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Drive globally balanced sustainability through regulatory coordination

In response to the COVID-19 pandemic, fiscal relief policies have been introduced to a greater extent in developed economies, notably in the EU and the US, than emerging markets. Consequently, revenues in these markets are more at risk of any economic downturn in the aftermath of the pandemic. The divergence in national responses has exacerbated existing regulatory fragmentation and its impact will remain even when COVID-19 subsides, but conversely the COVID recovery presents a real opportunity to re-orient capital flows towards sustainable investment.

Europe is the world leader in the burgeoning frontier of ESG reform and we fully support the EU's Renewed Sustainable Finance Strategy. Regulation aims to bring certainty to an arena where there is rapid change, considerable financial and legal risk, and a keen focus on organisational governance. These regulations should be harmonised globally as far as possible, to attract investors from around the world and, to this end, the EU's International Platform for Sustainable Finance (of which Japan is a member) will have an important coordination role. Regulatory harmonisation is critical for a common understanding of the rules and how various activities are categorised from an ESG perspective. However, regulatory harmonisation should be balanced against ensuring that the rules appropriately consider the varying economic circumstances, energy needs, infrastructure constraints and cultures of different jurisdictions and industry sectors. This means focusing on high level global standards, rather than detailed prescriptive rules, particularly early on when there will be material disagreement amongst market participants on the minutiae.

We note that sustainability-linked bonds have been eligible for the ECB's Asset Purchase Programme since January and further initiatives are under consideration to achieve the objectives of the European Green Deal. We appreciate the need to gather momentum towards a carbon neutral economy and support the Commission's drive for a long term attitude towards transition, noting the risks of "greenwashing" amongst market participants in order to meet certain targets or take advantage of applicable funding schemes. Policies that reward short-term actions may result in a pricing gap based on an entity's transition status, harming its access to funding and consequentially its ability to transition, and ultimately the economy as a whole. This is vital for enterprises with high climate change risks globally, where transition requires a huge amount of investment. The mission for banks and policy makers is to support clients' sustainable finance transition pathways with appropriate liquidity provision, recognising that there should be a proportionate application of regulations dependent on the client's circumstances.

In respect of Brexit, the envisaged memorandum of understanding covering financial services should provide a platform for EU-UK cooperation on regulatory standards to mitigate the effect of overlapping and inconsistent rules. An immediate concern for firms is how to find and interpret the law post-Brexit, due to the complexities introduced by the tangled web of statutory instruments promulgated as a result of the onshoring regime and the piecemeal temporary waivers set up to delay the anticipated "cliff-edge" effects.

Further regulatory divergence may also affect the competitiveness of the European financial market, with the average cost-to-income ratio of European banks being higher than that of US or Asian banks. This crucially affects third country banks operating in Europe, who may look to allocate capital elsewhere if their EMEA business is not sufficient to maintain sustainable growth. In addition to the increased cost that regulatory fragmentation brings for financial institutions, a key point that is often overlooked is the consequent impact for clients through direct cost increases, poorer service quality and more limited choice.

We urge policy makers to move towards global regulatory harmonisation and to enhance mechanisms for continuous and systematic cross-border cooperation, with appropriate deference for national and industry idiosyncrasies, so that all enterprises can thrive without being burdened unnecessarily with the cost of incremental compliance.