From Market Neutrality to Risk Discipline: a Green Central Banking Agenda for the Bank of Japan

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In 2025, Positive Money's Green Central Banking Scorecard found the Bank of Japan (BOJ) to be underperforming "relative to its potential" in terms of green central banking policies, given the country's well-developed financial system and institutional capacity.[2]

Since 2025, the BOJ's environmental policy toolkit has become more operationally consequential in three ways. First, the BOJ's Funds-Supplying Operations to Support Financing for Climate Change Responses (i.e., Climate Response Financing Operations) have continued to expand. Second, the BOJ's supervisory posture has shifted toward more structured integration of climate-related financial risks from dialogue, and integrated climate-change scenario analysis into supervisory dialogue expectations. Third, the BOJ has begun disposing its risk assets, adopting principles to sell its holdings of exchange-traded funds (ETFs) and real estate investment trusts (J-REITs), that imply the Bank will remain a major equity holder for a long time – making stewardship and portfolio alignment unavoidable governance issues.[3]

The BOJ can now move credibly toward a 'double materiality' approach – recognising both the financial risks posed by environmental change and the role of the financial system in shaping those risks – from 'green facilitation' (primarily supporting green finance through incentives and market development) without compromising its mandate or independence. To do so, the Bank should pursue four ambitious but feasible steps. These include: i) revising the Climate Response Financing Operations; ii) establishing a green collateral framework; iii) setting environmentally-resilient stewardship and portfolio strategies; and, iv) shifting to a double materiality approach in supervisory expectations and risk management.

Key steps the Bank of Japan has taken so far

According to the 2025 Green Central Banking Scorecard, the BOJ was relatively active on green monetary policy operations (16 points out of 50) compared to its ASEAN+3 peers, but contributed alongside other financial authorities to an underperformance on financial policy levers (14 out of 50), while only scoring 3 out of 20 points in the

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[2] *The East and Southeast Asia Green Central Banking Scorecard; Positive Money, 2025.*
[3] *Statement on Monetary Policy; BOJ, 2025.*

Scorecard's 'Leading by Example' category.[4] The BOJ's research and advocacy efforts were slightly above the regional average (6 points out of 10). The scorecard identified the BOJ's strong adherence to market neutrality and a preference for private-sector leadership as self-imposed constraints, which risk slow and fragmented growth in green and transition finance.[5]

The BOJ's green central banking actions so far can be categorised into four pillars:

i. *Strategy and internal governance*. In July 2021, the BOJ published a comprehensive climate strategy, linking climate change to potentially having an "extremely large impact" on medium- to long-term macroeconomic and financial conditions, and establishing an internal coordination structure (i.e., the Climate Coordination Hub).[6] The strategy states a desire to give consideration to market neutrality and to avoid direct involvement in micro-level allocation "as much as possible."

ii. *Targeted refinancing*. The BOJ's Climate Response Financing Operation provides funds against eligible collateral for climate-related lending and investment, with counterparties defining eligible activities subject to disclosure.[7] Initially offered at zero interest rate with incentives, the facility is now broadly aligned with the policy rate (around 0.75% as of early 2026) implying a shift toward a rate-neutral structure.[8] While the instrument's status as an active incentive tool has weakened, its role as a structural risk management tool remains. By maintaining the facility at a neutral rate, the BOJ is helping define a baseline for climate-competent banking, grounded in a double materiality perspective rather than relying solely on initiatives for green lending. Scope remains to strengthen incentives – through reserve remuneration, maturity, or balance-sheet treatment – without altering the monetary policy stance.

iii. *Assessment of market functioning and challenges*. The BOJ has supported market development through its integration of Climate Transition Bonds (CTBs) into its operations and collateral framework, signaling the Bank's willingness to facilitate transition finance. Without a double materiality lens that reflects the specific risks of these assets through adjusted valuations, however, this integration remains a tool of facilitation rather than risk-based neutrality. The

[4] See Box 1. Scorecard update.
[5] The BOJ itself noted, in its statement announcing the Funds-Supplying Operations to Support Financing for Climate Change Responses in June 2021, "The Bank considers that supporting the private sector's efforts on the [climate change] issues from a central bank's standpoint will contribute to stabilizing the macroeconomy in the long run. In taking actions from the monetary policy side, the Bank deems it important to give consideration to market neutrality. Against this background, in order to support private financial institutions' various efforts in the field related to climate change, the Bank judged it appropriate to introduce a new fund-provisioning measure, through which it provides funds to financial institutions for investment or loans that they make to address climate change issues based on their own decisions." See Statement on Monetary Policy; BOJ, 2021.
[6] The Bank of Japan's Strategy on Climate Change; BOJ, 2021
[7] Principal Terms and Conditions of the Funds-Supplying Operations to Support Financing for Climate Change Responses; BOJ, 2024. The scheme is valid through end-March 2031 unless the smooth conduct of market operations are interfered with.
[8] Outline of Climate Response Financing Operations; BOJ, 2021. Current and future take-up, therefore, is likely to be driven by banks seeking stable, long-term liquidity and regulatory alignment rather than direct profit from a concessional spread.

BOJ has also begun assessing the pricing of climate risks through its market functioning surveys, which indicate gradual but incomplete incorporation of climate risks into asset prices.[9]

iv. *Financial-system monitoring and scenario analysis*. In 2025, the BOJ and the Financial Services Agency (FSA) jointly conducted a second scenario analysis on climate-related risks with major banks, utilising the BOJ-FSA common scenario.[10] The analysis treated climate risks as drivers of credit and market risks and focused in part on shorter-term transition risk. The BOJ's *On-Site Examination Policy for Fiscal 2026* links these analytical exercises to supervisory dialogue – urging institutions to enhance scenario analysis, disclosure, and engagement with corporate customers. Specifically, the on-site examination policy prioritises an assessment of whether financial institutions "identify and manage climate-related financial risks, their information disclosure, and their engagement with corporate customers".[11]

Where the approach falls short

The BOJ's green policies are balanced poorly. The Bank's green lending operations are comparatively innovative, but its limited use of regulatory and supervisory levers and standards restrict its impact on the orientation of the financial system. Three key gaps in their approach are:

i. *Standard setting*. The BOJ's climate refinancing facility allows counterparties to determine what counts as activity that addresses climate change. Although counterparties are required to disclose their guidelines, the absence of fixed standards and inconsistent definitions risks undermining its effectiveness.[12] Japan has been building its disclosure foundations, but disclosure alone does not provide a consistent financing classification or prudential basis.

ii. *Risk discipline in core monetary operations*. The BOJ's climate stance remains concentrated in a targeted facility and market-development support, without comparable integration of climate or nature risk into its collateral framework or into its holdings of risk assets.[13]

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[9] *Results of the Fourth Market Functioning Survey concerning Climate Change; BOJ, 2025. The survey indicates that climate-related risks are increasingly being priced into the Japanese stock and corporate bond markets, with increasing maturity. The survey covers the stock market and the corporate bond market (specifically ESG bonds such as green and transition bonds). Respondents noted that the climate change-related ESG bond market remained stable, supported by Japan's GX strategy and the BOJ's climate-related funding facilities.*
[10] *The Second Scenario Analysis on Climate-Related Risks; FSA, 2025.*
[11] *On-Site Examination Policy for Fiscal 2026; BOJ, 2026, and On-Site Examination Policy for Fiscal 2025; BOJ, 2025.*
[12] *According to the Principal Terms and Conditions of the Funds-Supplying Operations to Support Financing for Climate Change Responses; BOJ, 2024, investment or loans that contribute to addressing climate change "shall be those that counterparties themselves determine to satisfy" as either "corresponding international standards or the Japanese government's guidelines" or "are substantially equivalent" to them.*
[13] *The BOJ has supported the development of Japan's sovereign Climate Transition Bond (GX bond) market by treating these instruments as eligible collateral within its monetary operations, thereby ensuring liquidity and facilitating market acceptance. However, consistent with its adherence to market neutrality, the BOJ has not provided explicit preferential treatment – such as differential haircuts or targeted purchases – limiting its role to one of market support rather than active portfolio tilting.*

iii. *Macroprudential oversight and supervisory stringency*. BOJ-FSA scenario analysis has become more sophisticated, and BOJ on-site policy now references climate risk management. However, Japan's posture still relies heavily on guidance, dialogue, and voluntary practices rather than explicit prudential expectations with credible escalation. International standards provide guidance for a stronger approach. The Basel Committee on Banking Supervision (BCBS) issued final principles for the effective management and supervision of climate-related financial risks in June 2022, intended to improve both banks' risk management and supervisors' practice.[14] The BOJ can align its on-site examination policy to those principles without needing to develop a Japan-only framework.

The BOJ's emphasis on market neutrality – which embeds carbon bias and weakens risk management – remains a central constraint.[15] Within its mandate, the BOJ can address these constraints by framing environmental measures as financial risk management within monetary and supervisory operations. Such an approach is consistent with supporting the resilience of the macroeconomy over the medium- to long-term. At the same time, the government's primary responsibility for climate and environmental policy – reflected in Japan's GX strategy and transition frameworks – provides an essential anchor, helping to legitimise and guide the Bank's operational decisions, including those related to collateral frameworks, asset purchases, and fund-provisioning measures.[16]

What the BOJ should do next

The BOJ can align its operations with a double materiality framework through four feasible measures consistent with: i) the BOJ's statutory mandate (i.e., price stability and contributing to financial system stability); ii) the BOJ's own environmental strategy framing (e.g., climate as macro-financial-stability relevant, while minimising micro-level allocation of funds); and, iii) emerging central bank best practice – as surveyed by the Network for Greening the Financial System (NGFS) on greening monetary policy operations (e.g., collateral haircuts, portfolio tilting and screening, targeted lending, and balancing market neutrality).[17, 18, 19, 20]

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[14] *Principles for the effective management and supervision of climate-related financial risks; BCBS, 2022.*

[15] *Central banks face an inherent tension between preserving policy neutrality and independence, and taking actions that may influence the allocation of financial resources. See Central Banks and Climate Change: Key Legal Issues; IMF, 2024. In addition, NGFS technical work makes clear that central banks are moving to operational instruments from principles precisely because climate risks may not be fully priced into securities and a strict market neutrality posture can embed implicit carbon bias. See Greening Monetary Policy Operations: Exploring Additional Options; NGFS, 2026. The Bank's emphasis on market neutrality is stated in its climate change strategy: "In taking actions from the monetary policy side, the Bank deems it appropriate to give consideration to market neutrality, avoiding direct involvement in micro-level resource allocation as much as possible." See The Bank of Japan's Strategy on Climate Change; BOJ, 2021.*

[16] *The BOJ Act requires close contact with the government so monetary policy and the government's basic economic policy remain compatible. The BOJ shall, "always maintain close contact with the government and exchange views sufficiently, so that its currency and monetary control and the basic stance of the government's economic policy shall be mutually compatible." See The Bank of Japan Act, Cabinet Office, 1997.*

[17] *The Bank of Japan's Strategy on Climate Change; BOJ, 2021.*

[18] *What are the purposes of the Bank?; BOJ website.*

[19] *The Bank of Japan's Strategy on Climate Change; BOJ, 2021.*

[20] *Greening Monetary Policy Operations: Exploring Additional Options; NGFS, 2026.*

1. Revise the Climate Response Financing Operations

The BOJ should upgrade its Climate Response Financing Operations into a transition-aligned facility with clearer eligibility, stronger conditionality, and explicit guardrails against greenwashing from a simple refinance window. The rapid increase in climate-response lending – to ¥21.11tr as of January 2026 – indicates strong demand for the facility, with its share of BOJ lending rising significantly since mid-2025.[21] Tightening the facility's integrity could have system-wide signaling and data standardisation effects, moving it beyond a niche pilot scheme.[22]

Currently, the BOJ's terms set the maximum loan size at the amount of counterparties' climate-relevant lending and investment, and allow counterparties themselves to determine qualifying activity (subject to disclosure of the standards and guidelines used). The BOJ can retain the existing architecture while tightening three design elements.

First, the BOJ can establish an eligible activity list, anchored in audited disclosure standards. The BOJ's operational outline links counterparty disclosure to the four pillars in the Task Force on Climate-related Financial Disclosures (TCFD) recommendations, and references the Sustainability Standards Board of Japan's (SSBJ) standards.[23, 24] The next step is to require facility-eligible finance to be: i) reported under SSBJ standards, which are aligned with international baseline frameworks; and, ii) classified under a transparent facility taxonomy that the BOJ adopts for this operation. Consistent with IMF legal guidance, the BOJ should frame this as an operational classification for risk control and impact integrity, and anchor it in existing government frameworks – notably Japan's GX strategy and climate transition finance guidelines – rather than as an independent policy determination.[25]

Political economy constraints – particularly the absence of a government-led taxonomy – are obstructing the BOJ from setting industrial standards. The Bank can resolve this, however, by developing an operational eligible activity list specifically for its own facilities. By anchoring this list in established government frameworks like the GX strategy, the BOJ can enforce risk discipline without making independent political determinations.

Second, the Bank should exclude from eligibility financing for misaligned activities (e.g., new unabated coal capacity, fossil fuel expansion, high-emission industrial processes)

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[21] Loan Disbursement under the Funds-Supplying Operations to Support Financing for Climate Change Responses; BOJ, Various dates.
[22] The BOJ can shift the facility to a key component of market infrastructure from a concessional tool. A higher policy rate reduces the spread, but tightening integrity through taxonomies and data standardization incentivizes take-up by reducing information asymmetry and providing counterparties with a credible green signaling mechanism. The Bank could also supplement stricter standards with non-rate incentives, such as tiered reserve remuneration or preferential collateral treatment for high-integrity assets.
[23] Outline of Climate Response Financing Operations; BOJ, 2021. The four thematic areas are governance, strategy, risk management, and metrics and targets.
[24] Outline of Transactions for Climate Response Financing Operations; BOJ, 2025.
[25] Unlike the EU, there is no single, binding government directive for the BOJ to reference. Anchoring this policy in government frameworks such as the GX Basic Policy and Climate Transition Finance Guidelines allows the Bank to avoid appearing to make policy choices. See Central Banks and Climate Change: Key Legal Issues; IMF, 2024

and require finance labelled as 'transitional' to be tied to credible sector pathways and transition plans. This is consistent with the BOJ observation in its market-functioning surveys – transition finance is used increasingly in high-emitting sectors and transition plans are becoming fundraising tools.[26]

Third, the Bank can set a pricing and incentive structure that improves additionality without adversely affecting the policy stance. The BOJ initially offered use of this facility at a zero percent interest rate while using reserve-tier incentives – that is, adjusting the remuneration or allocation of counterparties' reserve balances to reward qualifying lending.[27] In the current positive interest rate environment, the BOJ can preserve monetary policy control by making the operation rate-neutral overall (e.g., keep the loan rate tied to the policy rate), but adding state-contingent incentives (e.g., an additional remuneration tier or maturity extension) for finance demonstrated to meet the stricter eligibility and transition tests. This is consistent with NGFS analysis that targeted operations can influence the allocation of financial flows, while needing to remain consistent with the monetary policy stance and central bank mandate.[28]

2. Establish a green collateral framework

The BOJ should phase in environmental risk integration into its collateral framework through disclosure requirements, differential haircuts, and concentration limits.[29, 30]

The BOJ's acceptance of CTBs as collateral represents a material step, but the Bank's adherence to market neutrality constrains adoption of broader operations. This requires interpreting market neutrality in operational, risk-based terms – recognising climate and ecological risk as financially material and reflecting it in collateral valuations.

The European Central Bank (ECB) is moving to incorporate climate risk into its collateral framework, including plans to adjust valuation haircuts based on climate-related risks. It has already introduced climate-related disclosure requirements for collateral eligibility and stated that it will "limit the share of assets issued by entities with a high carbon footprint that can be pledged as collateral".[31] The BOJ can build on this credible model

[26] Results of the Fourth Market Functioning Survey concerning Climate Change; BOJ, 2025.
[27] The BOJ can use its tiered reserve remuneration system to reward (or penalize) banks indirectly, rather than changing the headline interest rate on a specific lending facility. Under its current framework, the BOJ does not pay a single rate on all reserves, but uses multiple tiers (i.e., a basic balance that is typically remunerated more favorably, a macro add-on balance that is linked to lending programs, and a policy-rate balance that earns the policy rate).
[28] "Central banks can influence the allocation of financial flows through the design of their monetary policy operations, including collateral frameworks and targeted lending facilities, while ensuring consistency with their primary mandate and the overall monetary policy stance." See Greening Monetary Policy Operations: Exploring Additional Options; NGFS, 2026.
[29] Collateral frameworks shape incentives across the entire banking system because they affect funding access and effective cost of liquidity. The BOJ acknowledges in its climate strategy that climate change can significantly affect financial institutions and financial system stability. If climate-related risks are not fully priced, incorporating them into collateral valuation becomes a matter of risk management – consistent with NGFS guidance and ECB practice – not industrial policy. See The Bank of Japan's Strategy on Climate Change; BOJ, 2021, and Greening Monetary Policy Operations: Exploring Additional Options; NGFS, 2026, which identifies haircut adjustment and negative screening as usable and effective measures in collateral frameworks.
[30] The BOJ could also integrate nature-related risks where and when data permit.
[31] The ECB approach is incremental but directional, moving from disclosure to risk assessment to pricing (haircuts). The "limit high-carbon collateral" idea is aspirational not yet rule-based. The BOJ can similarly adopt a risk-based and gradual approach. See ECB takes further steps to incorporate climate change into its monetary policy operations; ECB, 2022.

and adopt an analogous architecture while tailoring metrics to Japanese disclosure and data realities (i.e., SSBJ standards, transition plans, and sector pathways).

A key constraint on revising collateral pricing and margin ratios is data and model credibility. The ECB designed its climate factor to evolve with data and model availability, and to preserve adequate collateral availability.[32] The BOJ can phase in the greening of its collateral framework by beginning with the largest, most data-rich issuer industries (e.g., large, listed non-financial corporates) and expand as disclosure becomes mandatory and further developed.

Building on NGFS analysis that nature loss poses immediate, material risks to financial and macroeconomic stability, the BOJ should adopt an integrated environmental risk framework that treats climate and ecological breakdown as twin and interconnected systemic threats. The Bank should also therefore develop a nature-risk roadmap to phase nature into its collateral and supervisory operations. As an initial step, the Bank should require counterparties to disclose material nature-related dependencies and impacts – aligned, where feasible, with the Taskforce on Nature-related Financial Disclosures (TNFD), and consistent with broader FSA-led disclosure guidelines. Over time, the BOJ could pilot the incorporation of nature-related risk indicators into collateral valuation to better reflect ecological risks in market pricing.[33]

3. Set environmentally-resilient stewardship and portfolio strategies

The BOJ holds ETF assets with a book value of approximately ¥37tr, with a market value that has fluctuated to roughly ¥70–80tr depending on equity prices, equivalent to roughly 7-10% of total Japanese equity market capitalisation. In September 2025, the BOJ announced plans to dispose its ETF and J-REIT holdings, at a pace of about ¥330bn (book value) per year for its ETFs and ¥5bn (book value) per year for its J-REITs. At that pace, and under the BOJ's disposal principles of adequate prices, loss avoidance, and avoiding "inducing destabilising effects on the financial markets as much as possible", the full exit would take several decades.[34]

The BOJ, however, lacks a stewardship policy, and its reliance on major equity indexes is not neutral in risk terms, as these indices embed existing market biases and may not fully reflect climate-related risks.[35] At the same time, the disposal of ETFs represents a key milestone in policy normalisation and balance sheet restructuring. This creates an opportunity to align balance sheet risk management with climate and ecological resilience through a clear framework of stewardship and voting rights.

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[32] The ECB to adapt collateral framework to address climate-related transition risks; ECB, 2025.
[33] "Nature-related risks, including biodiversity loss, can have significant macroeconomic and financial implications and therefore fall within the remit of central banks and supervisors." See Statement on Nature-Related Financial Risks; NGFS, 2022.
[34] Given the Bank's expected long-term ownership, the BOJ will remain a major shareholder in Japan's corporate sector for decades. See Statement on Monetary Policy; BOJ, 2025. The BOJ also notes that market-value ETF sales are roughly ¥620bn per year as of end-March 2025.
[35] The Bank of Japan Must Define a Strategy for its ETF Holdings – Not Just its Sales; CEP, 2025.

Even if the BOJ continues to delegate voting to asset managers, it can provide guidance aligned with risk management and long-term economic stability (e.g., by supporting credible transition plans, and opposing backsliding on disclosure). The Bank could also apply an environmental-risk lens to its ETF disposal strategy, subject to market conditions, to reduce tail risk without altering the overall pace of normalisation.[36] This approach would be operationally complex, but consistent with the BOJ's emphasis on disclosure and risk transparency as prerequisites for functioning markets.[37]

A key constraint is concern that an environmentally-oriented stewardship policy could be perceived as politicising the central bank. To mitigate this risk, the BOJ should anchor any such policy in its core functions: financial risk management, established transparency norms, and its mandate to support financial system stability.

A more direct way to clarify governance and purpose would be to transfer the BOJ's ETF holdings into a public-interest vehicle.[38] Although politically challenging, ring-fencing the governance structure could reduce legitimacy concerns by separating monetary policy from long-term ownership decisions. This would allow the Bank to operate under a transparent framework for managing its holdings over an extended horizon, without being perceived as engaging in *de facto* industrial policy.

4. Shift to double materiality approach in supervisory expectations and risk management

Japan's supervisory framework should continue shifting from voluntary supervisory dialogue toward more structured and, where appropriate, enforceable expectations with credible escalation. The BOJ–FSA second climate scenario analysis frames climate risks as drivers of traditional risk categories and emphasises the potential for near-term transition risk materialisation. Building on this foundation, the next step is to translate analytical insights into supervisory practice.

Given that the FSA is the primary regulator, the BOJ should act in close coordination and within its financial stability mandate, using examination, monitoring and system-wide assessment to operationalise supervisory expectations.[39] This includes assessing whether financial institutions identify and manage climate-related financial risks, enhance disclosures, and engage effectively with corporate clients, while also encouraging more robust scenario analysis aligned with joint BOJ–FSA exercises and international standards.[40]

To operationalise this approach, the BOJ could structure its supervisory contribution around a three-tier supervisory framework. First, for systemically important and

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[36] *Statement on Monetary Policy; BOJ, 2025. The Bank's disposal principles allow temporary adjustment of sales in response to market conditions.*
[37] *Results of the Fourth Market Functioning Survey concerning Climate Change; BOJ, 2025.*
[38] *The Bank of Japan Must Define a Strategy for its ETF Holdings – Not Just its Sales; CEP, 2025.*
[39] *On-Site Examination Policy for Fiscal 2026; BOJ, 2026.*
[40] *Supervisory guidance on climate-related risk management and client engagement; FSA, 2022.*

regionally significant institutions, the Bank should articulate baseline expectations through its monitoring and on-site examination activities. These would include board-level accountability for climate risk, integration into credit screening and concentration management, and regular scenario analysis to assess balance sheet resilience. This is consistent with BCBS principles that banks' boards and senior management should oversee climate-related financial risks and embed them within existing risk management frameworks – across credit, market, liquidity, and operational risk – through robust identification, measurement, monitoring, and control.[41]

Second, the BOJ should use examination findings and system-wide assessments to inform supervisory dialogue and escalate material deficiencies to the FSA. Where weaknesses are identified, the BOJ can recommend remedial actions, timelines, and governance improvements, supporting the FSA's application of Pillar 2–type supervisory measures. This division of roles is consistent with BCBS guidance that supervisors should assess the adequacy of banks' climate risk management and take appropriate supervisory action where deficiencies are identified.[42]

Third, building on the NGFS's work on nature-related risks, the BOJ could introduce a "nature readiness" module into its monitoring and analytical framework. This would involve identifying system-wide exposures to nature-related risks in key sectors – such as agriculture, forestry, fisheries, and water-intensive industries – and encouraging disclosure aligned with the TNFD where relevant.[43] Insights from this work would feed into supervisory dialogue and inform coordination with the FSA on emerging prudential policies.

As the BOJ's authority is exercised primarily through monitoring and its financial stability mandate, its approach should remain grounded in coordination, transparency, and risk assessment. The BOJ can act within its mandate by tightening examination expectations and supporting the consistent application of BCBS and NGFS standards.

At the same time, the BOJ must remain attentive to mandate boundaries and quasi-fiscal risks. Environmental-related measures should be framed as extensions of core central bank responsibilities – particularly risk identification, risk management, and financial system resilience. Where actions have quasi-fiscal characteristics, they should be accompanied by appropriate safeguards, transparency, and, where necessary, government risk-sharing.[44] The Bank should therefore prioritise risk-based supervisory

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[41] *Principles for the effective management and supervision of climate-related financial risks; BCBS, 2022. See Principle 1 (board-level accountability), Principle 3 (integration into core risk frameworks), and Principle 6 (Pillar-2 type supervisory escalation).*

[42] *"Pillar 2–type approach" refers to supervisory escalation consistent with the BCBS Principles, under which supervisors assess bank-specific climate-related financial risks and require remediation where risk management is inadequate. This may include enhanced governance, improved risk identification and measurement, and integration into capital planning. In practice, escalation would occur where institutions cannot demonstrate credible transition engagement or adequately identify and quantify material climate exposures.*

[43] *Bank Negara Malaysia is piloting a TNFD "locate, evaluate, assess, and prepare" approach with three financial institutions and two corporates from the agriculture and construction sectors to understand the current state of nature-related risk assessments and disclosures in Malaysia. See Annual Report 2025; Bank Negara Malaysia, 2025.*

[44] *Central Banks and Climate Change: Key Legal Issues; IMF, 2024.*

inputs and incentive-compatible targeted lending, while leaving formal enforcement to the relevant prudential authority.

Conclusion: Embedding environmental risk into core monetary operations

As climate and nature-related risks become increasingly material to macroeconomic outcomes, financial conditions, and price stability, the distinction between environmental considerations and core central banking responsibilities is narrowing. International practice – including work by the NGFS and the evolving approach of the ECB – reflects a shift toward risk-based policy frameworks, where climate-related risks are treated as standard financial risks that must be incorporated into operations, rather than as external policy objectives. This shift recognises that the financial system not only faces climate and ecological risks, but can also amplify or mitigate them through capital allocation – requiring a more system-wide, forward-looking approach to risk management.

Strict market neutrality is not risk-neutral; where risks are underpriced or cannot feasibly be fully priced in, it embeds carbon bias in central bank operations. A shift toward risk-based neutrality – in which financial risks are consistently identified, measured, and reflected in policy operations – is therefore analytically justified and consistent with central bank mandates.

The four measures proposed in this briefing provide a coherent and feasible pathway for the BOJ to operationalise this shift. Strengthening the Climate Response Financing Operations would improve the integrity and signaling power of targeted lending. Phasing climate and ecological risk into the collateral framework would align liquidity provision with underlying risk exposures. Establishing a stewardship and portfolio framework for ETF holdings would address long-term balance sheet risk and governance challenges. Advancing supervisory expectations would move the financial system from voluntary progress toward credible risk management discipline.

These measures can be implemented incrementally within existing institutional constraints. They represent extensions of established central banking functions: risk management, collateral valuation, balance sheet governance, and supervision. Anchored in transparency, proportionality, and coordination with government frameworks, they are consistent with both the BOJ's statutory mandate and international best practice.

Ultimately, embedding climate and ecological risks into core policy operations is not a discretionary enhancement to the BOJ's framework – it is necessary to preserve the effectiveness of monetary policy and to safeguard financial system stability over the medium to long term. By moving from green facilitation to a double materiality-based framework of risk discipline, the BOJ can reform its policy framework so that it remains robust in the face of the structural transformations that will define the global and Japanese economies in the decades ahead.

Box 1: How could these measures impact BOJ's Green Central Banking Scorecard performance?

Category	2025 score	Current status	Proposed policy shift	Indicative score if fully implemented
Monetary policy	16 / 50	Strong use of targeted climate refinancing; initial integration of CTBs as collateral, but limited risk-based adjustment in core operations	Tighten Climate Response Financing Operations (i.e., eligibility, taxonomy, incentives); introduce climate-adjusted collateral framework (i.e., haircuts, disclosure, limits)	21–36 / 50
Financial policy	14 / 50	Improved scenario analysis and integration into FY26 on-site examination policy; still largely guidance-based with limited enforceability	Move to supervisory expectations with escalation (Pillar 2–type approach); align with BCBS principles; introduce nature-risk readiness module	19–29 / 50
Leading by example	3 / 20	Large ETF holdings with disposal strategy announced; no formal stewardship or portfolio alignment framework	Establish climate-resilient stewardship policy; integrate risk considerations into ETF disposal; consider public-interest vehicle for governance	8–16 / 20
Research and advocacy	6 / 10	Continued participation in NGFS and domestic market development; incremental expansion to nature-risk awareness	Deepen analytical work on climate and nature risk transmission; strengthen signaling through operational policy integration	7–10 / 10

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