

Remarks on green transition

Speech by Shigeru Ariizumi, Vice Minister for International Affairs, Financial Services Agency, Japan, at the “EUROFI Financial Forum 2024” on September 11, 2024

[Introduction]

Good evening, everyone, and it is my great pleasure to be here today. I would like to thank David Wright and the Eurofi team for inviting me to this financial forum in this historic and beautiful city of Budapest.

I would like to touch upon what the key messages will be for today. First of all, I think it will be important in terms of green transition to have the three following points. The first is that we need to have an inclusive and comprehensive approach. The second would be that we need a whole-of-economy, whole-of-government approach. Third is that, while we need to be ambitious in our aspiration, we must be practical in our approaches. I hope you do not leave now, as you have heard the key messages already.

Climate change is undoubtedly affecting everyone, and it is becoming more profound in various ways, particularly in recent years. It is a huge challenge that requires inclusive and comprehensive efforts, where all stakeholders need to work together. Today, I would like to share with you my thoughts and perspectives on the role of the financial authorities in our challenging journey.

【Green Transition】

Today’s theme is green transition, and firstly let me emphasize that a green transition cannot be achieved solely by the financial sector. It requires a whole-of-economy approach. While I fully understand and acknowledge the important role that the financial sector can play, every sector has its own respective ways to contribute. Such a comprehensive approach will enable all stakeholders to share the common goal, the common understanding and the benefits of a green transition. Under a market-driven economy, there are a variety of ways to push for a green transition. For example, regulations, incentives such as subsidies and tax breaks and carbon pricing. The view within the Japanese government is that collaboration among stakeholders provides a useful basis for a sustainable path towards achieving net zero. Our government has published a green transformation promotion strategy and sectoral roadmaps, thereby providing national benchmark transition pathways for industries. It not only outlines future transition plans, but also includes necessary public support for easier transition planning, even for SMEs.

The Financial Services Agency (FSA) has issued guidance encouraging financial firms to engage with clients to better support them in achieving their climate goals. These multi-faceted, on-the-ground, practical approaches will help create the fusion of formal

transition policies and market-driven transition approaches. I will refer to this later.

Next, let me turn to what financial authorities are doing to encourage our green transition. First is sustainability disclosure. As you are aware, various jurisdictions including the EU are taking steps to promote disclosure in sustainability. Promoting the disclosure of sustainability information, which could present not only risks but also opportunities to corporate finance, and enhancing constructive dialogue among key stakeholders such as investors, financial institutions and companies, can serve as leverage to encourage investment in sustainability. In light of the global nature of climate issues, priority should be given to introducing consistent, comparable, reliable, and interoperable disclosure standards in each jurisdiction, with the International Sustainability Standards Board (ISSB) standards as a global baseline.

Currently, the Sustainable Standards Board of Japan (SSBJ) is developing domestic standards which we believe would provide a functionally aligned outcome to the S1 and S2 standards finalised by the ISSB. They are currently under discussion, towards finalisation by March next year. While the SSBJ is working to ensure that domestic standards are functionally aligned to ISSB standards, the government is currently exploring how to apply the new standards. For example, we are discussing applying the standards gradually from companies with large market capitalisations, and setting an appropriate preparation time for disclosure and provision of assurances. We have also been mainly discussing the safe harbour rules and the scope and level of assurance. Here I think what is important is that we maintain the high quality of the standards while being mindful of the scalability aspect. This is not just about the size of the corporates, but the same applies for emerging economies as well.

Our government has been encouraging and supporting the private sector in starting sustainability disclosure. For me, the most important point is 'regulate but support'. This means we should take a whole-of-government approach. For example, in Japan we have provided a platform in which companies can use tools to calculate their greenhouse gas (GHG) emissions, in light of Scope 3 emissions. If you want to collect Scope 3 data, you need your clients, even the smaller ones, to be able to calculate that. Another thing we have been working on this platform is to be able to obtain emission intensity data of each product category, and also enable firms to see what the good practices are, so there is information sharing on the platform. This will make it easier for corporates, particularly the smaller ones, to be able to push their efforts towards net zero. In the private sector, some players are aiming to launch a mechanism to identify emissions throughout the supply chain – so it is not just about the single firm, but also about the overall supply chain – and to come up with a voluntary disclosure framework that SMEs can refer to when financial institutions and investors collect emission data from SMEs.

In this way, we believe that rather than seeking everything to be perfect from the

beginning, taking steady steps reflecting our present can push up the number of companies that respond to sustainability disclosure, and as a result improve the quality and quantity of information for investors in the longer term. The volume of sustainability investment is on the rise. If you look at what it was globally between 2016 and 2022, 2016 was \$22.8 trillion. In 2022, it was \$30.3 trillion. Looking to Japan, we find it was \$0.5 trillion in 2016, and \$4.3 trillion in 2022, so it has increased by eight times. We can see from this trend that investor interest in sustainability is growing. Simply put, we need to be ambitious in our aspiration, but practical in our approaches. The key to success in promoting green transition is how to respond practically while upholding high ideals.

[Transition Finance]

Next, I would like to talk briefly about transition finance. In our pursuit to net zero, steady decarbonisation will be critical, particularly in high emission industries such as electric power, steel and chemical. While we need to focus our attention to encourage these sectors from a whole-of-economy perspective, the reality is that not all industries can decarbonise very quickly. The government has published sector-by-sector roadmaps for high emission industries, encompassing future technologies and pathways that will help decarbonisation efforts. For the financial sector, the FSA has published guidance emphasizing the importance and identifying the ways in which financial institutions could engage with their clients to encourage them to move towards net zero. It is also clear that green transition requires huge global investment which neither the public sector nor the private sector alone can sufficiently provide. Japan has been advocating the importance of transition finance from the very beginning at the G20. However, its operationalisation remains a challenge, and I think that is also true for Europe.

Given that Asia accounts for a large share of global emissions, the accumulation of projects in Asia can contribute to its total reduction. The FSA has kicked off the Asia GX consortium – GX stands for ‘green transformation’ – with ASEAN countries, gathering high level participants from both the private and public sectors. Such regional approaches can help to consider public/private partnerships, including through identifying useful actual cases, hopefully leading to a consensus on best practices.

[Transition Plan]

Last but not least, let me talk about transition plans. For real economy corporations, transition plans are often strategic documents. When we talk about transition plans, it can mean aspirations to do better towards net zero. On the other hand, from a financial institution perspective, we are much more interested in the risks that it poses to clients, so there are differences of views on what transition plans should look like.

As I mentioned, while transition plans are used for various purposes, at least for

financial institutions, ensuring the implementations of credible transition plans by clients may also lead to the management of climate related risks, and this will not only reduce immediate transition and physical risks in their portfolios, but also ultimately bring down risks for the whole system, which is why financial authorities are interested in transition plans. One of the candidates for financial institutions' transition plan metrics is financed emissions. From Japan's perspective, given its backward-looking characteristics because financed emission is historical data, we need to supplement this with a set of forward-looking metrics that can measure how financial activities ranging from the provision of finance to engagement with clients contribute to emissions reduction alignment of client transition plans with net zero goals.

For example, there could be a temporary increase in financed emissions if you support high emissions sector but usually that comes with disposition of legacy assets later on, which will eventually reduce the financed emissions in the longer term. That is a forward-looking metric, and we need to be mindful of such aspects moving forward. Building on the above-mentioned guidance, the FSA aims to develop an effective monitoring framework for climate related risks. This framework will emphasize the dialogue with financial institutions, to identify the progress on how they manage climate related risks through supporting client alignment of transition plans, ultimately reducing climate related risk for the full financial system.

[Conclusion]

Let me finish by saying, as I mentioned at the outset, that we need to be inclusive. You may know that Japan does not take a taxonomy approach, because we think that all sectors should move towards net zero regardless of their characteristics, so we think an inclusive approach, a comprehensive approach, will be very important. Taking a holistic approach, such as the whole-of-economy, the whole-of-government approach will be quite important as well, and we also need to be practical in our approach. Under the whole-of-economy approach, we need to be mindful of the impact of our green transition on our macroeconomic policy management, competitiveness, and geopolitical tensions. By leveraging these approaches, we can avoid sustainability fatigue, but at the same time make steady and important progress towards green transition, which should remain as one of our top policy priorities. Thank you very much for your attention.