coordinate and cooperate between financial supervisory and regulatory authorities and non-financial supervisory and regulatory authorities.

Incorporating systemic risks into supervisory and regulatory approaches

5. Does the report identify relevant system-wide aspects that should be considered as part of supervisory and regulatory approaches to incorporate systemic risks arising from climate change? Please elaborate on other aspects that should be considered, if any.

We welcome that this report mentions trade-off considerations. We are concerned that the excessive restriction of financial support as a response to climate change risks could impede the flow of capital to areas where climate change really needs to be addressed, and that regional economies will suffer an excessive negative impact. It is necessary to consider risks from the perspective of a “just transition”.

In this regard, when conducting scenario analysis for the next 30 years, we believe that the functions and mechanisms to disperse and mitigate risks that are distributed unevenly in a specific sector as a whole society should also be examined for their potential impact on systemic risk and possible pathways. For example, even though such functions and mechanisms for risk diversification/mitigation actually exist, if the effect of risk reduction is not fully considered, systemic risk might be calculated inappropriately. In order to avoid such a situation, we first need further analysis and objective data.

6. Does the report accurately reflect the extent to which current supervisory and regulatory

tools and policies address climate-related risks?

Further analysis is needed to determine whether current supervisory and regulatory tools and policies address climate-related risks. For example, we believe that data such as the "Second order effect" and "risk transfers between sectors" described on page 14 of this report should be analysed in detail, and then, after confirming quantitative support, it should be considered whether systemic risk exists objectively and to what extent. In the absence of sufficient objective analysis results, it is feared that proceeding with discussions on the appropriate means of regulatory supervision and policies might lead to erroneous responses, and should be avoided.

7. Do the proposed recommendations on incorporating systemic risks into supervisory and regulatory approaches, including the expanded use of climate scenario analysis and stress testing for macroprudential purposes, address the appropriate areas? Please elaborate if there are any other features or tools that should be considered.

(Recommendation 2)

We believe that it would be optimal to expand the use of scenario analysis and stress testing for macroprudential purposes, given the long-term nature of climate-related financial risks. We recognise that it will require more time to establish a quantitative financial risk analysis and management framework. In addition, the risk measurement method for climate-related financial risks is under development globally, and therefore we would like the FSB and authorities to consider the appropriate timeline for rulemaking, reflecting the progress of international practices.

(Recommendation 4)

As mentioned on page 41 of this report, we understand that while the impact of climate-related risks on credit and market risk is under consideration, the impact on other risk categories has not yet been examined. Therefore, as mentioned in Recommendation 4, we believe that it is necessary to organise cases and methodologies for expanding the scope of risk categories other than credit and market risk.

Early considerations on other macroprudential tools and policies

8. Are there other areas of work, literature or research being conducted on macroprudential tools and policies on climate-related risks that should be considered in the report?

We believe that data and analysis results such as the "Second order effect" and "risk transfers between sectors" described on page 14 of this report should be confirmed in detail.

In addition to the Adaptation Report 2021 published by the Bank of England (BoE) referenced in section 5.3, in the Discussion Paper on "*The Role of Environmental Risks in the Prudential Framework*"[4] by the European Banking Authorities (EBA) published on 2 May 2022 and the Progress Report on "*Capturing risk differentials*

[4] https://www.eba.europa.eu/eba-launches-discussion-role-environmental-risks-prudential-framework

from climate-related risks"[5] by the Network of Central Banks and Supervisors for Greening the Financial System (NGFS) published on 19 May 2022, we recognise that the need for forward-looking analysis tools and time horizon considerations are identified as issues that are related to the incorporation of climate-related financial risks into Pillar 1 of prudential framework.

Additional considerations

9. Are there any other issues that should be considered in future work of the FSB on supervisory and regulatory approaches to climate-related risks?

(Global Consistency)

We support the FSB's effort to promote consistent frameworks across sectors and jurisdictions in a supervisory and regulatory approach to climate-related risks. However, several jurisdictions are already in the process of implementing or drafting supervisory expectations or guidelines on climate-related risks. If a financial institution operating globally is required to comply with all the different requirements in each jurisdiction, it would cause an undue burden and ineffectiveness, and might even give rise to conflicts between jurisdictions. We expect the FSB to take a leading role in harmonising the supervisory and regulatory approaches across jurisdictions. Having greater consistency across jurisdictions will allow financial institutions to concentrate their efforts and resources on effectively managing climate-related financial risks. A mutual equivalent mechanism between supervisors should also be encouraged.

(Risk-Based Approach)

The introduction of additional capital impositions on financial institutions and the introduction of a brown penalising factor for climate-related financial risks could lead to a decline in financial institutions' ability of lending and a worsening of the real economy as a whole, and conversely impair the stability of the financial system. Climate-related financial risk measurement, like other Basel regulations, should be a risk-based measurement method rather than a policy tool to incentivise or disincentivise financial institutions to take specific actions.

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We thank the FSB for the opportunity to comment on the Interim Report and hope our comments will contribute to further consideration in the FSB.

Yours faithfully,

Japanese Bankers Association

[5] https://www.ngfs.net/en/communique-de-presse/ngfs-publishes-two-new-documents-climate-related-risk-differentials-and-credit-ratings