Japan Securities Dealers Association
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March 8, 2024

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

**Consultation Response:**
**Basel Committee on Banking Supervision - "Disclosure of climate-related financial risks"**

Dear Sir/Madam:

The Japan Securities Dealers Association (JSDA) welcomes the opportunity to comment on the Basel Committee on Banking Supervision's (BCBS) consultative document "Disclosure of climate-related financial risks" (hereinafter, the "Consultation") and appreciates the work on the part of the BCBS to address climate-related financial risks posed to the global banking system.

Climate change is a critical issue faced by all stakeholders—across borders and sectors—and we believe a response to the issue is an urgent and high-priority matter. In this regard, we at the JSDA, a self-regulatory organization and trade association for the Japanese securities industry, have been promoting bonds such as Green Bonds and Social Bonds, as well as transition finance, with our member firms.

The JSDA has member firms that are subject to the Basel Framework. Moreover, the Consultation explicitly includes references to disclosures of facilitated emissions, the gross emissions attributed to capital markets and financial advisory services, which can potentially impact the intermediary function in the securities market, including in the field of climate transition finance. As such, we provide the following comments, predominantly in response to Q51 on disclosure of facilitated emissions. We strongly hope the BCBS takes our comments and views into consideration in its discussions going forward.

We submit these comments under the premise that the BCBS sets standards dedicatedly in pursuit of financial stability and enhancing the soundness of financial institutions. At the same time, industrial financial policies are clearly essential to achieve decarbonization, and the Japanese securities industry will continue to proactively work with the various industrial policy makers toward fostering climate transition finance and, through such discussions and collaborations, promote the financing necessary to achieve a sustainable society.

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**In Response to Q51**

| Q51. What are your views on the feasibility, meaningfulness and practicality of banks' disclosure of facilitated emissions? |
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We have the following three concerns outlined in A) through C) with regard to the feasibility, meaningfulness, and practicality of the disclosure of facilitated emissions. Given these concerns, we believe that it is more pertinent to consider the points raised in D), rather than formally formulate disclosure rules at this stage.

**A) Disclosure Rules Based on Financial Risks Posed to Soundness of Financial Institutions**

We share the view of the Consultation that the Pillar 3 disclosure framework for climate-related financial risks should be discussed specifically from the perspective of how such risks impact the soundness of financial institutions. That said, the Consultation has not provided a prudential rationale for how providing capital markets and financial advisory services subject to disclosures of "facilitated emissions" can potentially lead to transition risks that impact a bank's financial soundness. While such capital markets and financial advisory activities are a profitable source of revenue for financial institutions, they have been regarded as capital-light businesses. There have been no instances in the past where a decline in these revenues has triggered a financial crisis.

Therefore, the facilitated amount (i.e. the transaction value of the capital markets and financial advisory activities) and facilitated emissions do not represent direct metrics for financial risk that potentially affects the soundness of financial institutions. If such information is disclosed under the Pillar 3 framework despite not being a direct indicator for financial risk, this may unintentionally mislead or misdirect investors in their risk assessments, and ultimately facilitate an improper form of market discipline. Disclosure requirements without clear and logical rationales may raise concern that the BCBS is requesting disclosure with a hidden intention beyond its mandate.

In light of the above, we believe it necessary to clarify how capital markets and financial advisory activities pose material financial risks that can potentially threaten the soundness of financial institutions, specifically in terms of the recognition of risk and risk-weighted assets calculations under the Pillar 1 and 2 frameworks. If disclosure regulations are introduced before establishing a method on how to recognize the risk, there is the concern that the provision of figures will be reduced to mere formality, comparisons of them will not reflect the actual reality, and the disclosed figures will take on a life of their own after publication.

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**B) Practical Challenges in Disclosure of Facilitated Amounts and Facilitated Emissions**

The Consultation provides illustrative templates for the proposed disclosures of historic information as well as forecasts, and Template CRFR5 is dedicated to facilitated emissions related to capital markets and financial advisory activities. However, in Template CRFR5, important terms such as "capital markets activities" and "financial advisory activities" are not defined, and the methods of calculation for each column are unclear—as such, there may be large discrepancies across disclosed data, rendering the figures less useful for comparison.

Moreover, with regard to facilitated emissions, even if a precise and comparable calculation method were to exist, there are a number of challenges with respect to the interpretation of the metric itself. For instance, the calculation formula for facilitated emissions of a listed company pursuant to the PCAF standards is " GHG emissions of issuer × (facilitated amount / (market capitalization + total debt)) ×33% ". The outcome of facilitated emissions based on the PCAF formula will be affected by market factors such as changes in market capitalization and trend of the primary market, which do not relate to the emissions of the issuer. Moreover, the formula does not take into account differences in maturities—as such, companies that repeatedly issue short-term bonds are counted multiple times, resulting in inflated figures compared to those of companies issuing long-term corporate bonds or equities.

Disclosure of facilitated emissions has such technical and theoretical challenges, on top of challenges in refining the data on an issuer or client company's Scope 1 to 3 emissions commonly seen in calculating financed emissions.

Notwithstanding the above concerns, even if the BCBS were to proceed with Pillar 3 disclosures for climate-related financial risk including facilitated emissions, with respect to a proposed requirement of third-party assurance (Q10), we are still concerned that requiring such assurance for just climate-related financial risk disclosures would threaten the balance vis-à-vis other disclosure items under the Pillar 3 framework and risk the information being unintentionally and falsely conveyed with a larger weight to investors, undermining the whole picture of the Pillar 3 disclosure framework.

As such, we do not find it necessary to have third-party assurance mandatory, and in light of the fact that third-party assurance has been taken for sustainability-related disclosures in general, we suggest that the BCBS use language that indicates a bank may disclose voluntarily when it obtains third-party assurance, under the Pillar 3 framework.

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**C) Unintended Consequences to the Intermediary Functions in the Capital Market**

In addition to the concern that the disclosure of facilitated emissions would not effectively provide information of financial risk to investors, it may also result in unintended consequences to the intermediary function in the capital market. In this regard, discussions about disclosure of facilitated emissions differ from that of financed emissions, which are linked to a financial institution's investment and lending activities.

The securities market as an intermediary only functions insofar as the demands of investors and issuers match. As the paths to decarbonization pursued by issuers vary, so too do the investor demands for decarbonization, and underwriters are tasked with the challenge of striking a balance between these two objectives. If underwriters begin to set targets based on facilitated emissions, the transition plans of issuers, investors, and underwriters will become entangled, leading to a disruption in financial intermediation.

Disclosure of facilitated emissions will lead to discussions of setting reduction targets of the figures by underwriters, regardless of whether the figure itself is an appropriate metric for financial risk. In effect, for example, if an underwriter has set a quota for the allowance of facilitated emissions per year, there may be cases where the underwriter cannot mediate a transaction due to the aforementioned quota even if there were to be an issuer with a transition plan and a corresponding investor willing to invest in such issuer. In such cases, financing for projects contributing to decarbonization that would have materialized before is no longer possible. In particular, in the case of transition finance for high-emitting companies, the facilitated emission figures are expected to increase temporarily.

Further, increases and decreases in market share among securities firms—albeit not indicative of a change in the emissions of the economy as a whole—would directly impact the amount of facilitated emissions of each firm; that is, a securities firm that increases its market share would have a larger amount of facilitated emissions on that year. Given the variety of needs that exist in society that are not limited to decarbonization, we believe it is undesirable for securities firms that are increasing their market share and becoming more competitive through improvements in customer service to be at a disadvantage the more they grow. The ultimate objective should be a reduction in the emissions of the real economy as a whole, and focusing too strongly on the facilitated emissions of individual securities firms risks posing unintended negative effects on market competition.

Both issuers and investors are, in many cases, acting in accordance with their transition plan/strategies. Going forward, in light of the adoption of legal disclosure rules such as the ISSB standards, we would expect these transition plans/strategies would become more and more sophisticated. Additionally, recently major financial institutions engaged in capital markets and

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financial advisory activities have also established ESG screening policies to carefully scrutinize the individual projects in which they become involved. Therefore, there is less of a concern that financial institutions will engage in projects that deviate from the decarbonization policies of the countries in which they reside and be exposed to reputational risks that could threaten their soundness.

**D) Assessment of Transition Risk Based on Specific Industrial Policies Enacted in Each Jurisdiction**

In the finalization of Basel III, discussions were similarly made despite the limitation from a lack of data; however, after conducting repeated trial and error through multiple public consultations and Quantitative Impact Studies (QIS), the final rules were formulated. On top of using this approach, even after the implementation of the internal models method under the Pillar 1 framework and the Pillar 2 framework, financial institutions countlessly reviewed both data and risk measurement methods in order to adequately capture financial risk while receiving feedback from supervisory authorities, and finally incorporated them into their risk management processes. It is immensely meaningful for financial institutions and supervisory authorities to flexibly conduct thought experiments in this way, to allow for some roughness in data and to repeatedly revise the approach as deemed necessary. Imposing disclosure regulations before such a careful deliberation process would not lead to a meaningful understanding of the actual financial risks. We believe that the first step is to discuss policy approaches that can flexibly pursue ways to identify financial risks.

When considering the transition risk associated with capital markets and financial advisory activities, given that these transition risks are primarily human-induced policy risks, we believe it is important to fully grasp the actual risks in light of the specific industrial policies of each jurisdiction's government.

In the G20 New Delhi Leaders' Declaration agreed to in the India Summit in 2023, G20 leaders committed to "accelerating clean, sustainable, just, affordable, and inclusive energy transitions following various pathways, as a means of enabling strong, sustainable, balanced, and inclusive growth." In COP28's first global stocktake released on 13 December 2023, Parties were called upon to contribute to global efforts in decarbonization, taking into account the Paris Agreement and their different national circumstances, pathways, and approaches. Given that the economic circumstances surrounding each jurisdiction and sector vary, the likelihood, scale, and route through which transition risks will materialize depend largely on each country's specific industrial policy choices.

If disclosure requirements are incorporated into international standards without a full

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understanding of the actual financial risks, the fundamental issues remain unresolved, even if subject to jurisdictional discretion. If a jurisdiction seeks to introduce the disclosure regulations due to its own individual circumstances, the jurisdiction should independently demonstrate the purpose and significance of such disclosure and implement them separately from international standards.

In addition, even if a pathway through which transition risk manifests were to be identified, put another way, this would mean the real economy would suffer from corresponding damage. Before conducting any discussions on the loss absorbing capacity of financial institutions, we believe that it is more appropriate for financial regulators and industrial policy authorities to thoroughly discuss the transition risks associated with decarbonization policies. For example, for a financial institution’s investment and lending activities, in Japan, a working group jointly established by the Financial Services Agency, the Ministry of Economy, Trade and Industry, and the Ministry of the Environment, published a document outlining the specific ways to proactively conduct financing to pursue decarbonization without being unduly influenced by temporary increases or decreases in financed emissions. Taking these various discussions into account, for capital markets and financial advisory activities as well, we think it best to consider policy measures that would not serve as obstacles to the financing necessary for the transition to decarbonization.

Given the above, we believe that it is important to work on finding the optimal regulatory tool that is suited to the actual risk, rather than automatically focusing solely on the disclosure of facilitated emissions. Moreover, as capital markets and financial advisory activities are areas in which securities regulators, such as IOSCO, have expertise, we believe that it would be sensible to conduct discussions in an appropriate forum where policy measures can be considered from a variety of perspectives, not limited to prudential regulation.

**<u>In Response to Q6</u>**

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| Q6. What are your views on potentially extending a Pillar 3 framework for climate-related financial risks to the trading book? |

There are almost no references in the Pillar 1 and Pillar 2 frameworks regarding the risk calculations for climate-related financial risks on the trading book. As such, even if a Pillar 3 framework for climate-related financial risks were to be applied to the trading book, such disclosure would not serve meaningful or comparable for users. Discussions surrounding extending the Pillar 3 framework should be carried out at a stage when the Pillar 1 and Pillar 2 frameworks are fully established in this arena. Rather than disclosure regulations that lack flexibility to revise, we believe it would be desirable to consider policy measures that allow for

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flexible methods for identifying financial risks.

**In Response to Q52 and Q53 (Effective Date)**

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| Q52. What are your views on the feasibility of the potential effective date of the Pillar 3 climate-related disclosure requirements?<br>Q53. Would any transitional arrangements be required? If so, for which elements and why? |

While this Consultation aims to propose Pillar 3 disclosure requirements that would complement the ISSB framework, it also adds disclosure items that are not prescribed in the ISSB standards. As such, it is our opinion that the effective date of these requirements should be carefully considered regardless of the implementation date of the ISSB standards. In particular, with regard to the disclosure requirement of facilitated emissions, which the ISSB has decided not to proceed with, we believe that it is not necessary to take into account the implementation date of the ISSB standards.

From the perspective of compliance by financial institutions with these disclosure requirements, it would take time to identify the data necessary for quantitative disclosure, determine appropriate calculation methods, determine sector identification, and reconstruct existing data. Moreover, there are many aspects within this Consultation that lack clarity, and as such, financial institutions need to confirm the details of the disclosure requirements to begin preparations for compliance at each jurisdiction's rulemaking stage.

With the above in mind, in finalizing the Consultation, we believe that another public consultation is warranted to clarify the details of the disclosure requirements. With regard to the disclosure items not subject to jurisdictional discretion, the public consultation should also set a deadline for domestic rulemaking, and indicate a time schedule for financial institutions to prepare for implementation. In the finalization of Basel III, for instance, while 1 January 2022 was set as the initial implementation date, many jurisdictions including the US and the EU have still not yet completed the domestic rulemaking process—we believe there are lessons to be learned from this experience, which can be fully utilized here.

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This concludes our comments to the Consultation, primarily centered on Q51 on disclosure of facilitated emissions.

We highly appreciate the BCBS for providing this opportunity to hold a wide range of discussions with market participants regarding proposals at this early stage. We believe that such an approach is essential to creating effective and efficient standards to address climate-related financial risks in the financial system. We hope that our comments will be of some use to the

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BCBS's discussions going forward.

Yours sincerely,

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