Creating an Enabling Environment to Scale-up Transition Financing to Accelerate Decarbonization of Hard-to-Abate Sectors

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Japan Public and Private Working Group on Financed Emissions
to Promote Transition Finance

1. Issues to be addressed

(1) Roles Expected of Financial Institutions to Achieve Carbon Neutrality

Climate change is a common challenge to all humankind, and to accelerate global carbon decarbonization, the transition of emerging economies, particularly in Asia, towards a carbon neutral society has never become more relevant. According to AIGCC[i], US$ 26 to 37 trillion of investment is required by 2050 for Asia's decarbonization. As this amount of investment is unachievable only through public finance, mobilization of private finance through partnership with financial institutions is crucial.

The decarbonization of Asia requires various efforts including energy transition tailored to each country' unique circumstances. Scaling up of public and private finance towards transition activities of hard-to-abate sectors (transition finance) is crucial, especially where options available today to decarbonize are technologically and economically limited. Financial institutions have a critical role to play in facilitating and supporting decarbonization by providing transition finance along with active engagement.

Financial institutions around the world have expressed their active contributions on decarbonization[ii] and have set ambitious targets to make their direct and indirect emissions "net-zero", including financed emissions. Japan welcomes this strong commitment of financial institutions to address this challenge and recognizes the need to further facilitate their efforts in fulfilling their contributions towards decarbonization.

(2) Characteristics of financed emissions

Financed emissions are a useful metric that allows for easy comparison and evaluation of climate-related risks of a financial institution's investment and/or lending book, and progress to reduce emissions. This metric allows stakeholders to track quantitative progress on decarbonization. Therefore, requiring Scope 3 disclosures including financed emissions is being considered both at the TCFD and the ISSB, and is being used as a proxy to assess financial institutions' progress toward net-zero emissions.

Indeed, in cases where a financial institution provides new finance to hard-to-abate sectors that require financing for transition, thereby contributing to the emission reduction of the real economy, this may temporarily increase the financed emissions of the financial institution. Since financed emissions are not the best metric when it comes to evaluating corporations' strategies or actions towards decarbonization, this consequence may disincentivize some financial institutions from engaging in financing due to the concerns on such temporary increase hindering their mid-term target and may lead to reluctance in financing transition activities which will merit decarbonization in the long term.

To achieve carbon neutrality in Asia and other regions, an unprecedented amount of financing towards decarbonization by hard-to-abate sectors for their transition is essential. Therefore, it is important to develop an approach, aligned with global industry best practices, and ensure global financial institutions' efforts toward net-zero are appropriately evaluated/rewarded.

2．Necessary Approaches

（1）Disclosure of Financial Institutions' Progress

As noted above, financed emissions are a useful metric which enables all stakeholders to track the progress in their journey toward net-zero. It has been highly recognized by financial institutions as a climate-related disclosure metric and acknowledged as one of the recommended disclosure metrics in the TCFD Framework, along with the ongoing discussions in the ISSB Framework on sustainability disclosure[iii].

Transition finance is critical in achieving 2050 carbon neutrality and meeting the goals of the Paris agreement. While new financing may temporarily increase the financed emissions of financial institutions, such finance is based on the premise of borrowers/investee companies to achieve carbon neutrality by 2050, and therefore will contribute to mid- and long-term decrease in both real economy emission and financed emissions.

Focusing only on the current financed emissions and its temporary increase may hinder transition finance that facilitates decarbonization of the borrowers and investee companies, which could result in a delay in achieving 2050 carbon neutrality and meeting the goals of the Paris Agreement. Financial institutions should showcase their contributions to the real economy decarbonization in a comprehensive manner by focusing on the capital mobilization for transition and innovation. To allow stakeholders to appropriately evaluate such contributions by financial institutions and to further scale-up finance mobilization towards decarbonization, a complementary metric(s) for financed emissions and disclosure framework is required along with the current methodologies.

（2）The Working Group's Role

Japan has been a leader in transition finance through various efforts in tandem with the private sector to facilitate proactive financing for decarbonization. Some examples include the development of domestic guidelines for transition finance consistent with international best practices, and sector-specific technology roadmaps that help determine the eligibility of transition. Moreover, Japan is sharing its experience with Asian countries, and provides comprehensive support for the transition of the region.[iv]

To discuss the complementary metric(s) and disclosures to scale-up transition finance, a working group was established in February 2023, with participants from 10 global financial institutions[v], in addition to the Financial Services Agency, the Ministry of Economy, Trade and Industry, and the Ministry of the Environment. The Working Group will make suggestions on international standards regarding disclosures for stakeholders to appropriately evaluate financial institutions' efforts towards net-zero by developing appropriate complementary metric(s) in line with and building on the existing global standards, and thus accelerate efforts towards the transition of the Asian region.

Providing a solution to the issues described above and thereby a full utilizing public and private finance is required to accelerate the journey to carbon neutrality on a global basis.

The Working Group will work to create an enabling environment for financial institutions to actively provide transition finance to facilitate decarbonization in achieving 2050 carbon neutrality through the following engagement strategies:

- ◆ To discuss among governments including G7 and G20, and
- ◆ For the private sector to contribute to the discussions at PCAF (on attribution methodology), at TCFD and ISSB (on disclosure), and at GFANZ and its sub-sector alliances (on transition planning and financing strategies).

3．Steps going forward

The Working Group will produce a report by summer 2023 on complementary metric(s) and associated disclosure of financed emissions consistent with the goal to scale up transition finance, in line with the global industry practice. The results will be shared widely through intergovernmental discussions and private initiatives to develop an enabling environment aligned with the goal to mobilize capital to facilitate decarbonization.

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[i] The Asia Investor Group on Climate Change (AIGCC) is an initiative to raise awareness and encourage action among Asia's asset owners and financial institutions about the risks and opportunities associated with climate change and low-carbon investing. It is part of a global alliance of investors for climate change which is comprised of 4 investor groups: AIGCC, IGCC (Australia and New Zealand), IIGCC (Europe) and CERES (North America).

[ii] Signing up to GFANZ's sub-sector net zero alliances.

[iii] PCAF has published a standard on methodologies regarding financed emissions in November 2020.

During the meeting of ISSB, disclosure of financed emissions as Scope 3 Category 15 was suggested. Furthermore, financial institutions who joined GFANZ's sector specific alliances are required accelerated effort to achieve 2050 net-zero including Scope 3 reduction and disclosure.

[iv] The establishment and dissemination of "Asian Transition Finance (ATF), "is promoted in collaboration with ATF Study Group as part of the Asian Energy Transition Initiative (AETI), Japan's comprehensive support for transitions in Asia. The ATF Study Group is led by Japanese private financial institutions and those from Asia, Europe, and the United States. The ATF Study Group published two publications in September 2022 to support transition in Asia financially: (A) Asia Transition Finance Guidelines for financial institutions and (B) ATF Activity Report including requests to governments and international organizations. Furthermore, the G7 has established the Just Energy Transition Partnership (JETP) to support the energy transition in emerging economies. It utilizes public funding to catalyze private finance mobilization to scale up financing to accelerate "managed phaseout" of coal-fired power plants and expansion of renewable energy.

[v] Members of the Working Group

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Observers

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- Japanese Bankers Association
- JAPAN INVESTMENT ADVISERS ASSOCIATION
- JAPAN EXCHANGE GROUP

Organizers

- Financial Services Agency
- Ministry of Economy, Trade and Industry
- Ministry of the Environment