

## Transition Finance Initiatives in Japan

Keynote speech by Tomoko Amaya, Vice Minister for International Affairs, Financial Services Agency of Japan, at the RI Japan 2022 on May 24-25, 2022

### 1. Transition Finance Initiatives in Japan

Thank you for the opportunity to deliver this keynote address.

This year's RI Japan conference is titled "Japan's responses to rapid global sustainable finance evolution" and I understand that a variety of ESG-related topics were discussed yesterday and this morning. Now, I would like to introduce transition finance initiatives in Japan.

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In order to achieve the goals of the Paris Agreement, it is essential to provide financial support for the transition, meaning the transition of high-emitting entities toward a decarbonized society. The Japanese government has long advocated the importance of transition finance to support businesses that cannot make this transition overnight. The importance of transition finance is now widely recognized internationally. At the G20 meeting held last October, a roadmap for sustainable finance for the next several years was approved, and in particular, a high-level framework for transition finance is to be established for the year 2022.

The approaches and tools used to promoting transition finance vary widely, which include taxonomy, disclosure, and financial product development. The EU, ASEAN, and other regions are taking approach that determining whether a particular economic activity is green or not by utilizing so-called "Taxonomy". They are now in vies of expanding Taxonomies to transitional activities. In Japan, on the other hand, we have approached business entities with a view to promoting transitions for hard-to-abate sectors. In developing a high-level framework for transition finance at the G20, as mentioned earlier, G20 countries are to deepen our understanding of common elements while acknowledging the diversity of such approaches and tools.

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Now, let me introduce the entity-based approach in Japan in detail.

This approach consists of two elements: first, the development of transition strategies by companies in hard-to-abate sectors. To be more specific, A: hard-to-abate sector entities wishing to finance climate change response should refer to the relevant sectoral transition

pathway, the Roadmap, and develop a credible transition plan to carbon neutrality along the pathway. Then, the second element is that B: investors and financial institutions properly evaluate and ensure the credibility of those entities' transition plans. Together, these two elements will prevent so-called "transition-washing" while mobilizing the funds necessary for the transition of high-emitting entities and, as a result, achieving the transitions necessary to meet the goals of the Paris Agreement.

In order to embody this approach, relevant Japanese ministries and agencies come together and published "Basic Guidelines on Climate Transition Finance" and "Sector-specific Roadmaps" to assist companies of hard-to-abate sectors in developing their own transition strategies.

## **2. Basic Guidelines and Sector-specific Roadmaps**

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On the next page, I will explain the "Basic Guidelines on Climate Transition Finance". These Basic Guidelines were released in May 2021 jointly by the Financial Services Agency (FSA), the Ministry of Economy, Trade and Industry (METI), and the Ministry of the Environment. Based on the guidelines of the International Capital Markets Association (ICMA) published the previous year, the Guidelines recommend four elements that should be disclosed to investors and others by entities that raise funds for transitions.

The four elements are (1) strategy and governance, (2) materiality of the environment in the business model, (3) science-based, and (4) transparency.

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To ensure the "science-based" required as the third element of the Basic Guidelines, a "Sector-specific Roadmaps" has been created for hard-to-abate sectors. We expect Roadmaps to be a reference for entities to use when developing their climate action strategies and for investors and financial institutions to help determine whether a entity's strategy and efforts toward decarbonization qualify as a credible transition.

To be more specific, the Sector-specific Roadmap is a science-based procedure of technologies that are expected to be developed and deployed to make hard-to-abate sectors carbon neutral by 2050. The technologies are presented along with basic information and a time line, referring to domestic policies and international scenarios.

So far, the METI and the Ministry of Land, Infrastructure, Transport and Tourism (MLIT) have published 10 roadmaps for 9 sectors: steel, chemistry, electric power, gas, petroleum, cement and paper/pulp, shipping and aviation.

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In addition, as part of its efforts to develop a market for transition finance, the METI is conducting a model project to support financing cases based on the basic guidelines and roadmaps, and as of the end of May 2022, 12 model projects have been developed.

On page 5 of the slide, I introduce a case study of Japan Airlines issuing a transition bond as an example. Japan Airlines developed a transition bond framework based on the basic guidelines and obtained a second-party opinion on the framework from Sustainalytics, a third-party evaluation organization. As such, Japan Airlines issued the world's first transition bond in the airline industry.

### **3. Key Takeaways**

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As described earlier, we are promoting an entity-based approach to promote transition finance, but we believe that our efforts is just getting started and that continuous improvement and development is still needed. Based on this premise, we believe that the value of taking this entity-based approach at this point is threefold: Dynamic, Flexible, and Interactive. Let me explain them in turn.

First, on the point of “Dynamic”, it goes without saying that the transition toward 2050 is "dynamic" procedure. Sector-specific Roadmaps, by their very nature, capture the "movement" toward net zero, as compared to a "static" classification of economic activity represented by Taxonomy. This allows companies to develop dynamic transition strategies toward decarbonization.

To enable this dynamic approach, the Guidelines and Sector-specific Roadmaps are not intended to represent a uniform threshold. Companies can flexibly develop their own transition strategies by referring to various tools. In this sense, the Japanese approach allows for “Flexible” responses according to the ever-changing transition pathways and circumstances in which companies find themselves. We should note that accountability for the strategy and transparency in the rationale and evaluation behind is required even under those flexibility.

Finally, since there are still few examples of practices related to transition finance, efforts by all stakeholders need to be refined through dialogue from a variety of perspectives. The “Interactive” process of transition planning by entities and evaluation by investors and financial institutions can contribute to building the credibility of these efforts and the capacity of all parties involved.

#### **4. Next Steps**

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Now, I have explained that "our efforts is just getting started". For the further development of the transition finance market, it is necessary to further strengthen the efforts of both companies and investors as well as evaluation agencies. In closing my speech, I would like to explain three specific actions that the FSA is considering and taking as necessary in the future.

First is the continuation of efforts by the public sector in cooperation with the private sector. In order to maintain the credibility and usefulness of the Sector-specific Roadmaps, it will be necessary to continuously and regularly revise and update the Roadmaps to reflect new socioeconomic conditions, including through dialogue with investors.

The second is to improve the quality and credibility of the efforts of external evaluators and financial institutions. In February of this year, the FSA launched a " Technical Committee for ESG Rating and Data Providers, etc. " By June, the committee aims to develop a code of conduct such as on transparency, objectivity, governance for ESG rating and data providers, with reference to IOSCO (International Organization of Securities Commissions)'s efforts. For financial institutions, supporting clients' transitions is important for building a business foundation resilient to change and for their own sustainable management. In April, the FSA released a draft "Supervisory Guidance on Climate-related Risk Management and Client Engagement," which positions proactively helping clients deal with climate change as central to financial institutions' response to climate change. It is scheduled to be finalized in June after public consultation.

Of course, it is also necessary for entities themselves to strengthen their own efforts. In order to promote corporate initiatives, the METI declared in February the establishment of a "GX League" as a forum for leading companies that are transitioning to carbon neutrality to contribute to the " Green Transformation" of the Japanese economy, in cooperation with the government and academic experts. By the end of March, 440 companies had endorsed this "GX League" concept.

The development of approaches to transition finance is still in its infancy internationally. Establishing this approach will be a dynamic process that will take decades. Therefore, rather than searching for a uniform and rigid solution, sharing various approaches and know-how across public and private sectors, as well as across jurisdictions, would be an important first step in advancing the Paris Agreement on a global scale. Based on this view, the FSA participates in discussion fora, such as the G20, IPSF (International Platform on Sustainable Finance), IOSCO, OECD (Organization for Economic Cooperation and Development) and NGFS (Network for Greening the Financial System) , and leads discussions as chair occasionally.

Not only are the discussions by the authorities and regulators, but the efforts and initiatives of private sector also crucial to achieve the ultimate goal of the Paris Agreement. RI Japan 2022 focuses on how Japanese institutional investors and financiers can make their presence felt in the growing global trend of sustainable finance. It is our sincere hope that this two-day discussion will lead to the sharing and implementation of practical Japanese approaches to transition finance and revitalize the market.