February 3, 2021

European Banking Authority
Floor 24-27, Europlaza, 20 avenue André Prothin,
La Défense 4, 92400 Courbevoie, France

Japanese Bankers Association

JBA Comments on the EBA discussion paper: "*Management and Supervision of ESG risks for credit institutions and investment firms*"

Dear Sirs/Madams:

The Japanese Bankers Association[1] (JBA) appreciates the opportunity to provide our comments on the European Banking Authority's (EBA) discussion paper: "*Management and Supervision of ESG risks for credit institutions and investment firms*" (hereafter "the discussion paper") on November 3, 2020. It is one of the most prioritized topics not only within the EU but globally to incorporate ESG factors to financial institutions' business strategy and risk management framework. The JBA welcomes EBA's work on ESG risks, including definitions, methodologies, banks' risk management framework, and monitoring by regulators, based on the mandate from the European Commission and relevant regulations/directives.

General Comments

The JBA member banks, as non-EU financial institutions, have operations in the EU. We assume the discussion paper will impact the future discussions on a global scale and hope our comments will contribute to the policy debate going forward.
In addition to the responses we have made to specific questions, we would like to provide some high-level comments as discussed below;

1. Discussions going forward

The EBA expresses its holistic views on ESG risks in the discussion paper, and we understand this is a good starting point for further discussions. Although we duly understand the importance of addressing social and governance risk, at this point in time, we recognize managing environmental risk to be one of our top priorities from a global regulatory perspective.

According to the CRR2, it is our understanding that after this consultation, the EBA is tasked to finalize the report by June 2021 and will consider how to incorporate ESG factors in Pillar 1 and Pillar 3 requirements. The JBA requests the EBA to continue engaging with the industry periodically during their work to secure transparency and reflect any inputs made by the industry in finalizing the reports etc.

2. Scope of application or extension to third-country banks of supervision in EU

While the discussion paper is not designed to be legally binding, we need to understand the scope of application from a non-EU banks' perspective for if and when banks are subject to taking any actions in the future. It should be clarified whether our business operations on a global basis would be in scope of the possible regulatory requirements deriving from the discussion paper. We believe the scope of application should be clarified in

[1] The Japanese Bankers Association is the leading trade association for banks, bank holding companies and bankers associations in Japan. As of February 3, 2021, the JBA has 115 Full Members (banks), 3 Bank Holding Company Members (bank holding companies), 73 Associate Members (banks & bank holding companies), 58 Special Members (regionally-based bankers associations) and one Sub-Associate Member for a total of 250 members. Several of its largest member banks are active participants in the EU financial markets.

future discussions and moreover the scope should be limited to entities established within the EU. The JBA believes this consultation will enhance the ongoing discussions about the appropriate approach to banking supervision between industries and regulators, as well as the coordination between regulators.

It is extremely important for EU policy makers to consider that if and when our home regulator (or other host regulators in other major jurisdictions where we operate) decides to introduce an ESG related risk management framework or set forth supervisory expectations and regulatory requirements in dealing with climate change risk, Japanese banks would be required to comply with those as well. However, if these are different and/or inconsistent with those deriving from the discussion paper, the compliance exercise would unavoidably be inefficient and possibly be ineffective to comply with multiple requirements. To avoid such inefficiencies and additional inconsistency in requirements, we encourage the EU policy makers to incorporate the framework of equivalency/deference with respect to the third country regulatory requirements, based on the communication and dialogues with regulators in other jurisdictions.

To secure a global regulatory framework that works, the consistency with other existing and future international regulatory frameworks, such as the Basel requirements, should be ensured. Further, we request the EU policy makers to coordinate with other regulators, not only within the EU, but in other jurisdictions.

3. Importance of globally standardized definitions/Securing the flexibility

In the discussion paper, the focus is mainly to propose standards and definitions of ESG factors and risks that have an impact on the bank's balance sheets and to propose some guidance on how to integrate them into risk management. The coverage extends beyond "transition risks" and "physical risks", which are globally recognized risks but to define "other risks" as well.

Standardized definitions are useful but need to be flexible enough to foster innovations and facilitate transition. Limiting the flexibility of definitions would limit the future development of the risk management framework for financial institutions. We believe taking into consideration banks business model and proportionality, a flexible approach should be allowed. To that point, each definition should be high-level and non-exhaustive. Also, the EBA should consider the alignment with other international discussions being made at the Financial Stability Board (FSB), the Task Force on Climate-related Financial Disclosures (TCFD), and the Network of Central Banks and Supervisors for Greening the Financial System (NGFS) etc.

4. Establishment of practical framework

In the discussion paper, the EBA sets out that the risk from the "counterparty" of banks, and associated risks from dealing with the banks should be identified, assessed, and managed. It also indicates "the concept of counterparty may be understood as a client (e.g. an entity, individual) or as an issuer (e.g. sovereign, entity)." We generally agree with this approach, although based on this definition of "counterparty", banks will need to include the multiple types of stakeholders involved. For example, identifying quantitative and qualitative ESG risk of inter-bank transactions or sovereign transactions is extremely difficult and any methodology will need further consideration.

Going forward, we request the EBA to continue discussions and engagement with various stakeholders not only in the EU but also globally in order to establish a more practical and usable framework.

Specific comments

Please refer to each answer/comment to questions in the designated answer format.

(End)

February 3, 2021

[Specific Comments]

	Question	Answers
Chapter4:Common definitions of ESG factors, ESG risks and their transmission channels		
1	Please provide details of other relevant frameworks for ESG factors you use.	・ Some Japanese banks established “Environmental and social policy framework” mainly for E and S factors, referring to the international discussions.
2	Please provide your views on the proposed definition of ESG factors and ESG risks.	・ Limiting the flexibility of definitions would limit the future development of risk management framework in each financial institution. Considering banks business model and proportionality, flexible approach should be allowed. Common definitions are useful, but need to be flexible enough to foster innovations and facilitate transition. ・ We generally support the efforts of the EBA to further develop environmental, social and governance risks as they materialize on bank balance sheets. ・ With the aim of moving forward to a more sustainable economy not only at European level, but also globally, there is a strong need for common definitions to help banks and other financial institutions integrate ESG related risks into their existing risk management framework in a consistent manner, to avoid any fragmentation along jurisdictional lines. ・ Our membership has been involved in the assessment and reporting of various ESG factors across a broad range of financial products. Although the current use of definitions of ESG will vary across the membership of the JBA, we would strongly encourage the EBA to align the proposed definitions with commonly referred frameworks, such as the GRI Standard, UN Global Compact, ISO 26000, Guidance on social responsibility, SASB (Sustainability Accounting Standards Board), Environmental Reporting Guidelines (2018) and the recommendations of the TCFD.
3	Do you agree that, for the purpose of assessing their inclusion in institutions’ and supervisors’ practices from a prudential perspective, ESG risks should be	・ We agree with EBA approach to prioritize ESG risks, as it is essential to strengthen relationship with various stakeholders such as customers or investors, as well as to recognize relevant risks appropriately. Appropriate recognition is mandatory to make the

	Question	Answers
	approached primarily from the angle of the negative impacts of ESG factors on institutions' counterparties? Please explain why.	right decision for lending. In addition, we believe that attention should be paid to business opportunities, including customer transitions, etc.. ・ ESG risk analysis initiatives are not yet mature in the market and there are cases with no correlation between the indicators. Consideration of hasty incorporation into prudential regulation (Risk Weighted Capital Requirements, etc.) before completion of these empirical analyses should be carefully considered, as it may create unintended distortions in economic activities and accumulate risks in the financial system. ・ There is currently no global consensus on the impact of climate change risks. We believe that the first step should be to establish international consensus on the impact of future climate change risks through thorough quantitative analysis, and then to consider what measures are necessary to mitigate such impacts from the perspective of prudential regulations.
4	Please provide your views on the proposed definitions of transition risks and physical risks included in section 4.3.	・ Physical risks are defined as acute and chronic risks. However, acute risks include many natural disasters, and chronic risks are affected by future projected changes in temperature. ・ For acute risks, there is a lack of public data on many disasters. ・ Chronic risks are also difficult to calculate without detailed sector assumptions. In addition, emphasis on bottom-up methods creates hurdles because of the need to obtain individual company data. ・ The concept of chronic risk and transition risk may overlap to some extent, and will need to be sorted out in the future. ・ As described in Section 55, it is desirable to establish a certain degree of common risk measurement method for each risk driver and each sector, since there is no common method for risk transfer, information gathering from a wide range of data sources is necessary, and risk categories are defined a little different for NGFS and TCFD.

	Question	Answers
		・ It is also necessary to sort out the interaction between transition risk and physical risk in the future. However, since the prerequisites and technical knowledge and parameters required for transition risk and physical risk are completely different, it is necessary to devise ways to set up scenarios that are consistent between the two.
5	Please provide you views on the proposed definition of social risks and governance risks. As an institution, to which extent is the on-going COVID-19 crisis having an impact on your approach to ESG factors and ESG risks?	・ We would like to request more detailed definition especially for S and G. As long as we understand, social risk can be defined as the risk of “not be compliant with the relevant rules and regulations”, governance risk can be understood as the governance framework we have implemented so far. We are afraid there are not any factors that are specific to climate-change banks should consider.
6	Do you agree with the description of liability transmission channels/liability risks, including the consideration that liability risks may also arise from social and governance factors? If not, please explain why.	・ We would like to seek more detailed explanations including some examples of the cases where liability risks would be revealed.
7	Do the specificities of investment firms compared to credit institutions justify the elaboration of different definitions, or are the proposed definitions included in chapter 4 also applicable to them (in particular the perspective of counterparties)? Please elaborate on the potential specificities of investment firms in relation to ESG risks and on how these specificities, if any, could be reflected in this paper.	NA
Chapter5: Quantitative and qualitative indicators, metrics and methods to assess ESG risks		
8	Please provide your views on the relevance and use	・ The EBA should adopt a phase-in approach.

	Question	Answers
	of qualitative and quantitative indicators related to the identification of ESG risks.	・ Banks are currently in the process of assessing the impact of environmental/climate risks, which can impact in the medium and long term solvability of their clients. Such risks could be assessed with external data and few variables that can be used to build models and stress tests. Since other “ESG” risks are much more difficult to quantify, a qualitative approach is a first stage to progressively include those risks in our framework. A phase-in approach is necessary to organize the internal processes, systems, organization and retrieve appropriate data. ・ Regarding the use of historical data, please ensure that the quantitative calculation method used by the parent company outside EU can be allowed to apply mutatis mutandis to the EU subsidiaries of foreign banks.
9	As an institution, do you use or plan to use some of the ESG indicators (including taxonomies, standards, labels and benchmarks) described in section 5.1 or any other indicators, inter alia for the purpose of risks management? If yes, please explain which ones.	・ We understand Japanese banks do not use nor plan to use any of the ESG indicators described in section 5.1 at the moment. However, one of our member banks upholds TCFD and has been calculating and disclosing carbon-related assets in accordance with the TCFD recommendations since FY2019. With respect to calculation of carbon-related assets, the bank adopts the sector approach, in which the utility sector and the energy sector are specified as the scope and exposures that do not correspond to carbon-related assets (water project, renewable energy, etc.) are excluded from the utility and the energy sector. Incidentally, the bank is currently still under discussion how to utilize and develop the calculated figures.
10	As an institution, do you use or plan to use a portfolio alignment method in your approach to measuring and managing ESG risks? Please explain why and provide details on the methodology used.	NA
11	As an institution, do you use or plan to use a risk framework method (including climate stress testing	・ As an individual institution, scenario analysis has been conducted and we are planning to take deep study about necessary information to conduct scenario analysis following

	Question	Answers
	and climate sensitivity analysis) in your approach to measuring and managing ESG risks? Please explain why and provide details on the methodology used.	NGFS scenario, such as data and schedule, coordinating with Japanese Financial Services Agency (JFSA). We have yet to conduct stress testing as we are currently still under consideration.
12	As an institution, do you use or plan to use an exposure method in your approach to measuring and managing ESG risks? Please explain why and provide details on the methodology used.	・ Currently we have yet to use.
13	As an institution, do you use or plan to use any different approaches in relation to ESG risk management than the ones included in chapter 5? If yes, please provide details.	・ Currently we have no plan to use.
14	Specifically for investment firms, do you apply other methodological approaches, or are the approaches described in this chapter applicable also for investment firms?	NA
Chapter6: The management of ESG risks by institutions		
15	Please provide your views on the extent to which smaller institutions can be vulnerable to ESG risks and on the criteria that should be used to design and implement a proportionate ESG risks management approach.	・ Smaller institutions could be damaged more severely than large institutions/G-SIBs when ESG risks are revealed since their capital/liquidity capability to absorb those risks is limited. To some extent, smaller institutions should prepare for managing ESG risks. Proportionate approach should be implemented, based on the discussion with their home regulators.
16	Through which measures could the adoption of strategic ESG risk-related objectives and/or limits be further supported?	NA

	Question	Answers
17	Please provide your views on the proposed ways how to integrate ESG risks into the business strategies and processes of institutions.	NA
18	Please provide your views on the proposed ways how to integrate ESG risks into the internal governance of institutions.	・ Senior management governance framework, such as Risk Committee and Executive Committee, should be used. In addition, using disclosure framework such as integrated report or quarterly report is also essential.
19	Please provide your views on the proposed ways how to integrate ESG risks into the risk management framework of institutions.	・ We are recognizing ESG risk as one of our top risks and have started to consider integrating ESG risks into risk appetite framework in the medium to long term. However, we still have challenges in data availability and lack of evidence to integrate ESG perspective in assessment of creditworthiness or repayment ability of clients. Therefore, we believe that integrating ESG risks into the risk management framework requires a careful consideration at this stage. ・ In addition, with regards to recovery plans referred in page 113, it should be considered carefully to integrate elements of ESG risk (especially transition risk) management into recovery plans. There is the large gap in the concept of time frame between current recovery plans and the recommendation in the discussion paper. Current recovery plans require consideration of short-term recovery measures to recover from the current possible crisis (which requires recovery within one to several years at most). However, the analysis and management of ESG risks such as climate change risk requires consideration of a long-time horizon of several decades. Therefore, it is essential to make appropriate adjustments in the handling of this gap in order to integrate elements of ESG risk (especially transition risk) management into recovery plans properly.
20	The EBA acknowledges that institutions' approaches to environmental, and particularly climate-related, risks might be more advanced	・ We acknowledge S and G risks are important. However, since the impact of climate-related risks to banks' balance sheet is significant and interest of global regulators is increasing, we are dealing with environmental risks, especially on climate-related risks,

	Question	Answers
	compared to social and governance risks, and gives particular prominence in this report to the former type of risks. To what extent do you support this approach? Please also provide your views on any specificities associated with the management of social and governance risks.	in terms of risk management. We are planning to deal with S and G risks in the future, based on the importance of these risks. ・ Considering its emergency, we suggest prioritizing environmental risks, especially on climate-related risks. With regards to S and G risks, as we respond to the previous question, there are no consistent definitions of those risks yet, as well as methodologies to identify, assess and manage them. The impact from those two risks to banks' balance sheet is not ignorable, and we need to approach them in the future, but detailed study and global stock takings are indispensable.
21	Specifically for investment firms, what are the most relevant characteristics or particularities of business strategies, internal governance and risk management that should be taken into account for the management of the ESG risks? Please provide specific suggestions how could these be reflected.	NA
Chapter7: ESG factors and ESG risks in supervision		
22	Please provide your views on the incorporation of ESG factors and ESG risks considerations in the business model analysis of credit institutions.	・ Strengthening supervision of climate and environmental risk management should be coordinated with changes in the social structure or the development of appropriate risk reduction measures for such risks. ・ In addition, if only strengthening risk management is to be pursued first, it is desirable to consider sharing the burden of such risk management between the financial institution or its customers. ・ While it is possible to consider how climate change and environmental risks should be defined and managed, it is difficult to expect the automatic-risk-blocking effect immediately after the risk appetite and the risk limit are applied and the relevant risks are taken into consideration.

	Question	Answers
		・ The expected effects should be carefully verified and judged, and it should be recognized and understood that decisions on a case-by-case basis will be necessary, and that flexibility should be allowed. ・ Any guidance from the international standard setting bodies needs to be principle based to cater for local specificities. ・ Given the mutual dependency between borrowers and lenders (i.e. banks can only be “green” when borrowers become “green”), banks have the responsibility to facilitate the transition to “greener” activities through engagement, and any standards need to support such facilitation.
23	Do you agree with the need to extend the time horizon of the supervisory assessment of the business model and introduce as a new area of analysis the assessment of the long term resilience of credit institutions in accordance with relevant public policies? Please explain why.	・ We agree that risk management horizons should be prolonged compared with the current stress testing or supervisory analysis. However, the longer the time horizon will be, the less accurate the result of stress tests or assessment will be, because its uncertainty will increase. Banks and regulators should thoroughly discuss time horizon in advance to reach a consensus. Our final goal may be 2050, but considering 30 year horizon at one jump is not realistic, rather, we should set practical and predictive time horizon with the mind of 2050 target year when banks establish ESG risk management framework. ・ We acknowledge that the current 3-4 years risk management horizons will need to be expanded in order to facilitate the longer-term perspective needed to assess ESG risks. Currently banks have discussed a 10 years horizon, which is compatible with the weighted average life of bank assets.
24	Please provide your views on the incorporation of ESG risks considerations into the assessment of the credit institution’s internal governance and wide controls.	NA
25	Please provide your views on the incorporation of	・ We are under discussion.

	Question	Answers
	ESG risks considerations in the assessment of risks to capital, liquidity and funding.	
26	If not covered in your previous answers, please provide your views on whether the principle of proportionality is appropriately reflected in the discussion paper, and your suggestions in this respect keeping in mind the need to ensure consistency with a risk-based approach.	・ Please clearly state that the supervisory policy and approach of the home country authorities of foreign banks with headquarters outside EU should be fully considered in the application of this guide to the EU subsidiaries of foreign banks. ・ It is preferable that proportionality will be secured, but it is better to provide more specific information on what kind of simplification is possible.
27	Are there other important channels (i.e. other than the ones included in chapter 7) through which ESG risks should be incorporated in the supervisory review of credit institutions?	NA
Annex1		
28	As an institution, do you use or plan to use some of the indicators and metrics included in Annex 1? If yes, please describe how they are used in relation to your ESG risk management approach.	NA
29	If relevant, please elaborate on potential obstacles, including scope of applicability, granularity and data availability, associated with the indicators and metrics included in Annex 1.	NA

(End)