The Roles of Financial Institutions for a Sustainable Society

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1. The Covid-19 pandemic and long-term global challenges

- The Covid-19 pandemic has already dealt a serious blow to the global economy through restrictions on mobility and the stagnation of production activities. In particular, it has had serious impacts on the accommodation industry, aviation, tourism, and entertainment services. Furthermore, the damage was disproportionately inflicted on the socially vulnerable, including small and medium-sized companies. Currently, we face a task of supporting individuals, households, and companies which would have been viable as going concerns if the Covid-19 pandemic had not occurred.
- At the same time, the challenge for the post-Covid society is how to use digital technology in the way people live and work. In Japan, the new Cabinet under Prime Minister Yoshihiko Suga, launched on September 16th, promotes digital transformation. One of the questions is whether the transformation will lead to a shift from the concentration in large cities to the revitalization of provincial areas.
- If we look back to the human history, the world has suffered from plagues, disasters, wars and other misfortunes. But they have also led to new positive developments. Examples include urban planning, urban water and sanitation infrastructure, use of radars and computers, and aircraft. Women's social advancement also progressed, triggered by the war. So toward the future, we should try to gain some from the Covid-19.
- It is also necessary to continue to address long-term issues that must not be left behind because of the immediate need to respond to the Covid-19 pandemic. These issues are absolute poverty in many developing countries, widening income disparities in countries, including developed countries, climate change, natural disasters, marine pollution, gender equality, and education that can respond to fast-changing world.

2. Role in promoting corporate sustainability

- Today, it is important for companies to play a role as a force that promotes social progress, including addressing many of the above-mentioned issues. Indeed, the shift from short-term, shareholder-oriented capitalism to a new, multi-stakeholder-oriented capitalism looks accelerating.
- While the concept of CSR (corporate social responsibility) remains important, we should go beyond it. The concept of "corporate sustainability" which aims at both improving corporate value in economic terms and resolving social issues, is needed more than ever.
- The new roles that companies are expected to play for susutainability through their business and innovation are, first, to contribute to solving social issues or to create positive impacts, and, second, to reduce or avoid negative impacts on society and the environment. By pursuing these roles, companies can also increase their corporate value toward the future.

3. Solving social issues through finance

（1） Recent developments in sustainable finance

- The trend promoting sustainability is also taking hold in the world of finance. ESG investment is growing rapidly, as investment criteria incorporate non-financial information and environmental, social and governance (ESG) perspectives.
  - Between 2014 and 2018, global ESG investment grew at an annual rate of 13.8% from US $18.3 trillion to US $30.7 trillion. (Source: Global Sustainable Investment Alliance).
- The Paris Agreement in December 2015 has led to expectations for the use of private funds to deal with climate change issues, and the market size of green bonds has expanded rapidly. This trend has spread to the bank loan market.
  - In 2019, global green bond issuance rose 51.2% y-o-y to US $258.9 billion. Of this total, issues denominated in Japanese yen amounted to US $6.6 billion, which is smaller than those denominated in euros (US $108 billion) and US dollars (US $82.4 billion), but showed a large year-on-year increase of 153.8% y-o-y (Source: Climate Bonds Initiative).
- In recent years, the market for sustainability-linked finance is gathering momentum.
  - Sustainability-linked finance provides more concessional financing to investors, provided that the issuer's sustainability goals are met. Unlike green bonds, usage of funds is not identified.

- In Japan, Hulic Inc., a real estate company closely related to Mizuho Financial Group, plans to issue the world's first sustainability-linked bond in October 2020 as a public offering that conforms to the principles of the International Capital Markets Association (ICMA). Hulic has set two goals targeted for achievement by 2025: (1) to switch the company's electricity use to 100% renewable energy; and (2) to build Japan's first 12-story fire-resilient wooden commercial facility.

(2) How to further promote sustainable finance

- In order to promote the use of sustainable finance in each country and stimulate investors' interest, it is necessary to standardize the definition of sustainable finance, including green bonds.
- To this end, cooperation among financial regulators, leadership of international organizations, and a framework for information disclosure are necessary.
- Developing regions of the world, including Asia, need a balanced approach to achieve double targets such as " "Energy for All" and "Education for All" on one hand, and climate change countermeasures on the other.
- Another issue is how to support "transition finance", which does not meet the criteria for green finance but leads to the transition to a low-carbon economy.

(3) Financing sustainable infrastructure

- Financing sustainable infrastructure is one important element of sustainable finance. Climate change, large-scale disasters, and marine pollution all require more sustainable infrastructure investment. Examples include renewable power generation, or urban and transport infrastructure that is adaptable to climate change and resilient to large-scale disasters.
- Good infrastructure is fundamental to economic growth and is also essential to the enhancement of the social sector, such as education and health. Without electricity at home, women would be burdened with housework, and it would also be difficult for children to study at night. Without access to roads and railways, it would be difficult to go to a hospital, or work or get an education in a city far away.
- As mentioned above, it is important to finance sustainable infrastructure investment through sustainable finance.
- The key to sustainable infrastructure investment is to utilize advanced technologies. Recent technological advances have led to lower renewable energy prices, reduced water and fertilizer consumption through drip irrigation systems, hazard mapping based on satellite photographs, and many others.

- Countries should uphold the "G20 Principles on Quality Infrastructure Investment" endorsed at the June 2019 G20 Osaka Summit. This is an agreement among G20 member countries to consider the following issues in infrastructure construction in emerging countries: (1) economic rationality, (2) debt sustainability, (3) environmental considerations, (4) resilience against natural disasters, (5) social considerations, and (6) governance.
- It is also essential to mobilize private funds for sustainable infrastructure investment. In order to meet Asia's huge infrastructure demand, there is an urgent need to utilize private-sector funds and knowhow, while funding by tax revenues and government bond issues and provision of funds by international development organizations such as the ADB and the World Bank also play important roles. Modalities such as credit enhancement by public financial institutions should be used to strengthen incentives for private financial institutions to provide funds.

(4) Cooperation among Japanese and US financial institutions

- There is much room for cooperation between Japanese and US financial institutions in sustainable finance, particularly in the Asian region. In doing so, cooperation between Japan's JBIC and the U.S. International Development Finance Corporation (DFC) (formerly the Overseas Private Investment Corporation (OPIC)) is also useful.
- Japanese financial institutions have become more robust and international operations have taken a larger share of profits following the Asian Currency Crisis of the late 1990s, balance sheet adjustments in Japan, and the Global Financial Crisis of 2008. Japan's financial institutions have the largest share of Asian infrastructure project finance in recent years.
- China's lending is growing in Asia and the world. Some argue that they are causing problems in terms of the sustainability of debt and environmental and social impacts. First of all, it is necessary to continue to urge China to comply with the G20 Principles on Quality Infrastructure Investment. China will also be asked to participate, even as an observer, in meetings of the Paris Club of official creditors, and the OECD which decides guidelines for export credit and ODA loans.

4. Concluding comments

- The fundamental role of financial institutions is to promote the growth and development of society by discovering new business opportunities and supporting a wide range of companies including startups. They also provide essential social services such as deposit taking and settlement.

- At the same time, there are rising expectations for their contribution toward a sustainable society. Responding to such an expectation will lead to ensuring financial institutions' own viability and profitability over the long term.
- Japan has a history of sustainable finance. During the Edo period (1603-1868） under Tokugawa shogunate, which lasted about 250 years until 1867, it was part of merchants' morals to contribute to society and not only pursue profits.
- Eiichi Shibusawa (1840-1931), who was born in the Edo period, made a great contribution to the modernization of Japanese business in many fields including banking and insurance during the modernization of the Meiji period (1868-1912) . He was involved in the establishment of First National Bank (in 1873), which was one of the origins of Mizuho. He wrote a book "The Confucius Analects and the Abacus", and there he said that "genuine money-making is never permanent unless it is based on benevolence and morality" and that "we must reconcile economy with morality". He stressed the importance of corporations contributing to society from the perspective of sustainability.
- From 2024, Eiichi Shibusawa will become the face of the new 10,000 yen bill. This timing may be symbolic for the growing expectations toward financial institutions in the realization of a sustainable society.
- I look forward to active discussions on cooperation between Japan and the US on sustainable finance at this meeting.