February 16, 2022

Secretariat of the Basel Committee on Banking Supervision
Bank for International Settlements
CH-4002 Basel, Switzerland

Japanese Bankers Association

JBA comments on the BCBS Consultative Document: "*Principles for the effective management and supervision of climate-related financial risks*"

Dear Basel Committee members:

The Japanese Bankers Association[1] (JBA) appreciates the opportunity to provide our comments on the Basel Committee on Banking Supervision's (BCBS) Consultative Document: "*Principles for the effective management and supervision of climate-related financial risks*"[2] (hereafter "the Principles") released on November 16, 2021. We hope the following will contribute to further consideration in the BCBS.

We welcome the BCBS to consider the principles for the effective management and supervision of climate-related financial risk, which aim to provide a common baseline for internationally active banks and supervisors across jurisdictions. We support the overall concept of the Principles, which focus on climate-related financial risks within the banking sector and maintain sufficient flexibility and proportionality given the degree of heterogeneity and evolving practices in this area. We believe that the BCBS's role, as the global standard setter for the prudential regulation of banks, should be primarily focused on the financial risks and financial stability implications for the banking system associated with climate change in line with its mandate, not the promotion of actions taken by banks to tackle climate change.

The Principles provide a comprehensive set of approaches for effective management and supervision regarding Pillar 2 (supervision/internal control). It should, however, be noted that there remain a number of challenges for fully implementing them at this stage, such as, but not limited to, the lack of available data, uncertainty of government policies (e.g. carbon pricing) that affect clients and the economy as a whole, and a lack of globally established methodologies and tools. Some of these challenges are also interdependent with clients' cooperation and climate-related disclosures. While our member banks iterate trial and error for the effective management of climate-related risks and engagement with their clients, these are iterative and progressive processes in nature, and require banks to prioritize the areas where they focus their efforts. Therefore, the Principles should be "end-point" expectations and we would like the BCBS and respective supervisory authorities to accept that the overall response of banks to climate-related risks is handled step by step from the perspective of risk, urgency, and feasibility levels (e.g., data collection from clients and information disclosure to stakeholders, as well as internal risk measurement, risk management, and senior management involvement).

We are also of the view that the quantification of climate-related financial risks should not be directly linked to incorporation into the internal capital and liquidity assessment processes immediately at this moment, given the state and uncertainty of data and risk quantification methodologies, and the numerous assumptions needed to carry out the quantification. Considering the potential adverse impact on clients and the economy more widely by getting the assessments wrong, the high degree of uncertainty should be interpreted as a need to sufficiently and carefully consider the margin of error in those assessments at least at this stage. Furthermore, we recognize that there are arguments by some policymakers or regulators on whether capital requirements (Pillar 1) need to be adjusted to climate-related financial risks. However, such adjustment should first require a thorough review and analysis as well as full impact assessments, and we believe there is no clear and sufficient evidence to justify

[1] The Japanese Bankers Association is the leading trade association for banks, bank holding companies, and bankers associations in Japan. As of February 16, 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.bis.org/bcbs/publ/d530.pdf

the necessity or rationality of that at this moment. The hasty introduction of a Pillar 1 approach might even threaten the level playing field on a global basis, given the situation where common data definitions and common methodologies have not been fully developed.

Our responses to the questions

Q1. Has the Committee appropriately captured the necessary requirements for the effective management of climate-related financial risks and the related supervision? Are there any aspects that the Committee could consider further or that would benefit from additional guidance from the Committee?

We support the BCBS's approach of taking a principles-based approach that seeks to achieve balance between improving practices related to the management of climate-related financial risks and providing a common baseline for internationally active banks and supervisors, while maintaining sufficient flexibility given the degree of heterogeneity and evolving practices in this area.

However, several jurisdictions are already in the process of implementing or drafting supervisory guidelines[3]. If a financial institution operating globally is required to comply with all the different guidelines in each jurisdiction, it would cause an undue burden and ineffectiveness and might even give rise to conflicts between jurisdictions. We expect the BCBS to take a leading role in harmonizing the supervisory and regulatory approaches across jurisdictions. Having greater consistency among the guidelines across jurisdictions will allow banks to concentrate their efforts and resources on effectively managing climate-related financial risks. A mutual equivalent mechanism between supervisors should also be encouraged and formally provided in the Principles.

Furthermore, we believe that the importance of cooperation and collaboration between financial authorities and non-financial authorities should be emphasized. Key policies by non-financial authorities, such as carbon tax, energy policies, and mandatory climate-related disclosure requirements for corporates will significantly affect the economic activities of each bank's clients. Financial authorities should endeavour to ensure that non-financial authorities understand and effectively coordinate the efforts by the financial sector in order to avoid unintended consequences for the economy as a whole.

Q2. Do you have any comments on the individual principles and supporting commentary?

The Principles cover comprehensive principles for addressing climate-related financial risks in order to ensure the enhancement of financial stability. On the other hand, the practice in this area is highly heterogeneous and is in a stage of continuous evolution, and we would like the BCBS to consider the following comments to make these principles more effective.

#	Prin.	Para.	JBA Comments
1	-	6	- Physical risk largely depends on the geographical characteristics of each country. In addition, transition risk largely depends on the industrial structure of each country and public policies by the government. Given the uncertainties and constraints in measuring climate-related financial risk, as well as the cost of making mistakes, at least at this stage, frameworks leading to undue capital charge without clear evidence should be avoided.
2	-	10	- Although it is necessary to measure long-term risks, it is very difficult to predict how society as a whole will transition to a low-carbon economy or how each corporate will change its business in the long-term. In addition, it should be noted that when and how much risk appears depend on the assumptions and presumptions by each bank, and therefore the variation in measurement might

[3] Japan Financial Services Agency (JFSA) plans to release a draft guidance regarding its supervisory expectation to encourage financial institutions' concrete actions this year. (https://www.fsa.go.jp/en/news/2021/20210618/04.pdf)

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			be large. We would like the BCBS to clarify the concept of the time horizon for measurement as much as possible, recognizing the need to balance these expectations with each bank's discretion to make its own risk-based determinations, in order to ensure a common understanding of the intention of the principles among banks.
3	- 18	10 61	- We need a consistent and common understanding (measurement or methodology) for a transmission channel from the risk driver of climate-related financial risks, although we understand that the BCBS report published in April 2021[4] mentions the transmission relationship. A common approach would bring about enormous benefits, such as accelerating the risk assessment process in financial institutions and allowing comparison and benchmarking across the global financial system.
4	4	18	- When incorporating climate-related financial risks into existing risk management, such as credit ratings and credit costs, there are a number of challenges, including different time horizons (an extremely long term for climate-related financial risks, which contrasts with current horizons used for existing risk management), and a lack of data availability and credible data (such as data on the relationship between climate-related risk and credit losses). Therefore, we recognize that it will require a considerable amount of time to establish quantitative financial risk management practices at the client level. We would like the BCBS to consider an appropriate timeline for rulemaking, reflecting the progress of international discussions.
5	4	19	- We would like the BCBS and respective supervisory authorities to accept that each bank's response is handled step by step, because it takes time to secure human resources and establish an evaluation method.
6	5	Prin.	- We would like to propose adding the words "in line with the evolution of data, capabilities, and methodologies" at the end of this sentence to bring it in line with the supporting commentary in Paragraphs 21-23, and to avoid any misunderstanding by those who read only the principles and take the meaning out of context.
7	5 7	21-23 28	- Regarding the data, since it is necessary to carry out accurate calculations based on a forward-looking scenario for climate-related financial risks, data on future management plans for each corporate client based on climate change is required. Also, global disaster data on climate change will be needed. Regarding the calculation method, it is necessary to introduce a common model on a global basis, especially for models that convert NGFS scenarios into risk factors for traditional financial risk. (Currently, we recognize that there are multiple Integrated Assessment Models such as REMIND or MESSAGE.) - At present, given the lack of data availability and sufficiently matured common methodologies in the field of climate-related financial risk management mentioned above, the BCBS should have sufficient flexibility for further development before incorporating climate-related financial risks into internal capital and liquidity adequacy assessments, including stress testing.
8	5	21	- In Japan, the current ICAAP is conducted under the three-year capital planning horizons scenario, which differs from the extremely long-term time horizon of 30 to 50 years under the climate change scenario. The time horizons of the above

[4] Basel Committee on Banking Supervision, *Climate-related risk drivers and their transmission channels* https://www.bis.org/bcbs/publ/d517.pdf

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			scenarios are not compatible. - At this time, since common quantification methodologies have not been established, it should be left to the efforts of individual banks, subject to appropriate dialogue with respective supervisory authorities, until a common time horizon is established.
9	5	23	- We would like to propose adding the word "capable" in front of the word "methodologies" in the second line of this paragraph to make the sentence consistent with the following sentence. - We understand that ICAAP will mature over time as methodologies and data availability become more advanced, as described in the Principles: "climate-related financial risks will probably be incorporated into ICAAPs and ILAAPs iteratively and progressively". From the viewpoint of improving comparability among banks, the establishment of a global standard for methodology should be focused upon as the first step, and then incorporating it into ICAAP should be considered later. At present, we understand that there is no established methodology for quantifying climate-related financial risks, such as a VaR measure.
10	6	26	- Given that it will take considerable time to develop key risk indicators, we request that quantitative risk mitigation measures using internal limits be allowed in a phased manner, along with the principle of materiality, on multiple axes, such as by risk category, by business line, and by region.
11	6	27	- According to Paragraph 27 of Principle 6, "banks should monitor future developments and seek to understand, and, where possible, manage the impact of climate-related risk drivers on other material risks that may not yet be apparent." Since this is also important for supervisors, a principle consistent with it should be added to the section of "Principles for the supervision of climate-related financial risks." We are still learning by doing for managing climate-related financial risks, and it would be beneficial and reasonable for both banks and supervisors to share their efforts and knowledge to better understand these risks.
12	7	Prin.	- Challenges include internal reporting and data constraints under decision making by the board and senior management. Data aggregation and analysis take a long time, and there are many issues that are difficult to solve through the efforts of a single bank and it might require the development of systems. Therefore, regulators and supervisors should have a long-term perspective and promote international and inter-firm initiatives related to data aggregation.
13	7	28	- Although system investment for data collection is necessary, it should be allowed to be considered after industrial entities and third-party vendors have standardized and clarified the definition of data to be disclosed.
14	7	29	- Since globally harmonized definitions of data aggregation have not been established and disclosure by corporate clients is not sufficiently advanced at this moment, each bank iterates trial and error in data aggregation. In such a situation, accurate risk measurement is difficult, so we would like to ensure careful consideration and sufficient time. - Although the BCBS allows the use of reasonable proxies and assumptions as alternatives, a globally harmonized definition of data or classification code is necessary to avoid the undue burdens and ineffectiveness of risk calculation in each jurisdiction. Duplicate work is more problematic where head office and

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			branches, or parent companies and subsidiaries, are located in different jurisdictions. - In order to obtain detailed output through scenario analysis, etc., elaborate management plans (for example, how to deal with climate-related risks) of corporate clients are required from the perspective of understanding long-term transition risks. Since the collection of these plans is likely to be very burdensome and time-consuming, we would like to ask for flexibility on the scope of risk measurement (for example, which industries or sectors should be targeted for risk measurement, etc.).
15	7	31	- As for the quantitative metrics of assessment, monitoring, and reporting, there are no common industry practices for quantitative indicators. It is more efficient for the BCBS or respective supervisory authorities to develop examples of harmonized methods and concepts, instead of each bank developing them individually.
16	8	32-33	- We would like the BCBS to allow banks to take a step-by-step approach, starting with sectors that are considered to have higher climate-related risk.
17	9-11	-	- Currently, although the impact analysis of climate-related risks on credit risk is ongoing, the same analysis on market/liquidity/operational risk is in its initial stage. So, we would like the BCBS and respective supervisory authorities to secure enough time to consider the measurement of climate-related risks on market/liquidity/operational risk. In particular, we should achieve a consistent and common understanding (measurement or methodology) of the transmission channel from the risk driver of climate-related financial risks on each risk.
18	9	35-36	- We understand that measuring market risk and other risks will mature over time as methodologies and data availability become more advanced. From the viewpoint of improving comparability among banks, the establishment of a global standard for methodology should be focused upon as the first step, and then evaluating the potential risk and establishing effective processes to control should be considered later. At present, we understand that there is no established methodology for quantifying climate-related financial risks, such as a VaR measure.
19	11	Prin.	- Supervisors and banks should work together to study specific risk scenarios of climate-related financial risks (particularly in the development of BCPs) in terms of operational risk and other risks, as well as methods of assessing the impact of climate-related risk drivers on these risks, methods of determining tolerance limits, avoidance methods, and mitigation methods. Regarding operational risk and other risks, there is no common understanding of specific risk scenarios for climate-related financial risks compared to the credit risk area. Therefore, it is necessary to clarify what mitigation measures should be considered for risk events.
20	12	Prin.	- We would like to propose adding the words “start building risk analysis capabilities and” after “should” in the first sentence, and also adding the words “, as the methodologies and data used to analyse risks continue to mature over time” at the end of the first sentence. It should be clarified that scenario analysis, like ICAAP or ILAAP, will mature as the methodologies and data availability become more advanced. - For quantifying climate-related risks, the scenario analysis is still a pilot exercise and undergoing improvement. It would be improved in an iterative manner, so we would like to request the BCBS and respective supervisory authorities not to

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			stick to one single result of the scenario analysis to determine the adequacy of capital and liquidity. An appropriate level of capital should be assessed by an appropriate risk measurement, so we should prioritize the enhancement of a risk management toolkit before incorporating it into capital imposition. We should focus on the enhancement of risk management first, for several years at least.
21	12	42	- More guidance could be provided in the selection of scenarios that "cover a range of plausible pathways" (e.g., 1 or 2 pathways selected from Representative Concentration Pathways (RCP) 2.6, RCP 4.5, RCP 6 or RCP 8.5) and employing the prevailing Nationally Determined Contributions (NDCs) of all countries at a specific point in time. This would allow banks to save resources and focus on assessing the impact from the most likely pathways. Furthermore, this would allow the results to be easily aggregated at the national, regional, or even global level.
22	16	56	- We support the BCBS's approach to promote collaboration between supervisors. To achieve this, we should take advantage of an existing framework, such as Supervisory College, rather than establishing a new framework. - The BCBS principle could go further to link Paragraph 56 with Paragraph 54, in that host supervisors should primarily use the home supervisor's approach to scenario analysis and/or stress testing in meeting their supervisory expectations. This would help to avoid the situation where host supervisors impose different scenarios or approaches to scenario analysis for individual entities within the same banking group, which might damage the effective and efficient management of such a banking group and its affiliated entities' vulnerabilities to climate scenarios.

Q3. How could the transmission of environmental risks to banks' risk profiles be taken into account when considering the potential application of these principles to broader environmental risks in the future? Which key aspects should be considered?

With regard to broader environmental risks, various risks such as biodiversity risk and water pollution risk, etc. can be included, and there seems to be no consensus on the scope. Before considering the impact on financial systems and individual financial institutions, it is important to discuss the scope of these risks, the impact on society and the economy, and what kind of risk scenarios can be envisioned.

In addition, many works are in the very early stage, such as identifying the transmission channel from broader environmental risks to financial risk, and assessing whether the impact and time horizon of that risk transmission can be calculated in the traditional risk category framework.

Furthermore, in terms of data availability and methodologies, those related to broader environmental risks are even much more premature than those of climate-related risks. Therefore, it is necessary to identify and conduct an adequate assessment/analysis before expanding the scope. For the same reasons discussed above in the case of climate-related risks, the imposition of Rough-and-ready quantification for broader environmental risks without reliable evidence, which could even impede the economy and the environment, should be avoided.

In conclusion, we would like to propose focusing on climate-related risks first, rather than immediately expanding the scope to broader environmental risks. Many issues remain regarding climate-related risks, and therefore the examination of new fields should not proceed prematurely. Environmental topics contain broader aspects, and analysis/assessment of risks related to such issues is in the initial stage. The world should gain experience by discussing climate-related issues first, and lessons learnt should be leveraged to discuss environmental issues. We also believe that it is necessary to enhance collaboration with relevant stakeholders, such as NGFS, FSB, or TNFD, and focus on a global consensus on these issues.

(End)