ESG trends in business and finance

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The business community and financial community working together

The attention on sustainable finance has been significantly increasing globally, including in Japan. I see this topic appearing more often on the agendas of international and national conferences in the financial sector. The ESG investment has been rapidly growing. For example, some reports state that in Japan, the issuance of ESG bonds doubled between 2017 and 2018.The JFSA is proactively working to support the SDGs initiative given that SDGs' vision is consistent with the JFSA's mission, i.e., to contribute to the national welfare by promoting the sustainable growth of the economy and stable asset building.

At the same time, it is also important that the private sector (e.g., companies, investors and financial institutions) takes action to achieve SDGs on their own initiatives in such a manner as to enhance corporate value and investment returns in the medium to long term.

From this perspective, we see great value in the FSB Task Force on Climate related Financial Disclosures (TCFD) initiative. With more than 200 companies and organizations supporting it, Japan now has the highest number of TCFD supporters in the world. Among the TCFD supporters, the number of business corporations is larger than that of financial institutions. Moreover, carbon intensive industries such as energy, electricity, steel, chemical and cement have also expressed their support and willingness for engagement with the TCFD recommendations.

As a background to this increase, the TCFD Consortium was established as a private sector initiative in May 2019. The Consortium brings together companies and investors to discuss challenges and share leading practices to move ahead with corporate disclosure aligned with the TCFD recommendations. As a product of such discussions, the Consortium released Green Investment Guidance last year to demonstrate viewpoints and good practices for investors making use of information disclosed in line with the TCFD recommendations. This Green Investment Guidance would also help companies better understand investors' expectations, and thereby improve their own disclosures. In furtherance of the work, the Consortium is planning to revise the Guidance for Climate related Financial Disclosure (TCFD Guidance), which was initially published in December 2018. Both the Green Investment Guidance and the revised TCFD Guidance will facilitate collaboration with the business and finance sectors.

The inclusive, dialogue-based framework of the Consortium is the key to success of increased support of the TCFD in Japan. Through its activities, participants are able to deepen their thoughts on the effect of climate change on their business environments. We expect both business corporations and financial institutions to review their strategies, business models and risk management, which may contribute to turning the risk into an opportunity for innovation in the low- and zero-carbon economy.

Liange Liu

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Sustainable finance: China's practices, challenges and future actions

In recent years, sustainable finance with green finance at its core witnessed robust development in China. It has become common practice among major Chinese financial institutions to support sustainable development as a key aspect of embracing corporate social responsibility. As of the end of 2019, China had a green credit balance of approximately USD 1.5 trillion, and witnessed a total of more than USD 150 billions of green bond issuance.

Mutual funds that have incorporated ESG related strategies reached a volume of USD 7 billion, while other innovative green financial products, such as Green Insurance, Green Trust and Carbon Finance, are thriving.

Despite the rapid growth, sustainable finance development in China is still facing challenges.

The total volume is still insufficient to meet needs. According to the China Green Financial Development Research Report 2019, the total demand for green finance in 2018 stood at about USD 300 billion, while the supply was less than USD 200 billion, making a shortfall of over USD100 billion. The financial industry needs to attach more importance to and effectively stimulate internal driving forces to fill the gap.

The structure of sustainable finance imbalanced. In China, the funding for urban rail transit and renewable energy is ample, but that for environmental restoration relatively falls short. Although green bonds are growing rapidly, green credit still accounts for over 90% of the green finance. Financial institutions need to foster product innovation and provide better-targeted services.

External incentives and policy support are insufficient. As public product, the pricing of sustainable finance is difficult. Compared with regular financial projects, sustainable financial projects often involve longer duration, higher-standard disclosure requirements, and more cost of management and risk control. China has introduced a comprehensive policy framework to support green finance development, while the specific measures are still in the process.

More efforts should be made to further promote the sustainable finance in China.

Financial institutions should actively tackle the challenges and provide strong support for environmental and social sustainability.

Boosting internal driving forces. To enhance the development on sustainable finance, financial institutions should develop a unified strategy of sustainable development and incorporate it into the management framework, strengthen the strategy implementation and post-assessment, and reasonably increase the weight of sustainable finance indicators in the KPI assessment system.

Enhancing the service capabilities. Adhering to market principles, financial institutions should implement differentiated pricing on the sustainable development risk of customers, strengthen development of green bond/credit and product innovation of green insurance, green trusts, green industrial funds, etc., and build powerful brands, to support the development of an eco-value compensation mechanism, hence the appropriate pricing on externalities of green projects.

Improving the quality of development. By establishing an international platform to share best practices in sustainable finance, financial institutions can share relevant policies, data information and business experiences on sustainable finance, and co-establish a supportive and coordinative mechanism to improve the global participation and development quality.

Sylvie Goulard

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Greening the financial sector remains an urgent need to face the persistent challenge of climate change

Amidst the current Covid-19 crisis, we all need to keep fighting another crisis, climate change, and keep thinking about the best measures to undertake to finance the transition to a low carbon economy. In that perspective, one priority stays to ensure that "green" projects can be appropriately funded. Financial institutions must be able to assess the risks and returns of such projects on the accurate (longer) time horizon. Considering climate change seriously also means, for the financial sector, taking into account the financial risks relating to transition- notably the risks of stranded assets- and physical risks in their own balance sheets. In a nutshell, climate-related risks must become a widespread axis of risk analysis by financial institutions.

The political will to produce standards should not weaken in the context of the current Covid-19 crisis.

Over the past years, the financial sector has been moving in a greener direction, no doubt. Part of this trend has indeed resulted from both market pressure and clients' appetite for greener products. However, regulation has also played a key role, both at national and European levels, by setting disclosure standards for instance. In France, since 2016[1], financial institutions must disclose their exposure to climate-related risks and assess the related financial risks.

The French supervisory Authority for Banks and Insurance (ACPR) recent studies[2] find that there was a significant progress in the governance of climate change risks and in the analysis of transition risks. The need to closely monitor climate-related financial risks is also observed globally: the Central Banks and Supervisors' Network for Greening the Financial System (NGFS) is planning to release a Status Report on this topic in the coming weeks.

This is something we follow upon carefully as we, Central Banks and Supervisors, definitely believe that we can support this evolution and foster its harmonization, along with standard setters. The Banque de France is particularly active within the NGFS, launched at the One Planet Summit in 2017.

This network is a coalition of Central Bankers and Supervisors willing to share best practices and leverage each other's knowledge. At the national level, the ACPR established last year a Commission on Climate and Sustainable Finance aiming at keeping track of the commitments taken by banks and insurers relating to climate risks. Our next step will be to simulate the resilience of these institutions: a pilot exercise, based on climate scenario analysis, will be conducted by the Banque de France and the ACPR in 2020.

Nevertheless, the NGFS is not a standard setting body, and we rely on standard setters and policy makers to allow for homogenous data, without which no consistent monitoring and pricing of climate- related risks can exist. The political will to produce standards should not weaken in the context of the current Covid-19 crisis. We should keep in mind that the fight against climate change is vital. Some experts even suggest that both crisis are related at some point. Hence, the biodiversity loss and its impacts on the financial sector may be one topic to further explore in the future.

1. Act of 17 August 2015 on energy transition for green growth
2 Analyses et Synthèses n°101 et 102, avril 2019

Ricardo Laiseca

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Sustainable finance: bringing the age of opportunity to everyone

"Good comes out of evil", a Japanese proverb states.

We are living an unprecedented paradigm driven by an unknown evil, the Coronavirus. It is going to have a negative impact on the financial system, the real economy and, also, the aggregated social welfare function.

Good swiftly came out: the whole society, public bodies and private agents quickly reacted to do whatever it takes to jointly battle the COVID-19. We will overcome this tempest. The decisions we are taking now could transform our lives.

Our coordinated response against evil is going to evidence that society, altogether, can overcome huge challenges. Cooperation and working together are the only way. It is time to think about the reconstruction, and to apply what we have learnt from this experience to deal with some other challenges, such as climate change.

> *Breaking the "tragedy of the horizon" and working as one engaged team towards a "new horizon" is the only way forward.*

Public bodies and private agents must keep working as one engaged team that thinks big towards a common goal: to provide value added financial solutions that help society to beat the consequences of negative shocks, like the two previous ones.

In that vein, sustainable finance is also needed to come out as a good and being part of the solution. The Coronavirus is testing companies' environmental, social and governance (ESG) commitment and strategies in a hard uncertain environment. ESG investing and funding has proven some resiliency and a good track so far: there is some empirical evidence that points a better ESG performance than the market in aggregated terms during the last year.

Sustainability is going to gain traction because social dynamics are leading the response, and companies are going to be penalized by investors if they do not take care of their employees and the rest of their stakeholders.

I firmly believe that providing value added environmental and social solutions according to the society and our clients' needs is a win-win that can generate a virtuous cycle:

On the supply side, banks can jointly positively impact the economy and the financial system and contribute to the achievement of the Paris Agreement. We must proactively interact with our clients to provide some high-quality advice and deliver new business opportunities.

On the demand side, the aggregated social welfare function will be enhanced because their needs will be better and more efficiently met. Indeed, society is the key driver of this transformation which is happening faster and deeply than expected.

The enrichment of both, supply and demand, will allow for an improvement of the production possibilities frontier, and will be a catalyzer for sustainability to continue accelerating.

To achieve that upgraded frontier, sustainable finance markets need to continue their development which is still small and still lacks depth and breath. Banks can contribute by expanding our product offering, strengthening our advisory capabilities and updating our internal processes levering on digital tools and technology.

Last but not least, public authorities, financial regulators & supervisors and international bodies play a vital role, obviously. Their bold and effective response when the COVID-19 impacted the whole system last March, empirically proves that they are also a good needed by the society and by the financial agents.

"Breaking the tragedy of the horizon" and working together for a "new horizon" is the only way forward. There is some work to be done and no time for procrastination: we have the chance of bringing the age of opportunity to everyone when most needed.

Ann Prendergast

Managing Director
and Head, State Street Global
Advisors Ireland

Hope on the horizon: addressing the ESG challenge

A growing number of financial institutions, investors and policymakers have shifted focus toward sustainability investing, or incorporating environmental, social and governance (ESG) matters into the investment process.

Although the topic of ESG may seem like a novel phenomenon, the financial services industry has weighed in on certain financially-material ESG factors for some time. What is different now is a heightened sense of urgency given the physical devastation of climate change has become measurably real.

There are two key drivers in this focus shift. The first is increased client demand for sustainable investment and their general changing mindset requiring more stable returns over the longer-term that poses no harm the wider environment.

Even amid the current market turmoil due to the Coronavirus pandemic, investors appear keen to maintain ESG values, for instance by monitoring companies' treatment of employees. The second – perhaps, in part, driving client demand – is regulation which has prioritised policies broadly relating to ESG in recent times, albeit globally divergent approaches have emerged. Clearly, the paradigm has changed and progress has been made.

Nevertheless, persistent key challenges must be addressed. The first step, especially from an investor perspective, is to achieve a common language – or taxonomy – on what constitutes a sustainable investment. The European Union has made headway in classifying economic activities that contribute to its environmental objectives.

> *Clearly, the paradigm has changed and progress has been made.*

To articulate a common understanding of sustainability in practice, however, binary definitions that could limit choice of sustainability products and services should be avoided. Moreover, for financial market participants to apply any taxonomy, there needs to be significant improvements in the quality of sustainability data. Specifically, greater clarity and simplicity is needed for corporate ESG disclosures.

This means harmonisation of reporting standards as well as convergence of data sets and scoring methodologies, at the international level, to allow for better comparability of the sustainability of investments.

Financial institutions, investors and policymakers continue to develop toolkits needed to incorporate sustainability into the investment process. Efforts by the Sustainability Accounting Standards Board (SASB) and the Taskforce on Climate-Related Financial Disclosure (TCFD) have already been important contributions to help industry coalesce around common metrics and reporting standards, akin to what the major credit rating agencies use today to measure credit risk. Importantly, these international frameworks ensure the concept of materiality is upheld when considering ESG integration.

Ultimately, we need to be mindful that the policy goal is not to elevate sustainability risks above other critical components of the investment process, rather it is to ensure ESG is on an equal footing so as to enable private capital flows to be reoriented towards a more sustainable future.

Dr. Kay Swinburne

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Diversity: time to act upon the evidence

The financial services sector will become more effective if it meets societal demands, such as diversity.

ESG (environmental, social and governance) is the investment phenomenon of our time. The independent research firm ETFGI suggest assets in exchange-traded funds that consider ESG criteria increased from \$6bn to more than \$250bn between 2015 and 2019.

Much of the ESG debate tends to focus on climate change – the E. This is understandable, but the S and G factors should be of equal prominence. One aspect of S is diversity, on which the sector's record falls short.

Europe's financial services businesses remain remarkably "pale and male". Women, people of black, Asian and minority ethnicity (BAME), and staff with disabilities are all notable by their low numbers. LGBT staff, the industry itself acknowledges, need much greater support[1].

Unfortunately, the COVID-19 crisis may magnify some of these imbalances. In these times of economic stress with no childcare or schooling, it makes sense for the partner earning less to do the childcare. In a greater proportion of households this is likely to be the woman.

Some progress is being made, particularly on gender. The consultant Oliver Wyman says the proportion of senior women in finance now stands at around 20%, doubling over the past 16 years[2]. But women account for only 17% of "approved individuals" according to the UK Financial Conduct Authority[3]. And the European Banking Authority says 42% of credit institutions and investment firms do not yet have a diversity policy[4].

Why should we take this seriously? Well, leaving aside the moral imperative to embrace equality of opportunity, the research overwhelmingly shows a clear link between diversity and corporate performance. Morgan Stanley's "Holistic Equal Representation" research, for example, rates businesses on the diversity of their senior leadership[5]. The stocks of European companies with higher ratings have outperformed by an average of 1.6% a year over the past eight years, it says.

McKinsey research found companies in the top-quartile for gender diversity on executive teams were 21% more likely to outperform on profitability and 27% more likely to have superior value creation[6].

> *Europe's financial services businesses remain remarkably "pale and male".*

Lack of diversity creates "group think" and stifles imagination and creativity. Businesses that look completely different to the range of customers they serve cannot expect to understand their needs.

Recognising these issues, however, is more straightforward than tackling them. The jury remains out, for example, on mandatory quotas. France and Germany have both set legally binding targets for women on the board, at 40% and 30% respectively. In the UK, a softer Government approach has seen the number of women on FTSE 100 boards grow from 12.5% to 33% since 2011[7]. The Women in Finance charter is an example of how a voluntary approach can work well[8].

Quotas will not fix all ills. There is some evidence that the focus on women in the UK has coincided with a fall in BAME representation at the senior levels of companies[9]. No-one is suggesting mandatory quotas for disabled people or the LGBT constituency.

Increased reporting may be part of the answer. Countries including France, Germany, Iceland and the UK already require many businesses to publish data on their gender pay gaps.

This appears to be having some positive results. Given that pay differentials based on gender, sexual orientation, ethnicity, disability and other factors are illegal across much of Europe, there may be scope to do more. The European Commission is now consulting on mandatory gender pay gap reporting.

At the micro level, good practice at some financial services businesses shows what it is possible to achieve. Initiatives linking pay to good diversity-related performance in recruitment and retention show promise. So do efforts to promote flexible working, particularly where both men and women participate; shared maternity and paternity schemes are a good example. Other firms have trialled 'returnee' intern programmes for women who have taken extended breaks from the workforce.

Such initiatives beg an obvious question – will more financial services businesses do more to practice what they preach? ●

1. https://www.theia.org/sites/default/files/press-releases/document/20180701-bringingourwholeselvestowork.pdf
2. https://www.oliverwyman.com/content/dam/oliver-wyman/v2/publications/2019/November/Women-In-Financial-Services-2020.pdf
3. https://www.fca.org.uk/publication/research/research-note-gender-diversity-in-uk-financial-services.pdf
4. https://eba.europa.eu/eba-calls-measures-ensure-more-balanced-composition-management-bodies-institutions
5. https://www.morganstanley.com/ideas/womens-impact-on-the-economy
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7. https://www.gov.uk/government/news/third-of-ftse-100-board-members-now-women-but-business-secretary-says-more-needs-to-be-done
8. https://www.gov.uk/government/publications/women-in-finance-charter
9. https://www.green-park.co.uk/insights/green-park-leadership-10-000-2019/s94929/

Suzan Revell

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Why Purpose Matters

This EuroFi conference was going to focus on key challenges for European financial services and beyond – chief amongst them was to ensure sustainability plays a central role in financial services and to leverage digitalisation and technology to help future proof the European financial services sector, in particular in its delivery to consumers and clients. Whilst the Covid-19 crisis may have diverted our attention temporarily, these concepts remain central to the future of financial services.

In looking to tackle them, we cannot lose sight that financial services – despite the advent of algos and AI, Machine Learning and DLT – remains a people business. The human element is critical in determining how our industry can meet these future challenges. Ensuring that our firms remain sustainable, that they stay ahead of the curve within an environment of ever accelerating pace of technological change, requires dedicated individuals, working collaboratively and being attune to the corporate Zeitgeist. In turn, as leaders we need to ensure our industry continues to attract talent in the face of competition, particular from the tech sector, and enable them to reach their full potential.

It is here that the recent Corona crisis comes into sharp focus. It has and is challenging us to find new ways to interact with each other, to work at physical distance to each other including the closest co-workers, to understand the personal circumstances of colleagues and family members – the human element has taken centre stage. And it is the individuals, up and down the organisation, that we rely on to continue to serve clients and deliver services across the various parts of our organisations.

A lot of research has been conducted in how companies can succeed in such challenging circumstances. Through our work on corporate purpose, including by participation in AFME and UK FCA working groups, we have explored how critical individual employees' perception of their personal connection with the organisational purpose can be in setting a framework for all the other corporate objectives that we collectively work towards. A corporate purpose that is focused on serving all of its stakeholders - in addition to shareholders also customers, employees and the community - can help to transform a short term focus on profitability into a longer term focus on sustainability. It is key in setting corporate culture and in turn shapes governance processes and decisions - both in business-as-usual circumstances, but particularly in challenging situations where formal governance structures may need to adjust to meet the needs of the organisation, such as the current Covid-19 crisis.

> *A corporate purpose that is focused on serving all of its stakeholders can help to transform a short-term focus on profitability into a longer term focus on sustainability.*

It is therefore critical that companies can embrace a corporate purpose which individuals can align to and rally around. This can take different forms – whether a mission statement, a set of company goals, shared perspective on tackling global challenges. And that corporate purpose can be relevant in multiple different facets – purpose can be a benefitting factor for motivation of the wider workforce but also for wider company alignment. But crucially, being able to internalise a purpose, to harness a purpose which drives performance and profitability, allows companies to compete with a distinct competitive advantage. As the E&Y Beacon Institute has found "companies who clearly articulate their purpose enjoy higher growth rates and higher levels of success in transformation and innovation initiatives".

Whilst purpose is primarily an internal driver, a purpose that permeates into corporate strategy and product development can also be a key success factor with clients. As an example, a company that sets itself a clear purpose to be sustainable may be better able to launch products with a sustainability angle – against the backdrop of growing investor interest in sustainable investment products this can be a crucial success factor.

But there is also a risk in communicating a corporate purpose if such mission statements are not followed up by actions. If they are perceived by the own workforce or externally as mere campaign slogans. In that sense, acting against a stated purpose can bear significant risk for the corporate. A disconnect between the purpose that is being communicated widely and the action undertaken by the firm, can lead to a breakdown in authenticity which, in turn, can lead to a breakdown in trust and ultimately longer-term reputational damage.

These risks aside, I believe the industry and the wider ecosystem, including policy makers, need to embrace corporate purpose as a key factor for our industry in the years to come. To meet the many challenges that lie ahead, only an engaged, talented and inspired workforce can deliver success – and leading by example, embracing a purpose is not only a means to that end but a critical ingredient. ●